Mihaela Tofan • Angela Roman • Irina Bilan
(editors)

EUFIRE 2017

The Proceedings of the International Conference on European Financial Regulation

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I. Tofan, Mihaela (ed.)
II. Roman, Angela (ed.)
III. Bilan, Irina (ed.)

TABLE OF CONTENTS

SECTION 4.
EU PUBLIC SPENDING AND CONTROL

SECTION 5.
EU TAX LAW

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Section I

EU FINANCIAL REGULATION AND FINANCIAL STABILITY

FINANCIAL INTEGRATION AND FINANCIAL CONTAGION. A PROBLEM FOR FINANCIAL STABILITY?

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Abstract
The aim of this paper is to highlight the relation between financial integration and financial contagion, with the desire of financial stability. For this purpose we reviewed the literature in this field and then we did an analysis in order to draw relevant conclusions and to provide a clearer picture of the relationship between the two phenomena. For our analysis, we retrieved data from the Eurostat and World Development Indicators (World Bank) including the EU 28 member states over the time span 2000-2014. Our results show that is a significant relationship between the variables considered, and also financial integration and financial contagion are inversely proportional, financial contagion having a negative influence on the financial integration. It is consensual that a higher level of financial integration in partner economies can promote a process of strengthening the domestic markets involved, which is essential for the domestic corporate environment and also contributes to capital accumulation and technological innovation, key elements for economic growth, and the crisis contagion poses a systemic threat to the stability of the global financial system. For these reasons, studies about financial integration and contagion are relevant.
Keywords: *financial integration, crisis, financial contagion, financial stability.*
JEL Classification: F15, F36, G01, G10

1. INTRODUCTION

It is consensual that a higher level of financial integration in partner economies can promote a process of strengthening the domestic markets involved, which is essential for the domestic corporate environment and also contributes to capital accumulation and technological innovation, key elements for economic growth, and the crisis contagion poses a systemic threat to the stability of the global financial system. For these reasons, studies about financial integration and contagion are relevant.

The financial contagion became more and more the main idea of many studies in this field because it is often associated with the financial crises and it is perceived as a real problem.

Also, financial integration, financial contagion and financial stability are closely linked. This way was supported by the Ms Gertrude Tumpel Gugerell, Member of the Executive Board of the European Central Bank, at the ECB colloquium "European integration and stability" held on the 19th of May 2011. He said that „an integrated financial market is the basis for a smooth and equal transmission of monetary policy, it increases the efficiency and overall welfare of the economy, and enhances the resilience of the financial system from risk diversification. But despite our commitment and our support for financial integration, we also had to learn– with the experience of the past 4 years in mind – that financial integration and financial stability do not always go hand in hand. Indeed we have witnessed that in a financially integrated market risks can spread and spillover to other segments of the financial market, increasing the likelihood of contagion of financial fragilities and systemic risks" (Tumpel-Gugerell, 2011).

The aim of this paper is to highlight the relation between financial integration and financial contagion, with the desire of financial stability. For this purpose we reviewed the literature in this field and then we did an analysis in order to draw relevant conclusions and to provide a clearer picture of the relationship between the two phenomena.

2. LITERATURE REVIEW

According to Karunaratne (2002) crisis contagion could be defined as the phenomenon of the currency crisis in one nation precipitating a currency crisis in another nation, often in the same region. He said that because the crisis contagion poses a systemic threat to the stability of the global financial system, the reform of the international financial architecture is matter of utmost importance in order to minimize the occurrence of crises and crises contagion. Rejeb & Boughrara (2015) aimed in his study to examine the volatility relationship that exists between emerging and developed markets in normal times and in times of financial crises, using the Vector Autoregressive methodology. So, it has been shown that financial liberalization contributes significantly in amplifying the international transmission of volatility and the risk of contagion.

Matos *et al*. (2015) had in their study the purpose to measure how financially integrated and how strong is the financial contagion in BRIC, one of the most famous acronyms that stands for heterogeneous emerging economies: Brazil, Russia, India and China. According to their result, because we can evidence a contagion effect with Brazilian and Chinese financial markets playing a leading role, the economic linkages and information asymmetry within BRIC may be strong. Their evidence that BRIC establish a mutual relationship of long-term equilibrium and are also under contagion effect are robust to a structural break identified due to the recent global crisis, in 2008.

Armeanu *et al*. (2014) studied the financial contagion of the capital markets, as a result of instability or financial shocks, such as financial crisis, and also the way financial contagion occurs. They find that the contagion issue is more profound, as it expands through many regions, and, therefore, it is important to find correlations between the countries, in order to reduce contagion effects, proving that the financial markets have underestimated this type of risk generated by the interconnections between countries.

Fei (2009) examined in his PhD thesis the evolution of the financial integration and contagion of international stock and bond markets. His main results showed that large (/growth) stock portfolios are more integrated with the world than small (/value) portfolios, financial integration, and for testing contagion, he found that the conditional variance of assets returns and the increased level of integration are excellent variables for identifying the crisis period, focusing on the transmission of price shocks at times of financial crisis.
Burzala (2016) presented in his research the deals with the process of contagion in selected capital markets during the financial crisis of 2007–2009. The research that was carried out indicates that rates of return in the studied European markets react simultaneously to a much greater extent as a result of interdependencies than as a result of mutual contagion.

Villar Frexedas & Vayá (2005) studied in their paper the financial contagion in times of crisis, one of the consequences of the integration of markets. The authors used the implementation of Spatial Econometrics. According to the results, in each crisis the market more closely controlled by governments show similar channels of contagion, and also the market more dependent on market forces show a distinctive trend.

Mollah *et al*. (2014) studied the phenomenon of financial market contagion using the Dynamic Conditional Correlation-Generalized Autoregressive Conditional Heteroskedasticity (DCC-GARCH) and vector error correction (VEC) models. The empirical results demonstrate the existence of contagion in the financial markets during the global crisis.

Inci *et al*. (2011) used the local correlation is used to examine financial contagion. They have detected contagion from U.S. futures to other futures markets, and also there is no reverse contagion from any of the German, British, Japanese, and Hong Kong spot or index futures markets to those of the U.S.
Bekaert *et al*. (2005) defined contagion as a correlation between markets in excess of that implied by economic fundamentals. They said that, however, there is considerable disagreement regarding the definition of the fundamentals, how they might differ across countries, and the mechanisms that link them to asset returns.

Gencer & Demiralay (2016) analized financial contagion in the emerging markets during the European sovereign debt crisis and the global financial crisis at the aggregate and disaggregate level. At the aggregate level, their results document contagion incidences only during the European sovereign debt crisis. They said that, with regard to the idiosyncratic contagion effects, the real economy sectors are heterogeneous in the sense that they display co-movements at varying magnitudes during both of the crises.

Piffaut & Miro (2016) aimed in their study to detect and capture the spread between the main stock indices in the Europe, Asia and United States markets. Using the Garch model, they noticed that the stock markets were highly correlated during the financial crisis creating a full-fledge contagion process.

Devereux & Yu (2014) said that financial integration helps to diversify risk but also may increase the transmission of crisis across countries. Their results showed that the financial integration leads to a significant increase in global leverage, doubles the probability of balance sheet crises for any one country, and dramatically increases the degree of 'contagion' across countries.

Ye *et al*. (2017) developed a quantile regression model to measure the financial contagion. Their empirical results showed that the contagion existed during the Euro crisis between Greece and all tested European markets and during the US banking crisis between the US and all tested markets.

You *et al*. (2014) tried to explain the phenomenon about how the China stock market exhibited a very different level of performance during the financial crises, using a composite index for the economic integration and a dynamic conditional correlation model to capture the correlations between stock returns of China and those of other important markets around the world. Their results showed a positive influence for the aim of the study.

Devereux & Shuterland (2011) developed a simple two-country model in which financial liberalization across countries takes place in the presence of credit market distortions within countries. Their main conclusion was that it is necessary to identify the financial structure that most efficiently exploits the trade-off between the cost of financial contagion and the gains of financial market integration.

Gallegati (2012) used a wavelet-based approach to test for financial market contagion. His results indicate that Brazil and Japan are the only countries in which contagion is observed at all scales, because all stock markets have been affected by the US subprime crisis.

Luchtenberg & Vu (2015) studied in their paper the phenomenon of contagion and its determinants during the 2008 financial crisis. They discovered that both economic fundamentals such as interest rates, industrial production, trade structure, inflation rates and regional effects, and investors' risk aversion contribute to international contagion.

3. DATA AND METHODOLOGY

Since the objective of the study was to highlight the relation between financial integration and financial contagion, we did my analyses by identifying the key definitions, approaches, statistical methods of the two topics, found in the literature regarding analyzed topics. Then we synthesized in this paper some of the key points of view and results found in the literature, and we did a regression analysis in order to draw relevant conclusions and to provide a clearer picture of the relationship between the two phenomena.

Also, empirical studies realised so far on this subject have used methodologies that measured separately the two phenomena, not their relationship or influence on his neighbour. In this regard, the financial integration was measured by CAPM (Fei, 2009), multivariate cointegration (Matos *et al*., 2015), two-country model (Devereux & Shuterland, 2011), while the financial contagion was measured by VAR model (Vector Autoregressive) (Rejeb & Boughrara, 2015; Matos *et al*., 2015; Burzala, 2016; Ye *et al*., 2017), GARCH model (Fei, 2009; Mollah *et al*., 2014; Piffaut & Miro, 2016; *You et al*., 2014), an exploratory spatial analysis (Villar Frexedas & Vayá, 2005), wavelet-based approach (Gallegati, 2012), local correlation analysis (Inci *et al*., 2011). We have not attended one of this methodologies because our purpose is to study the relationship between the two phenomena, and not separately.

Our empirical analysis was performed based on a multiple linear regression between the dependent variable and the independent variables, and as econometric software will be used the programs Eviews Statistics and SPSS, which helped us to create a clearer picture on the correlations between variables.

The dependent variable was financial integration, expressed by gross capital formation, and the independent variables will be financial contagion, expressed by unemployment rate, inflation rate, bank's Z score and government expenditures. We chose these variables because they were used in others studies (Racickas & Vasiliauskait, 2012; ECB, 2005) concerning the two phenomena.

The data used for empirical analysis focuses on the period 2000 - 2014, with an annual frequency. This information was obtained from the Eurostat and World Development Indicators databases.

The equations for the regression are expressed by the following formulas:

$$\text{GROSS\_CAPITAL\_FORMATION} = C(1)*\text{BANKS\_Z\_SCORE} + C(2)*\text{GENERAL\_GOVERNMENT\_EXPENDITURE} + C(3)*\text{INFLATION\_RATE} + C(4)*\text{PUBLIC\_DEBT} + C(5)*\text{UNEMPLOYMENT\_RATE} + C(6) \quad (1)$$

$$\text{GROSS\_CAPITAL\_FORMATION} = C(1)*\text{BANKS\_Z\_SCORE} + C(2)*\text{GENERAL\_GOVERNMENT\_EXPENDITURE} + C(3)*\text{UNEMPLOYMENT\_RATE} + C(4)*\text{CRISIS} + C(5) \quad (2)$$

$$\text{GROSS\_CAPITAL\_FORMATION} = C(1)*\text{UNEMPLOYMENT\_RATE} + C(2)*\text{GENERAL\_GOVERNMENT\_EXPENDITURE} + C(3)*\text{BANKS\_Z\_SCORE} + C(4)*\text{EUROZONE} + C(5) \quad (3)$$

4. RESULTS

Considering the literature, we can say that financial integration has led to the financial contagion, especially in times of crisis. Financial integration has both benefits and costs. According to Chiwira & Tadu (2012), the most frequently mentioned benefits of financial market integration include:

- consumption smoothing due to international diversification of risks (reduction of the large country-specific shocks);
- the positive effect of capital flows on domestic investment and economic growth;
- improving efficiency of the financial system;
- increasing prudence of financial market agents;
- the attainment of a high level of financial stability.

Conversely, the major costs of financial integration include:

- insufficient access to funding at times of financial instability inappropriate allocation of capital flows;
- loss of macroeconomic stability;
- herd behavior among investors;
- financial contagion and high volatility of cross-border capital flows.

So, the most significant cost of financial integration is the risk of financial contagion.

Even if it received a lot of definition in the literature until the present, financial contagion is a very complex and multivariate process, without an accepted definition and an accurate measurement methodology.

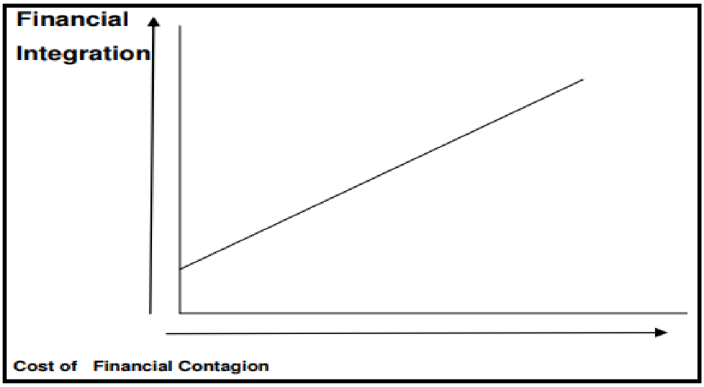
According to Chiwira & Tadu (2012) financial integration can be defined as a transmission of a crisis across borders whose reasons can't be explained by macroeconomic fundamentals.

According to OECD Economics Department (2012), the extent and nature of international banking integration, which led to unprecedented transmission of financial instability, is one important factor that made the recent financial crisis so widespread and deep. The international financial integration led to increase of economic efficiency and growth, but it may also increase the vulnerability to contagion. So, the growth of the cross-border loans of the banks led to a higher risk of contagion.

The hypothesis that financial integration can help the financial stability and as well as extend a financial crisis through financial contagion effects means that it is a "double edge sword". So, the phenomenon of financial integration can move as a mechanism in which a crisis can be transferred, and the financial stability can be attained. This thing leads to the affirmation of the idea that a deeper financial integration lead to a greater cost of financial contagion, implying a concession between them.

Figure 1 shows the relationship that exists between financial integration and financial contagion in a simplified representation.

Figure 1. The relationship between financial integration and financial contagion



Source: Chiwira & Tadu (2013, p. 131)

According to Racickas & Vasiliauskaite (2012), financial contagion could be measured by several indicators (see table 1).

Table 1. Indicators of financial contagion

Financial contagion indicators	Interpretation
	External sector (current account)
Real exchange rate	A measure for the change in international competitiveness and a proxy for over(under)valuation. Overvalued real exchange rate is expected to produce higher probability of financial crisis.
Export growth	An indicator for a loss of competitiveness in international good market. Declining export growth may be caused by an overvalued domestic currency and hence a proxy for currency overvaluation. On the other hand, if export growth slows due to reasons unrelated to the exchange rate, this may cause devaluation pressure. In both cases, declining export growth can be a leading indicator for a sizeable devaluation.
Import growth	Weak external sector is part of currency crises. Enormous import growth could lead to worsening in the current account and have been often related with currency crises.
Terms of trade	Increases in terms of trade should strengthen a country's balance of payments position and hence lower the probability of crisis. Terms of trade deteriorations may precede currency crisis.

Financial contagion indicators	**Interpretation**
Ratio of the current account to GDP	A rise in this ratio is generally associated with large external capital inflows that are intermediated by the domestic financial system and could facilitate asset price and credit booms. Increases in the current account surplus are expected to indicate a diminished probability to devalue and thus to lower the probability of a crisis.
External sector (capital account)	
Growth of foreign exchange reserves	Declining foreign reserves is a reliable indicator that a currency is under devaluation pressure. A drop in reserves is not necessarily followed by devaluation, central bank may be successful in defending a peg, spending large amounts of reserves in the process. On the other hand, most currency collapses are preceded by a period of increased efforts to defend the exchange rate, which are marked by declining foreign reserves. Total value of foreign reserves is also used as indicators of a country's financial difficulty dealing with debt repayment.
Ratio of M2 to foreign exchange reserves	Captures to what extent the liabilities of the banking system are backed by foreign reserves. In the event of a currency crisis, individuals may rush to convert their domestic currency deposits into foreign currency, so that this ratio captures the ability of the central bank to meet their demands.
Financial sector	
M1 and M2 growth	These indicators are measures of liquidity. High growth of these indicators might indicate excess liquidity which may fuel speculative attacks on the currency thus leading to a currency crisis.
M2 money multiplier	An indicator associated with financial liberalization. Large increases in the money multiplier can be explained by draconian reductions in reserve requirements.
Ratio of domestic credit to GDP	Very high growth of domestic credit may serve as a crude indicator of the fragility of the banking system. This ratio usually rises in the early phase of the banking crisis. It may be that as the crisis unfolds, the central bank may be injecting money to the bank to improve their financial situation.
Excess real M1 balance	Loose monetary policy can lead to currency crisis.
Domestic real interest rate	Real interest rate can be considered as proxy of financial liberalization, in which the liberalization process itself tends to lead to high real rates. High real interest rates signal a liquidity crunch or have been increased to fend off a speculative attack.

Financial contagion indicators	Interpretation
Lending and deposit rate spread	An increase of this indicator above some threshold level possibly reflects a deterioration in credit risk as banks are unwilling to lend or decline in loan quality.
Commercial bank deposits	Domestic bank run and capital flight occur as crisis unfolds
Ratio of bank reserves to bank assets	Adverse macroeconomic shocks are less likely to lead to crises in countries where the banking system is liquid.
Domestic real and public sector	
Ratio of fiscal balance to GDP	Higher deficits are expected to raise the probability of crisis, since the deficits increase the vulnerability to shocks and investor's confidence.
Ratio of public debt to GDP	Higher indebtedness is expected to raise vulnerability to a reversal in capital inflows and hence to raise the probability of a crisis.
Growth of industrial production	Recessions often precede financial crises.
Changes in stock prices	Burst of asset price bubbles often precede financial crises.
Inflation rate	The inflation rate is likely to be associated with high nominal interest rates and may proxy macroeconomic mismanagement which adversely affects the economy and the banking system.
GDP per capita	High income countries may be less likely to reschedule their debt than poorer countries since the costs of rescheduling would tend to be more onerous for more advanced economies. Deterioration of the domestic economic activity is expected to increase the likelihood of a banking crisis.
National saving growth	High national savings may be expected to lower the probability of debt rescheduling.
Global economy	
Growth of world oil prices	High oil prices are associated with recessions.
US interest rate	International interest rate increases are often associated with capital outflows.
OECD GDP growth	Higher foreign output growth should strengthen exports and thus reduce the probability of a crisis.

Source: Racickas & Vasiliauskait (2012, p. 95-97)

Of these, we tried to choose three indicators that would correlate with financial integration to see the relationship between the two phenomena. The two indicators are: government expenditure, inflation rate and unemployment rate. We chose these variables because government expenditures are very important to ensure the well-being of the population, and the living standards, which leads to the reduction of migrations and favors economic growth. Also the unemployment rate is an important indicator because it specifies the percentage of the unoccupied population, which requires employment. The employment of the population is very important because it leads to the growth and development of the economy as a whole and to the maintenance of financial stability. The inflation rate is also important because it affects the economy and the banking system. As independent variables, we used also the Banks Z score, which is a measuring indicator of bank's solvency risk, It explicitly compares buffers (capitalization and returns) with risk (volatility of returns), and because of this it can be used as an indicator of financial contagion. Also, as control variable we used public debt, which is a good way for countries to get extra funds to invest in their economic growth. They were the independent variables. The dependent variable was the financial integration, expressed by gross capital formation. For financial integration we used gross capital formation because, according to the literature, this is an important indicator of stock market integration. Also, based on a previous study, we found that it is the most important factor through which financial integration influences economic growth. We created a two dummy variables, crisis, which take the value 0 before 2008 and 1 otherwise, and eurozone, which take the value 0 for the non-eurozone countries and the value 1 for the eurozone countries.

The summary statistics of the variables included in our model are presented in Annex no. 1.

In the table 2, we can see the results of the regression analysis. In the first model, as it can be seen the variables which refers to financial contagion (unemployment rate, government expenditure, bank's Z score) are significant and negatively correlated with the variable which refers to financial integration (gross capital formation), which means the higher is the level of unemployment rate, government expenditure, or bank's Z score, the lower is the level of gross capital formation, this being demonstrated by the probability of T-test statistic (< 0.05) and the negatives values of the variables coefficients. Also in the first model we can see that the public debt has a significant and negative influence on the gross capital formation, and the inflation rate does not have a significant influence. In the second model, we can see that the dummy variable EUROZONE does not have a significant influence on the dependent variable, so we can say that the independent variables have a greater influence on the dependent variable in the non-eurozone countries. In the third model, we can see that the dummy variable CRISIS has a significant and negative influence on the dependent variable, so we can say that the independent variables have a greater influence on the dependent variable in the post-crisis period. Thus we can say that the two phenomena, financial integration and financial contagion are inversely proportional, financial contagion having a negative influence on the financial integration. Because of this others authors (Chiwira & Tadu, 2012) stated that financial contagion is considered a cost of financial integration.

Table 2. Results of regression estimation of gross capital formation and the independent variables for the EU 28

Variables	Model 1	Model 2	Model 3
C	31.32788*** (1.468650)	36.93665*** (1.297653)	33.72442*** (1.246629)
Crisis			-2.424302*** (0.360804)
Eurozone		0.368169 (0.362471)	
Bank's Z score	-0.001299*** (0.000327)	-0.001612*** (0.000357)	-8.29E-05*** (2.32E-05)
General government expenditure	-0.105075*** (0.032512)	-0.267224*** (0.026907)	-0.172170*** (0.027032)
Inflation rate	0.090488* (0.046827)		
Public debt	-0.049655*** (0.006458)		
Unemployment rate	-0.156437*** (0.038963)	-0.265005*** (0.039548)	-0.204177*** (0.039667)
R-squared	0.351851	0.253685	0.310718
Adjusted R-squared	0.344023	0.246492	0.304074
Total panel (balanced) observations	420	420	420
Standard error in parentheses, *** p<0.01, ** p<0.05, * p<0.1			

Source: author calculation

In base of Pearson's correlation coefficient which is the covariance of the two variables divided by the product of their standard deviations, we relate the results of our test (see table 3). Depending on the size of Pearson between of the six variables, we can see that it is a low negative correlation between the dependent variable, gross capital formation, and the independent variables (general government expenditures, unemployment rate, public debt) for a risk of 1%. The negative correlation means that as one independent variable increases in value, the dependent variable decreases in value. This justified the earlier claim that financial integration and financial contagion are inversely proportional.

Table 3. Pearson's Correlations

		Gross capital formation	General government expenditure	Unemployment rate(% of labor force)	Inflation rate	Public debt	Banks Z score
Gross capital formation	Pearson Correlation	1	-,383**	-,254**	,251**	-,537**	-,084
	Sig. (2-tailed)		,000	,000	,000	,000	,085
	N	420	420	420	420	420	420
General government expenditure	Pearson Correlation	-,383**	1	-,030	-,354**	,565**	-,195**
	Sig. (2-tailed)	,000		,535	,000	,000	,000
	N	420	420	420	420	420	420
Unemployment rate (% of labor force)	Pearson Correlation	-,254**	-,030	1	-,065	,253**	-,082
	Sig. (2-tailed)	,000	,535		,181	,000	,094
	N	420	420	420	420	420	420
Inflation rate	Pearson Correlation	,251**	-,354**	-,065	1	-,249**	,000
	Sig. (2-tailed)	,000	,000	,181		,000	,994
	N	420	420	420	420	420	420
Public debt	Pearson Correlation	-,537**	,565**	,253**	-,249**	1	-,078
	Sig. (2-tailed)	,000	,000	,000	,000		,110
	N	420	420	420	420	420	420
Banks Z score	Pearson Correlation	-,084	-,195**	-,082	,000	-,078	1
	Sig. (2-tailed)	,085	,000	,094	,994	,110	
	N	420	420	420	420	420	420

Source: author calculation

5. CONCLUSIONS

Both financial integration and financial contagion are multivariate processes which were strongly debated in the literature until the present. The most authors have dealt with the definition of the two concepts and then with the search of different methodologies to measure separately each phenomenon. The main ideas discovered by the literature were that financial contagion is the most important cost of financial integration, because the financial integration helps to diversify risk but also may increase the transmission of crisis. The crisis contagion poses a systemic threat to the stability of the global financial system.

Because the empirical studies realised so far on this subject have used methodologies that measured separately the two phenomena, not their relationship, we did a regression analysis which suggest the fact that the factors used, have what can be considered as the expected significant coefficient signs, there is a significant relationship between the variables, namely financial integration, expressed by gross capital formation, and financial contagion, expressed by general government expenditure, unemployment rate, bank's Z score, public debt, and also financial integration and financial contagion are inversely proportional, financial contagion having a negative influence on the financial integration. Also, the results show that the independent variables through which financial integration affects financial contagion have a greater influence in the post-crisis period and in non-eurozone countries. So, the fiscal policies should search measures for reduce the risk of crisis transmission (which determines the financial contagion), and for increase the benefits of financial integration, with the desire of financial stability.

The phenomenon of financial integration can move as a mechanism in which a crisis can be transferred, and the financial stability can be attained. This thing leads to the affirmation of the idea that a deeper financial integration lead to a greater cost of financial contagion, implying a concession between them.
We will concentrate the future research directions on this topic to find others methodologies through which can be measured the relationship between the two, phenomena, financial integration and financial contagion.

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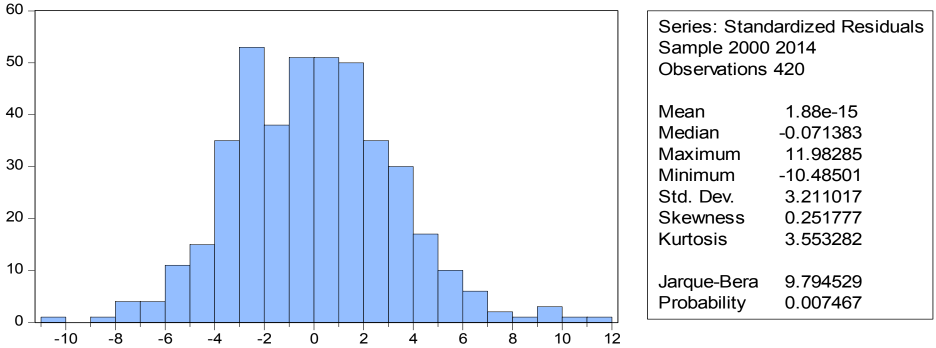
Annex 1. Descriptive statistics

	GROSS_ CAPITAL_ FORMATION	BANKS_ Z_ SCORE	GENERAL_ GOVERNMENT_ EXPENDITURE	INFLATION_ RATE	PUBLIC _DEBT	UNEMPLOYMENT_ RATE
Mean	22.61	169.44	44.55	3.06	54.40	9.00
Median	22.13	25.91	44.70	2.45	49.35	7.85
Maximum	38.40	4628.80	65.30	45.67	179.70	27.50
Minimum	10.82	-222.26	32.10	-4.48	3.70	1.90
Std. Dev.	3.99	496.28	6.42	3.63	31.44	4.33
Skewness	0.68	5.33	0.08	6.18	0.86	1.42
Kurtosis	4.59	35.77	2.50	62.21	4.00	5.32
Jarque-Bera	76.51	20790.01	4.76	64024.14	68.99	234.86
Probability	0.00	0.00	0.09	0.00	0.00	0.00
Sum	9496.28	71162.77	18710.80	1283.48	22847.80	3780.30
Sum Sq. Dev.	6665.37	1.03E+08	17269.27	5522.66	414255.3	7839.15
Obs.	420	420	420	420	420	420

Source: author calculation

Annex 2. Descriptive statistics



Source: author calculation

Annex 3. One-Sample Test ANOVA

	Test Value = 0.05					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Gross capital formation	115,92	419	,00	22,56	22,18	22,94
General government expenditure	142,05	419	,00	44,50	43,88	45,12
Unemployment rate (% of labor force)	42,41	419	,00	8,95	8,54	9,37
Inflation rate	16,97	419	,00	3,1	2,66	3,35
Public debt	35,42	419	,00	54,35	51,33	57,37

Source: author calculation

THE IMPACT OF POLITICAL AND SOCIAL EVENTS ON THE STABILITY OF THE EU CAPITAL MARKETS

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Abstract
Countries are becoming more and more interconnected through trade linkages and financial integration, which is constantly increasing. This is one reason why the financial crisis has spread so fast and was able to affect a significant number of countries and the majority of studies are focusing on how a financial shock on one market can lead to contagion on several other countries. In order to achieve or maintain financial stability and reach sustainable economic growth, we believe it is essential to evaluate whether markets also respond to political or social shocks that occur on other markets as these are becoming important factors in preserving a healthy and stable market. This theme is of great interest to economists, investors, researchers in the field and for the political sector. Our paper proposes an analysis using the representative stock market index of each of the 28 EU countries over the period 2010-present. In order to obtain a stability index which takes into account the evolution of each particular country we are following the methodology described by Diebold & Yilmaz (2009) by forecasting the error variance decomposition of a VAR model to see what fraction of the 10-step-ahead error variance in forecasting is caused by shocks to the same variable or shocks to another variable. We are setting 4 null hypothesis in order to see whether political or social shocks have a negative impact on the markets and we are considering 4 such events: the conflict in Ukraine, the main events that followed the Brexit announcement, ISIS intensified terrorist attacks and Donald Trump's election as US president. Our results show that indeed shocks such as terrorism or the UK's announcement to leave the EU or even the US election results have a negative impact and are generating high volatility on all studied markets.

Keywords: *financial stability, spillover index, stock markets, political and social shocks.*
JEL Classification: G1, C1

1. INTRODUCTION

The recent period of economic decline has made analysts focus on understanding the causes of financial instability and how its effects can be reduced, in a desire to develop mechanisms for monitoring vulnerabilities, the sources of a possible contagion and assessing the persistency and magnitude of economic shocks.

As we are living in a turbulent period in terms of political and social events, we should pay close attention and be aware of how these are destabilizing the financial system. The current period only validates the importance of an analysis on such events that have shaped the financial market in the latest years, because even the smallest imbalance can have major consequences on the stability of the economy.

This paper aims to contribute to the literature, as there are very few articles dealing with this topic and focusing on political and social shocks spreading among markets. From what has been studied, we have not found any article to perform a quantitative analysis similar to the one that we propose in our article.

This study is of great interest for economists, for the political sector and for investors because these types of shocks should weight more in the decision of investing and in the asset allocation, having more confidence in countries that have a stable political system.

The work is divided into the following sections: the literature review presents analysis and studies on this topic and the authors' conclusions; the methodology, in which we mention, in detail, the methods and models used, and then followed by the case study with the analysis results and our personal contribution through a new approach to obtain results in the subject matter of the study and finally, the conclusions of the analysis.

2. LITERATURE REVIEW

This article contributes to the slowly growing scientific literature on studying the financial market's behaviour in response to political or social events. The existing literature is scarce as there are not many current studies on this topic and there are even less that are referring to countries from Europe. Most of them analyze the political or social shocks on markets such as: Iraq, Pakistan or Lebanon, where these events are either frequent, or represent the main reason for their market destabilization.

Jonston & Nedelescu (2005) study the consequences of terrorism on financial markets, as well as the response of policy makers and regulators. The studied terrorist attacks are the World Trade Center attack on the 11th September 2001 and the attack in Madrid from the 11th March 2004. They found that healthy markets proved to be more resilient to terrorism shocks as they were able to absorb the shocks effectively. The competent authorities had a strong role in this critical situation because they acted successfully and quickly. This was imperative for it showed the importance of having in place business continuity plans, but it also indicated the weaknesses that existed and needed to be treated in order to minimize the effects. Chen & Siems (2004) reach to the same conclusion as they also mention how US markets have a rapid recovery after shocks and that global markets are inter-linked, which can easily lead to spillover effects. This means that regulators and policy makers should be alert of what is happening in other countries and also try to collaborate to find solutions and develop plans to reduce the outcome of such events.

The negative impact of terrorism shocks are also investigated by Bashir *et al.* (2013) on the Karachi Stock Exchange in Pakistan. The studied events are represented through dummy variables and their effect is analyzed by using a GARCH(1,1) model, which is considered to be appropriate for financial data in order to estimate volatility. Their results show that terrorism is negatively influencing the movement of the stock exchange index.

In terms of political risks, the International Monetary Fund mentioned in the Global Financial Report from 2011 (IMF, 2011) that the lack of certainty in the political sector and the slow policy response could trigger increased market volatility and shake the market confidence. In order to assess the political risk, Baek & Qian (2011) analyze its impact on the Foreign Direct Investments (FDI) established by the International Country Risk Guide to see the effect of each political risk component on developed and developing countries. The authors demonstrate that indeed political risks affect both industrialized and developing countries, however the magnitude of the impact differs for each type of country and depending on the political risk component. Also, it seems that only the internal conflict (which is one of the 12 political risk components) has no effect on the flow of FDI. Furthermore, they observed that after the 9/11 terrorist attacks the political risks have proven to have a more significant impact on FDI, particularly in developed countries. Saret & Manzo (2016) use the 5-year CDS spread to investigate the impact of the political risk factor on the Italian market. For this, they test a set of political events such as: prime ministers' resignations, referendums or parliamentary elections, over the period 2007 - 2016. They learnt that the Italian political risk have affected Greece, Cyprus and Spain the most, followed by Portugal, Belgium and Ireland, which is explained by the authors as being countries very similar to Italy in terms of political instability, amount of debt as percentage of the size of their economy. An interesting result is that the latest referendum did not have such a high impact as it was expecting, a possible reason being that the outcome was not surprising so it did not create any panic or uncertainty on the markets. The predictability of the political event is also mentioned by Bernhard & Leblang (2006) whose study (pp. 86-102) reflects how investors shift their portfolios depending on the political developments and how the size of the shock is related to the expectedness of that particular political event and its result.

In a study from November 2016 by Hartwell and Horvath regarding the impact of Brexit, the European Parliament mentioned that an EU without UK may have consequences in investment decisions, monetary policy and trade links. The authors call Brexit "a reputational hit" to the EU, considering that it will trigger different other problems and that, although it has created short-term volatility, in the end the EU is the one that controls the Euro Area stability (Hartwell & Horvath, 2016).

3. METHODOLOGY

The main focus of our analysis is to test whether markets respond to political or social events that occur on other markets. For this purpose, all the EU markets were considered, for which we used the representative capital market index of each country, as in table 1.

Table 1. List of EU countries and their corresponding market index

Country name	Market index	Country name	Market index
Austria	ATX	Italy	MIB40
Belgium	BEL20	Latvia	OMXR
Bulgaria	SOFIX	Lithuania	OMXV
Croatia	CRBEX10	Luxembourg	LUXX INDEX
Cyprus	CYSE20	Malta	DWMLT
Czech Republic	PX50	Netherlands	AEX25
Denmark	OMXC20	Poland	WIG30
Estonia	OMXT	Portugal	PSI20
Finland	OMXH25	Romania	BET
France	CAC40	Slovakia	SAX
Germany	DAX30	Slovenia	SBI20
Greece	ATHEX20	Spain	IBEX35
Hungary	BUMIX14	Sweden	OMXS30
Ireland	ISEQ20	United Kingdom	FT30

Source: stooq.com

The analyzed period is January 2010 - April 2017 (leading to a total number of 1870 observations), while the sources of the daily financial data were: investing.com and stooq.com.

In order to achieve the objective of this study we are using the Diebold & Yilmaz (2009) approach, by estimating a spillover index using a vector autoregressive (VAR) in order to quantify return spillovers among international capital markets. Measuring the spillover requires forecasting the error variance decomposition of a VAR model to see what fraction of the H-step-ahead error variance in forecasting a variable is caused by shocks to the same variable or shocks to other variables. In our case, the decomposition of the 10-step ahead forecast error variance of each of our 28 variables (creating a 28 dimensional VAR model) enabled us to estimate these fractions and aggregate them so that in the end to obtain the spillover index, which can be viewed, essentially, as a financial stability index. More specifically, we assumed a second order VAR with 28 variables:

$$\boldsymbol{X_t = \sum_{i=1}^{p} \phi_i \cdot X_{t-i} + \varepsilon_t} \qquad (1)$$

The Moving Average representation of VAR could be written as:

$$\boldsymbol{X_t = \sum_{i=0}^{\infty} A_i \cdot \varepsilon_{t-i}} \qquad (2)$$

where:
$\boldsymbol{\varepsilon_t \sim i.i.d\ (0, \Sigma)}$
$\boldsymbol{p\ is\ the\ order\ of\ the\ VAR\ (here{:}\ p = 2)}$
$\boldsymbol{X\ is\ a\ N\ variable\ vector}$
$\boldsymbol{\Sigma\ is\ the\ variance\ covariance\ matrix}$
$\boldsymbol{A_i\ is\ the\ N\ x\ N\ coefficient\ matrix}$; with:

$$\boldsymbol{A_i = \phi_1 \cdot A_{i-1} + \phi_2 \cdot A_{i-2} + \ldots + + \phi_p \cdot A_{i-p}}$$

Due to these economically uncertain times, we used the rolling window method which allows us to follow the market behaviour in order to better capture the market movements at each moment in time. Having such a high number of variables required a sufficient number of observations for the moving average (in our case, 800 observations). Using the contributions of the variance decomposition, we constructed the total spillover index:

$$\boldsymbol{Spillover\ Index = \frac{\sum_{h=0}^{H-1} \sum_{i,j=1}^{N} a_{h,ij}^2}{\sum_{h=0}^{H-1} trace\ (A_h A_h')} \cdot 100} \qquad (3)$$

(representing the total spillover as a proportion of the total forecast error variation)

According to Diebold & Yilmaz (2009), the spillovers are the cross variance shares, meaning that these indicate the fractions of the H-step-ahead error variances in forecasting X_i due to shocks to X_j (the amount of spillover that countries “receive” from other countries, together with the spillover that they “give” to the other countries).

The reason for combining all the data into one index was to have one measurement that contains each country’s evolution throughout the analyzed period, with the purpose of assessing which of the major political and social events had a negative impact on all these markets. The political and social events that were considered are:

- the Ukrainian conflict: represented by the Ukrainian revolution of 2014 (Euromaidan revolution 18.02 - 23.02.2014), the Crimean Crisis (20.02 - 19.03.2014) and the War in Donbass (6.04.2014 - present);
- the intensification of the ISIS terrorist attacks in Europe (for a full list of all the dates, please refer to *Appendix 1*);
- UK's vote to leave the EU (Brexit): considering the main events that followed the Brexit announcement on 24.06.2016, such as: 29.06.2016 when the EU leaders declared that they want UK to trigger Article 50 of the Treaty of the EU "as quickly as possible", 13.07.2016 when Theresa May became the new Prime Minister and 29.03.2017 when the UK Government triggered Article 50;
- Donald Trump's election as US president: 9.11.2016.

In terms of creating the dummy variables, the data was collected from chronological lists and timelines of main events that followed the Brexit announcement, as well as the unfolding of the Ukrainian conflict *(please see the web pages mentioned in the Reference section).* Additional research was also needed for pinpointing the exact moments of the ISIS terrorist attacks, between 2015 and 2017. In order to better capture the impact of the terrorist attacks, we considered for the creation of the dummy variables the day of the attacks and the following day, which were marked with the value 1. The reason for this adjustment was to account for any possible lags and to make sure we also catch the market opening and how it responds to the event. The same adjustment applies to both the dummy variables for Brexit and Donald Trump's election.

Setting the Null Hypothesis:

- Null Hypothesis 1: The Brexit announcement did not have a negative effect on the markets;
- Null Hypothesis 2: The terrorist attacks did not have a negative effect on the markets;
- Null Hypothesis 3: The US election results did not have a negative effect on the markets;
- Null Hypothesis 4: The terrorist attacks did not have a negative effect on the markets.

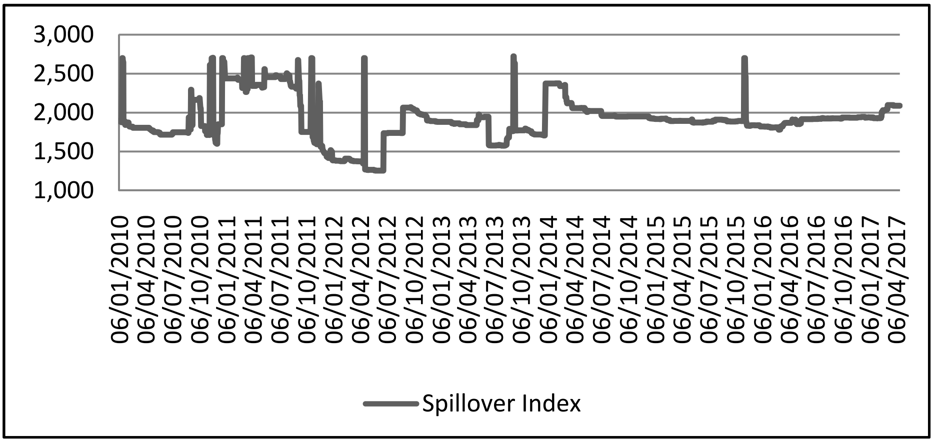
By obtaining a negative and statistically significant coefficient (with a p-value less than 5%) for these dummy variables, the null hypothesis would be rejected, thus, meaning that the particular event that was tested has a negative impact of the studied European markets.

A GARCH(1,1) model was estimated, with the spillover index as the independent variable and as dependent variables: the spillover index lagged with 1 period, the constant c and, separately, each of the 4 dummy variables. For each model we considered a generalized error distribution (GED) for errors because, by comparison, it is the most appropriate for the data used, as the maximum number of significant coefficients is obtained, the log likelihood is maximum and the Akaike Information Criterion (AIC) is the lowest. At a reduction in log likelihood, the AIC increases and thus weakens the ability of the model to be used in forecasts.

4. RESULTS

This section presents the results after following the methodology described in the previous section.

Figure 1. Evolution of the Spillover Index



Source: authors' computations

As it can be seen in the above figure (fig. 1) the period between 2010 and 2014 marks a period with high instability represented by the effect of the financial collapse in 2008 and followed by the sovereign debt crisis. For the current analysis our focus is mainly the period after 2015. One reason for avoiding this tumultuous period (2010-2012) is because the crisis was at its peaks in most of the analyzed countries and the results would have been inconclusive as the impact of political and social events would have been difficult to separate from the impact of the financial crisis. It is also worth mentioning the spike from November 2015, where a possible cause could have been the intensification of the migrant crisis in Europe, when countries such as Austria and Slovenia began building barriers along their borders to reduce the inflow of migrants. What is important to state, as well, is that in the following days the dreadful terrorist attacks in France occurred.

Out of the 4 events analyzed, 2 of them represent internal shocks (the ISIS attacks in Europe and Brexit) because they occurred in the countries whose markets are included in the spillover index, meaning that we would expect to see a significant impact caused by these shocks. As compared to the other 2 external shocks (that involved the US market or the Ukrainian and Russian market) we expect to see less or no influence on the analyzed markets.

Table 2. Results of GARCH estimations

Variable	Coefficient	Std. Error.	z-Statistic	Prob.
@SQRT(GARCH)	-0.2229	0.000002	-113846.5	0
DUMMY_BREXIT	**-0.7828**	**0.004679**	**-167.2915**	**0**
SPILLOVER_INDEX(-1)	0.9925	0.000001	1092176	0
C	42.7255	0.000149	286192.3	0
GARCH	-0.0099	0.000119	-83.56195	0
DUMMY_TERRORISM	**-0.0130**	**0.000021**	**-636.0703**	**0**
SPILLOVER_INDEX(-1)	0.9993	0.000000	3709776	0
C	81.7385	0.002823	28953.04	0
GARCH	-0.0096	0.000000	-73599.57	0
DUMMY_TRUMP	**-0.0224**	**0.008861**	**-2.522505**	**0.01**
SPILLOVER_INDEX(-1)	1.0002	0.000000	15472648	0
C	82.5995	0.001045	79027.64	0
@SQRT(GARCH)	0.024883	0.000152	163.8109	0
DUMMY_UKRAINE_2	1.173168	0.005126	228.8643	0
SPILLOVER_INDEX(-1)	0.9872	0.000001	1143277	0
C	20.2684	0.011589	1748.921	0

Source: authors' computations

We reject the null hypothesis for the first 3 equations (presented in table 2) because not only that the conditions mentioned in the Methodology section are met (the coefficient of the dummy variables have a negative sign and are statistically significant), but also the coefficients of the variance equation have p-values less than 5%, the Adjusted R^2 is over 80% and the DW statistic is between 1.93 and 2.07, thus proving that there is no autocorrelation of prediction errors. This does not apply for the last equation; although, the p-values are below 5%, the other criteria are not fulfilled.

UK's vote to leave the EU and the main events that followed the referendum results had a negative impact on the studied European markets. This came as a shock for investors that were not anticipating such an outcome. As a result the pound became weaker and the government bonds also dropped. In terms of the Ukrainian conflict it may have had an influence of the surrounding countries, but our results show that overall the 28 EU countries were not affected. Although the index is composed of all the EU countries, there are strong economies such as Germany, France or the UK that can be considered to "dictate" the evolution of the index. This could be a reason why the Brexit or the ISIS attacks negatively affected all the European countries studied and this is because the markets on which they occurred have strong economies that generate an important weight in the estimation of the spillover index. It is a similar case with the US: the election result was an event that shocked the market as it was entirely unexpected. This decision was viewed as a political risk by the markets and created tension among investors. The value of stocks dropped as investors were aggressively selling them in order to invest in less riskier securities and this created high volatility on all European markets (Koukoulas, 2016; Kiersz, 2016). This shows once more that the interdependencies that exist between countries, generated through trades and financial linkages could lead to spillover.

5. CONCLUSIONS

In a time of global uncertainties it is also important to analyze the market reactions to political and social shocks. The current paper analyzes the shock spreading of events such as: UK's vote to leave the EU, ISIS terrorist attacks in Europe, Donald Trump's election of US president and the Ukrainian conflict, on the financial markets of the 28 EU countries. We achieved this, by estimating a spillover index, following the Diebold & Yilmaz (2009) approach and testing it under a GARCH(1,1) model with each dummy variable (which correspond to the 4 shocks previously mentioned).

It was obtained that, except the conflict from Ukraine, all the events that were studied had a negative impact and generated volatility on the European markets. Even if the impact is not persistent as compared to a financial crisis, in which markets recover slower and the risks are higher, the impact of political and social shocks on the financial stability should not be ignored. Although, the market is designed to self-correct and rebalance, all the destabilization that it is facing could add-up and create tension among investors leading to unexpected behaviour as they lose trust in the market and the policy makers.

Such events that cause geopolitical tensions are hard to predict, could be considered as "black swans". For example, even if the dates for elections or referendums are known, the results are still unpredictable, making it hard to forecast how markets will respond (Wolfers & Zitzewitz, 2016). The same applies to social actions, such as terrorism, that are even more difficult to foresee as they are random and subjective and as compared to financial shocks, in this case, there are no known triggers or warning signs.

Elvira Nabiullina, the director of the Central Bank of Russia, mentioned, according to the article "Black swans: How political shocks are changing the world financial market" that these political and social actions could have the same starting point - the burden that the world economy is currently bearing:

high debt, slow growth, the increasing gap between the rich and the poor, unfairness and corruption and that all these have led to such terrible behaviour.

What we have proven in this study is that due to trading and financial connections that exists between countries, markets have started to become sensitive not only to financial shocks that could lead to contagion, but also to political and social unsteadiness, which can also threaten financial stability. According to Helleiner (2010) the international cooperation has an important role (in terms of research, information sharing or global warning systems) in supporting global financial stability, so it is not an option to weaken the links between countries. Still, effective mechanisms for monitoring and assessing the risks should be continuously developed in order to strengthen the actions taken in response to existing vulnerabilities. Therefore, it is necessary to have an overview of the entire economy, which is critical in order to achieve stability and sustainable economic growth.

As a further study, it may prove to be useful to calculate the spillover index separately for countries in the EuroZone and in the non-member countries and see how the impact differs. Another analysis that could be considered would be the calculation of directional spillover to know the exact contribution of each country, and not only the total spillover.

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Appendix 1
List of ISIS terrorist attacks

Date of terrorist attack	*Country affected*
07.01.2015	France
26.06.2015	France
13.11.2015	France
14.11.2015	France
07.01.2016	France
26.02.2016	Germany
22.03.2016	Belgium
13.06.2016	France
14.07.2016	France
18.07.2016	Germany
24.07.2016	Germany
26.07.2016	France
06.09.2016	Italy
27.09.2016	Italy
16.10.2016	Germany
31.10.2016	Germany
19.12.2016	Germany
03.04.2017	Russia
07.04.2017	Sweden

Source: https://en.wikipedia.org/wiki/Terrorism_in_Europe;
https://en.wikipedia.org/wiki/Islamic_terrorism_in_Europe_(2014-present)

Appendix 2
List of sources used for the timeline of analyzed events

Name	*Source*
Brexit Timeline (2017)	https://www.dlapiper.com/ro/us/focus/brexit-legal-impact/timeline/
The Ukraine Crisis Timeline (2017)	http://ukraine.csis.org/index.htm
Ukraine Timeline of Events (2016)	http://www.europarl.europa.eu/news/en/news-room/20140203STO34645/ukraine-timeline-of-events
Terrorism attacks in Europe (2014-present)	https://en.wikipedia.org/wiki/Islamic_terrorism_in_Europe_(2014%E2%80%93present)
Terrorism in Europe (2017)	https://en.wikipedia.org/wiki/Terrorism_in_Europe
Timeline of the European Migrant Crisis (2017)	https://en.wikipedia.org/wiki/Timeline_of_the_European_migrant_crisis

FISCAL CONSOLIDATION AS ALTERNATIVE PUBLIC DEBT REDUCTION STRATEGY IN THE EU MEMBER STATES

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Abstract
The high increase in public debt in many EU Member States, in the context of the recent economic and financial crisis, has brought into public authorities' attention, especially since 2010, the need to define and implement strategies aimed at reducing it to acceptable levels, unharmful for economic growth. Given the lack of other viable and consistent desindebtedness alternatives, as well as the concerns with regard to long-term fiscal sustainability, fiscal consolidation emerged as the main option for governments, although the concrete measures implemented varied in both amplitude and content.
Against this background, the paper aims to comparatively assess the fiscal consolidation strategies implemented in recent years by the EU countries. In particular, using data reported by the European Commission, we evaluate the incidence and magnitude of fiscal consolidation episodes in the EU countries, in relation to their public debt's dynamics, as well as the composition of fiscal consolidation measures. In this respect, we assess to what extent the fiscal consolidation strategies implemented by the public authorities of the EU Member States focused on reducing public expenditure, increasing budgetary revenue, or a more balanced mix of these alternatives. Given that public debt reduction strategies should be designed so that long-term growth prospects are not affected, the paper also assesses to what extent the potential impact on economic growth has been taken into consideration when deciding the amplitude and composition of fiscal consolidation strategies. Overall, our results emphasize very different approaches of public authorities, although public expenditure (and even public investment) cuts have been common features of many fiscal consolidation strategies, especially in some, more indebted, EU countries.
Keywords: *fiscal consolidation strategy, public expenditure, budgetary revenue, public debt, EU countries.*
JEL Classification: H30, H60

1. INTRODUCTION

As the recent international economic and financial crisis emerged, the public debt of many countries, especially of the EU Member States, increased considerably, exceeding by far the sustainable level. The average general government debt of the EU countries increased by more than 30% in just 3 years (from 2007 to 2010), almost reaching 80% of GDP in 2010, a level well above the 60% limit of the Stability and Growth Pact. Also, public debt came to exceed 100% of GDP in some particular countries, already highly indebted prior to the crisis, like Belgium, Greece, Italy, and Portugal. Against this background, the governments of the EU Member States became increasingly concerned with defining and implementing public desindebtedness strategies, aimed at stabilizing or cutting down debt to bearable levels that do not imply risks to the financial stability of the country and do not adversely affect its pace of economic growth.

In the light of previous debt reduction experiences of different countries, several possible options have been considered, among which *economic growth, debt's depreciation by inflation, the sale of public (financial and non-financial) assets, fiscal consolidation and default* (Bilan, 2014; Aizenman & Marion, 2011; OECD, 2012; Daniel *et al.,* 2003). In practice, a country's public debt reduction strategy may include a mix of these options, tailored to its public finance, the desired/required size of government debt and required adjustments, the internal and international economic and financial situation, etc.

Although all the other solutions identified may contribute, to a greater or lesser extent, to achieve and keep prudent public debt levels, it is generally appreciated that it is necessary to complement them by concurrent fiscal consolidation measures, resulting in lower structural budget deficits or even structural budget surpluses over the medium-term. Thus, it becomes possible to reduce the pace of public debt growth or even make available additional financial resources for debt's amortization.

Against this background, the paper aims to comparatively assess the fiscal consolidation strategies implemented in recent years by the EU countries to reduce public debt and ensure the sustainability of public finance, especially focusing on the amplitude, length and composition of fiscal consolidation episodes.

2. SOME CONSIDERATIONS ON FISCAL CONSOLIDATION OPTIONS AND THEIR POTENTIAL EFFECTS

Generally speaking, fiscal consolidation means discretionary fiscal policy decisions adopted by public authorities with the aim to cut down budget deficits and restore fiscal policy sustainability. Therefore, fiscal consolidation results in lower budget deficits or even budget surpluses and smaller government debt.

Although simple in theory, in practice there is no single way of quantitatively defining fiscal consolidation episodes, views differing either by considering the improvement in different budget balance indicators (primary balance, cyclically adjusted primary balance, etc.) or by the time framework of the adjustment and the minimum amount of budget deficit reduction required.

One standard approach to fiscal consolidation is to consider the decline in CAPB (cyclically adjusted primary balance). Amo-Yartey *et al.* (2012)

appreciate that a fiscal consolidation episode occurs when CAPB to potential GDP ratio improves by at least 1% in one year (or in two consecutive years). So, a fiscal consolidation episode begins when the CAPB improves by 1%, continues as long as it continues to improve and ends when the change in the CAPB becomes zero or negative. The same condition is imposed by Ahrend *et al.* (2006), but the CAPB must improve by at least 0.5% of potential GDP in the first of the two years, while the fiscal consolidation episode ends when CAPB deteriorates or improves by less than 0.2% and then deteriorates. Also, an interruption in the improvement of this indicator is accepted, if CAPB does not deteriorate by more than 0.3% of GDP and this deterioration is more than offset in the following year. A more important improvement in CAPB is considered by Alesina& Ardagna (1998), who appreciate that CAPB must change by more than 2% of GDP in one year, or 1.5% over two consecutive years.

With regard to the composition of fiscal consolidation measures, two categories of options are available to cut down budget deficits, each of them with different economic effects:

a. Measures aimed at increasing budgetary revenue, in particular tax revenue: introducing new taxes; increasing the quotas of existing taxes; widening the tax base; minimizing tax concessions and exemptions; improving the efficiency of tax administration, by reducing tax avoidance, eliminating tax evasion, and enhancing tax compliance, etc.;

b. Measures aimed at reducing budgetary expenditure, either capital or current ones: reducing public wage bill; cutting down transfer spending; increasing public sector efficiency; reducing public investment spending; etc.

Expenditure measures usually are important in countries with a large public sector and high welfare spending. Also, when governments are highly determined to consolidate, they are more willingly to cut current expenses, in particular social ones (OECD, 2007). However, for countries with large adjustment requirements, fiscal consolidation may need to be a balanced combination of spending cuts and revenue increases (Baldacci *et al.,* 2010).

From the perspective of their results, fiscal consolidations based on expenditure cuts, in particular current expenditure, are usually found to be more effective than tax based consolidations. A study of OECD (2007), analyzing a large number of fiscal consolidation episodes in OECD countries starting in the late 1970s, highlights that expenditure based consolidation measures generally have higher and longer lasting effects. Also, there are better chances of reducing or stabilizing public debt as % of GDP when social expenditure cuts are considered as a key dimension of fiscal consolidation strategies. A possible explanation is found to come from the potential effects of expenditure cuts on interest rates, private saving, and therefore economic activity, which could be boosted.

Besides their composition, other factors could, at their turn, affect the success of fiscal consolidation measures. An initial unfavorable public finance (large budget deficits and public debt) and macroeconomic (in particular, high interest rates) situation could help to easier overcome the resistance of involved parties to fiscal consolidation measures (OECD, 2007). Also, countries that have well-designed fiscal rules, with powerful enforcement mechanisms and large covering (extended to sub-national governments), are more likely to implement successful fiscal consolidations strategies, as confirmed by Molnar (2012).

In designing fiscal consolidation measures, it is imperative to take into account their potential impact on economic growth, especially when such measures are applied against the backdrop of economic recession or modest economic growth rates. From this point of view, economic theory and empirical studies on earlier fiscal consolidation episodes suggest mixed results.

In line with the perceptions of the Keynesian theory, fiscal consolidation measures are appreciated to adversely affect global demand and thus output and economic growth rates. This result is confirmed by Hernandez de Cos & Moral-Benito (2013). On the other hand, infirming this theory, a great number of theoretical and empirical studies indicate the possibility of opposite, expansive effects of restrictive fiscal policies (Giavazzi & Pagano, 1990; Giavazzi & Pagano, 1995; Giudice *et al.,* 2003; Afonso, 2006), pointing to the complementarity of fiscal consolidation and economic growth objectives.

The incidence of these "non-Keynesian" effects of fiscal consolidation is under the influence of some factors, including the size of public debt prior to the launch of such a fiscal consolidation strategy. Especially when countries are facing large, unsustainable public debts, fiscal consolidation measures can positively contribute to economic growth, while, on the contrary, expansionary fiscal policies could inhibit economic activity, further widening the recession (Sutherland, 1997). Also, the expansionary effects of fiscal consolidation are found to be more likely in the case of some particular budget expenditure cuts, like final consumption and social transfers (Afonso, 2006).

From the perspective of the structure of fiscal consolidation measures, in order to ensure the prerequisites for economic growth it appears to be more rationale the option to reduce public expenditure, mainly final consumption ones to the detriment of public investment, with a positive impact on economic growth and long-term development. An eventual increase in budget revenue could be achieved, without detrimental effects to economic growth, by measures that do not imply an increase in the tax rate, for example measures aimed at a better control of tax evasion. Some recent studies of Alesina *et al.* (2015; 2017) confirm that public expenditure and transfer spending cuts reduce output by less than increases in taxes. Guajardo *et al.* (2014) reach the same conclusion, namely that fiscal consolidations driven by tax measures tend to imply larger output losses than expenditure-based fiscal consolidations. Estevão & Samake

(2013) conclude that shifting the composition of public expenditure toward capital spending supports long-term economic growth, therefore fiscal consolidations based on public investment cuts being more detrimental.

3. COORDINATES OF FISCAL CONSOLIDATION STRATEGIES IN THE EU COUNTRIES

Given the need for large-scale public debt adjustments, the additional long-term challenges to public finance sustainability (e.g. resulting from population aging), but also the opportunity and limited availability of other public desindebtedness options, fiscal consolidation emerged as the main component of the debt reduction and stabilization strategies of the EU Member States. This option was confirmed when most of them signed, in 2012, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (also known as Fiscal Stability Treaty), stipulating the express commitment of the signatory states to reaching balanced or in surplus national budgets, a commitment deemed to be achieved to the extent that the structural budget deficit does not exceed 0.5% of the nominal GDP.

Considering the approach of Amo-Yartey *et al.* (2012) in defining fiscal consolidation episodes, we can see in table 1 that, beginning with 2010 and sometimes even sooner, many of the EU Member States implemented fiscal consolidation measures resulting in the reduction of the cyclically adjusted primary balance with 1% of potential GDP in one or two consecutive years.

Table 1. Fiscal consolidation episodes in the EU countries over the period 2008-2016

Country	*Period*	*Overall improvement in CAPB**	*Average yearly improvement in CAPB**	*CAPB at the end of the episode**
Belgium	2012-2013	1.7745	0.8873	1.1539
Bulgaria	2010-2013	3.3475	0.8369	0.5997
	2015-2016	4.9919	2.4960	0.8727
Czech Republic	2010-2011	2.1125	1.0563	-1.2465
	2013	3.1763	3.1763	1.4184
	2015-2016	1.1419	0.5710	0.8727
Denmark	2013-2014	4.0681	2.0341	4.0742
Germany	2011-2015	2.9530	0.5906	2.3343
Estonia	2009-2010	8.2206	4.1103	3.2339
Ireland	2011-2013	29.1798	9.7266	0.8982
Greece	2010-2012	13.5630	4.5210	3.0136
	2014	8.4034	8.4034	6.3088
	2016	5.6726	5.6726	8.6776
Spain	2010-2014	8.9267	1.7853	1.4054

Country	*Period*	*Overall improvement in CAPB**	*Average yearly improvement in CAPB**	*CAPB at the end of the episode**
France	2011-2015	2.8991	0.5798	-0.7165
Croatia	2012-2016	7.1424	1.4285	3.0454
Italy	2011-2013	3.0672	1.0224	4.1677
Cyprus	2012-2013	5.2428	2.6214	1.8867
	2015	6.0842	6.0842	3.3826
Latvia	2009-2012	6.0724	1.5181	1.3525
Lithuania	2009-2010	3.5615	1.7808	-1.3947
	2012	4.9387	4.9387	-0.4093
	2014-2016	1.9913	0.6638	1.2736
Luxembourg	2008	1.2628	1.2628	3.3133
	2011-2013	2.6249	0.8750	3.5891
Hungary	2008-2009	4.5446	2.2723	2.1046
	2012	4.4377	4.4377	4.1840
Malta	2009	2.8569	2.8569	0.9477
	2011	1.1218	1.1218	1.6359
	2016	2.5114	2.5114	2.4947
Netherlands	2011-2013	3.1284	1.0428	1.2453
	2016	1.7825	1.7825	1.9911
Austria	2011-2013	2.2990	0.7663	1.6143
	2015	1.6080	1.6080	1.8052
Poland	2010-2013	4.7040	1.1760	-0.9048
Portugal	2011-2013	10.4347	3.4782	2.2198
	2015-2016	3.2058	1.6029	2.5386
Romania	2009-2015	8.6949	1.2421	1.3241
Slovenia	2012	3.9022	3.9022	0.1748
	2014-2016	11.3974	3.7991	1.5462
Slovakia	2011-2013	6.2504	2.0835	0.2539
United Kingdom	2010-2011	3.0028	1.5014	-2.4266
	2013	2.1500	2.1500	-1.4784
	2015-2016	1.9362	0.9681	-0.7662

* In % of potential GDP at current prices.

Source: Authors' computation based on data from European Commission (2017)

Overall, 44 fiscal consolidation episodes were registered during the period 2008-2016, in 26 of the 28 EU Member States. The exceptions were Finland and Sweden, countries that recorded moderate public debt (of below 40% of GDP) and high cyclically adjusted primary surpluses (close to or over 3% of potential GDP) prior to the crisis, and were also able to better cope with the crisis' effects, therefore rending fiscal consolidation measures less necessary.

Most of fiscal consolidation episodes took place between 2010 and 2014, although consolidation measures had already started to be applied in some countries since 2009 (Estonia, Latvia, Lithuania, Malta, and Romania) or 2008 (Luxembourg, Hungary). In fact, some countries with limited budgetary margin, recording large cyclically adjusted budget deficits (Romania) or public debt (Hungary) at the onset of the crisis, were forced to apply pro-cyclical fiscal policies, discretionary increasing budget revenues or cutting public spending, despite the negative effects of the crisis on national economies that called for fiscal stimulus measures, as a more rational public policy option. Or, this type of pro-cyclical behavior, highly representative for Romanian public policy-making, can have no positive effects on the long-term economic growth and development (Bercu *et al.,* 2015).

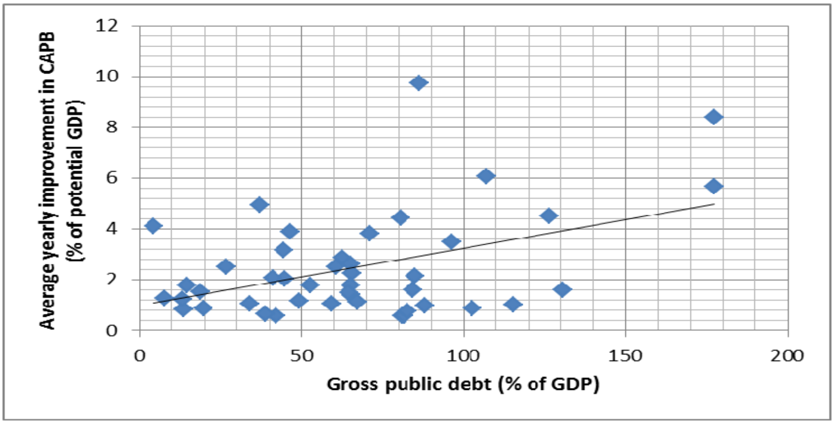
Starting in 2015, fiscal consolidation efforts diminished, only 10 countries still being engaged in such episodes in 2016. At the same time, according to the European Commission's estimates, cyclically adjusted primary balances are expected to decrease in 24 of the 28 EU Member States in 2017, with just one undergoing fiscal consolidation episode, in Ireland (2016-2017) (European Commission, 2017).

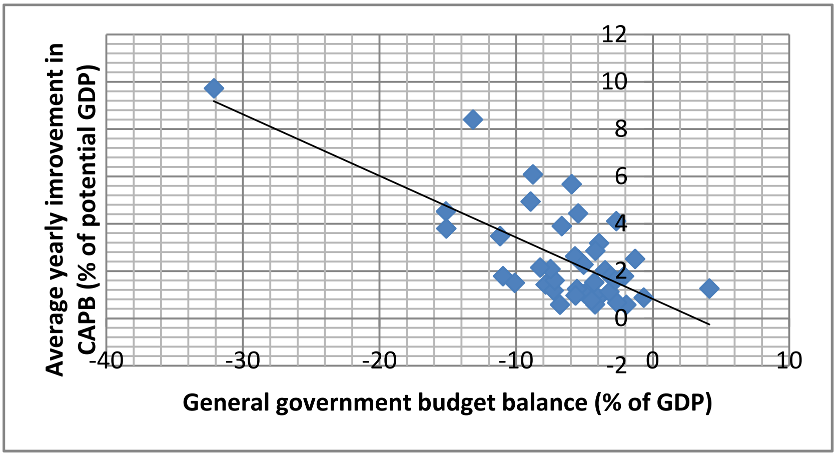
Although in large number, many consolidation episodes were of only short duration. The average duration of a fiscal consolidation episode was 2.43 years, most episodes during no more than 3 years. Longer episodes, of 5 or more years, were registered in Germany (2011-2015), Spain (2010-2014), France (2011-2015), Croatia (2012-2016), and Romania (2009-2015), proving that, with the obvious exception of Romania, more developed countries seem able to support longer consolidation episodes.

Despite their short duration, many fiscal consolidation episodes involved important gains, the average yearly improvement in the cyclically adjusted primary balance for our sample countries being of 2.48 % of the potential GDP. Only in 9 cases the yearly improvement was below 1%, while in other cases, of some highly affected by the financial crisis and highly indebted countries, it exceeded 5% of the potential GDP (Ireland, 2011-2013; Greece, 2014 and 2016; Cyprus, 2015). Also, in general, fiscal consolidation episodes had not been ended before CAPB returned to positive values (budget surpluses), with the exception of the Czech Republic (2010-2011), France (2011-2015), Lithuania (2009-2010, 2012), Poland (2010-2013), and United Kingdom (2010-2011, 2015-2016).

The high amplitude of fiscal consolidation episodes in the EU countries was largely driven by unfavorable public finance situation, the data in fig. 1 confirming that previous fiscal conditions had an important impact on the size of fiscal consolidation efforts.

Figure 1. Public finance situation and amplitude of fiscal consolidation episodes*





* Data on gross public debt and general government budget balance refer to the year preceding the beginning of the fiscal consolidation episode.

Source: Authors' computation based on data from European Commission (2017)

Countries with a large public debt and a high negative budget balance were forced to operate more severe adjustments, often under the pressure of commitments to international financial institutions (IMF, European Commission), resulting in wider negative social reactions. In Greece, the cyclically adjusted primary deficit decreased by 8.40% of the potential GDP in 2014 and 5.67% in 2016, while in Ireland it decreased by 9.73% per year over the period 2011-2013. On the contrary, in indebted countries with a stronger financial position, at least compared to the above mentioned ones, adjustments could be made at a smaller pace, of 1-3% of GDP per year (Belgium, Italy, Portugal, and the United Kingdom), and resulted in lower negative reactions.

This points to the need to continue fiscal consolidation efforts over the medium- and long-term, both as pillar of the public debt reduction strategies and as support for shaping a strategic vision of public authorities that is primarily focused on preventing and not correcting future imbalances, and avoiding new, severe adjustments, harder to be beared by society members.

Table 2. Composition of fiscal consolidation episodes in the EU countries over the period 2008-2016

Country	*Period*	*Overall change in cyclically adjusted revenue*		*Overall change in cyclically adjusted primary expenditure*	
		% of potential GDP	*% of overall change in CAPB**	*% of potential GDP*	*% of overall change in CAPB**
Belgium	2012-2013	2.4305	136.97	0.6560	-36.97
Bulgaria	2010-2013	1.9689	58.82	-1.3786	41.18
	2015-2016	-1.0087	-20.21	-6.0006	120.21
Czech Republic	2010-2011	2.2265	105.40	0.1140	-5.40
	2013	0.7887	24.83	-2.3876	75.17
	2015-2016	0.1955	17.12	-0.9464	82.88
Denmark	2013-2014	2.2848	56.16	-1.7831	43.83
Germany	2011-2015	1.6537	56.00	-1.2993	44.00
Estonia	2009-2010	4.0708	49.52	-4.1503	50.49
Ireland	2011-2013	1.0345	3.55	-28.1444	96.45
Greece	2010-2012	7.2260	53.28	-6.3370	46.72
	2014	-2.1196	-25.22	-10.5231	125.22
	2016	1.4847	26.17	-4.1878	73.83
Spain	2010-2014	4.1346	46.32	-4.7921	53.68
France	2011-2015	3.4584	119.29	0.5592	-19.29
Croatia	2012-2016	6.5909	92.28	-0.5515	7.72
Italy	2011-2013	2.5579	83.40	-0.5093	16.60
Cyprus	2012-2013	0.5732	10.93	-4.6697	89.07
	2015	-0.5735	-9.43	-6.6577	109.43
Latvia	2009-2012	2.9591	48.73	-3.1132	51.27
Lithuania	2009-2010	0.7171	20.13	-2.8444	79.87
	2012	-0.6281	-12.73	-5.5668	112.72
	2014-2016	1.4889	74.77	-0.5024	25.23
Luxembourg	2008	1.0730	84.97	-0.1897	15.02
	2011-2013	0.7895	30.08	-1.8355	69.93
Hungary	2008-2009	0.8818	19.40	-3.6628	80.60
	2012	1.9807	44.63	-2.4569	55.36
Malta	2009	0.2061	7.21	-2.6506	92.78
	2011	0.8233	73.39	-0.2987	26.63
	2016	-0.7920	-31.54	-3.3034	131.54

Country	***Period***	***Overall change in cyclically adjusted revenue***		***Overall change in cyclically adjusted primary expenditure***	
		% of potential GDP	***% of overall change in CAPB****	***% of potential GDP***	***% of overall change in CAPB****
Netherlands	2011-2013	0.8115	25.94	-2.3169	74.06
	2016	0.7261	40.73	-1.0564	59.27
Austria	2011-2013	1.2686	55.18	-1.0304	44.82
	2015	0.5801	36.08	-1.0277	63.91
Poland	2010-2013	0.8713	18.52	-3.8326	81.48
Portugal	2011-2013	4.3680	41.86	-6.0668	58.14
	2015-2016	-1.5028	-46.88	-4.7087	146.88
Romania	2009-2015	1.4059	16.17	-7.2889	83.83
Slovenia	2012	1.1560	29.62	2.7462	70.38
	2014-2016	-1.5620	-13.70	-12.9594	113.70
Slovakia	2011-2013	4.0491	64.78	-2.2013	35.22
United Kingdom	2010-2011	0.9833	32.75	-2.0194	67.25
	2013	0.9158	42.60	-1.2341	57.40
	2015-2016	0.9764	50.43	-0.9599	49.57

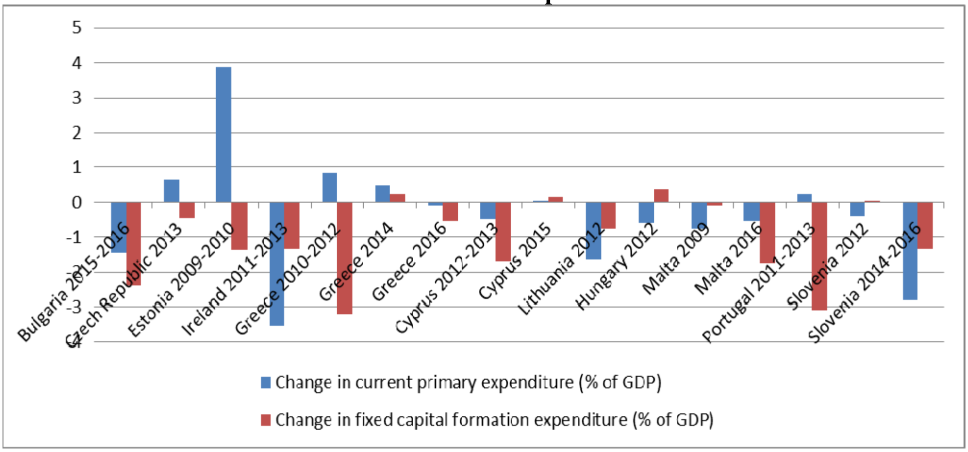
* An increase in cyclically adjusted revenue has a positive contribution to CAPB, and, therefore, fiscal consolidation, while an increase in cyclically adjusted primary expenditure has a negative contribution to CAPB, thus diminishing fiscal consolidation efforts.

Source: Authors' computation based on data from European Commission (2017)

As structure, the fiscal consolidation strategies of the EU Member States were diverse in composition (see table 2), focusing either exclusively or mainly on primary expenditure cuts (Bulgaria, 2015-2016; Czech Republic, 2013 and 2015-2016; Ireland, 2011-2013; Greece, 2014 and 2016; Cyprus, 2012-2013 and 2015; Lithuania, 2012; Malta, 2009 and 2016; Portugal, 2015-2016; Romania, 2009-2015; Slovenia, 2014-2016; etc.), exclusively or predominantly on increases of budget revenue, especially tax revenue (Belgium, 2012-2013; Czech Republic, 2010-2011; France, 2011-2015;Italy, 2011-2013; Croatia, 2012-2016; etc.), or on a more balanced mix of the two categories of measures (Bulgaria, 2010-2013; Germany, 2011-2015; Greece, 2010-2012; United Kingdom, 2015-2016; etc.), in relation to the particularities of each country and the total fiscal consolidation required. However, as a rule, large fiscal consolidations, resulting in above average yearly improvement in the cyclically adjusted primary balance, heavily relied on expenditure cuts, while increases in budget revenue usually contributed only to a limited extent to this outcome.

Although data on cyclically adjusted structural components of public expenditure are not available, the changes in the composition of general government expenditure, as % of nominal GDP, can give us an idea on public authorities' preference for current or capital expenditure cuts (see fig. 2).

Figure 2. Changes in the composition of public expenditure during large fiscal consolidation episodes*



* Large fiscal consolidation episodes were considered to be those with above average yearly improvement in the cyclically adjusted primary balance

Source: Authors' computation based on data from European Commission (2017)

It results from fig. 2 that, in many situations, large fiscal consolidations were achieved through major public investment cuts, reflected in the decrease of fixed capital formation expenditure (Bulgaria, 2015-2016; Cyprus, 2012-2013; Malta, 2016; Slovenia, 2014-2016). In some, more unfavorable cases, the effects of lower investment expenditure were even offset by increases in current primary expenditure (Estonia, 2009-2010; Czech Republic, 2013; Greece 2010-2012). This is a reprehensible situation since, although we admit that in the case of inefficient and uneconomical use of funds for this purpose, the reduction of public capital expenditure due to their rationalization is a viable fiscal consolidation option, usually this reduction is more strongly correlated with the economic growth peace of a country, compared to current expenditure cuts

4. CONCLUSIONS

Analyzing the strategies implemented, especially since 2010, by the EU Member States to reduce public debt to acceptable levels (within the limit of the Stability and Growth Pact) and ensure long-term public finance sustainability, our paper emphasized that fiscal consolidation measures represented the core of these strategies, overall 44 fiscal consolidation episodes in 26 of the 28 EU countries being recorded during 2008-2016.

Although ambitious and usually of important amplitude, most episodes lasted no more than 3 years, and fiscal consolidation efforts diminished considerably once the economy resumed its growth, in recent years (in 2017, most EU countries are expected to record a decrease of their cyclically adjusted primary balance). This shows that old habits die hard, pointing to the lack of long-term, strategic vision of public authorities, that should be more oriented towards prevention and not correction of potential future imbalances.

The same conclusion is reflected by the analysis of the composition of fiscal consolidation measures, our results emphasizing, besides the very different approaches of public authorities, that public investment cuts were common features of many fiscal consolidation strategies, especially in some, more indebted EU countries. Or, these expenses are generally appreciated to be more strongly correlated with the economic growth peace of a country and, with the exception of the inefficient and uneconomical use of funds for this purpose, should be the last to be sacrificed.

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BUDGET RESPONSIBILITY AND FISCAL DISCIPLINE IN LOCAL DEBT MANAGEMENT

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Abstract
This paper studies the relationship between local public debt and fiscal policy, bringing in particular the arguments which come to strengthen that in the context of the great recession from 2008 and of the need for sustainable public finance, all the rules in force that include limitations on the amount of borrowing and/or debt service, restrictions on the purpose of debt and on borrowing from national and international financial institutions and/or from the central bank, need to be strongly stipulated with the objective of budget responsibility and fiscal discipline. Basically, in our analysis, we want to build a research that stressed the importance of interplay between the variables involved, with the objective of public finance stability and capacity to manage high vulnerability of local governments to adverse changes in market interest rates. For our analysis, we will use the Eurostat and World Bank's databases for all the EU 28 member states over the time span 2000-2014. Our results reveal that there is a significant relationship between the level of local debt, budget responsibility and budget discipline, and the international financial instability, has increased the importance of financial sector policies. Recently implemented reforms aiming to enforce fiscal discipline following-up the Fiscal Compact strengthened the local budgetary framework and restrained, therefore, local discretionary power to act towards development. So, countries need strong macro-prudential policy frameworks responsibility and discipline in local debt management.
Keywords: *local public debt, fiscal policy framework, fiscal discipline.*
JEL Classification: H63, H7, H74

1. INTRODUCTION

From the point of view of terminology, in local public finance one may distinguish between local budget responsibility and local budget discipline. For the first one, it is about an assumption to intervene for each financial decision where self-assessment of benefits and costs intervenes; the second one is related to any kind of institutional rules which limit in advance the possibility of deficit spending or borrowing. The problem of public deficits is defined at international level, more exactly the Maastricht Treaty stipulates at article 109 J (1) that the general governments financial position of any Member State must be sustainable that is (i) the ratio of government deficit to GDP must not exceed the reference value of 3% and (iii) the ratio of government debt to GDP must not exceed the benchmark value of 60%. So, in line with Stability and Growth Pact, if local self-government entities do not react in a timely fashion to market signals (e.g. increases in borrowing costs), deficits and debt can mount to unsustainable levels, before the governments are shut off market financing.

A clearer image of public finances deficiencies and public debt management permit to the public sector to inform policy-makers, financial markets, and other users of statistics, moreover, this need for improving the availability and international comparability of general government and public sector debt stability was once again reinforced by the international financial crisis that started in 2007/2008. In this way, the financial standing of local governments across the European Union it was affected by the economic crisis. At the same time, local government sector conducted vast investment policies reaching 10.2% of all investments in the EU countries in 2010. The more accurate and strategic approach of public finance mechanisms, reflect the performance of local authorities. Greenberg & Hillier (1995) consider that financial situation from organization's can be measured through a series of indicators closely related to three dimensions: sustainability, flexibility and vulnerability. If sustainability means the organization's ability to maintain, promote and protect the well-being of the population, using the resources available to it, flexibility is understood to be the capacity of an organization to respond to the transformation of the economy or its own financial situation within the limits of its own skills, capacity which depends of the degree to which it can react to such transformations by modifying the rates of taxes, public debt limits or transfers

The research from the area of fiscal sustainability has been intensified since 2008, when several Mediterranean European Union (EU) members experienced serious fiscal troubles, such as the sustainability of sovereign debt for Greece analyzed by Cline (2013) and the International Monetary Fund. Some authors (Cline & Wolff, 2012; Eller & Urvová, 2012) analyze numerous alternative scenarios regarding debt projections for Italy and Spain, showing that the primary balance is not responsive enough to fiscal and macroeconomic shocks and there is a need to found a mechanism for management also of the local public debt like part of general debt. It seems that the indebtedness who expanded significantly, implied much more attention in coordinating Public Debt and Monetary Management, and also, implied a consolidated of Budget responsibility and fiscal discipline (Rossi & Dafflon, 2002; Bilan, 2015). Other authors (Wiewiora *et al.,* 2009), consider that the regulations limiting on the size of the local government debt level are the result of the lack of a insufficiently efficient economic mechanism to manage the situations in which the level of the debt would rise excessively and the growing cost of credit would be constrains from further borrowing. However, as a result of the global economic crisis, the contemporary world demonstrates there are not effective strategies that allow good management of unfavorable situations who lead to economic and financial stability.

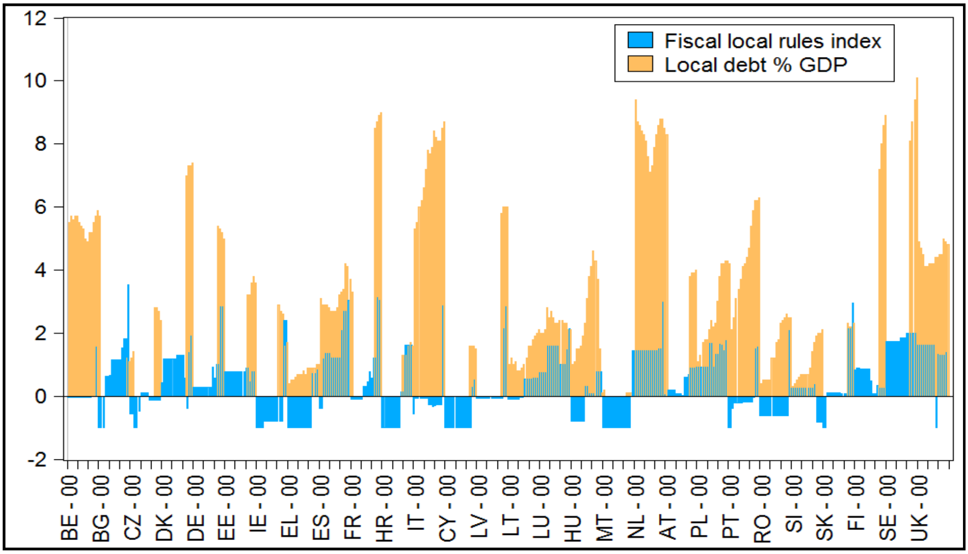
Some authors (Galinsky, 2015; Wiewiora *et al.,* 2009) think that local public debt and the situation of local government interfere with at least three issues. Firstly, a bankruptcy of local government is often unacceptable for political reasons and rarely applied. Secondly, there might be restricted access of creditors to some sensitive information. Thirdly, in many cases local governments are reluctant to implement some radical actions in order to improve their financial situation and credit-worthiness (Wiewiora *et al.,* 2009; Bercu, 2014).

With the objective to verify whether stricter rules of control over deficit and borrowing are effective in the sense that general level of indebtedness is lower were the rules are more stringent, we choose to highlight the correlation between fiscal policy outcomes, fiscal discipline and fiscal rules. Apparently, we find that political institutions and budgetary institutions have a direct implication in fiscal discipline. But, if certain institutions are more favorable to fiscal discipline, it would be possible because voters or politicians in this collectivity are more conservative in their attitude toward debt financing than in other collectivities with more debt friendly settings (Poterba, 1996) In some jurisdiction, voters can be less inclined to borrow to support current state outlays or to use deficits to shift the burden of paying for current state programs to the future. So, if these voters are more likely to support the legislative or constitutional limits on deficit finance, we can really say that the link between fiscal rules and fiscal policy could be spurious.

2. BUDGET RESPONSIBILITY AND FISCAL DISCIPLINE IN THE EU COUNTRIES

Wyplosz (2013) points that in order to fight with external shocks and instabilities of any kind, European Union countries, while showing differences in the causes of economic instability, must have like common future fiscal discipline. In the same line, Larch & Turrini (2011) and Von Hagen (2010) find that fiscal rules are very important tools of fiscal consolidations and are the main pylon of medium term fiscal objectives.

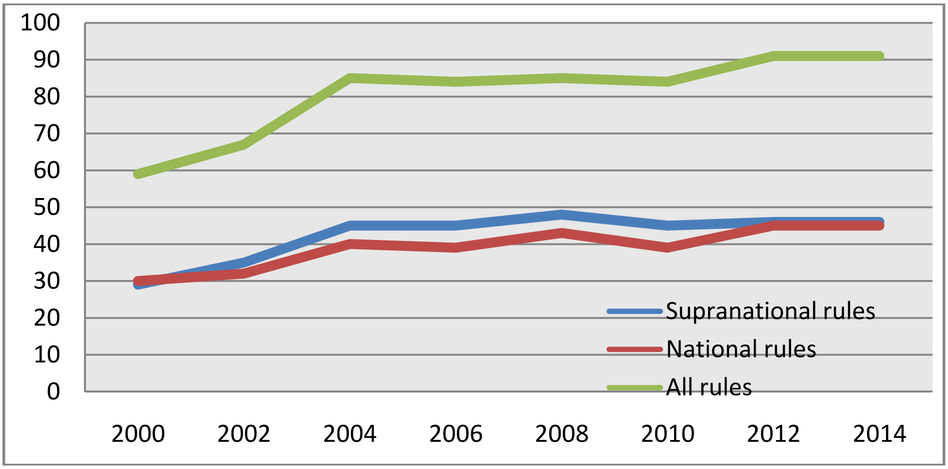
Figure 1. Evolution of fiscal local rules index and local debt % GDP- UE, 2000-2014



Source: IMF Fiscal Rules Database

Figure 1 shows there is a close link between the level of local government debt and the tax rules applicable at this level, more precisely, if we refer to the profile of countries like Cyprus, we find that the high level of local government debt in 2010-2014, is also linked to negative values of the fiscal rule index. Thus, poor management and lack of local managerial strategies increase the level of public debt. This is also true for some countries like Bulgaria, the Czech Republic, Italy or Romania.

Figure 2. Number of national and supranational NFR, 2000-2014



Source: IMF Fiscal Rules Database

The official data reveals the increasing number of numerical fiscal rules (NFR) used by EU Member States as fiscal device since 2000, as shown in fig. 2. The main types of NFR in EU Member States are Balanced Budget Rule (BBR), Debt Rule (DR), Expenditure Rule (ER) and Revenue Rule (RR). In 2008, there were 67 rules in place in EU Member States, of which more than one third were budget balance rules; debt and expenditure rules represented about one quarter each and revenue rules accounted for less than 10% (European Commission, 2015).

3. DATA AND METHODOLOGY

In literature there are only few studies that analyze the local public debt and the implications of its growth with its specific determinants for the EU-28 over the period 2000-2014. A study of Aisen & Veiga (2013) invokes both fiscal variables and socio-economic, respectively, investment expenditures in total expenditures, interest payments of debt in total expenditures, own revenues in total revenues without loans, unemployment or earnings. Their research indicates that structure of expenditures and revenues affects the debt, whereas higher unemployment rates generate higher debt (Aisen & Veiga, 2013). In line with this point of view, Ashworth, Geys & Heyndels (2005) emphasize that debt may be the consequence of strategic behavior by politicians, where it is increased to compromise future governments' policy options. Therefore, the issue of managing local debts and creating a strategic reference framework to intervene in the oscillating situations of the economy and to counteract the crisis situations is also deepened by social and behavioral issues that are under politics stand and political statements.

Dafflon (2002) shows that public or political preferences could become in the end a main factor explaining the comparative evolution of debt. More specifically, we have the following formulas:

A= The voters, Preferences for fiscal restrains
B= The budgetary or fiscal rules or institutions
C= The Fiscal policy outcome

In this case, C=function of (B) preferences have no influence
C=f(A), fiscal institutions play no role
C=f(A, B), both are simultaneously important

The observed correlation could appear as C=f(B), but in fact reflect either C=f(A) or C=f(A,B).

In line with these views, we also identify papers that show that the political configuration can influence fiscal performance, minority governments, coalition governments are related to more deficits, while direct democracy reinforces debt control (Dafflon & Rossi, 1999; *Pola et al.,*1996). The influence of political issues on the local government deficit is also addressed in other papers (Letelier, 2011; Benito & Bastida, 2004; Davulis *et al.,* 2013, Bostan & Petrișor, 2011), in which case the importance of the fiscal rules is emphasized with the purpose of observing the principles of fiscal-budgetary responsibility. Aronson & Hilley (1986) indicated that borrowing in local governments was influenced by the business cycle, which also determined the structure of the debt. Hence, in the period of the economic slowdown credits have a tendency to grow. Furthermore, the high interest rate prevents local governments from borrowing for a long term (Aronson & Hilley, 1986). However, Balaguer-Coll *et al.* (2016) specify other variables, such as: economic activity, density of residence or issues of decentralization, which might be tied with the debt.

It is evident from the literature review section that several studies focus exclusively on the studying the link between budget responsibility and fiscal discipline in local debt management, most of these studies rather insist on the aspects preceding the principles in question, emphasizing the implications of social elements, the effect and less the cause of the problem. Moreover, most studies address the central government budget problems, eliminating the importance of local budgets in the sustainability of public finances, to demonstrate this, we will run the regression model for both central and local governmental levels. In case of our research, we focused efforts on studying the EU case using a linear regression model based on those of Jia-qin, (2014), Galiński (2014, 2015) in base of a panel data sample of 28 countries over the time span 2000-2014. The novelty of the study is emphasized by include in analysis a variable who test local fiscal discipline, more exactly, subnational fiscal rules, name by International Monetary Fund-Locale Rule Strength. The model adopts the following form:

$$Y_t = \beta_0 + \beta_t X_t + \mu \quad (1)$$

Where:
Y_t= Local debt % GDP
β_0= Constant term
β_t = Vectors of coefficients
X_t = Regressors (Fiscal local rules strength index, GDP growth, Local expenditure as percentage of total national expenditure, Local revenue as percentage of total national revenue, Tax revenue as a percentage of total subnational revenues and grants % GDP)
μ = Error terms of the model

In base of our research and based on previous studies we quantified budget responsibility and fiscal discipline in terms of fiscal local rules incidence, taking into consideration the local government assumption to intervine for each financial decision where self assessment of benefits and costs intervenes and also, any kind of institutional rules which limit in advance the possibility of deficit spending or borrowing.

For the analysis of the relationship between budget responsibility and fiscal discipline in local debt management we use data from the International Financial Statistics Online, European Comission and World Bank. In case of fiscal local rules index, we appeal to our own calculations according to the steps indicates in FMI fiscal rules database[1] because the statistics provide data rather at the central level, the same methodology was applied to the local level. The methodology was inspired by Deroose *et al.* (2006).

4. EMPIRICAL RESULTS AND DISCUSSIONS

The results of the empirical analysis are presented in table 1, our analysis highlights the fact that all factors used in the regression model, have what can be considered as the expected significant coefficient signs, there is a significant relationship between the fiscal rules and level of public debt, which means a greater care to strengthen the sustainability of public finances. In what regards these two models, we choose initially to make reference at the general budget situation, highlighting the implications of some variables on central government debt.

[1] Fiscal local Rule Strength Index (FRSI) is calculated taking into account five criteria: 1) legal base, 2) binding character, 3) bodies monitoring compliance and the correction mechanism, 4) correction mechanisms, and 5) resilience to shocks.

Table 1. Variables determining local and general growth government's debt in EU between 2000 and 2014

Variable	Model I	Model II
Const	68.23190 (18.62693)	6.716469 (1.500204)
FISCAL RULES INDEX	-3.880250*** (1.176603)	
INTEREST RATES	-0.346655*** (0.136201)	
INVESTMENTS % GDP	-2.813316*** (0.300773)	
TOTAL GENERAL GOVERNMENT EXPENDITURE %GDP	-1.743256*** (0.327808)	
TOTAL GENERAL GOVERNMENT REVENUE %GDP	3.554382*** (0.325486)	
LOCAL GOVERNMENT EXPENDITURE % GDP		-1.223429*** (0.318958)
LOCAL GOVERNMENT REVENUE % GDP		1.024618*** (0.327511)
LOCAL FISCAL RULES INDEX		0.405739*** (0.124438)
INVESTMENTS % GDP		-0.060246** (0.034769)
TAX REVENUE AS A PERCENT OF TOTAL SUBNATIONAL REVENUES AND GRANTS %GDP		0.064151* (0.067808)
GOVERNMENT BONDS RATES		-0.211787* (0.059807)
INTEREST RATES		-0.031573*** (0.014858)
REA GDP GROWTH PER CAPI		-0.173860** (0.036314)
Adjusted R-squared	0.515572	0.501514
Autocorrelation (LM test	[0.623]	[0.625]
Heteroscedasticity (White test)	[0.379]	[0.442]
Normality	[0.008]	[0.020]

1) under the parameters there are standard errors of estimation; 2) significance of parameters: *** - p-value: 0.01, ** - p-value: 0.05, * - p-value: 0.1

In this case an interesting point of view is that general government fiscal rules strength index has the expected negative correlation to general government debt, we can see that we have a significance at 0.01 level, which means that the higher is the level of tax rules and the more insisting on fiscal accountability through a well-defined legal framework, the lower is the government debt level.

However, referring to the specific situation of local public debt, the results of the second regression model, show us that the coefficient is positive at 1 percent level, the explanation in this case being that the local budget rules and the legal framework applicable to local budgets, apart from the fact that they differ from one country to another, are also weakly consolidated in the sense of local authority accountability and also recently implemented reforms aiming to enforce fiscal discipline following-up the Fiscal Compact strengthened the local budgetary framework and restrained, therefore, local discretionary power to act towards development. We also note that expenditures, investments and real GDP growth rate % of PIB are significant variables in both models, with a direct influence on the level of local or general government debt. It is evident that the higher is the level of these variables, the lower is the level of debt and this thinks being also explained by economic issues.

5. CONCLUSIONS

The recent economic crisis had a visibly negative impact on public sector finances, including local government budgets. As a result of weaker operating surpluses and implementation of active investment policies, local governments' indebtedness increased significantly across the EU-28. Also, as a result of this, in the context of future debt repayments and the required deleveraging process there is a need for consolidation of local public finances, taking into account the aspects of fiscal and budgetary responsibility. Until now, these risks were partly mitigated by the gradual decrease of market interest rates, which relieved local governments' expenditure budgets. But as a result of European financial integration, globalization and free movement of capital, the role of local budgets and the level of local public debt, it is becoming an increasingly important issue, the vulnerability being increasingly high.

Following the analysis we noticed that fact that all factors used in the regression model, have what can be considered as the expected significant coefficient signs, there is a significant relationship between the fiscal rules and level of public debt and we considered that financial integration affects the composition of government debt, and only a consolidation of fiscal policies and specific instruments, would satisfy the desire of economic growth. It is clear that there is a significant relationship between the level of local debt, budget responsibility and budget discipline, and the international financial instability has increased the importance of financial sector policies.

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FISCAL DISCIPLINE AND ECONOMIC GROWTH: A CONTROVERSIAL RELATIONSHIP

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Abstract
One of the key objectives of every government is to obtain higher economic growth rates but, in current turbulences, this objective becomes harder and harder to achieve. As the recent crisis emerged, it showed that the solidity of public finances has reached an impasse – it needs to be enhanced. One of the paths to do this is by using fiscal rules, institutions and mechanisms that put constraints on policy-makers. There are two key currents in the specific literature on subject. The first one states that putting restraints on governments by limiting public debt, expenditure and deficits levels, and therefore the size of public investments, determines lower economic growth levels. The second view suggest that putting restraints on governments determines them to spend more efficient, invest more wisely, and therefore obtain better results regarding economic growth. This paper analyses the impact of fiscal discipline measured through fiscal rules indexes and a fiscal discipline score on economic growth rates throughout the European Union, the period sample being years 1994-2015. Our results strongly indicate that enhancing fiscal discipline and the solidity of public finances by using fiscal rules, institutions and mechanisms (our calculated fiscal discipline score) determines higher growth rates for European states – GDP per capita, gross national product and gross national income, thus confirming the second point of view found in the literature. Also, one of our results indicates that restraining policy-makers power by using fiscal rules may also conduct to lower economic grow rates measured through the grow rate of the gross national income. These results confirm a fact that we have stated with other occasions: designing fiscal constraints and enhancing the solidity of public finances is a fact easier said than done – it needs to take into consideration many variables: development degree, debt levels, existing institutions and framework, other national and international regulations.
Keywords: *fiscal discipline, fiscal rules, economic growth, European Union.*
JEL Classification: E61, E62, H62, H63

1. INTRODUCTION

The Maastricht Treaty that founded the EU stipulated some simple but very powerful fiscal rules: a country's maximum allowed public deficit of 3% of its GDP and a maximum allowed level of public debt of 60% of its GDP. The reason behind the introduction of these fiscal and budgetary constraints is that in order to maintain stability and to prevent the formation and spread of internal shocks, fiscal discipline needs to be acquired and maintained by every participant state of the Union. As the solidity of public finances all across the EU deteriorated, and fiscal discipline weakened, as proved by the recent crisis, new treaties were signed (SGP, SGP II and the Fiscal Compact) in order to enhance the sustainability of public finances and individual states fiscal discipline. These new treaties brought with them new rules to be accounted and implemented. Almost all fiscal rules act as fiscal constraints on governments, limiting the power of policy-makers.

At a first glance, this seems to be a harmless and good idea, as literature long debated the subject of governments being excessive and careless spenders. But, by limiting public spending, the rules also limit public investments and major projects. As so, a key question is born in this regard: does fiscal discipline impact negatively economic growth?

There are two main directions that the literature follows on this subject:

i. First, fiscal discipline enhanced through fiscal rules limits the power of governments, but also limits public investments, thus determining lower economic growth rates, as some of the private investments depend on public investments;

ii Second, by limiting the power of policy-makers, and public spending implicit, governments become more responsible as there are numerical targets to be accounted. Therefore, public spending becomes a more efficient process, oriented to economic growth, as a government cannot borrow more than a specific target allows it to.

We believe that each of the two suppositions are right, the literature confirming the fact, as our analysis confirms it overall. Each country is different, has its own government, development degree, own legislation, internal and external macroeconomic factors, different budgeting process, fiscal and budgetary positions and objectives. Also, each country has its own institutions (independent or not), sanction mechanisms and monitoring bodies and instruments. All these variables to be accounted make us believe that analysing the impact of fiscal discipline on other significant macroeconomic variables should target individual states or group of states highly integrated. All this factors that need to be taken into consideration are the ones that denote different results in the literature.

Our chosen set of countries consists of the 28 member of the European Union, sample period being years 1994-2015. Our key dependent variables are logarithm of GDP per capita, growth rate of the GDP (Gross Domestic Product) and the growth rate of the GNI (Gross National Income). We used in order to quantify fiscal discipline 3 variables: the Fiscal Rules Index calculated by the European Commission by using its own old methodology, the Fiscal Rules Index calculated by the European Commission by using its own new methodology, and our own calculated Fiscal Discipline Score. We also used other significant control variables such as grow rate of public expenditures, revenues, public deficit and debt.

In order to test the implications of fiscal discipline on economic growth we set two basic hypotheses:

1. fiscal discipline has a positive impact on economic growth, as it brings with it more efficient public investments, doesn't incorporate money from economy through domestic founding of debt, and leads to less pro-cyclical fiscal policies;

2. fiscal discipline may also exert a negative impact on economic growth as it limits government interventions in economy, public investments and government reactions to different states of the general economy.

Our two hypotheses are contrary, as they are based on existing literature on subject that hasn't offered a clear and standing argument or result. As so, it is our goal to try to clarify the subject, by offering a new and bold analysis, and to try to set a new starting point for future analyses.

2. LITERATURE REVIEW

Fiscal rules are defined as institutional mechanisms that are implemented by varying degrees in an increasing number of countries (Neyapti, 2013), their effects targeting macroeconomic variables related to government's decisions and fiscal policies. Fiscal discipline and flexibility are the main principles governing budgetary and fiscal policies in any country, even more in a group of countries as the EU and EMU (Buti *et al.,* 1998). The fiscal rules are adopted by individual states and groups of countries for many reasons: strengthening fiscal solvency and sustainability, stabilization (reducing pro-cyclicality), and making fiscal and budgetary policies designing and execution more resilient to government corruption and private sector lobbies (Elbadawi *et al.,* 2015).

According to the first point of view, fiscal discipline limits the power of policy-makers, but also the ability of a government to spend more, as fiscal rules limit debt and deficit levels. For example, Attinasi and Klemm' analysis showed that fiscal consolidation is likely to be harmful for growth in the short term, although it depends on the fiscal consolidation measures taken (Attinasi & Klemm, 2016). As the same authors state, the effects of fiscal consolidation measures on economic growth must be carefully taken into account when designing the measures, as Neyapti (2013) analysis shows that fiscal rules have direct implications on both public expenditures and revenues. The negative impact of fiscal consolidation was also accounted by Attinasi & Klemm (2014), their results indicating that the reduction in public investment and consumption are growth reducing. While such rules may be well intended, they reduce public expenditure, and thus public investments, that may have brought future benefits (Mintz & Smart, 2006). The empirical analysis done by Reuter (2015) shows that even though fiscal rules are sometimes not complied with, they tilt fiscal policy variables towards their numerical targets. Nevertheless, the results found in the literature still remain controversial. For example, Landon & Smith (2017) proved that that fiscal rules as the balanced budget rule or rules regarding public-to-GDP debt ratios may have positive and negative effects on welfare, depending on the other restrictions regarding public spending, the time period for which the rules apply, discretionary policies, volatility of government spending and private consumption.

Fiscal rules, as stated before, tend to limit public spending. This action may be a good one, as Afonso & Furceri (2008) suggest that higher public spending (transfers, subsidies, government consumption) is detrimental to economic growth, except investment expenditures. Also, as proven by Checherita & Rother (2010), higher debt levels, beyond 70-80% of the GDP, as stated by authors, exert a negative influence on economic growth. Higher levels of public deficits also tend to slow economic growth, as shown by Ezeabasili *et al.* (2012). Other suggested variables to be accounted are the means by which the deficits are funded – if they are funded through domestic debt, then they inhibit growth; if the higher levels of deficit are financed by limited seigniorage, then they may have a positive effect if they are a result of public investments (Adam & Bevan, 2005). Also, financing the deficit and debt through higher tax levels negatively influence short-run state economic growth, which lowers state output levels (Tomljanovich, 2004).

According to the second point of view, limiting the power of governments through fiscal constraints determines the policy-makers to spend more wisely and efficient, leaving more money in the economy for private investments and welfare. The analysis conducted by Mașca *et al.* (2015) shows that a reduction in government expenditure was a real engine growth in EU states. A reduction on wages and salaries in the public sector accompanied by relaxed fiscal pressure has positive effects on growth. These results are confirmed by Brașoveanu & Brașoveanu (2008), according to whom even if budgetary expenses may be productive, the effects of financing the distortionary and non-distortionary taxes on economic growth are negative. Also, higher public deficits exert a negative impact on economic growth as they tend to bring with them a raise in long-term interest rates (Gale & Orszag, 2003). We can state that the rules act as a benchmark for solid fiscal policies for policy-makers. Lower debt levels also tend to enhance economic growth, with the mention that it matters the type of country that is taken into consideration – continental, nordic, liberal (Ahlborn &

Schweickert, 2016). These restrictions (fiscal rules) reduce volatility of fiscal variables and their pro-cyclical effects, economies displaying higher growth rates (Fatas & Mihov, 2003).

As it seems, fiscal rules (discipline) cannot' be considered a universal prescription to overcome macroeconomic distortions and to enhance economic growth (Sonmez, 2013). It is not a one fits all 'product'. Fiscal consolidation calls for fiscal sustainability and austerity programs in some cases, economic growth and fiscal solidity being up a to a point interdependent variables.

3. DATA

3.1. Sample composition

We used in our analysis data composed of 28 countries, meaning the member states of the European Union, the sample period being 1994-2015 (annual records).

As dependent variables in order to quantify economic growth we used logarithm of GDP per capita (LNGDPCAP), grow rate of the GDP (GRGDP) - expressed in mil. Euro and the grow rate of the GNI (GRGNI) – expressed in mil. Euro. As independent variables that quantify fiscal discipline we used the Fiscal Rules Index calculated by the European Commission for each country by using its old methodology of quantifying (FRIOLD), the Fiscal Rules Index calculated by the European Commission for each country by using its new methodology of quantifying (FRINEW) and our own calculated score for fiscal discipline (FDS), score that includes aspects such us the existence of a balanced budget rule in national legislation, a debt rule, expenditure rule, revenue rule, positive values if the fiscal rules index calculated by the European Commission, existence of an independent enforcement body, existence of sanctions for non-compliance regarding the BBR, existence of an independent monitoring body for the BBR, existence of an alert mechanism regarding the fiscal rules, existence of an automatic sanction and correction mechanism, countries that have a public deficit under 3% of their GDP, a public debt under 60% of their GDP and a growth rate of public expenditures lower than the growth rate of the GDP. Each country could achieve a maximum score of 13 points, as it has implemented the specific rules, mechanisms and institutions.

Also, we used as control variables for our analysis the real grow rate of the public deficit (GRDEF), real grow rate of the governments consolidated debt (GRGCD), the grow rate of public expenditure (GRPE), real grow rate of public revenues (GRPR), the grow rate of the gross fix capital formation of the general government (GRGFCFGG), real grow rate of exports (GREXP) and real grow rate of imports (GRIMP). We used dummy variables such as member of the EU (1), non-member of the EU (0), member of EMU (1), non-member of EMU (0), in order to capture the influence of the accession to EU and EMU membership.

In order to capture the influence of the crisis we used the dummy variable (POC), which checks the value of one during 2008-2011 and zero otherwise.

Table 1. Logarithm of GDP per Capita, growth rate of the GDP, growth rate of the GNI, Fiscal Rules Index old methodology, Fiscal Rules Index new methodology, Fiscal Discipline Score

Country	Number of observations	LNGDPPCAP	GRGDP	GRGNI	FRIOLD	FRINEW	FDS
Austria	22	10.327 *0.181*	3.134 *1.854*	3.311 *2.324*	-0.046 *0.560*	-0.072 *0.525*	3.727 *2.142*
Belgium	22	10.270 *0.180*	3.149 *1.913*	3.117 *2.492*	0.131 *0.400*	0.284 *0.443*	1.727 *1.579*
Bulgaria	22	7.99 *0.609*	7.985 *11.771*	8.858 *5.060*	0.441 *1.418*	0.647 *1.589*	3.636 *2.803*
Croatia	22	9.084 *0.233*	3.503 *5.707*	5.374 *5.992*	-0.377 *0.993*	0.339 *1.002*	1.772 *1.540*
Cyprus	22	9.812 *0.240*	4.405 *4.712*	5.066 *6.364*	-0.754 *0.479*	-0.654 *0.614*	1.636 *2.036*
Czech Republic	22	9.189 *0.443*	6.928 *6.931*	7.171 *7.358*	-0.439 *0.400*	-0.514 *0.323*	2.636 *1.677*
Denmark	22	10.521 *0.198*	3.295 *2.420*	3.825 *2.659*	0.758 *0.527*	0.731 *0.509*	6.636 *1.865*
Estonia	22	8.882 *0.630*	10.569 *9.051*	12.762 *11.158*	0.641 *0.206*	0.741 *0.214*	6.500 *1.263*
Finland	22	10.283 *0.239*	3.673 *3.292*	4.808 *4.867*	0.550 *0.612*	0.404 *0.541*	6.000 *2.093*
France	22	10.197 *0.164*	2.916 *1.889*	3.215 *1.839*	0.325 *1.159*	0.383 *1.182*	3.181 *2.196*
Germany	22	10.267 *0.146*	2.171 *2.157*	2.401 *2.241*	0.655 *0.836*	0.792 *0.889*	5.318 *2.146*
Greece	22	9.671 *0.231*	2.802 *6.158*	2.279 *5.705*	-0.686 *0.661*	-0.654 *0.661*	1.363 *2.194*
Hungary	22	8.889 *0.407*	6.049 *7.022*	5.955 *7.122*	-0.365 *0.787*	-0.306 *0.822*	1.909 *1.508*
Ireland	22	10.507 *0.218*	8.569 *9.316*	6.681 *8.339*	-0.469 *1.075*	-0.464 *1.020*	3.181 *2.322*
Italy	22	10.077 *0.159*	3.141 *3.695*	3.134 *4.004*	0.030 *1.05*	0.196 *1.188*	2.136 *1.833*
Latvia	22	8.642 *0.649*	9.904 *11.696*	11.149 *10.500*	-0.127 *0.929*	0.032 *1.066*	4.090 *2.688*
Lithuania	22	8.637 *0.670*	10.962 *10.899*	11.442 *10.394*	0.124 *0.765*	0.163 *0.770*	4.090 *2.368*
Luxembourg	22	11.052 *0.277*	5.926 *4.417*	4.839 *9.022*	0.839 *0.858*	0.632 *0.745*	4.954 *2.627*

Country	Number of observations	LNGDPPCAP	GRGDP	GRGNI	FRIOLD	FRINEW	FDS
Malta	22	9.461	5.879	5.003	-0.773	-0.696	1.500
		0.291	*3.311*	*4.376*	*0.703*	*0.847*	*1.921*
Netherlands	22	10.375	3.509	3.804	0.685	0.724	5.363
		0.202	*2.706*	*3.517*	*0.677*	*0.680*	*2.059*
Poland	22	8.762	7.464	8.087	0.869	0.777	3.909
		0.428	*8.692*	*10.057*	*0.857*	*0.799*	*2.044*
Portugal	22	9.548	3.508	3.376	-0.220	-0.220	2.000
		0.204	*3.393*	*3.197*	*0.936*	*0.897*	*1.690*
Romania	22	8.144	9.528	9.956	-0.424	-0.217	2.454
		0.678	*11.203*	*11.453*	*0.759*	*0.993*	*2.109*
Slovakia	22	8.869	8.776	9.556	0.070	0.041	3.727
		0.581	*7.242*	*7.317*	*1.193*	*1.125*	*2.548*
Slovenia	22	9.533	4.480	5.928	-0.265	-0.958	3.272
		0.279	*3.995*	*7.392*	*0.524*	*1.140*	*1.517*
Spain	22	9.847	4.318	4.641	0.898	0.920	4.181
		0.238	*4.142*	*3.864*	*1.165*	*1.158*	*2.500*
Sweden	22	10.423	4.251	4.988	1.167	0.771	6.045
		0.222	*6.511*	*6.908*	*1.048*	*0.839*	*2.768*
United Kingdom	22	10.286	5.130	4.247	0.928	0.854	5.636
		0.202	*8.457*	*8.608*	*0.949*	*0.897*	*2.573*

First row is the *mean*. Second row is the *standard deviation* of the variable

Source: authors' calculations

Table 1 marks our part of descriptive statistics, the first row being the mean and the second row presenting the standard deviation. As expected, higher values of the GDP per capita correspond to more developed members of the EU, such as Luxembourg, Germany, Sweden, Austria, France and the UK, and lower values for developing countries such as Romania, Slovakia and Bulgaria. The highest values for the grow rates of the GDP and GNI correspond to countries such as Bulgaria, Czech Republic, Estonia, Latvia and Romania, this because more mature and developed economies have lower but more stable grow rates of their economies. Regarding fiscal discipline, best values for the FRINEW and FRIOLD correspond to countries such as Denmark, Luxembourg, Sweden, UK and Spain, as the smallest values correspond to countries such as Cyprus, Greece and Malta. Best scores for our own calculated FDS were obtained by Denmark, Finland, and Sweden, while worst scores were obtained by Cyprus, Greece and Malta. Our descriptive statistics allow us to depict some of the more disciplined countries and some of the countries with a weaker fiscal discipline.

3.2. Preliminary analysis

While the results depicted in table 1 offer a small hint on what are the links between our chosen dependent and independent variables, a further deeper analysis is required.

Table 2. The correlations between the Fiscal Rules Index, Number of institutions, Government Consolidated Debt and Public Deficits as percentage of GDP

		LNGDPPCAP	GRGDP	GRGNI	FRIOLD	FRINEW	FDS
LNGDPPCAP	Pearson Correlation	1					
	Sig. (2-tailed)						
GRGDP	Pearson Correlation	**-0,326****	1				
	Sig. (2-tailed)	0,000					
GRGNI	Pearson Correlation	**-0,389****	**0,951****	1			
	Sig. (2-tailed)	0,000	0,000				
FRIOLD	Pearson Correlation	**0,349****	**-0,149****	**-0,126****	1		
	Sig. (2-tailed)	0,000	0,000	0,004			
FRINEW	Pearson Correlation	**0,297****	**-0,143****	**-0,118****	**0,975****	1	
	Sig. (2-tailed)	0,000	0,001	0,008	0,000		
FDS	Pearson Correlation	**0,324****	**0,002**	**0,043**	**0,839****	**0,806****	1
	Sig. (2-tailed)	0,000	0,965	0,335	0,000	0,000	

**. Correlation is significant at the 0.01 level (2-tailed).

Source: authors' calculations

Table 2 depicts our further investigation into the links between our independent and dependent variables. Following the previous results, the correlations indicate the fact that there is a negative correlation between the grow rate of the GDP/GNI and logarithm of GDP per capita. While there is a strong positive correlation between all fiscal discipline indexes and GDP per capita, there also is a strong negative correlation between the fiscal rules indexes calculated by the European Commission and the growth rates of the GDP and GNI. Our own calculated fiscal discipline score is positive correlated with the fiscal rules indexes provided by the EC.

4. METHODOLOGY

In order to establish the relationship between economic growth and fiscal discipline, we employ the next basic model (1):

$$Economic\ growth\ indicators_{,c,t} = \alpha_i + \beta_1 Fiscal\ discipline\ indicators_{c,t} + \beta_2 EU_{c,t} + \beta_3 UEM_{c,t} + \beta_4 POC_t + \beta_5 N_{c,t} + \varepsilon_{i,t} \quad (1)$$

Where:

$\boldsymbol{Economic\ growth\ indicators_{c,t}}$ - is one of the 3 indicators for economic growth of a state used in analysis: logarithm of GDP per capita (LNGDPCAP), growth rate of the GDP (GRGDP) and the growth rate of the GNI (GRGNI);

$\boldsymbol{Fiscal\ discipline\ indicators_{c,t}}$ - is one of the three fiscal discipline indicators used as main independent variables: Fiscal rules index old methodology (FRIOLD), Fiscal rules index new methodology (FRINEW) and the Fiscal discipline score (FDS);

$\boldsymbol{UE_{c,t}}$ - depicts the European Union accession dummy by year;

$\boldsymbol{UEM_{c,t}}$ - is the European Monetary Union accession dummy by year;

$\boldsymbol{POC_t}$ - is a dummy variable, depicting the 2008-2011 global financial crisis;

$\boldsymbol{N_{c,t}}$ – represents country specific variables regarding public policies and economic growth: the real grow rate of the public deficit (GRDEF), real grow rate of the governments consolidated debt (GRGCD), the grow rate of public expenditure (GRPE), real grow rate of public revenues (GRPR), the grow rate of the gross fix capital formation of the general government (GRGFCFGG), real grow rate of exports (GREXP) and real grow rate of imports (GRIMP).

In order to capture the influence of fiscal discipline indicators on economic grow indicators we used we used and Ordinary Least Squares panel distribution with fixed effects to allow for country specific characteristics as government spending and revenues, imports and exports to be accounted. While the fiscal rules indicators (both new and old methodology) were calculated by the EC according to a specific algorithm, the fiscal rules score was calculated by us by using hand collected data from the Fiscal rules database provided also by the EC. In order to circumvent the risk of serial correlated errors, we have done our analysis with all the standard errors clustered at a country level.

5. EMPIRICAL RESULTS

In order to test our hypotheses we used the previous mentioned basic model. In the second model we introduced into our analyses the dummy variable accession to EMU membership (MBEMU) to view if our results record significant changes. Finally, in model 3 we introduced the dummy variable crisis to see if it has an impact over or analysis and if the results change.

Table 3. The impact of fiscal discipline on economic growth

	Panel A: Dependent variable: LNGDPCAP			Panel B: Dependent variable: GRGDP			Panel C: Dependent variable: GRGNI		
Variable	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3
	-1.094	-1.094	-0.971	-0.532	-0.530	-0.406	-0.355	-0.371	-0.276
FRIOLD	(0.826)	(0.825)	(0.823)	(0.817)	(0.815)	(0.829)	(0.838)	(0.822)	(0.816)
	-0.0109	-0.009	-0.118	-0.601	-0.597	-0.706	-1.471	-1.472	**-1.532***
FRINEW	(0.625)	(0.636)	(0.633)	(0.659)	(0.669)	(0.688)	(0.886)	(0.878)	(0.867)
	0.492***	**0.492*****	**0.473*****	**0.492*****	**0.493*****	**0.474*****	**0.600*****	**0.600*****	**0.583*****
FDS	(0.099)	(0.101)	(0.099)	(0.110)	(0.112)	(0.111)	(0.174)	(0.173)	(0.172)
	0.000*	0.000	0.000	-0.000	-0.000	-0.000	-0.000	-0.000	-0.000
GRDEF	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
	-0.026**	**-0.026****	**-0.024****	**-0.023****	**-0.023****	**-0.021****	-0.0161	-0.016	-0.015
GRGCD	(0.011)	(0.011)	(0.011)	(0.010)	(0.010)	(0.010)	(0.015)	(0.016)	(0.016)
	0.115**	**0.115****	**0.0117****	**0.119****	**0.119****	**0.121****	**0.133****	**0.132****	**0.133****
GRPE	(0.049)	(0.049)	(0.049)	(0.055)	(0.055)	(0.055)	(0.061)	(0.061)	(0.060)
	0.522***	**0.522*****	**0.516*****	**0.497*****	**0.496*****	**0.490*****	**0.501*****	**0.502*****	**0.497*****
GRPR	(0.043)	(0.044)	(0.045)	(0.046)	(0.047)	(0.046)	(0.057)	(0.056)	(0.056)
GRGFCFG	0.008	0.008	0.008	0.008	0.008	0.008	0.004	0.004	0.004
G	(0.008)	(0.008)	(0.008)	(0.009)	(0.009)	(0.009)	(0.007)	(0.007)	(0.007)
	0.164*	**0.164***	**0.165***	**0.156****	**0.155***	**0.156***	0.074	0.075	0.075
GREXP	0.082	(0.082)	(0.083)	(0.077)	(0.077)	(0.077)	(0.049)	(0.049)	(0.049)
	0.007*	0.007*	0.007*	0.026	0.026	0.027	0.0706	0.069	0.070
GRIMP	(0.074)	(0.074)	(0.075)	(0.066)	(0.066)	(0.066)	(0.052)	(0.052)	(0.052)
	-1.747***	**-1.742*****	**-1.640*****	**-1.668*****	**-1.655*****	**-1.552*****	**-1.200*****	**-1.222*****	**-1.138*****
MBRUE	(0.418)	(0.419)	(0.411)	(0.389)	(0.392)	(0.377)	(0.408)	(0.433)	(0.407)
		-0.022	0.043		-0.067	-0.001		0.120	0.167
MBEMU		(0.433)	(0.454)		(0.413)	(0.431)		(0.494)	(0.500)
			-0.327			-0.330			-0.247
POC			(0.291)			(0.273)			(0.413)
Number of observations	536	536	536	539	539	539	475	475	475
R squared	0.836	0.836	0.835	0.839	0.838	0.839	0.789	0.788	0.788
F-Stat (p-value)	263.57 (0.000)	245.34 (0.000)	229.61 (0.000)	325.47 (0.000)	324.91 (0.000)	348.91 (0.000)	121.48 (0.000)	123.69 (0.000)	149.33 (0.000)

First row is beta coefficient. Second row is the standard errors clustered at country level. *** denotes significant at 1%, ** at 5%, and * at 10%.

Source: authors' calculations

Our results confirm mainly both hypotheses and the literature on subject. First, as all our models and panels confirm, the fiscal discipline measured through our own calculated fiscal discipline score exerts a positive influence on all economic growth variables: growth rate of the GDP, growth rate of the GNI and Logarithm of GDP per capita. As new treaties we're signed, and the media and general public interest increased, governments included in their own national legislations fiscal rules, especially regarding debt, deficit and expenditure, plus the introduction of new mechanisms and institutions in order to ensure the soundness of their public finances and the appropriate implementation of the rules. With fewer options at hand, governments had to limit their public expenditures and to spend more efficient. In align with the literature on subject, our second hypothesis was also confirmed by Model 3 Panel C. As our results indicate, a higher level of fiscal discipline (measured through the Fiscal rules index calculated by using the new methodology) brings with it lower growth rates of the Gross National Income. As countries become more disciplined, they need to keep their budgets balanced. As so, in some cases, they may need to impose higher tax rates with negative impact on the gross national income. Unfortunately, the Fiscal rules index calculated by using the old methodology of the EC has no impact on our dependent variables.

Other significant variables that exert a positive influence are the growth rates of public expenditures and revenues. These results can be explained by the fact that between the beneficiaries of public expenditure are private consumers. But, to spend more, governments need funds, thus higher revenue levels. Higher levels of exports also exert a positive influence. As known in the literature, higher growth rates of the government consolidate debt have a negative influence on economic growth, fact proven in Panels A and B.

Accession to EU membership also had a negative impact on economic growth, as the catching-up process slowed down and as governments could not allocate discretionary new expenditures for sectors as infrastructure and constructions for example. Economies also alienated in an economic growth process with lower growth rates but more stable and sustainable. Being a member of the EU brings with it more duties and tasks on many fronts: medicine, education and social protection – non-investment expenses.

6. CONCLUSIONS

Fiscal discipline and economic growth are two of the most discussed subjects in economic literature. Our goal was to study the relationship between these two important macroeconomic variables. The obtain results are in alignment with the specific literature on subject.

First, our results strongly indicate that a higher fiscal discipline level measured through our fiscal discipline score (FDS) has a positive impact on economic growth. We believe that the key causes that conducted to this result are:

i. As states become more and more disciplined from a fiscal standpoint, their decisions become more transparent and are subject to further verifications. Due to these aspects, governments cannot take individualistic or selfish decisions, only in their advantage, as pressure from independent monitoring institutions, sanction institutions and from the general public increases;

ii. Due to regulations and fiscal rules, public expenditures, debt and deficit levels are limited, thus future spending needs to become more efficient and more responsibly done;

iii. Numerical targets leave also less space for unjustified expenditures. In order to spend more, governments need to collect more. Without economic growth, policy-makers powers regarding public expenses become even more limited;

iiii. Higher discipline levels may bring with them newer and wiser investments, more rational spending of public money, thus creating the path for higher economic growth rates;

Our second hypothesis also was confirmed – higher fiscal discipline brings with it lower economic growth rates, as our last model shows. The more rules are implemented and discipline gains strength, the growth rate of the gross national income seems to suffer. We offer support for this results through the next statements:

i. Numerical fiscal targets limit fiscal expenditures, thus target indirectly private consumption and private companies. As governments are obliged to spend less in some cases, some investment projects may be abandoned, salaries of public sector employees may register downfalls, as private consumption as well, slowing down economic growth;

ii. Too much pressure on governments may lead to political instability, changing governments, stress decision-making or, in the worst case scenario ignoring all fiscal rules;

iii. There are private companies that depend on contracts with the general or central governments, form areas such as armament production, public constructions, and infrastructure. These domains that incorporate large companies are the first afflicted by budget cuts;

iiii. In order to pay all its obligations without inflicting danger on debt and deficit levels, governments may need to increase tax rates in order to cover current and future expenses, leaving less money in the economy for private investments and private consumption.

We pointed out what we see as being the causes of our and other authors' paradoxical results to suggest the fact that fiscal discipline has two faces: a good and a bad one. It 'shows one face or the other' depending on the leading party in the government, economic development, previous economic growth, financial stability, future plans and objectives, current economic conditions, the existence of implementing, monitoring and sanctioning institutions and mechanisms regarding fiscal discipline and many other variables. Our analysis was conducted on a heterogeneous group of countries – EU member states. We believe that driving the same analysis on individual states will also provide different results, as it is important to individualise each situation.

Our paper contributes to existing literature by using a new set of variables and timeline, and by the use of our own calculated fiscal discipline index. At a first glance, we are glad that our analysis confirms the paradox and the existing literature on subject, but we believe that new analyses are need in order to bring more light on to a high complexity subject.

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Section II

EU FINANCIAL AND BANKING REGULATION

ANALYSIS OF THE PERFORMANCE OF MOROCCAN BUSINESS THROUGH THE SUMMARY STATEMENTS

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Abstract
In a continuously changing economy, the uncertain became certain and the only constant thing is change. Therefore to ensure sustainability, companies need to ensure their market share by adopting a pertinent system of resource control and maintain proper financial management based on actual data to assess past and current situation of the company. The objective of this work is to present a dynamic view of the financial analysis, offering a reflection on the existing methods to assess the financial situation and clarification of some basic concepts for assessing the financial structure of the company within the Moroccan general accounting plan.
Keywords: *financial analysis, profitability, summary statements, ratios.*
JEL Classification: G32, L25

1. INTRODUCTION

Historically, the financial analysis is a profession that has developed as part of a loan banking. His first concern was logical for the granting of funding by credit focused on the study of the repayment ability. Today, the financial analyst tends increasingly to be an analyst of economic value and creating that value. The growing role of financial markets and transparency in the trading of financial assets, which are realized by the display of a price or course, strongly point in that direction. The dominant question of the financial analyst is that of the present and future value of financial assets: stocks, but also debt securities.

“Shareholders, legal owners of the company, are interested in the supposed profitability remunerate their capital at risk. The banker, financial creditor, wants to ensure the ability of the company to meet its current and future commitments. Workers, major input, are concerned with the distribution of wealth and survival of the organization. Government, guarantor of the environment, are directly affected by the financial health of the company, indicator of economic growth" (Corhay & Mbangala, 2007, p. 41).

It is in this context that we must pay more attention to financial analysis and determine the appropriate tools for a fair assessment of the profitability and the value of the company.

We will try to present the importance of financial analysis and objectives, assess the company's profitability and conclude with the best instruments and financial diagnostic tools referring to the Moroccan general accounting.

2. ANALYSIS OF PROFITABILITY

The financial analysis is a recent discipline, considered one of the concerns for the company. It can be defined as the set of methods to assess the past and present financial situation, assist in decision making and to evaluate the state of the financial health of the company. It is a set of concept, method and instruments to formulate an opinion on the financial position of a business, the risks affecting it, the level and the quality of its performance.

The financial analysis is developing a framework for assessing the economic situation of different industries and companies.

2.1. The objectives of financial analysis

For short-term loans, donor funds are primarily interested in the liquidity of the company, ie by its ability to pay short-term maturities, without neglecting the financial balance in the long term. In the case of long-term credit, they will be interested in the long-term solvency and profitability of the business that condition the payment of interest and repayment of principal.

"The objective of financial analysis is a priori easy to determine: to achieve the formulation of a comprehensive diagnosis of the financial position of a company. This is a judgment on its current and future performance and ability to sustainably finance its activity" (Caby & Koëhl, 2012, p. 25).

Assessment of the creditworthiness of the company:

According to Cohen (1997), the solvency of a firm or economic agent as its ability to ensure the settlement of its debts when they come due. Originally, the financial analysis was developed by bankers, for the purpose of assessing the creditworthiness of their customers, ie their ability to ensure their cash flow, the debt service. The credit is based on the financial resources available to meet its liabilities.

So credit is a key concept because insolvency, even temporary, is the suspension of payments condition that can lead to loss of independence of the company.

The study of credit allows to answer the following key questions: is the level of own resources sufficient?; the development of own resources-sufficient?; the risk to the structure are they weak?; sustainability of own resources it is ensured?.

***Evaluate the company's profitability*:**

The company's profitability is assessed from its financial structure, "profitability is the ratio of a result obtained by committed capital to get".

Beside the solvency requirement of a minimum level of profitability is essential for the survival and development of the company to generate positive results and fund growth and the repayment of its loans.

2.2. Foundations and principles

Historical financial analysis for understanding the past evolution of the company, through ratios (static analysis) and financial flows (dynamic analysis) and clarify certain financial decisions. The interpretation of the historical financial statements of the company is not quite enough, the Investment is led to the development of serious financial forecasts for the company and also the use of strategic thinking, to link findings with those of the past present and future.

The key points of analysis and financial analysis

An analytical approach can be proposed as follows:

Table 1. Financial diagnostics approach

1st step: Exploring ways of business by the financial structure and overall debt of the company. The working capital day sales (VAT): Interest expense /operating income. Treasury: EBE /CA (HT) Study the company's operation: Solvency: own resources /Total assets Profitability: Sales Management Providers	*Step 2*: Preparation of information sources: - Sources of accounting information - Sources of non-accounting information - Reprocessing and preparation of financial information - Restatement of Financial Statements - Development of indicators, dashboard, etc.
Step 3: selection tools of financial analysis: Financial Balance; Solvency; Profitability; Ability to repay; Financial autonomy; Financial risk etc.	Step 4: financial analysis and synthesis

Source: Frachon & Romanet (1985)

The concept of financial balance

The financial analysis is the study of accounting and financial information on a company to diagnose. The analysis should lead to a diagnosis, so as to conclude the performance of the company studied and allow to understand the determinants especially if this performance appears mediocre. This approach assumes the existence of standards and prior definition of the concept of financial balance.

Indeed according to Charreaux financial balance is achieved if the capital providers, shareholders and financial creditors are paid up to the risk they incur.

The minimum financial balance rule requires that stable jobs are funded by sustainable resources. Indeed, strict observance of this rule does not totally guarantee the absence of cash-flow problem. For this, a "margin of safety" is needed. This margin is the working capital.

2.3. The study of balance

The balance sheet is a summary document in which are grouped, on a given date, the total resources available to the company and all the jobs it has made. It shows its financial position at one point in time. It is neither more nor less a picture of society.

The Report sheds light on a Financial Report with the objective of financial is to show the real heritage of the company and to assess the risk of non-liquidity of the latter, and through reclassifications and restatements.

The functional assessment

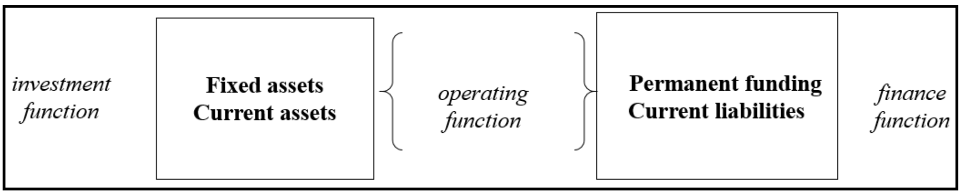
Financial analysis, balance sheet has always been an essential document for the assessment of the solvency and financial stability of the company.

Thus, the functional assessment aims to explain the operation of the company, and allows you to view at any given time the status of jobs and the company's resources, ie it owns and what it needs.

The presentation of this report is based on the concepts of the financial cycle and stability of resources and jobs: investment cycle, funding cycle, operating cycle, stable resources, not stable resources (or circulating) stable employment and unstable jobs (or non-current).

These positions are classified as follows :

Figure 1. The positions of the balance sheet



To interpret the data of functional assessment, we use indicators of financial balances are:

- *The functional working capital (FWC)*:

This is the amount of permanent financing of fixed assets, it measures the financial equilibrium conditions in the company, and it can be calculated in two ways:

- From the top of the balance sheet: Permanent Funding - Fixed assets = FWC

Table 2. The balance sheet above

Employment	**Resources**
Fixed assets	Permanent funding

- From the bottom of the balance sheet: Current assets + cash (assets) - Current liabilities (excluding cash) - cash (liabilities) = Working capital

- *The overall financing needs*:

It is calculated by the difference between current assets excluding cash and current liabilities excluding cash. If the difference is positive, it indicates a need for funding, if it is negative, then it is a funding resource.

- *Net cash*:

It provides information on cash position (Assets Cash - Cash liabilities) or (Working capital – the need for working capital). If it is positive, it is an expenditure. If it is negative, it represents a financial resource.

***The balance sheet*:**

Also called patrimonial balance sheet or liquidity due, is obtained after analysis and adjustments of certain items in the functional balance sheet of the Moroccan accounting and off-balance sheet items (leasing), it allows to present the real heritage of the company, to analyze the structure and financial position of the company and assessing the liquidity and solvency of the company.

3. FINANCIAL INSTRUMENTS AND DIAGNOSTIC TOOLS

3.1. The concept of financial ratio and liquidity

A ratio is defined as the proportion between two quantities that may give an indication, an explanation on the financial position of the company.

The measurement of equilibrium depends on the study of ratios which is the result of a relationship between two homogeneous quantities that lead through a dialectical reasoning to conclusions about the homogeneous object. This analysis method is known and used by managers, business consultants and bankers.

The company`s ratio is a financial analysis tool. He compares in the form of a coefficient two accounts or groups of accounts from the balance sheet and/or income statement. It allows to measure the financial health of a company and to compare from one year to another or with that of other companies.

Financial autonomy ratio

We use one or other of the following ratios:

R1 = Equity / Liabilities
R2 = Total Debt / Liabilities

Both ratios are used to measure the level of the financial autonomy and the financial independence of the company; they also measure the risk upon the creditors of the company, who have interest in seeing equity prevailed in the corporate structure.

- The long-term debt:

The capacity of the long-term debt is measured by three ratios:

R3 = Financing Debt / Equity
R4 = Financing Debt / Permanent capital
R5 = Equity / Permanent capital

- The capacity of term debt repayment:

Three ratios measure the ability of the company to meet its commitments to its creditors:

R6 = Financing Debt / Self-financing capacity
R7 = Operating Income / Financial expenses
R8 = Self-financing capacity / annuity in principal debt + financial expenses

The R6 ratio reflects the number of years necessary for the company to ensure the full repayment of term debt, using its cash flow.

The banker considers financial risky position of any company whose term debts exceed five years from cash flow.

The R8 reflects the ability of the company to cope with annual repayments in terms of principal and interest.

***Liquidity ratios*:**

The liquidity is the ability to meet its expenditures through optimal flow of cash flows (collection, disbursement). It is the character of a sum of money which can be arranged almost immediately.

Table 3. Calculation of Liquidity Ratios

Ratio	Formula
The general liquidity	R1 = Current assets (including cash assets) / Current liabilities (including cash liabilities)
The reduced liquidity	R2 = Current assets - inventories / Current liabilities
Immediate liquidity	R3 = Cash Assets / Current liabilities

Source: Bouayad (2016)

Frachon & Romanet (1985), meanwhile insist on the importance of liquidity, considering that it constitutes for the manager a strategic data as important as the profitability.

R3 ratio measures the company's ability to meet its short-term liabilities with its available resources.

***Inventory rotation ratios*:**

They are used to determine the average time flow of inventory meaning their transformation into debt or cash.

- Raw materials, consumable materials and supplies: The flow average time expresses the number of purchase days or consumption represented by the stock.

R1= Average stock of Raw materials and consumable materials and supplies / Purchase consumed with materials and operating supplies. Average stock = (Initial stock + Final stock)/2

- Finished products: The average time flow of finished goods stocks in relation to the cost of sold goods:

R2= Average Stock of finished goods / Production sold

***The credits rotation*:**

The average time of debt collection is calculated by the following ratio:

R1= Accounts receivable - customers payable / turnover (inclusive of tax)

R1 can appreciate the average credit period granted by the company.

***The rotation of supplier credit*:**

The average payment time granted by suppliers is:

R1= payables - Receivables from suppliers / Purchases (inclusive of tax)

The study of products and Charges Account and Balance Management of State

***The account of income and expenses*:**

It is presented as a list, and it allows to generate various levels of results, which reflect the consequences of the business operations and its funding policy, its non-routine transactions and corporate tax.

Thus, it shows the following interim results:

Operating result: Operating income - Operating expenses

It corresponds to the surplus generated by transactions related to the ordinary activity of the company (purchasing, production, sales), and it is an indicator of industrial action and / or trademarks of the company. It reflects operating income before the impact of financial transactions related to non-current items and income taxes.

Operating profit: Earnings before interest and taxes+ other operating income - other company`s expenses - Operating allowances + releases of provisions Financial result: Financial income - Financial expenses

It allows to qualify the financial engineering of the business (debt policy, cost of credit, use of inadequate funding and less expensive). It measures profitability of financial operations.

Current profit: Operating income + financial income

It reflects the level of both commercial/industrial performance and company financials. As it incorporates the results of the company's financing and investment operations, it will depend on interest rates, financial market performance and the financial risk of the company.

Non-operating income: non-current revenues - non-current charges

The result of operations that fall outside of the ordinary business of the company or that alters its structure.

Net income for the year: This is the final balance of the income and expenses, it integrates all aspects of the business. It is obtained by the difference between the revenues and expenses of the company.

Net income for the year: operating profit (+) or (-) non current income – tax on earnings

***The table of results formations*:**

Viewing through the intermediates financial ratios allows the company to comprehend how the earnings and cash flow are generated. These ratios are:

- The gross margin on sales: It is the difference between sales of goods and the purchase cost of goods sold and used to monitor the trade policy of the company and to measure its operating resources.

The gross margin on sales: Sale of goods - Purchase of goods sold

- Production of the exercise: This indicator concerns the industrial companies. It reflects the productive activity of the period: what a company has manufactured and sold, it has produced, what remains in stock and what she made for herself.

Exercice production = sales of goods and services produced (+ or -) + inventory variation + assets produced by the company itself

- Added value: To evaluate the economic dimension of the business. It also measures the newly created wealth by the company.

Value added = gross profit + exercice production - exercise consumption

- Earning befor interest and taxes: It measures the economic profitability of the company. This is the remuneration of capital input and is also the resource generated by the operation of the business regardless of the investment policy, tax policy and non-current elements. What makes this indicator very effective in inter-company comparisons.

Earning before interest and taxes = Added value + farm subsidies - tax - personnel expenses.

- Operating income: It measures the industrial and commercial performance of the business and this is the reason for its creation so it must always be positive.

Operating income: Earning befor interest and taxes + Other operating income - Other operating expenses + operating reversals and expenses transfers - Operating allowances.

***Self financing capacity*:**

Self financing capacity represents internal resources generated by the company's activity during exercise and can destine to self-financing, it is a potential cash flow generated by the own activity of the company in the course of an exercise. It finds its primary source in the gross operating profit, potential cash surplus generated by operating activities. It allows to increase investment, increase working capital, repay loans, to pay the partners and to measure the company's financial independence.

- The additive method

From the net profit after tax, it is to eliminate the calculated income and expenses calculated.

Table 4. Calculation of the self financing capacity

Sign	Calculation method	Sign	Calculation method	Sign	Calculation method
+	Net income for the exercice	-	Non-current reversals	=	Self financing capacity
+	Operating allowances				
+	financial allowances	-	Proceeds from disposals of fixed assets	+	Dividends
-	Non-current allowances				
	Operating reversals				
-	financial reversals	+	net values of depreciation of fixed assets sold	=	Self-financing

- The subtractive method:

This method uses EBIT to deduct other cashable expenses and add other cashable products.

Self financing capacity = EBIT + Transfers of operating expenses + other operating income - Other operating expenses + Financial income (excluding reversals) - Financial expenses (excluding allowances) + non-current income - non-current expense - income taxes

3.2. Analyzing the ratios of activity and profitability

These ratios are used to measure changes in business activity, productivity, profitability and performance achieved by the company.

Table 5. Calculation of profitability ratios

	Ratio	Formula	Comment
profitability ratios	Operating profitability ratios	R1 = EBIT / turnover (excluding Tax) R2 = Operating Result / turnover (excluding Tax)	The R1 is the rate of gross operating margin and reflects the performance of the company through its ability to generate cash resources.
	The ratio of financial profitability	R = Profit for the year / Equity	This ratio is the best indicator of the return on equity
	Productivity ratios	R1 = Added Value / Production of the exercice	R1 measure the degree of integration of the company's activities and its contribution to the economy
		R2 = Added value / Gross Fixed Assets	The R2 measures the performance of the production tool

3.3. Study of the cash flow statement

The analysis of the financing table makes it possible to apprehend all the financial flows that correspond to investment, financing, operating and cash transactions. It shows and explains the movements or variations in jobs and resources (variation in wealth) during a financial year. The cash flow statement has two parts:

- ✓ Summary of the balance sheet masses
- ✓ Employment and resources.

***Summary of the balance sheet masses*:**

The summary table of balance sheet masses is obtained directly from the net amount of two successive balance sheets. It allows to calculate:

- The functional working capital for the exercice, the previous exercice and its variation.
- The need for global funding for the exercice, the previous exercice and its variation.
- The net cash of the the exercice, the previous exercice and its variation.

It allows to identify the equation of financial balance: The functional working capital - The need for global funding = net cash (variation functional working capital - variation Change need for global funding = variation net cash).

Employment and Resources:

The table of jobs and resources provides information on the evolution of the company's jobs and resources during a fiscal year:

In detail, in terms of job flows and resources, referring to the top of the balance sheet (stable resources and stable jobs). This makes it possible to assess the investment policy, its financing and the self-financing policy.

Synthetically, , in terms of net change in the masses of jobs and circulating resources, with reference to the masses of the balance-sheet.

4. CONCLUSIONS

We have shown that the financial analysis aims to review the financial situation of the company highlighting their strengths and weaknesses. It is a necessary part of the performance, it allows the company to remedy the shortcomings observed to occupy a prominent place. The diagnosis is done from the financial statements of the past in a dynamic and comparative perspective. It collects documents on the last two or three years to study the evolution of the centreprise and to compare performance over time. This comparison is done using ratios.

It should be noted that ratios are more relevant if they are made over several years to see the evolution of the company`s situation and that they should be compared with competitor companies. However, the ratios do not take into account many factors that can have a profound impact on the business, yet can not be quantified or expressed in accounting term.

The study of the subject led us to conclude that there are a multitude of financial analysis ratios and should therefore select the most relevant ones based on the company and its activity. And so financial analysis is not limited solely on financial statements (even if it is an important step) but should be extended to the study of the environment: the geographical area, market and customer analysis, changes in legislation etc.

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INSURANCE CONTRACTS UNDER IFRS - EVOLUTION AND PERSPECTIVES

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Abstract
The development of the insurance market over the last decades, as well as the global financial market, has also led to an increase in the complexity of the products offered by companies active in the field. At the same time, connecting with the other markets led, on the one hand, to increasing the complexity of the products by the insurance companies and, on the other hand, to take additional measures of supervision by the competent authorities and institutions in order to ensure the stability and transparency of the insurance market. In parallel with this development, there has also been an increase in the associated risks due to the increasing volatility of financial markets, thus leading to an important increase in the risk management function at the level of the insurance companies.
The initiatives implemented in the supervision of insurance companies, both by the authorities involved and by the management of these companies, focused - besides monitoring the liquidity ratios and asset and liability management - and trying to standardize a model Through the adoption of the Solvency I Directive at European level since 1973, replaced by a new model called Solvency II in force on 1 January 2016.
Additionally, specific accounting standards and financial reporting have been adopted and applied through the adoption by the European Union of standards issued by the International Accounting Standards Board. Thus, in March 2004, the first financial reporting standard for the insurance sector was issued under the name of IFRS Standard 4 - Insurance Contracts, the reasons for issuing this standard being to bring improvements to the accounting of insurance contracts and to impose on the entities issuing insurance contracts to provide information on these contracts.
The adoption of IFRS 4 meant only the beginning of an analysis process to continuously improve accounting standardization, the conclusions being focused on a new standard - IFRS 17, under discussion, scheduled to be issued and published in the course of 2017, with applicability from 2021. The new standard aims to improve the comparability of the reported data and the quality of the resulting financial information.
Keywords: *insurance contracts, IFRS, insurance market.*
JEL Classification: G22

1. INTRODUCTION

Considered second insurance market in the world at the end of 2015, with a share of 32% (followed by North America and Asia - *Insurance Europe, 2016),* the European insurance industry has experienced in recent decades with significant challenges, despite the fact that it remained one of the constant and solid economic sectors, increasing both in volume and in the complexity of the products offered. With a level of 1,200 billion euro in 2015 - a 1.4% increase over the previous year - with a GDP penetration rate at European level of 7.4% and an average of 2,010 euro *per capita* spent in insurance, European insurance market still proved an important contributor to economic growth and development, supporting and encouraging investment risk transfers.

At the same time, Europe's insurance sector is the largest investor in the European space, with about 9.8 billion euro in assets managed, invested in the economy in 2015, equivalent to 61% of GDP at European level.

The increase in the complexity of the insurance sector has been an important factor that has ensured the development of this sector through the appearance of certain elements, mentioned below:

- increasing the importance of risk management function, due to the awareness of the emergence of certain risks in the financial markets;
- the development and emergence of new insurance products, such as life insurance with the unit-linked investment component;
- the emergence of new bancassurance insurance distribution channels, in partnerships with the banking companies, by associating the insurance policies with the banking products.

As a result of these increases, in both volume and complexity, naturally a greater need for supervision by the authorities - in order to ensure optimal customer protection - has been raised, as well as concerns about increasing transparency. As a consequence, a series of initiatives and measures for qualitative and standardization improvement was set up regarding the legal framework for regulating the insurance industry, transposed by:

- the unitary application of a new solvency calculation model;
- the application of international accounting standards.

Beginning in 1997 as a process of improving the parameters taken into account in the assessment of the solvency of insurance companies (EIOPA, 2017), new Solvency II regime was an important change in the European regulatory framework for insurance. Adopted by the 2009/138/EC - Solvency II Directive in November 2009, supplemented by the 2014/51 / EU - Omnibus II Directive by the European Parliament in April 2014 (Insurance ERM, 2015), the new solvency regime has been implemented in the European insurance market since January 1 2016. Thus, the Solvency II Directive codified and harmonized at the same time. European insurance legislation, applying a new principle by which the capital of European insurance companies must be managed in order to reduce the risk of insolvency.

The main objectives of the Solvency II regime are the following (EIOPA, 2017):

- ensuring a superior level of consumer protection;
- modern and centralized supervision of European insurance markets active in the field;
- a high level of integration of the European insurance market;
- increasing the international competitiveness of European insurers.

Solvency II does not refer only to equity and risks assumed by insurance companies. The new solvency regime sets new regulatory requirements, covering licensing processes, corporate governance and management, reporting to supervisory bodies, public transparency, classification of available funds, and ways of calculating technical provisions.

In parallel with the process of adopting the Solvency II Directive, the international accounting standards - IAS (subsequently gradually transformed into international financial reporting standards - IFRS) have been gradually developed and adopted, which is a set of rules to be followed by the reporting entities, in order to apply them in the accounting treatment, thus ensuring a level of standardization at that market level (IFRS Foundation, 2017b). IFRS standards are developed and maintained by the International Accounting Standards Board (IASB), with the intent that these standards can be applied globally, thereby providing investors and other users of the information contained in financial reporting with a higher degree of transparency. At this time, IFRS standards are implemented in over 100 countries - including the European Union - being developed by IASB, a body of the IFRS Foundation, which is a public interest organization.

At the level of the European Union, all listed companies are currently required to prepare consolidated financial statements in accordance with IFRS. In order to be applicable at European level, IFRS standards must be approved by the European Parliament and the Council of the European Union, with EFRAG's prior approval of the European Financial Reporting Advisory Group and with the prior vote of the ARC-Accounting Regulatory Committee.

2. CHANGING THE STANDARDS APPLICABLE TO INSURANCE CONTRACTS: IFRS 17 VERSUS IFRS 4

In defining an insurance contract, three essential aspects are considered:

- the insurance premium, as an obligation of the insured;
- the specified event, produced as a result of the activation of the risk assumed by the insurer, in accordance with the need to cover it proposed or identified by the insured;
- the promise of payment to the insured as an obligation of the insurer.

Thus, under an insurance contract, the insurer accepts that in return for the insurance premium, to pay the insured amount - or the part of the insured sum, so that the value of the object of the insurance will be restored to the physical level and the initial value - to the production of certain events - Risk assumption (CECCAR, 2013).

At European Union level, member countries have provided in their own legal frameworks, definitions of the insurance contract, as follows (selective examples) (European Commission, 2017):

- Austria: “In the case of indemnity insurance, the insurer is obliged to compensate the policyholder for the financial damage suffered. In the case of life insurance and accident insurance, the insurer is obliged to pay the policyholder the agreed amount. The Policyholder is obliged to pay the premium Agreed." *(Insurance Contract Law Act);*

- France: "an agreement whereby one party (the insurer) agrees to provide coverage to another party (the insured), on the occurrence of a specified event that is beyond the control of either party, in exchange for receiving payment of premiums from the Policyholder" *(commonly Agreed definition - no legal definition of year insurance contract the Insurance Code);*

- Germany: "By the insurance contract, the insurance undertaking undertakes to make payments or, if specifically agreed, to make provision in kind to the other party (the policyholder) or to a third party, in return for a premium, on the occurrence of the event on Which it has been the insurer's Agreed That depends Obligation (the insured event)" *(Art. 1 of Law 2496/97 in Regard to insurance contracts);*

- Italy: "Insurance is the contract with which an insurer (in exchange for the payment of a certain premium) has itself: (a) to pay the compensation to the insured; 2) to pay year if the income or capital of life-related event Occurs." *(Art. 1882 Civil Code);*

- Spain: "the contract of insurance is the contract by which the insurance contractor agrees, for a specified consideration (premium) and when an event occurs (the risk of which is the object of the coverage) Agreed limits, the damage suffered by the insured or to pay a capital sum, the rent or other compensation Agreed." *(Art. 1 Insurance Contract Act);*

- The United Kingdom: "whereby one party (the insurer) promises in return for a consideration (the premium) to pay the other party (the insured) a sum of money or to provide him with a corresponding benefit upon the occurrence of one or more Specified events." *(no statutory definition of insurance contracts year - definition Adopted by Channell J. in Prudential v Commissioners of Inland Revenue - 1904);*

- Romania: "the insurance contract is a contract in which the policyholder or the insured is obliged to pay the insurance premium and the insurer, it must pay the indemnity in the event of the insured risk, the insured or the injured third party Insurance beneficiary.” *(Article 2199, Civil Code of Romania).*

Standard IFRS 4 - Insurance Contracts was issued by the IASB in March 2004 in order to bring about improvements in accounting for insurance contracts and to require entities issuing insurance contracts (insurers) to submit information on these contracts. The overall objective of IFRS 4 is to specify how financial reporting of insurance contracts applies to any entity that issues such contracts (the insurer).

In defining the insurance contract, IFRS 4 sets out primarily the essence of the contract, which is uncertainty in the form of risk, identifying three situations considered uncertain at the start of an insurance contract (CECCAR, 2013):

- whether an insured event will occur or not;
- the moment when it will take place;
- how much the insurer must pay if the insured event occurs.

The risk in the definition of the insurance contract refers to an insurance risk, considered a pre-existing risk, which this IFRS defines as a risk, other than financial risk, transferred from the holder of a contract to the issuer. Thus, the following examples are insurance contracts (with significant risk transfer) (CECCAR, 2013):

- insurance against theft and damage to property;
- liability insurance;
- life insurance;
- Life annuities and pensions;
- medical insurance;
- fidelity bonds and bonds;
- credit insurance;
- product guarantees;
- title (property) insurance;
- travel assistance;
- the "catastrophe" bonds;
- swap contracts for insurance contracts;
- reinsurance contracts.

At the same time, the following examples do not represent insurance contracts in accordance with IFRS 4:

- investment contracts in the form of an insurance contract that do not expose the insurer to significant insurance risk;
- financial reinsurance contracts or group contracts - which bring the significant risks back to the policy holder;
- self-insurance;
- gambling contracts;
- derivatives;

- financial guarantee contracts.

IFRS 4 applies to all insurance and reinsurance contracts that the entity issues and reinsurance contracts that it holds and does not apply to the financial assets and liabilities of insurers, which fall under other standards.

The main treatment required by IFRS 4 refers precisely to the components of the insurance contract, because in practice, some contracts contain both the insurance component and an investment component, called the deposit component. Whether it is just the separation of the insurance risks - preexisting to the financial risks in defining the insurance contract, the standard also requires the separation of the insurance components from the investment or deposit components, as follows:

- imposed segregation conditions: an insurer can assess the separate deposit component; Accounting policies do not require it to recognize the obligations and rights that result from the deposit component;
- separation is permitted if the deposit component can be evaluated, but policies require recognition of the obligations and rights resulting from the deposit component;
- separation is forbidden if the deposit component cannot be separately assessed.

In order to separate a contract, an insurer must apply the IFRS 4 standard to the insurance component and apply IFRS 9 - Financial Instruments to the Deposit Component respectively.

The insurance risk is significant if an insured event could cause an insurer to pay significant additional benefits in any situation. Thus, if an insurance contract is separated into a deposit component and an insurance component, the importance of the insurance risk transfer will be assessed according to the insurance component.

In addition to IFRS 4, IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, establishes that an insurer must:

- not to recognize as debt any reserves for possible future claims - such as disaster reserves and equalization reserves;
- to carry out the debt adequacy test; According to IFRS 4, the debt adequacy test is an analysis of the need for the carrying amount of a liability associated with insurance contracts to be increased (or the carrying amount of deferred acquisition costs or intangible assets to be low) based on a review of the flows Future treasury; As minimum provisions, the test will take into account current cash flow estimates (claims processing costs) and cash flows resulting from embedded options and guarantees, and if the results show that the debt is inadequate, the entire difference will Be recognized in profit or loss;
- to eliminate a liability associated with insurance contracts in the financial position only when it is liquidated;

- not to offset the assets associated with reinsurance contracts or the income/expense with the reinsurance contracts with the income from/expense with the related insurance contracts;
- to examine whether its assets associated with the reinsurance contract are impaired.

Some insurance contracts have a discretionary participation feature as well as a guaranteed element. The discretionary participation feature is a contractual right to receive, besides the guaranteed benefits, additional benefits that are based on the performance of a certain portfolio, the return on investment or the company's profit or loss (CECCAR, 2013). Thus, in the case of the issuance of such contracts, the issuer:

- may, but is not obliged, to recognize the guaranteed element separately from the discretionary participation feature;
- if it recognizes the characteristic separately from the guaranteed element, it should classify that characteristic either as a liability or as a separate component of equity;
- can recognize all premiums received as income without separating any part that is related to the equity component;
- if the contract contains an embedded derivative that is subject to IFRS 9, it will have to apply IFRS 9.

Regarding the second objective of IFRS 4, namely disclosure by insurers, they need to explain their values and to provide users with information that identifies and explains the values of their financial statements generated by insurance contracts. Thus, insurers have to submit (CECCAR, 2013):

- its accounting policies for insurance contracts and its assets, liabilities, income and expenses;
- assets, liabilities, income and expense recognized (and cash flows through the direct method);
- gains and losses recognized in profit or loss when buying reinsurance;
- if it is a cedent that deferred and amortized the gains and losses resulting from the purchase of reinsurance - the amortization for that period and the values remaining unamortized at the beginning and the end of the period;
- reconciliations of changes in debt and associated assets and deferred acquisition costs.

On the other hand, insurers are required to explain the nature and extent of risks arising from insurance contracts. Thus, they must provide information that allows users to assess the nature and extent of the risks generated by insurance contracts, such as:

- its risk management objectives, policies and procedures;
- insurance risk information (sensitivity, concentration, evolution of claims);
- information on credit, liquidity and market risks;

- information about the market risk exposures generated by derivatives embedded in an insurance contract (analyzes and qualitative information on sensitivity).

Although the provisions of IFRS 4 on the disclosure of financial information have been implemented by insurance companies since 2004, the development of the insurance industry over the last decades, as well as the increasing complexity of financial markets have exposed the entities in the insurance field to various uncertainties and long-term. As a result, accounting for insurance contracts no longer provides users with the information they need in order to understand the financial position of the insurers and also their financial performance and risk exposure. In addition, the new Solvency II solvency regime implemented since 2016 requires additional information due to the complexity of the calculation models and the possibility to choose from the insurance companies between the standard calculation model and the internal model of the solvency. Consequently, in June 2013, the IASB published a new draft law on applicable standards for accounting for insurance contracts for public consultation. The problems identified by the new project generally referred to the complexity of the information needed to be understood by the users and targeted the following areas:

- orientation of the insurance entity;
- diversity of accounting models for different insurance contracts;
- estimates of long-term traditional contracts,
- lack of information regarding the economic value of the options and guarantees;
- percentage discounts based on estimates of return on investment;
- lack of updates related to non-life insurance liabilities.

The main drafts of the project referred to:

- improving comparability;
- increasing transparency;
- increasing convergence with the US GAAP accounting system.

As a result, the IASB issued the new standard called IFRS 17 - Insurance Contracts, to replace IFRS 4, to be approved in May 2017 and scheduled to enter into force on 1 January 2021, after a period of three years, in which support will be provided for its implementation.

Future standard IFRS 17 will establish new requirements for accounting for insurance contracts for all insurance companies in a way that provides:

- current estimates at each reporting date of the obligation created by the insurance contracts, reflecting up-to-date information about the financial flows from those contracts, and the periods and risks associated with those financial flows;

- information about:
  - The source of the profit or loss from the insurance business and the investment premiums paid by the clients;
  - Measure and nature of the risks arising from insurance contracts.

These measures are designed to provide users of financial statements with relevant information about their financial position and performance, while also ensuring greater transparency and comparability of the information they transmit. A comparative situation between the two standards is presented in table 1.

Table 1. Comparative analysis between IFRS 4 and IFRS 17

Current standard: IFRS 4	**Future standard: IFRS 17**
Comparability among companies	
Accounting for insurance contracts varies significantly between companies operating in different jurisdictions.	Companies will apply a consistent accounting framework for all insurance contracts.
Comparability among insurance contracts	
A multi-national group is allowed to consolidate subsidiaries using non-uniform accounting policies as insurance contracts can be measured applying the relevant local accounting requirements of each jurisdiction.	A multi-national group will measure insurance contracts in a consistent manner within the group, increasing the comparability of its results by product and geographical area.
Comparability among industries	
Some cash or deposits received as revenue. This is contrary to accounting applied in other industries, in particular banking and investment-management industries.	Revenue will reflect the insurance coverage provided, excluding saving components, like any other industry
Value of insurance contracts	
Use of out-of-date assumptions does not provide useful financial information.	Insurance contracts will be measured at the current value using updated assumptions about cash flows, discount rates and risk at each reporting date.
Some companies use the 'expected return on assets held' as the discount rate to measure insurance contracts, distorting the value of the insurance contract liabilities	Companies will use a discount rate that reflects the characteristics of the insurance cash flows to measure their insurance contracts.
Some companies do not consider the time value of money when measuring liabilities for claims incurred.	Companies will report future claims on a discounted basis.

Current standard: IFRS 4	Future standard: IFRS 17
Some companies include a 'default allowance for risk' in the measurement of their insurance contract liabilities.	Companies will calculate and disclose an explicit risk margin.
Information on profitability of insurance contracts	
There is a lack of transparency about the sources of profit recognized from the insurance contracts, especially when the revenue is reported on a cash basis.	Companies will provide information on current and future profitability arising from insurance contracts.
Obligations arising from insurance contracts are highly uncertain.	Companies will provide additional information on estimates and assumptions used to measure insurance contracts.
Many companies provide non-GAAP information, usually about the future profitability of long-term insurance contracts.	Limited need to produce non-GAAP information.

Source: IFRS Foundation (2017a)

The new standard will also produce changes in the presentation of the financial statements, as in table 2.

Table 2. Classical presentation of insurance companies Profit or Loss Account

IFRS 4	IFRS 17
GWP (Gross Written Premiums)	Insurance Revenue
Investment Income	Incurred claims and expenses
Incurred claims and expenses	Insurance Service Result
Change in insurance contract liabilities	Investment Income
Profit / Loss	Insurance Finance Expense
	Net Financial Result
	Profit / Loss

Source: IFRS Foundation (2017b)

3. INTERPRETATION OF IFRS FOR INSURANCE CONTRACTS BY THE EUROPEAN INSURANCE MARKET

According to the latest official data for 2015, the European insurance industry represents the largest insurance market in the world, with a 32% share, followed by North America with a 31% share and Asia by 30%.

On the other hand, the insurance sector is the largest institutional investor in the European Union, with about EUR 9.8 billion representing financial assets invested in the economy in 2015, which is equivalent to 61% of GDP in the European Union.

At the level of the gross premiums written following the conclusion of insurance contracts, the year-on-year increase of 1.3% to EUR 1,200 billion was recorded in the year 2015 (IAIS, 2016), with the companies in table 3(the top 10 insurance companies At EU level).

Table 3. The ranking of the top 10 insurance companies at EU level

GROUP	COUNTRY	Premiums written (Billion euro)	MARKET SHARE	SOLVENCY MARGIN
AXA	FRANCE	92	19%	2.46%
ALLIANZ	GERMANY	77	16%	2.00%
GENERALI	ITALY	74	15%	1.64%
PRUDENTIAL	UK	51	11%	2.50%
ZURICH	SWITZERLAND	44	9%	2.03%
Talanx	GERMANY	32	7%	2.19%
CNP ASSURANCES	FRANCE	31	6%	1.18%
CREDIT AGRICOLE ASSURANCES	FRANCE	30	6%	1.19%
AVIVA	UK	30	6%	2.20%
MAPFRE	SPAIN	22	5%	2.55%
TOTAL		**483**	**100%**	

Source: Insurance Europe (2016)

From the analysis of the top ten companies, the first three insurers: AXA, ALLIANZ and GENERALI (AXA Group; 2016; Allianz Group, 2016; Generali 2016), with a cumulative market share of over 50%, amounting to a gross written premium income of 243 billion euro, are noted.

In the case of AXA, the debts to clients related to insurance contracts are now accounted for in accordance with IFRS 4, which generally permitted the continuation of the accounting policies that are applicable before the conversion to IFRS but the IASB's issuance of the new draft Standard - IFRS17 requires redefining current principles.

These new principles can significantly affect the settlement of debt to insurance policy holders at the time of first application of the new IFRS (early 2021). Before applying this standard, another standard will be applied in parallel - IFRS 9 - Instruments Financial standard issued in 2014, effective from January 1, 2018. However, given the interaction between financial assets and liabilities represented by technical provisions, the IASB proposed to postpone the application of IFRS 9 until the new standard of the insurance industry will enter into force, in January 1, 2021.

The company publishes the financial statements in accordance with IFRSs and the related interpretations, which are final and effective on 31st December, in accordance with the measures adopted by the European Union. However, there are still discussions at the IASB on changes to IFRS, and these changes can have a significant impact on insurers and other institutions, including AXA. Consequently, given that company management cannot reliably predict the potential impact of proposed changes or other potential changes in the future, the company believes that these changes may have an adverse impact on results and operations.

The following IFRS standards were considered by the Company:

- IFRS 9 - Financial Instruments - a standard published in 2014, has replaced IAS 39, with the following features:

- Classifications and valuations: IFRS 9 uses a single adoption to determine whether a financial asset is measured at amortized cost, fair value under other sources of income or fair value through profit or loss;
- The depreciation model applied by IFRS 9 reflects anticipated credit losses, as opposed to IAS 39, where credit losses were recorded at the effective level;
- „hedge accounting" - IFRS 9 introduces new requirements in order to align the accounting model the principles of risk management.

- IFRS 15 - Revenue from contracts with customers, published in 2014 and amended in 2015, provides a revenue-based approach to income recognition and introduces the concept of recognizing income for liabilities as they are extinguished. It applies to all contracts with customers except: insurance contracts, leases, financial instruments and non-monetary exchanges between entities operating in the same field.

- IFRS 16 - Leasing - published in 2016, laid down the principles of recognition, measurement, presentation and detail leasing activities for both Petri of contract.

Regarding the treatment of insurance and investment contracts concluded with discretionary participation Characteristics company AXA proceeded as follows:

- except where it applies IAS 39, IFRS 4, recognition and derecognition are based on accounting policies established before the adoption of IFRS, except for equalization reserve and changes permitted by IFRS, as follows:
  - technical reserves should be sufficient;
  - acquisition costs are deferred to the extent they are recoverable and amortized based on estimated gross profits, to limit the lifetime of the contract;
  - reserves damage to goods and property represents estimated costs.

On investment contracts without discretionary participation Characteristics company AXA proceeded as follows:

- in accordance with IAS 39, these contracts are accounted for using „deposit accountancy", which implies non-recognition of financial flows corresponding premiums, benefits and damages in profit or loss. This category includes Unit-Linked contracts who do not meet the definitions of insurance contracts and investment.

In case of Allianz, financial statements are prepared according to IFRS, as adopted by the European Union and also in accordance with German Commercial Code.

Considering that IFRS does not provide specific guidance for the recognition and measurement of insurance contracts and reinsurance and investment contracts with discretionary participation feature, the company has applied IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors for matters not covered by IFRS 4, were applied accounting principles generally accepted US accounting system - US GAAP.

Thus, insurance and reinsurance contracts and investment contracts with discretionary participation feature was accounted for under US GAAP accounting principles system, while investment contracts without discretionary participation Characteristics were accounted for in accordance with IAS 39.

As mention insurance contracts that do not fully meet the general conditions of the insurance contract, were separated from insurance contracts and accounted for as derivatives classic IFRS 4 and IAS 39.

In addition, Allianz believes on annuities issued in the United States that they meet the criteria for classification as insurance contracts under IFRS 4 because they include options for holders of contracts for choosing contingent annuities. These contracts currently do not expose the company to a significant risk of longevity, nor is forecasted to happen so in the future, due to very low tariff rates first.

Also, traditional contracts issued in France and Italy do not incorporate significant insurance risk, although they are accounted for as insurance contracts because of their discretionary participation. Similarly, a significant proportion of unit-linked contracts issued in France and Italy do not include a significant insurance risk.

The following IFRS standards were considered by the company:

- IFRS 15 - Revenue from Contracts with Customers - group planned adoption of this standard on the official entry into force (January 1, 2018). Company routinely evaluates new rules to determine the method of application and also the financial impact of the new standard. It is estimated that income from fees and commissions - initially recorded as a site related to asset management fees will represent the chapter most affected by the adoption of IFRS 15;

- IFRS 16 - Leases - The Company routinely evaluates new rules to determine the method of application and also the financial impact of the new standard.

4. CONCLUSIONS

After analyzing the effects of adopting IFRS by the two companies, it follows that the treatment of insurance contracts under IFRS 4 produce risks for the interpretation of data and information at the Balance Sheets elements level, or more precisely, the data derived from recording contracts insurance. The centralized balance sheets for the two companies are presented in table 4.

It is noted firstly the largest share of the investment and financial assets (unit-linked), 78% in AXA, namely 72% for ALLIANZ in total balance sheet assets, in consideration with the responsibilities and liabilities related to the passive, represented by insurance reserves and investment, and financial liabilities, amounting to 85% for AXA, respectively 78% for Allianz.

Table 4. Presentation and analysis of the balance sheet items for 2015, in case of AXA and ALLIANZ insurance groups

INSURANCE GROUP	**AXA**		**ALLIANZ**	
BALANCE SHEET	**AMOUNT**	**%**	**AMOUNT**	**%**
TOTAL ASSETS, FROM Which:	887	100%	849	100%
INVESTMENTS	**500**	**56%**	**509**	**60%**
FINANCIAL ASSETS - Unit Linked	**195**	**22%**	**106**	**12%**
BANKING ACCOUNTS	26	3%	15	2%
ASSETS intangible	47	5%	13	2%
OTHER ASSETS	119	13%	206	24%
Total Liabilities, Which FROM:	887	100%	849	100%

INSURANCE GROUP	AXA		ALLIANZ	
BALANCE SHEET	AMOUNT	%	AMOUNT	%
EQUITY	73	8%	66	8%
INSURANCE AND INVESTMENTS RESERVES	**675**	**76%**	**558**	**66%**
FINANCIAL participation rights	**79**	**9%**	**106**	**12%**
OTHER Liabilities	60	7%	119	14%

Source: Allianz Group (2016) and Axa Group (2016)

In conclusion, the new provisions required by IFRS 17 will bring changes on the one hand in the calculation and accounting of certain items and, on the other hand in the manner of presentation related financial statements separately as follows:

- asset side: insurance contracts will be valued at the current value, using estimates of future generating financial flows, which will lead to increase in insurance claims and hence the balance sheet;

- total liabilities: insurance companies will record and report estimates of future payments related claims recorded in technical reserves, which will generate an effect of increasing the liabilities.

Last but not least, should be taken into account permanent concern insurance companies regarding the investment of financial assets - on the one hand the obligation to issue contracts for unit-linked - why these balance sheet items are covered by standard IFRS 9 - financial instruments.

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THE ROLE OF THE REGULATIONS FOR ENSURING OF AN ADEQUATE TRANSPARENCY LEVEL FOR RISK MANAGEMENT

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Abstract
The transparency of the bank became an important subject both for supervisors and for the market operators. The banking legal framework was traditionally used in order to force information disclosure with prudential purpose or for monetary politics reasons and less likely for an assessment of the financial risks. This paper aims at identifying the transparency degree for the commercial banks in Romania using their reports elaborated according to current regulations. The survey is based on a detailed analysis of the information available for the Romanian banks and intends to reveal to what extent the regulations have improved the transparency degree.
Keywords: *risk, transparency, accountability, banks, disclosure.*
JEL Classification: M41, G31, G32

1. INTRODUCTION

Banks operate in a market-oriented environment that is constantly changing, offering them a range of opportunities but also complex and variable risks. Accordingly, credit institutions need to rapidly acquire risk management skills to survive, resist competition from foreign banks, and support private sector-led growth.

Measuring earnings and managing risk is important in assessing the quality of banking activity and its performance. Considering all possible risks, the essential purpose of bank managers is to achieve maximum profit under minimal risk. Banking performance and analysis are very useful to investors, lenders, simple depositors, or business people who have stable and large-scale relationships with a particular banking institution.

One of the problems of banks in financial reporting is to establish the correct amount of information to be made public. In this respect, the confidentiality and the maintenance of the financial stability of the institution has a significant weight in the decision making of financial information. Therefore, the purpose of this article was to measure the quantity and quality of the information presented through the transparency reports drawn up according to the presenting frameworks in force.

Many reviews have analised the role of the transparency in the monetary politics.

Borio & Zhu (2009) affirm that the changing characteristics of the financial system have recently encouraged a shift of focus in the analysis from the role of monetary controls to that of prudential controls in the transmission mechanism, especially to that of capital regulation".

In his paper Witherell (2003) shows that transparency is a key factor contributing to financial market efficiency and for providing the information necessary for market discipline to be effective. Another papers explored the ideea that the transparency could be benefit ex ante, the main idea being that the increase of the transparency strenghtens the market discipline over the banks.

Lamming *et al*. (2004) are stating that the implication for managers, is that transparency might indeed be created and usefully managed within supply relationships but that it would differ fundamentally in meaning from previously posited concepts, with the same name, in different contexts".

Nier (2005) afirms that în particular, the key argument is that the bank transparency increases the sensitivity of the bank's funding terms to the risk it takes and that this in turn can create incentives for the bank to control its risk (e.g. ante discipline).

His review emphasized the connection between the political factors and the increase of the bank's transparency, representing a potential manner to increase the stability of the banks. He admits that a market discipline determined by more transparency could be often harmful.

Ratnovschi (2013) shows that transparency may depend on the volume of disclosure adopted by a bank. However, transparency may also rely on issues beyond formal disclosure. Even when related to direct information release, transparency may be determined by the credibility of bank communication".

The paper made by Van Oorschot (2010) shows that managers might however be reluctant to release risk information since this might be commercially sensitive and can give competitors an advantage".

2. THE GENERAL FRAMEWORK FOR RISK DEVELOPMENT IN FINANCIAL REPORTS INTRODUCED BY BANKS

The first initiatives on disclosure of risks by banks were of the International Accounting Standards Board. Further risk information is required by Pillar 3 of Basel II (2008) and Basel III (2010) from 2014.

IAS 30 "Disclosures in the Financial Statements of Banks and Similar Financial Institutions" is the standard that provides adequate rules for reporting and presentation to banks and financial institutions assimilated, for example: the requirement that the income and loss items of income and expenses to be classified according to their nature, and in the balance sheet to be in the order of relative liquidity. At the same time, disclosure requirements include assets, liabilities and off-balance sheet items, loan losses and advances, as well as general banking risks. Although some banking risks may be reflected in the financial statements "explanations can help users to better understand their management (Higson, 2009). This standard was issued especially for banks in accordance with IAS 1 "Presentation of Financial Statements" regarding the suggestion that the financial statements may be accompanied by comments from managers detailing and explaining the information presented in the financial statements. In addition to the disclosures required by IAS 30, users need information to enhance their understanding of the importance of balance sheet and off-balance sheet financial instruments for a bank's financial position, performance and cash flows. This information is necessary to evaluate the values, timing and certainty of the future cash flows associated with such instruments. This issue is addressed by IAS 32 "Financial Instruments: Presentation" and IAS 39 "Financial Instruments: Recognition and Measurement". Although these standards have been issued as separate standards, they are applied in practice on a unitary basis because they deal with the same accounting phenomenon.

IAS 32 "Financial Instruments: Presentation" supplements the disclosure requirements of IAS 30 and specifically requests that disclosures should be made in the light of the risks associated with financial instruments. The specific objectives of this standard are to prescribe requirements for balance sheet presentation of financial instruments and identify the disclosures, financial instruments both on-balance-sheet (recognized) and off-balance sheet financial instruments (unrecognized).

IAS 39 "Financial Instruments: Recognition and Measurement" deals with issues relating to the recognition and measurement of financial instruments and contains some additional disclosures to those required by IAS 32 and recommends the fair value accounting of financial instruments, in the asset side of the balance sheet. "However, the Basel Committee on Banking Supervision considers that a fair value approach is necessary in situations where financial instruments are held for trading purposes" (Van Greuning & Brajovic-Bratanovic, 2009).

The need for a much more harmonized financial reporting framework, with a focus on appropriate disclosure and disclosure, has led to the emergence of IFRS 7 "Financial Instruments: Presentation" which, although replacing IAS 30 (which was a standard for banks) was not published as a specific industry-specific standard and could be applied to all companies, including those not part of the financial services sector and using fewer financial instruments. Unlike IAS32, this standard introduces new disclosure requirements that improve the information about financial instruments. It requires the submission of qualitative and quantitative information on the exposure to risks arising from financial instruments, including a minimum of disclosures about credit risk, liquidity risk and market risk, including market risk sensitivity analysis. Therefore, the objective of the standard is to impose on companies a series of presentations that allow users of financial statements to assess the importance of financial instruments in the context of the company's financial position and development and the nature and extent of the risks arising from the financial instruments to which the company is exposed, and the management of these risks.

With fiscal years beginning on or after 1 January 2009, IFRS 7 requires the disclosure of additional information on fair value measurement and liquidity risk. Therefore, fair value measurements of fair value items will be presented according to the source of the information used, using a three-tier hierarchy, by category, for all financial instruments recognized at fair value. In addition, it is necessary to submit: a reconciliation between opening and closing balance for fair value measurements of level three, as well as significant transfers between fair value hierarchy levels. Changes in liquidity risk also clarify the disclosure requirements for liquidity risk information related to derivative transactions and assets used for managing liquidity.

Although only these standards have been described, we mention that they complement other financial reporting standards that apply to both bank and non-bank entities. Publishing obligations and other accounting standards specific to banks come from the IFRS framework.

Adopting internationally accepted accounting standards has certainly been a necessary measure to facilitate transparency and fair interpretation of financial statements, but in order to ensure greater transparency in the banking system, efforts have also been made by the Committee Basel, which are regulated under the Basel II agreement, the third pillar "Banking discipline", according to which banks must provide both supervisory authorities and the general public with detailed, qualitative and quantitative information on the risks, capital and policies, and risk management procedures. In order to enhance transparency, accountability and regulation by improving the quantity and quality of capital in the banking system, the Group of Central Bank Governors and Heads of Supervision (GHOS) has agreed on a number of measures to strengthen banking sector regulation, adopted and published by the Basel Committee on Banking Supervision (BCBS) under the Basel III framework.

The Basel III capital agreement introduces extensive capital and quality capital requirements, new liquidity requirements, a counterparty credit risk review, and a benchmark for banks in member countries of the Basel Committee. The legal framework for the Basel III package governing the access to activity, supervision and prudential rules applicable to credit institutions and investment firms is being implemented gradually from 1 January 2014 until the end of the year 2018.

Currently, the legal framework for supervision and prudential rules applicable to credit institutions and investment firms is made up of Directive

2013/36/EU on the access to credit institutions' activities and the prudential supervision of credit institutions and investment firms and of Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) no 575/2013. 648/2012, establishing uniform and directly applicable prudential requirements for all credit institutions and investment firms authorized in Member States of the European Union.

In our country, the central bank issued in this regard the Regulation of the National Bank of Romania no. 5/2013 (R. BNR no. 5/2013) on the prudential requirements for credit institutions which allowed its harmonization with the CRD IV/CRR legislative package. The Regulation transposes technical provisions of Directive 2013/36/EU and specifies how the national options included in the CRD IV/CRR package were exercised.

At the same time, the Regulation takes over, amends and / or complements the relevant provisions of the previous regulatory framework, harmonized with the CEBS / EBA guidelines in areas such as corporate governance (including the responsibilities of the credit institution's management board, risk management, remuneration practices, outsourcing of the credit institution's activities), internal risk capital adequacy assessment process, crisis simulations, internal rating models for credit risk, operational risk-specific approaches and internal models used to determine capital requirements for market risk.

3. METHODOLOGY AND ANALYSIS OF RESEARCH

Studies conducted by both Romanian authors (Căpraru, 2010; Dumiter, 2014) and foreigners (Witherell, 2003) analyzed the level of transparency for the central bank. This article aims to analyze the information provided by the Romanian banks in transparency reports according to the legal requirements. The main objective of this paper is to analyze compliance based on a grid based on the requirements of the Regulation of the National Bank of Romania no. 5/2013 on prudential requirements for credit institutions and with Regulation (EU) No 575/2013 on prudential requirements for credit institutes and investment firms. The score obtained according to the grid allowed us to assess compliance through a four-point Linkert scale: 0 - lack of conformity; 1 - low compliance; 2 - medium compliance; 3 - high compliance.

We have seen that in order to meet regulatory requirements to ensure an adequate level of transparency, banks are required to prepare and publish an annual transparency report for public information on capital and risk assessment processes. The report includes both information found in the financial statements posted to the websites of the banks studied, as well as additional information. The additional information we have been looking at when we analyze the transparency reports is that provided by the legal framework on:

- its structures and policies related to the activity management framework, including: the objectives, the organizational structure, the activity management framework, the structure and organization of the management body, the participation in its meetings, and the incentive and remuneration structure of the credit institution;

- the nature, extent, purpose and economic substance of the related party transactions if they have a material impact on the credit institution;
- the way in which the business strategy and risk management strategy (including management involvement) and predictable risk factors are established;
- established committees of the credit institution, their attributions and composition;
- the framework for internal control and the way control functions are organized, the main tasks they perform, the way in which their performance is monitored by the management body, and any significant changes planned to those functions.

In the analyzed period 2013-2016, the number of banks in Romania remained unchanged: 40, of which 31 are Romanian legal persons and 9 are branches of foreign banks. Of the 30 commercial banks in the sample, three do not make any reference to the annual transparency report, for others the report on transparency and disclosure requirements is posted on the website of each bank. Therefore, we find that almost 90% of banks comply with the publication requirement, which means they are interested in disclosing information. The average number of information published in such transparency reports is 7.85, the maximum figure being 14. The main information presented by the banks in the transparency requirements and information disclosure report is given in table 1.

Table 1. Categories of published information

Published information	**No. of banks**	**%**
Organization and administration framework	27	100%
Risk management objectives and policies	27	100%
Capital management	27	100%
Credit risk	27	100%
Market risk	27	100%
Liquidity risk	27	100%
The leverage effect	25	92.59%
Internal control	15	55.55
Remuneration Policy	25	92.59%

Source: own contribution

Table 1 shows that banks have reached a high level of identification of the main information required to be published. Most of the public information relates to the risk profile estimation for banks, with the role of supporting the process of supervising the financial system. This can be explained by the strength of the legal framework that is recognized as force in the presentation of information.

The overall level of compliance with reporting requirements in the legal framework in force is shown in table 2.

Table 2. Level of compliance

Level of compliance	No. of banks	%
High compliance	15	55.56
Average compliance	8	29.63
Low compliance	3	11.11
Lack of compliance	1	3.70
Total	27	100

Source: own contribution

Table 2 shows that banks in Romania have a good level of compliance, although when the content analysis was performed, it was found that not all the information presented has the same degree of detail.

4. CONCLUSIONS

Understanding financial reporting and the fact that some banks are preparing financial reports to provide detailed information to investors in such a way that instead of providing all the necessary information, they hide them with skill, it can not be ignored the importance of transparency in financial reporting. The provision of transparent and useful information on market participants and their transactions is an essential component of an orderly and efficient market, as well as a prerequisite for imposing market discipline.

The provision of information is essential to promote the stability of the banking system.

Banks are encouraged to improve their internal information systems to develop a reputation for quality information providers.

In order to protect the interests of depositors and to ensure the stability and viability of the entire banking system, banks are prudentially supervised. The purpose of prudential supervision is to determine to what extent the governance framework, strategies, processes and mechanisms implemented by credit institutions and its own funds ensure prudent management and adequate risk coverage in relation to the credit institution's risk profile. In theory, there is no system or optimal scheme for bank regulation and supervision.

In reality, these regulatory and supervisory systems differ considerably from country to country. Banking prudence indicators are generally expressed in some reports and cover the main aspects of bank management. For European countries, banking prudence can be quantified by indicators such as: bank solvency, high risk factor, market risk adjustment ratio, financial participation level, minimum capital level. At each country level, there are own levels of ratios, as well as the liquidity ratio and the own funds ratio of the permanent resources.

Since 2009, the European Council has stressed the need to establish a "single European regulatory framework" applicable to all credit institutions and investment firms in the internal market.

Shaping prudential requirements in the form of a single regulation would ensure uniform conditions for all institutions, which would also increase confidence in the stability of institutions, especially in times of crisis.

The legal framework for supervision and prudential rules applicable to credit institutions and investment firms is made up of Directive 2013/36/EU on the access to credit institutions' activities and the prudential supervision of credit institutions and investment firms and of Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) no 575/2013. 648/2012, establishing uniform and directly applicable prudential requirements for all credit institutions and investment firms authorized in Member States of the European Union.

In our country, the central bank issued in this respect the Regulation of the National Bank of Romania no.5/2013 on prudential requirements for credit institutions.

This paper aimed to identify the degree of transparency for commercial banks in Romania, based on the reports they have overcome according to the regulations in force. The results of the study indicate that Romanian banks comply with the rules on presentation requirements, which means that regulators contribute to greater transparency and accountability.

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THE NEW BANKING MODEL – BETWEEN INTERNET BANKING ERA AND STRICTLY REGULATORY/LEGAL FRAMES

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Abstract
The internet banking technology represents nowadays for the financial institutions a great opportunity, but in the same time a greater threat. Internal and external regulators (National Banks or Central European Bank) are analysis these "new types of banking products" as a cyber risk - part of the global operational risk.
So, they want to have in mind a new idea of how the banks can establish security programs and comply with related requirements – which are more traditional than exploring the new technologies.
Apart from these threats, banks are in a "big problem", if we speak about non financial institution which compete directly with banks for loans, payment products, financial investments and so on. So they are thinking about two ways of getting out of this - either they adopt strategies and tactics to compete with this institutions, nor to get in partnership with them, in order to serve their own "I@skilled" customers and grow this part of market share.
Compared to traditional banks, the new "internet banks" must demonstrate the ability to innovate in more creative ways, for the new partners that appears from the "internet era" – here we speak about the E-generation which is very familiar with internet stuff and are very often bored with the products of traditional banks.
In the last years, regulators reviewed the governance of the banks, they supervise that process and through this, to avoid negative perspectives such as managing the risks in business lines and how those risks are being managed.
Keywords: *internet banking, cyber risks, new banking products, new regulatory frames.*
JEL Classification: G21, G23

1. TRADITIONAL BANKING ERA

Traditional banks were the financial depository institutions who offer checkable deposits and after that giving a personal loan – most of the time with mortgage guarantees.

All the traditional banks accept deposits (saving money) from people and make loans and they are also responsible for maintaining liquid checkable deposits that are used as money for the economy.

Lending activities can be performed either directly or indirectly through capital markets and due to their importance in the financial stability of a country, banks are highly regulated in most countries by national and international laws. In addition to regulations for ensuring their rate of liquidity, banks must apply minimum capital requirements based on international standards, known as the Basel Accords.

Banking began in the ancient world, with banks of merchants which made loans to farmers and traders who carried goods between cities - somewhere around 2000 BC in Assyria and Babylonia. Later, in ancient Greece and during the Roman Empire, lenders based in temples made loans and added two important innovations: they accepted deposits and they were changing money. There were found proofs of ancient banking in ancient China and India.

Banking in its modern sense appeared in the 14th century in Italy, but in many ways was a continuation of ideas and concepts of credit and lending from the ancient period. In the history of banking, a number of banking dynasties — notably, the Medicis, the Fuggers, the Welsers, the Berenbergs and the Rothschilds — have played a central role over many centuries. We must notice that the oldest existing retail bank is Banca Monte dei Paschi di Siena located in Italy.

Modern banking began in the 17th and 18th centuries, with merchants who started to store their gold with the goldsmiths of London, who possessed private vaults, and charged a fee for that service. In exchange for each deposit of precious metal, the goldsmiths issued receipts certifying the quantity and purity of the metal they held as a bailee.

The first one that began the permanent issue of banknotes, in 1695, was The Bank of England -known as the first national bank of country. By the beginning of the 19th century a bankers' clearing house was established also in London, which allows multiple banks to clear transactions - so this is the time that we can speak about the first steps for payments between banks.

2. THE NEW INTERNET BANKING ERA

Internet banking is an electronic payment system of the banks that let customers to make financial transactions through the financial institution's official website. The internet banking system will connect to the core banking system, and they will operate the clients operations.

Over time, bankers have started demanding more from their Internet Banking Solution -especially younger customers who are used to instant access to information (Agarwal *et al.*, 2009). Fortunately, there are now comprehensive, secure, high-performance Internet Banking Solutions available, that meet their many financial and personal needs. Customers are looking for added functionality in multiple areas - easy access to online statements enables customers to search for their transaction history and also helps deliver the proofs required to migrate to paper statement suppression – a key cost benefit to banks.

With modern internet banking applications you can also save the details of your payments in order to use for the future payments -that means you will save a lot of time then and you will be sure that you have the correct account number, name and so on.

The precursor for the modern internet banking services were the distance banking services from the early 1980s. The term 'online' became popular in the late 1980s and referred to the use of a terminal, keyboard and TV (or monitor) to access the banking system using a phone line. 'Internet banking' can also refer to the use of a numeric keypad to send tones down a phone line with instructions to the bank.

While financial institutions took steps to implement e-banking services in the mid-1990s, many consumers were hesitant to conduct monetary transactions over the internet. It took a lot of time and many efforts for the adoption of electronic commerce, based on internet banking, to make the idea of paying for items online widespread. By 2000, 80% of U.S. and EU banks offered e-banking.

The early 2000s saw the rise of the internet banking as a continue process of banks to go lower costs. Banks attract customers with lower fees for transactions – sometimes these costs are reduced even down to zero. They can implement such a system because they have no costs with employees.

3. RISK, COMPETITION & REGULATORY FRAMES ABOUT INTERNET BANKING

One of the most important challenges for Internet Banking refers to consumers' security (Gkoutzinis, 2006), and that has proven to be one of the biggest barriers in adopting Internet Banking.

Although internet banking can provide a number of benefits for customers and new business opportunities for banks, it came also with the traditional banking risks, especially security issues.

When we decide where to put our money, there are many options to consider, including credit unions, online banks and local banks. Each of these alternatives to standard international banks offers advantages, or disadvantages depending on our needs (Cronin, 1997).

Credit unions are financial institutions that are cooperatively owned by all members and democratically run by members who volunteer as board members. The members vote on issues like interest rates, and because these institutions are not for profit, account holders usually get better rates on both loans and savings interest. Online banks is another alternative to traditional banks, because online banks don't have to spend money on supporting locations, so they're able to pass on these savings to customers.

Local banks are vital for local business, and they function for loans and basic services. These types of banks are more flexible with loan requirements than big banks, and they based their lending services considering character, family history and discretionary spending in making loans.

If we talk about the risks, those of us who use online banking have probably become comfortable with authentication methods, and part of that workflow is being forced to use mobile apps developed by the banks themselves.

Using malware infections, it's entirely possible for a bank application to be compromised and to have your credentials stolen or intercepted. Even using something like two-faction authentication might not be enough to prevent this.

No matter how secure a bank's system might be, it will never be perfect — and there will always be someone who finds a way to exploit weaknesses.

No bank is ever safe from this kind of cyber attack - if a database exists, it can be stolen. It's debatable whether online banks are less secure than traditional banks, but everyone can agree that online banks are far from perfect.

Regulation of internet banking is a difficult matter because many regulations which were designed to regulate banks in the past might encounter some difficulty when they are viewed in light of an online banking service. Some of these regulations are primarily focused on elements of the bank that are physical, and therefore, would not apply to online banks. But some steps have been taken to ensure that some of the regulations put into place in the past do extend to cover internet banking.

Furthermore, banks operating by internet platforms have to comply with many of the most basic standards, including rules concerning the bank's role as an agent acting on behalf of customers (Aladwani, 2001). Regulations are also in place which would protect customers in online banking from wrongdoing their operations or fraud.

The primary methods of ensuring that an online bank is legal, is to prove that the bank has some level of validity to it and that its customers are protected from the bank's potential failure of operations.

When banking online, one of the primary concerns that may arise is that the customer's information is going out into the Internet, where some "bad guys" can stole it, and use the information of those individuals who perform online banking to break into those customers' accounts and steal large sums of money or doing a lot of transactions for their own profit. But online banking services work very hard to ensure customers' safety from attempts to penetrate their online privacy, as they are required to do under law.

This is because consumers are still protected from fraudulent uses of their bank accounts, and if the banks do make payments based on fraudulent authorizations, then the banks have to return the funds back to clients. As a result, banks implement stronger and stronger security measures for online banking in order to protect both themselves and their customers from attempts to steal information.

In addition to legal policies which ensure that banks have both a desire and responsibility to protect customers from information theft, there are legal policies which extend to the practices of online banking services which would protect customers from having their information given out, and used it by third parties.

4. TRADITIONAL VERSUS INTERNET BANKING

Although using a traditional bank might seem old-fashioned, there are certain advantages unique to banking with a financial institution that has physical branches. Knowing some of the benefits of using a traditional bank can help you decide if it’s a good solution for keeping and handling your money.

Whether you want a personal savings or checking account, trust fund, certificate of deposit or other operations, most major financial institutions can provide all these services in one place. Many traditional banks offer wealth management by private banking and investment services.

Many banks offer customers the flexibility of being able to walk into a branch to deposit cash or to transfer money via a smartphone. Despite all the progress, the industry still has to contend with a traditional form of currency: cash. For banking customers who deal with cash frequently, a traditional bank is an attractive and convenient option.

Traditional banks are notorious for their lower interest rates on savings accounts, compared with online banks. In fact, recent surveys show that the best savings accounts are the one made with internet banking applications. When we talk of a traditional bank, we think about banking fees which are greater than internet banking costs.

Recent studies shows us that one of the major downfalls of big banks is that they don’t understand customers’ needs and don’t provide personalized service. According to surveys, the top banks are on the last places of the customer satisfaction rankings, while smaller financial institutions with a smaller number of clients, help them gain insight into who’s banking with them and what those customers want.

Since 99% of the interactions with the bank will be through a website, online programs are complex, with plenty of features and a very fast response time, the operations are made immediately, at every hours from 00 to 24. As a result of this, anything you need to do can be done online at any time. If you feel like opening a new term deposit or a new account in the night, you can. You don't have to wait for a branch to be open, you don't have to drive to the branch, wait in line, and then fill out papers or meet with a banker.

While rare, it's not unheard of for the websites of to go down. In 2008, HSBC Direct suffered a technical failure that rendered its website inaccessible for quite some time and that happened also for ING Bank Romania in 2016, when the server collapsed while a maintaining process for server was tested.

Banking business was conducted as usual (deposits were registered, withdrawals were processed, etc.) but customers couldn't log into their accounts, and some of them couldn't pay with their credit cards.

On the other side, if we speak about a traditional bank there is something comforting about being able to go somewhere and talk to someone face to face. With internet banking, the relationship aspect of banking, which is most critical when dealing with loans, is gone.

If we speak about security, traditional banking is not so sensitive to e-security threats than the internet banking, which is a very tempting target for hackers. Security is one of the problems faced by customers in accessing accounts through internet.

The only security problem is with traditional banking employees which sometimes is exposed to internal fraud - and this is also a system problem - a non function in procedural or a one with weaknesses.

5. CONCLUSIONS

The future of banking is changing and not so predictable. With high interest rates, low fees and a propensity for digital technology, internet banking is successfully competing with traditional banks, forcing them to go on the same road of internet and mobile banking.

The recently published World Fintech Report 2017 by Capgemini, LinkedIn and Efma continues this tradition with chapter titles such as "In face of Fin Techs, traditional firms struggling to apply innovation". But a closer look at the data shows the picture is actually not that black and white. One of the main instruments of fear is the claim that millennials are not as loyal to financial institutions -this point has been shown in multiple surveys and articles.

Traditional banks are simplifying their organizational structure to reduce costs and are focusing on their core competencies, according to a recent report by Deloitte. In light of the rise of the financial technology — also known as Fin Tech — industry, startups, and online banking companies looking to exploit the weaknesses of large financial institutions, there's little doubt that the banking landscape must keep up with the changing times. The options in the financial sector don't mean that traditional banks are not a choice — it just depends on each customer's particular needs. Banks are adding internet and mobile banking, while continuing to provide the traditional services for most customers are used to, so that consumers can benefit from these changes.

Regarding the risks and compliance with legal frames, there is an idea of a new department which must watch the prescriptive requirements, the testing of these new products, and their vulnerability sides – the internet is a huge door to a lot of good purposes but also to hackers. This department can be a part of the compliance or audit teams, but with higher skills on informational threats. The hope came with the younger clients who use only this kind of products and they will use this modern instrument.

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MIFID II KEY REFORMS, OPPORTUNITIES AND LIMITATIONS: FROM A COMPLIANCE TO A BUSINESS CHALLENGE

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Abstract
This paper is focused on MiFID II implementation and on the business challenge that this process represents. In order to understand this significant reform of the European regulatory landscape and the direct and indirect implications for financial activities, we'll summarize, as the legislative process nears its conclusion, the main impact areas of the reforms for buy-side firms: market structure, organisational requirements and conduct of business rules for firms. After an examination of the steps of the process provided by MiFID II, we will identify its key reforms and their implications, with special reference to actual operations and to conduct of a business rules for firms and financial operator like asset managers, private bankers and independent financial advisors. We will try to discover which conduct should be putted in the field in the transition from a pure compliance vision to a business challenge approach.
Keywords: *MiFID II, buy-side firms, market structure.*
JEL Classification: K20, L10

1. BACKGROUND

One of the aspects of the crisis that has most transformed the financial sector is the wave of new national and supranational rules approved from 2007 to present: rules on systemic risk and the strengthening of capital reserves, issues of governance and control, markets and customer directives that are still being developed and implemented. The Markets in Financial Instruments Directive (MiFID), which came into force in 2007, represented the European Union's (EU) first attempt to regulate its financial markets (Directive 2004/39/EC of the European Parliament and of the Council). It introduced harmonised rules for authorisation, conduct of business and investor protection, competition between new categories of trading venues, and new requirements for transaction reporting in equities. The objective of MiFID II – references to MiFID II include the revision to the Markets in financial instruments Directive (MiFID II) (Directive 2014/65/EU of the European Parliament and of the Council) and the accompanying Regulation (MiFIR) (Regulation (EU) No 600/2014 of the European Parliament and of the Council) described in 2.1 of the present paper –

was largely to build upon this work and represents the first comprehensive enhancement to this regime. If MiFID represented a revision for the system that modified and regulated how to provide financial advice, MiFID II should be viewed as a natural continuation of the road that has been undertaken and strengthened by some principles, including greater transparency for savers in terms of costs and conflicts of interest. What is found in the new transparency obligations is a revolution in terms of point of view: the customer is made aware of the cost of the service offered in a transparent way and can then be able to evaluate and firs of all consider the value of the quality of the advice received. If MiFID II should have a positive impact on retail customers, all new business models that are developing or undergoing in redefinition. Looking at the changes introduced by the directive, the emphasis should be placed on two aspects: the customer becomes really central and evolved advice represents a distinctive service in a relation with the customer itself. This one can then benefit from his relationship with financial intermediaries properly trained and up-to-date consultants, and consultancy models will have to be able to provide a wider range of quality products with stringent selection processes.

The main structure of the MiFID II reforms is now in place, even though some of the implementing measures and supporting guidance from the European Commission (EC), the Financial Conduct Authority (FCA) (FCA, 2017) and UK government's economic and finance ministry (HM Treasury) are still awaited (HM Treasury, 2017). Within an appropriate timeframe prior to implementation day (3 January 2018), we will investigate MiFID II implementation planning in financial sector, including necessary revisions to compliance documentation and monitoring programmes. After a presentation of the status quo of the roadmap for the definitive implementation of MiFID II, this paper focuses on opportunity and risk elements in the perspective of progressive digitization of processes. From the impact of increased cost on profits to the refinement of advice (which corresponds to the need to face greater complexity) we will try to identify what and how many are the scenarios in which financial operators will act in the immediate future.

2. THE MiFID II PROCESS

2.1. Level 1

The EC first announced its proposals for the review of MiFID back in 2011. The primary legislation (known as "Level 1") consists of two linked instruments both of which "came into force" in July 2014:

- Directive 2014/65 on markets in financial instruments (MiFID II); and
- Regulation 600/2014 on markets in financial instruments (MiFIR).

Collectively, these texts are usually referred to as "MiFID II". MiFIR has direct force across the EU and hence does not require separate implementation in each member state. MiFID II – the Directive – must be transposed into each national jurisdiction's laws and regulations. MiFID II's original timetable has been delayed by one year, with national transposition now required by 3 July 2017, and the go-live date itself now set for 3 January 2018.

2.2. Level 2

This contains the often crucial, operational-level detail, which comes in two forms of implementing measures:

• Delegated acts – which are drafted by the EC on the basis of advice from the European Securities and Markets Authority (ESMA). These are only now being gradually rolled out (originally due mid-2015), broken down into Delegated Directives (DD) which must be transposed into the law of member states, and Delegated Regulations (DR) with direct force.

• Technical standards – which are drafted by ESMA and approved by the EC. These are further broken down into Regulatory (RTS) and Implementing (ITS) Technical Standards. The majority of these were published in September 2015, although the EC initially pushed back on a handful of issues for further consideration by ESMA.

Although both sets of implementation measures are subject to final ratification by the European Parliament and Council, the majority have now cleared this hurdle and further substantive changes to the remainder are now unlikely.

2.3. Level 3

Given the complexities and inherent possibility of inconsistencies in the implementation process, it is reasonable to expect a further round of guidance from ESMA closer to January 2018, probably supplemented by Q&As.

3. MiFID II: THE KEY REFORMS AND THEIR IMPLICATIONS

This section splits the reforms into three main areas, and under each issue we summarise the main reforms and also the significant implications for buy-side firms:

- Market structure;
- Organisational requirements for firms;
- Conduct of business rules for firms.

3.1. Market Structure

3.1.1. Transparency in equities and bonds

Key reforms

MiFID II greatly expands the existing pre- and post-trade transparency requirements into new equity-like and non-equity instruments.

Article 3 of MiFIR extends the pre-trade transparency requirements to equity-like instruments, such as depositary receipts, ETFs, and certificates, and Article 6 does the same for post-trade transparency. Article 4 concerns waivers for certain equity transactions (e.g. large orders and illiquid shares), and Article 7, the deferral of post-trade publication (all similar to the current regime for equities). Article 5 concerns the Volume Cap Mechanism which limits the volume of transactions dealt in dark pools. Waivers in a given share in each trading venue will be capped at 4% of the volume traded in the previous 12 months, and total trading in each share across all EU venues at 8%. The above structure is replicated for the non-equity instruments, where Article 8 extends pre-trade transparency to bonds, structured finance products, emission allowances and derivatives traded on a trading venue. Article 9 concerns waivers for these products, Article 10 post-trade transparency, and Article 11 deferred publication. RTS 1 contains the post-trade requirements for shares and share-related instruments executed on trading venues, with Annex I containing the data fields to be made public, including the list of flags to be attached (e.g. deferred publication) and information about the trading venue (e.g. quote-driven). RTS 3 sets out the technical standards for the volume cap mechanism.

Following the same pattern as above, Draft RTS 92 contains the equivalent for bonds, structured finance products, emission allowances and derivatives. Definitions of liquid markets are critical here as there are waivers for illiquid instruments with Annex III containing the liquidity assessment of each asset class. Responding to the EC's criticism of its original proposals, ESMA has accepted the recommendation of a four-year phase-in both in relation to determining whether a particular bond is "liquid" (as defined by the average number of trades per day) and in the setting of size thresholds for establishing waivers for "large" transactions. ESMA has however proposed that this phase-in be automatic and accompanied by its annual liquidity assessment, with the RTS only being amended to prevent the next stage of automatic phase in where liquidity has significantly declined.

Implications for buy-side

The new transparency regime has limited direct impact on the buy-side, but potentially major secondary effects to the liquidity of individual instruments and asset classes and, hence, the viability of many investment strategies. Clearly, any impact would be felt most by firms employing strategies which invest heavily in the equity-like and/or non-equity asset classes which are being brought within the transparency regime for the first time.

3.1.2. Trading venues

Key reforms

MiFID II refines the existing definitions of Regulated Markets (RM), Multilateral Trading Facilities (MTF), and introduces a new category of venue, the Organised Trading Facility (OTF). OTFs are mainly distinguished from MTFs in that the execution of orders on an OTF can be carried out on a discretionary basis (therefore, certain conduct of business duties to clients will apply) – see Articles 18-20 of MiFID II. Overall there are few differences in the obligations applying to these 3 types of venue.

The definition of a Systematic Internaliser (SI) is also being overhauled – a "firm which, on an organised, frequent, systematic and substantial basis, deals on its own account when executing client orders". The RTS specify how financial instruments are admitted to and suspended from trading on regulated markets, and the information to be provided by MTFs and OTFs to competent authorities.

Implications for buy-side

No direct impact but the intention behind the new OTF and amended SI concepts is to bring what were previously off-market broker crossing networks "into the light" with transparency requirements equivalent to other trading venues. Note also that the OTC derivative contracts now falling under the new trading obligation must be traded on an RM, MTF or OTF where there is sufficient liquidity. It should be considered how market counterparties are likely to adapt to the new venue categories.

3.1.3. Trading obligation for cleared OTC derivatives

Key reforms

MiFID II builds on the regulatory assault on OTC derivatives markets begun under the European Markets Infrastructure Regulation (EMIR). Article 28 of MiFIR establishes that the requirement to trade OTC derivatives on trading venues has equivalent scope to EMIR, namely any contract entered into by financial counterparties, non-financial counterparties above the clearing threshold and equivalent third country entities. Article 32 again mirrors EMIR in applying the trading obligation to classes of OTC derivatives subject to the clearing obligation, but introduces further liquidity criteria that must be satisfied. RTS 26 contains the detailed methodology for the timely acceptance for clearing of contracts, known as Straight-Through-Processing (STP).

Implications for buy-side

As well as dealing with the operational aspects of trading cleared derivatives on regulated venues, firms should consider the impact of OTC derivative markets effectively becoming a thing of the past in many asset classes.

3.2. Organisational requirements on firms

3.2.1. Internal functions (compliance, conflicts of interest, risk management and telephone recording)

Key reforms

Article 16 of MiFID II carries forward and refreshes the organisational requirements of the original MiFID which in turn are transcribed in the SYSC sourcebook of the FCA Handbook.

The most critical areas are:

• Compliance: an independent function with the necessary authority, resources and expertise to monitor and assess the firm's compliance with its regulatory obligations;

• Risk management: an independent (at least from portfolio management) function to identify the risks relating to the firm's activities, processes and systems and, where appropriate, set the level of risk tolerated by the firm;

• Conflicts of interest: effective arrangements to prevent, manage or disclose (in the last resort) actual or potential conflicts between the firm and its clients or between two or more clients;

• Product governance: appropriate controls over financial products that the firm has either "manufactured" or is distributing to ensure that these are consistent with the needs of the identified target market (similar to the FCA's Treating Customers Fairly regime);

• Record-keeping: adequate records of all services, activities and transactions undertaken by the firm. These must include the recording of telephones and electronic communications relating both to transactions and conversations "intended to result in a transaction". Note that the previous FCA exemption for discretionary investment managers relying on their brokers to record disappears under MiFID II. All such records must be maintained for five years (or seven, if required by regulator).

The prescriptive requirements for these and other organisational requirements are set out in Articles 21 to 29 of the relevant DR.

Implications for buy-side

Although there are few substantive changes to the existing SYSC requirements on firms, product governance (particularly for MiFID firms marketing funds on behalf of a third-party manager) and record-keeping/telephone recording are both areas where significant changes in arrangements are likely to be necessary. greatly expands the existing pre- and post-trade transparency requirements into new equity-like and non-equity instruments.

3.2.2. Inducements, dealing commissions and paying for research

Key reforms

Article 24 (8) of MiFID II prohibits investment managers from accepting "fees, commissions or any monetary or non-monetary benefits paid or provided by any third party". This imposes a total ban on inducements other than in relation to "minor non-monetary benefits", and was initially interpreted by many (including the FCA) as ending all dealing commission arrangements to pay for company research. After a protracted period of political debate, the EC finally published its proposals in its DD on "fees, commissions or any monetary or non-monetary benefit" in April 2016. Article 12 sets out a list of non-monetary benefits that are minor and therefore acceptable. These must be reasonable and proportionate and unlikely to influence the recipient in such a way that is detrimental to the client's interest, including:

- Basic information relating to a financial instrument or investment service (either generic or personalised to an individual client);
- Conferences or training events on the features of a specific financial instrument or investment service;
- Hospitality of reasonable *de minimis* value, e.g. food provided at a conference. Article 13 states that substantive research services can only not be an inducement (and hence allowed) if they have been paid for either:
- Directly by the firm out of their own resources; or
- From a separate Research Payment Account (RPA) controlled by the firm.

The RPA must be funded by a specific research charge to each client of the firm. The amount of funding must be determined by a research budget which must be set and regularly re-assessed in line with the perceived need for research. The firm must also make regular formal assessments on the quality of research received and whether it has actually contributed to better investment decisions. The specific research charge to each client must be based on the research budget as established by the stated need and must not be linked to the value or volume of transactions – in other words, a simple Commission Sharing Arrangement (CSA) is no longer allowed.

However, the text does allow for an operational arrangement whereby a research charge is collected alongside a transaction commission – in other words a "research commission" – but which contains a mechanism to revert to execution-only commission rates once the RPA is fully funded. Sometimes this arrangement is referred to as an "enhanced CSA.

Implications for the buy-side

These reforms for inducements and paying for research amount to a radical break from past practice. Alongside a rule on sell-side firms requiring them to split out execution commissions from "other benefits or service", they amount to an effective unbundling of receiving research "free" in exchange for commissions paid. Going forward, paying for research without some sort of "arrangement" in place between investment manager and broker would appear to be problematic. RPA's will also need to be set up in such a way that they do not amount to buy-side firms "holding client money" which would require a separate permission and an additional layer of compliance – a potential problem that may point towards a delegation solution.

3.2.3. Algorithmic and high frequency trading, and direct market access

Key reforms

MiFID II attempts to address concerns arising from the rapid pace of technology in financial markets and, in particular, the market integrity issues stemming from algorithmic and high frequency trading. Definitions are important in determining who is caught by the new requirements (Article 4 of MiFID II):

• Algorithmic trading: "where a computer algorithm automatically determines individual parameters of orders such as whether to initiate the order, the timing, price or quantity of the order or how to manage the order after its submission, with limited or no human intervention";

• High frequency algorithmic trading (HFAT): "an algorithmic trading technique characterised by… infrastructure intended to minimise network and other types of latencies… system-determination of order initiation, generation, routing or execution without human intervention… or high message intraday rates (at least two per second for an individual instrument, or four per second across all instruments traded on a trading venue)".

Article 17 of MiFID II requires all firms undertaking such activities to be registered with their home competent authority and that of the trading venue of which they are a member. Organisational requirements include systems and risk controls to prevent the transmission of erroneous orders or causing a disorderly market. These controls include non-live testing of algorithms prior to roll out (and periodically thereafter) and detailed systems requirements in relation to risk management, business continuity and outsourcing. The firm's home competent authority may, at any time, require the firm to provide details of the systems and controls it has in place and, in relation to algorithmic trading, a description of the nature of its strategies.

HFAT firms (a sub-set of algorithmic traders) are subject to additional requirements including retaining detailed records of their trading systems for at least five years and making these available to regulators upon request. HFAT firms using market making strategies may be caught by the requirement to participate in market making schemes with trading venues.

Article 17 also introduces a new layer of regulation for investment firms providing direct market access (DMA), requiring them to supervise their clients' activity to prevent disorderly trading and market abuse. RTS 13 specifies the detailed organisational requirements for firms engaged in algorithmic trading, and RTS 14 does the same for MTFs and OTFs. RTS 15 determines that a firm making continuous quotes for at least 30% of the trading day will be considered to be pursuing a market making strategy, and establishes the requirements for market makers and market making schemes.

Implications for the buy-side

The proposals amount to a shift in the burden of proof between regulator and firms, with the latter having to present positive evidence of their systems meeting integrity and resilience standards. Those caught by the new definitions face a significant additional layer of obligations and compliance monitoring. Firms using DMA providers are also likely to face significant changes to legal agreements, reflecting the greater responsibilities falling on DMA's to monitor the trading of their clients.

3.2.4. Third country firms

Key reforms

Although MiFID enabled EU investment firms to passport their services across the EU, it did not extend this treatment to non-EU firms, with each country left to apply its own rules to such entities. MiFID II introduced a harmonised framework of regulation for non-EU firms for the first time.

Article 39 of MiFID II establishes rules for third country firms providing services to retail or elective professional clients, requiring them to do so through an EU branch. Article 46 of MiFIR introduces a regime for third country firms providing services to per se professional clients and eligible counterparties which allows them to passport these services across the EU. Such firms will, however, be required to register with ESMA who will assent to passporting subject to the fulfilment of three conditions:

- The firm must already be authorised and subject to effective supervision in a third country;
- The EC must have adopted an equivalence determination for that third country;
- Cooperation arrangements must be in place between the EU and the third country.

ESMA will maintain a publically available register of all such registered third country firms (this is expected to be known as the Article 48 register).

Implications for the buy-side

The new rules for third country firms potentially amount to a significant opening up of EU financial markets particularly at the wholesale end. In practice, as we have seen with the Alternative Investment Fund Managers Directive (AIFMD sets out to ensure regulatory supervision of all EU alternative investment fund managers) marketing passport, much will depend on how effectively the equivalence assessment process works in respect of third country regimes.

3.3. Conduct of business rules for firms

3.3.1. Best execution

Key reforms

Article 27 contains the best execution obligation, including changing the requirement to take "all reasonable steps" to "all sufficient steps". As subtle as that re-wording would seem, this represents an enhancement to the position under the original MiFID, and will underpin the importance of looking to the relative importance given to the execution factors ('price', 'costs', 'speed' and 'likelihood of execution') as part of a firm's monitoring processes. It is likely that being able to demonstrate that best execution has been consistently achieved will become a significantly more burdensome exercise for firms, involving the recording and analysis of a greater volume of comparison data across markets and trading venues.

Also, firms must summarise and publish annually their top five execution venues in terms of volume and information on the quality of execution actually obtained, and enhance their execution policies and client disclosure, with a view to increasing transparency to investors. Not much has changed in respect of the enhanced best execution obligations from the text of the Delegated Acts over and above the Level 1 text and RTS. There is more emphasis placed on best execution obligations in respect of Securities Financing Transactions (SFT), making it expressly clear that, whether the order under contemplation will involve entering into an SFT is one of the criteria that firms should assess in determining the relative importance to be given to the execution factors.

Implications for the buy-side

The enhanced best execution obligation represents a major strengthening of a regime which, outside of the equities sphere, some firms have only just started to get to grips with. Compliance teams will need to engage with their front office to expand upon the detail contained within their order execution policies, outlining their execution strategy and approach across all relevant asset classes traded. Additionally, firms will need to reconsider the mechanics of their current trade surveillance process, to ensure that they encompass a sufficient breadth of currently available (and soon to be available) data for market / pricing comparison to facilitate monitoring of execution quality and the public disclosure element.

3.3.2. Transaction reporting

Key reforms

MiFIR broadens the scope of financial instruments caught by transaction reporting beyond equity instruments, and greatly increases the number of data fields to be reported. Under Article 26, transaction reporting will apply to all financial instruments admitted to trading on a trading venue, or whose underlying is such a financial instrument, or financial instruments based on a basket where at least one component of the basket is such a financial instrument. The currently exempted bond, interest rate, commodity and FX derivatives thus all come into scope, as do all instruments traded on MTFs and OTFs.

Trading venues also become responsible for all transactions executed through their systems by non-MiFID firms. Although Article 26 sets out the high-level requirements, the details of the new data fields are set out in RTS 22. These include Legal Entity Identifier (LEI) codes, any applicable waivers under which the transaction has taken place, short sales and the ID's of the individual trader or algorithm responsible for the decision to trade. Annex I of this RTS contains the table of fields, amounting to 65 fields in total.

The original MiFID carried an exemption for firms relying on a third party to make reports on their behalf which was interpreted broadly by the FCA to mean that discretionary investment managers can rely on their brokers (assuming they are MiFID investment firms) to transaction report. This exemption is only partially carried forward under MiFID II, introducing the concept of an investment manager "transmitting" an order to a broker for execution. Where this occurs, the transmitting firm may still rely on the "receiving" firm (the broker), but only where two conditions are fulfilled:

- A prior written transmission agreement between the transmitting and receiving firms; and
- The sending of certain specified details about the order to the receiving firm, including identifying the client or clients for whom the transaction has been made (if across a number of funds/accounts), the identification of the individual or algorithm who make the decision to trade, and execute it, and a designation to identify short sales.

Implications for the buy-side

Importantly for UK AIFMs, the FCA proposes to apply the new transaction reporting rules only to MiFID investment firms, and not extend them to managers of collective investment undertakings (including AIFMs and UCITS managers) or pension managers. The impact of this, should it carry through the FCA's consultation process, would be that UK AIFMs would not be subject to the transaction reporting regime under MiFID II. For MiFID firms, transaction reporting becomes much more onerous, and the delegation of reporting to executing broker more complicated.

3.3.3. Commodity derivatives reporting

Key reforms

Although commodities traded on spot markets remain outside the financial instrument definition, the scope of commodity derivatives is now very broad (see Annex I section C of MiFID II), including all contracts that are cash settle-able and all physically settle-able contracts traded on a trading venue. Emission allowances also now come into the MiFID definition. Existing exemptions for commodity firms narrow to non-financial firms whose trading activity is "ancillary" to their main business.

Article 57 of MiFID II establishes position limits (to be set by national competent authorities) for firms trading commodities and commodity derivatives, in order to support orderly pricing and prevent market abuse. Article 58 establishes the details of daily position reports that firms must make to trading venues on a daily basis. Trading venues are required to send this data to ESMA on a weekly basis and they in turn will publish aggregated data which distinguishes between commercial and financial firms.

In response to ESMA's RTS 21, the EC proposed lower position limits in some agricultural commodities to take account of the high volatility of such instruments. It also proposed greater flexibility in the use of open interest as a parameter to set limits in contract months other than the one closest to expiry and an expansion of the definition of Economically Equivalent OTC contracts which must also be subject to position limits. ESMA has responded to each of these issues with proposals to: lower position limits on commodities with foodstuffs as underlying to 2.5%; adjust position limits for other contract months where deliverable supply and open interest diverge significantly; and by widening the definition of contracts traded "OTC only" to prevent this being used as a means to circumvent the position limits regime.

Implications for buy-side

Daily position reporting will become a fact of life for any buy-side firm pursuing commodity based investment strategies. The intention is that the integrity of commodity trading should improve as market squeezes and other forms of manipulation become harder to effect without detection.

4. FROM A COMPLIANCE TO A BUSINESS CHALLENGE

Most of the provisions contained in MiFID are strengthened in MiFID II, for example: an enlarged scope of products and activities, a revised marketing and targeting process, more comprehensive client profiling, a broader definition of complex instruments, more detailed client reports and new pre- and post-trade reporting. All of these changes will bring further transformation to the banking and asset management industries, which must be compliant by the expected implementation date.

Out of the whole MiFID package, a single article has sent shockwaves throughout the industry: article 24, which prohibits the common practice of retrocessions (inducements) for discretionary asset management and 'independent' advice. Article 24 creates a huge difference between MiFID and MiFID II: while the first generated compliance costs, the second puts significant revenue at risk. In other words, MiFID was mainly a compliance matter for the financial industry, but MiFID II poses challenges for operators' revenue and thus their strategy and business model.

By end-2016, all 28 EU member states were on a level playing field, unless certain countries went for more stringent rules (gold plating). In the meantime, national regulators throughout Europe have already taken tough measures to either ban retrocessions or strictly limit them. Several countries, including the United Kingdom, Italy, Netherlands and Germany, already have requirements that go beyond MiFID II.

One of the most notorious changes to legislation is the United Kingdom's Retail Distribution Review (RDR), which came into effect on 31 December 2012. In particular, it bans commissions received by financial advisors from fund managers on all new products (including insurance products). Already after few months under the RDR regime, the effects were clearly visible, a number of institutions having withdrawn their advisory services from the mass market, believing that this offer would become unprofitable without retrocessions (Clare *et al.*, 2013).

4.1. Discretionary asset management

Discretionary asset management (DAM), i.e. the management of client assets under a mandate allowing the manager to buy and sell securities on behalf of clients without explicit client consent for each transaction, will be directly impacted by MiFID II. Banning inducements in DAM may remove a significant portion of the asset manager's revenue. In particular, retrocessions received from third-party funds will disappear. This may lead the asset manager to:

• Increase DAM fees transparently charged to clients, as far as the client agrees to pay them;

• Increase the minimum portfolio size to make DAM services economically viable, thereby excluding many investors from accessing affordable advice;

• Promote in-house funds, since buying third-party funds would not provide any advantage;

• Encourage clients to shift to non-independent advisory, where inducements are not banned.

4.2. Proprietary distribution

In principle, banks and asset managers with integrated distribution networks can be considered 'non-independent' because they tend to favour the sale of in-house products. However, such networks may also provide access to third-party funds, giving a veneer of independence.

Large banks and asset managers may, as far as possible, combine non-independent and independent advice inside their own distribution network, applying different remuneration models depending on the situation:

- non-independent advice organised more or less as it is today;
- independent advice with a strict ban on inducements and a revised remuneration model (developed later in this article).

This 'hybrid profile' scenario would have the advantage for banks of leaving the door open to retrocessions for all non-independent advice. However, banks would have to deal with increased operational complexity, since distribution models and the related remuneration of each service would depend on whether this particular service is provided on an independent basis or not.

4.3. Independent financial advisors

Independent Financial Advisors (IFA) are individuals or small- or medium-sized companies that do not belong to banking or insurance groups. Consequently, they do not have access to an internal distribution network.

IFA are generally remunerated by commissions received from third-party product providers. Their remuneration will therefore be directly impacted by MiFID II. The change will mean:

- IFAs will have to be paid by investors for the advice they provide, instead of receiving remuneration from product providers. They will need to demonstrate to their clients that their advice is of added value and worth the fee (lessons can be learned from the recent experiences in the United Kingdom and the Netherlands, and by looking at models in the United States where similar rules exist);
- Tough times for IFAs unable to revise their remuneration model and offset the loss of retrocessions;
- Assessing how legacy assets will be affected during the transposition period;
- Simplification of the product offering, where standardised/straightforward products will be preferred by investors because they are easy to understand and have lower management fees.

4.4. Private bankers

In a similar way to IFAs, private bankers will see their revenue decrease, since retrocessions often constitute a considerable portion of their remuneration.

The potential impacts may be comparable to those of IFAs. However, private bankers will generally be able to increase the advisory fees charged to clients, and so be less vulnerable than IFAs to the changes introduced by MiFID II.

4.5. Distribution platforms

Distribution platforms primarily offer a wide range of funds to buyers (e.g. sub-distributor, client advisor). Acting as an intermediary between the management company and the buyer, these platforms mainly receive remuneration in the form of retrocessions from management companies, which will be banned under MiFID II.

In order to survive, distribution platforms will need to revise their contracts and means of remuneration. In fact, their commission for enabling distributors to select funds according to the risk profile of clients is justified, however it is received (e.g. fees paid by investors instead of retrocession from the management company), and should be reconsidered.

The diversification of revenue sources will be necessary. Asset platforms can provide other ancillary services that can be charged for separately, such as investment advice (e.g. fund screening and selection, provision of factsheets), transaction management, risk reporting and other types of reporting, and analytical services. Going beyond a pure model of operating as a logistical hub, platforms will broaden their revenue sources and re-establish their position on the market.

5. TOWARDS A REVOLUTION OF BUSINESS MODELS

5.1. Independent or not: that is the first question

Since article 24 of MiFID II gives advisors the option to adopt independent status, there is a decision to be made. Opting for the status of independent advisor will be a strong commitment to giving up all kinds of retrocessions and advising on a wide range of financial instruments. An open question remains as to how much clients will value the independence of their advisor and how much they will be willing to pay at the 'point of advice' to benefit from independent advice. One answer to this question may be that the greater the wealth of a client, the greater his ability and desire to pay for real independent advice. This would mean that, on one hand, pure private bankers serving the HNWI segment would claim independence and increase advisory fees, while on the other hand, the mass market would be served by non-independent advisors guiding them through in-house products or third-party products with generous retrocessions. It should be noted that the definition of 'independent advisor' is to be clarified by ESMA, as part of the technical standards it will be working on over the next years.

5.2. New fee structures

Various fees are paid by the client to its bank and/or financial advisor. Some fees are straightforward and very transparent (e.g. account opening/closing fees, account maintenance fees, transaction fees, custody fees, advisory fees), some are less so (trailer fees, performance fees, finder's fees, soft commissions and other types of inducements). The objective of MiFID II is to shine a light on or ban most of the non-transparent fees listed above. The challenge for the sector will be to adequately re-evaluate its fee structure and find innovative and cost-effective solutions. As experience in the United Kingdom and the Netherlands has shown, new fee structures may include hourly rates, a percentage of funds invested and annual flat fees.

The main question sector players will have is: what additional costs will the customer be willing to pay, especially in times of economic crisis, low gross returns, mistrust in the financial sector and often an uncertain investment horizon? The task will be to measure the perceived value of advice and effectively market this service along with other ancillary services from which clients can benefit. Substantial investment in the revision of contracts and schedules, as well as staff training, will be needed before informing clients of the new arrangements.

5.3. Increased use of technology as a response to lower fees

One solution may be to provide an asset management service that is highly computerised, where the algorithm defines portfolio allocation based on a profile completed online, in a similar way to 'wrap' programmes. This would, admittedly, be less attractive than a discussion in a cosy living room, but may be more attractive for wealthy European clients in the retail rather than the (U) HNWI category.

Platforms such as Skype, Paypal, Amazon, Booking. com and many others have already revolutionised their respective industries and captured millions of clients. They have quickly proven to be efficient and cost effective. Will financial advisory become the new development area for platforms? For sure, those that can implement innovative solutions to target the mass market will win.

It is clear that many retail clients are now choosing not to pay for financial advice, instead opting to either use online platforms or go direct. This is a concern, not only for the advisors losing clients and assets under management, but also for regulators if they see that the number of retail clients investing directly without prior advice is growing. Furthermore, this could create unintended consequences such as poor tax planning, inappropriate liquidity and uninformed purchasing of products with high cancellation fees.

5.4. Changes in the product offering

A review of the service offering, business models and pricing may also be accompanied by changes in the product offering. Since the level of retrocessions will no longer be a differentiating factor, the focus of advisors will, more than ever, be drawn to the brand, product performance and costs.

Passively managed investment products may receive more attention. While they were disregarded by certain advisors because the products did not generate sufficient income to pay retrocessions, such products may now appeal to customers who object to paying advisory fees.

New share classes have emerged, as investment managers have had to develop clean share classes that strip out commission and platform fees. Despite the increased complexity introduced by the existence of multiple share classes, each with its own remuneration scheme, this method has the advantage of offering MiFID-compliant solutions for each type of service and client.

6. CONCLUSIONS

The times of hefty commissions or inducements being charged—directly or indirectly—to clients have definitely gone. The whole industry needs to question its current model. We expect small advisors or portfolio managers serving the mass affluent and making a living from opaque retrocessions to be the most impacted.

High-margin and complex products may be penalised by increased transparency requirements, whereas simple, low-load, passively managed funds might become more appealing to investors because of their low-cost structure. The emergence of clean share classes has come as a MiFID II-compliant response to the ban of inducements, leading to increased complexity in operations.

While MiFID was mainly a compliance matter for private banking, MiFID II calls into question strategies and business models. Although MiFID II will not be implemented before the end of 2017, the major implications are known and require action. Since changing a business model may take years, investment firms need to address these implications now.

An effective response to MiFID II may create new opportunities for the smartest firms to enhance their market position.

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THE SHADOW BANKING SECTOR IN ROMANIA

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Abstract
The discussions and studies around the 'shadow banking' topic have increased considerably in recent years, especially soon after the start of the most recent financial crisis. Current developments reveal that institutions belonging to the shadow banking sector are becoming more active. Moreover, the share of their assets in the GDP is increasing against a readjustment and some tightening in the traditional banking sector. There is strong evidence that this sector has grown in size and complexity in the last decade, either due to migration of some banking activities into the 'shadows' or the establishment of new non-bank operations (fostered by a low interest rate macroeconomic environment). Romania is not an exception from the EU and the global trend although, in its case, as the paper highlights, the shadow banking sector is small and simple. The current paper aims to unpack the 'shadow banking' concept and to provide a fresh perspective – mostly quantitative – into the level of development of this sector in Romania, since its earliest stages.
Keywords: *shadow banking, traditional banking, non-banking financial institutions, investment funds.*
JEL Classification: G21, G23

1. INTRODUCTION

Seen only as a complex and peculiar process of credit intermediation, which takes place outside the regulated banking system, 'shadow banking' can be traced back decades ago. However, it was the occurrence of the most recent financial crisis that shed light on the existing and growing system that comprises shadow banking entities and activities, as we know it today. The scholars from the Federal Reserve Bank of New York suggested that "the shadow banking system originated in the depths of the Great Depression of the 1930s with the creation of government-sponsored enterprises including the Federal Home Loan Bank system in 1932, the Federal National Mortgage Association (Fannie Mae) in 1938, the Government National Mortgage Association (Ginnie Mae) in 1968, and the Federal Home Loan Mortgage Association (Freddie Mac) in 1970" (*apud* Girasa (2016)).

The concept itself (i.e., "shadow banking") was first employed no more than a decade ago in a 2007 speech at the annual financial symposium hosted by the Kansas City Federal Reserve Bank in Jackson Hole (in Wyoming), by economist Paul McCulley. Soon afterwards, it was picked up by members of the academia and policymakers alike in their speeches and investigations on financial and banking related topics. Since then, the concept has acquired various and sometimes different definitions and interpretations to an extent that it poses practical difficulties, in terms of precision and usefulness.

The discussions and studies around the 'shadow banking' topic have increased considerably in the last years. Current research goes beyond theoretical debates and confirms that institutions belonging to the shadow banking sector are becoming more and more active. Moreover, the share of their assets in the GDP is increasing (making them a widely discussed phenomenon, especially in the US economy) against a readjustment and some tightening in the traditional banking sector. Romania is not an exception from the EU and the global trend although the share of assets of shadow banking institutions in the total banking sector is rather small.

The paper continues as follows: Section 2 provides a thorough analysis of the existing theoretical research on the topic (thus unpacking the concept), Section 3 offers an insight into the size and complexity of the shadow banking sector in Romania and foremost its implications on the well-functioning of the overall financial system and the economy as a whole (including comparisons with some EU countries, including from Central and Easter Europe), and Section 4 outlines the most interesting findings of the paper.

2. LITERATURE REVIEW

McCulley first used the term to describe "the whole alphabet soup of levered up non-bank investment conduits, vehicles and structures" (McCulley, 2007) and had mainly an US focus. Precisely these "conduits, vehicles and structures" (collectively, "special purpose entities" or "SPEs" – see Schwarcz *et al.* (2004) have engaged in liquidity and maturity transformation although they are not subject to traditional bank regulation and do not have traditional depositors whose funds are covered by insurance – placing them in the 'shadows' (Kodres, 2013). As we will find further on, the lack of public support as guarantees for the credits provided by shadow banks was also highlighted in the definition provided by Pozsar *et al.* (2010): "shadow banks are financial intermediaries that conduct maturity, credit, and liquidity transformation without access to central bank liquidity or public sector credit guarantees". Some of the first studies that focused on analysing shadow banking were performed soon after McCulley's proposal, such as the ones of: Pozsar (2008), Adrian & Shin (2009), Tucker (2010) etc.

The variety of definitions and interpretations of shadow banking is supplied not only by representatives of the academia (various scholars and researchers) but also by policy makers and institutional bodies alike (those that provide the regulatory and supervisory framework). Despite that, due to "the complexity, the wide range of activities and a small transparency of this [shadow banking] system" (Markiewicz, 2015), it is very difficult to establish a unanimously recognized and accepted definition of the concept. An interesting fact is that the majority of these viewpoints reveal a pejorative connotation – although firstly not intended –, or, as Girasa R.J. calls it, "a sinister development in the financial services environment" (Girasa, 2016).

Nonetheless, the concept is widely preferred because it "neatly captures the principle of inverse parallelism" (Lysandrou & Nesvetailova, 2015). According to this principle, particular activities performed by entities within the shadow banking system are, to some extent, *similar* to those conducted by regular banking institutions *and*, at the same time, *different* from them, in the sense that they fell outside the scope of regulatory supervision. One can notice the applicability of this principle in Bernanke's definition too: "shadow banking as usually defined, comprises a diverse set of institutions and markets that, collectively, carry out traditional banking functions – but do so outside, or in ways only loosely linked to, the traditional system of regulated depository institutions" (Bernanke, 2013). There are also some cases where the use of other terms such as "market-based financing" is preferred to "shadow banking" (FSB, 2013). In this respect, there is a strong emphasis on the sources of credit intermediation activities: market-funds rather than bank-funds, as also expressed in Deloitte's definition of shadow banking. To quote: "[s]hadow banking is a market-funded, credit intermediation system involving maturity and/or liquidity transformation through securitization and secured-funding mechanisms. It exists at least partly outside of the traditional banking system and does not have government guarantees in the form of insurance or access to the central bank." (Deloitte, 2012).

Among the first official (institutional) definitions of the concept was provided by the Financial Stability Board (FSB) in 2011, according to which shadow banking is "the system of credit intermediation that involves entities and activities outside the regular banking system" (see FSB (2011) or FSB (2012b)). A rather similar definition of the concept was provided by the US Financial Crisis Inquiry Commission (FCIC), highlighting also the "inverse parallelism" principle mentioned earlier by Lysandrou & Nesvetailova (2015). To quote: "bank-like financial activities that are conducted outside the traditional commercial banking system, many of which are unregulated or lightly regulated" (FCIC, 2010). Nonetheless, the FSB reconsidered its approach in the light that not all 'entities and activities outside of the regular banking system' presents the same level of risk to the traditional banking sector. The narrower definition referred to those specific 'entities and activities outside of the regular banking system' that "raise i) systemic risk concerns, in particular by maturity/liquidity transformation, leverage and flawed credit risk transfer, and/or ii) regulatory arbitrage concerns" (FSB, 2012a).

Table 1. Different definitions of Shadow Banking as classified by IMF

<table>
<tr><th></th><th>Activities</th><th>Entities</th></tr>
<tr><td></td><td>Unregulated or lightly regulated bank-like intermediation (FCIC, 2010)

Money market funding of capital market lending (Mehrling et al., 2013)
All financial activities, except traditional banking, requiring private or public backstop to operate (Claessens & Ratnovski, 2014)</td><td>Levered-up financial intermediaries with liabilities perceived akin to bank deposits (McCulley, 2007)
Maturity transformation outside banking social contract (Ricks, 2010)
Entities that conduct maturity, credit, and liquidity transformation without government guarantee or access to central bank liquidity (Pozsar et al., 2010; Pozsar et al., 2013)</td></tr>
<tr><td></td><td>Market-funded, credit intermediation system involving maturity or liquidity transformation through securitization and secured-funding mechanisms (Deloitte, 2012)</td><td>Nonbank financial institutions that behave like banks, borrow short, leverage, and lend and invest long in illiquid assets, but less regulated (Acharya et al., 2013)</td></tr>
<tr><td>Activities & Entities</td><td colspan="2">Credit intermediation involving entities and activities outside the regular banking system (FSB, 2013)
Provision of financial products and services by shadow entities and financial markets (Schwarcz, 2012)
Institutions, old contracts (repo), and more esoteric instruments (ABCP, ABS, CDO, and the like) (Gorton & Metrick, 2012)
Entities with liabilities supposedly redeemable at par but without a government guarantee, and instruments that trade as if they have a zero performance risk (Kane, 2014)</td></tr>
</table>

Source: IMF (2014)

While the FSB's view on shadow banking offers a beacon at a global level, some specific efforts are also made at a European level, specifically by the European Systemic Risk Board (ESRB). More than being in line with the definition provided by the FSB, ESRB uses a dual approach when looking for potential financial stability risks of shadow banking-type activities in the EU (ESRB, 2016). More specifically, ESRB is mapping and monitoring shadow banking threats that originate either from financial institutions ("entity-based approach") or from their activities ("activity-based approach"). The International Monetary Fund (IMF) also uses the same dual approach (activities vs. entities) to make a schematic summary of the different definitions of and perspectives on shadow banking up until 2014. Table 1 provides the mainstream definitions that fit in one of the three mentioned categories (oriented towards activities, entities or both). IMF proposes a new and interesting definition of the concept, based on non-traditional (noncore) funding. To quote: “financing of banks and nonbank financial institutions through noncore liabilities constitutes *shadow banking*, regardless of the entity that carries it out” (IMF, 2014). Regardless of the approach (activities vs. entities), shadow banking is more about redefining the economic paradigm in this regard, by repositioning the role of asset managers and traditional banks (Munteanu, 2016).

In the *Green paper* on shadow banking published by the European Commission (EC), the EU institution refers to “entities operating outside the regular banking system engaged in one of the following activities: accepting funding with deposit-like characteristics; performing maturity and/or liquidity transformation; undergoing credit risk transfer; and, using direct or indirect financial leverage” and to bodies that perform “activities that could act as important sources of funding of non-bank entities” such as securitisation, securities lending and repurchase transactions (EC, 2012a). Bank of Canada refers to shadow banking as a network of entities and markets that develop specific activities such as: “i) conduct or facilitate a chain of credit intermediation, ii) involve a material degree of maturity or liquidity transformation, and iii) are at least partly outside the perimeter of prudential regulation” (Chang *et al.*, 2016). Another working definition is proposed by the Assistant Director of the IMF’s Monetary and Capital Markets Department, according to which the shadow banking sector comprises “… financial institutions that act like banks but are not supervised like banks” (Kodres, 2013).

When attempting to delimitate the perimeter of shadow banking, Agresti (2016) recommends that this should be done by considering a dual prospective: a *macro* and a *micro* one. While the macro-prospective is generally employed in monitoring and macro-prudential policy needs, the micro-prospective is frequently used to “identify and analyse the risk characteristics of entities and activities that are de facto outside both the regulatory banking perimeter and out of scope of any supervisory requirements” (Agresti, 2016). Nonetheless, Broos *et al.* (2012) consider that given the lack of organization along national and sectorial lines, the perimeter of shadow banking is constantly changing and it is very difficult to fully capture it in regular statistics.

What most of the institutional definitions of the concept as well as the ones provided by the academia have in common is there extensive focus on the ‘flow perspective’ of the shadow banking system. A suitable example in this case is the short but to the point definition provided by Mehrling *et al.* who consider that shadow banking is simply “money market funding of capital market lending” (Mehrling *et al.*, 2013). According to Schwarcz (2012) there is a clear distinction between the flow perspective in most of the definitions and the stock perspective in some of them. If within the first branch of the literature, the focus is on the ‘activities’ as dynamic financial transformation processes, in the second branch the attention is on the 'products' as outputs of those processes. As such, the author defines shadow banking as: "not only the provision of financial products and services by shadow banks, but also the financial markets used to provide those products and services" (Schwarcz, 2012). Pozsar and Singh are also among the few authors that focus on the stock dimension of the concept by referring to financial products such as 'assets' or 'securities'. In this regard, they specify three key functions undertaken by shadow banks: reverse maturity transformation, collateral mining and liquidity transformation (Pozsar & Singh, 2011). On the same note, Claessens *et al.* (2012) outline that the two main functions of shadow banking are 'securitization' and 'collateral intermediation'. While the first function assures the creation of long-term safe assets for savers, the second one allows the reducing of counterparty risk.

Another interesting aspect that captures ones' attention is the changing spectrum of shadow bank's definition from a broader perspective (as the first attempts to define the concept such as the ones provided by FSB or FCIC) – one which 'casts the net wide' over all types of entities and activities (Agresti, 2016) – to a narrower one – which focuses especially on those specific elements that pose systemic risks. In another broader approach, the shadow banking sector comprises a "web of specialized financial institutions that conduct credit, maturity, and liquidity transformation without direct, explicit access to public backstops" (Adrian & Ashcraft, 2012). Gerding (2011) also emphasises the existence of a "web of financial instruments (asset-backed securities, credit derivatives, money market mutual funds, repurchase agreements) that connected commercial and household borrowers to investors in capital markets". These two last approaches commonly refer to some financial fragile bodies that are involved in channelling funds from savers to investors and that distinguish themselves from classical commercial banks. Gorton and Metrick are in line with the broadest definition and consider that shadow banking includes "familiar institutions as investment banks, money-market mutual funds, and mortgage brokers; rather old contracts, such as sale and repurchase agreements ("repo"); and more esoteric instruments such as asset-backed securities, collateralized-debt obligations, and asset-backed commercial paper" (Gorton & Metrick, 2010).

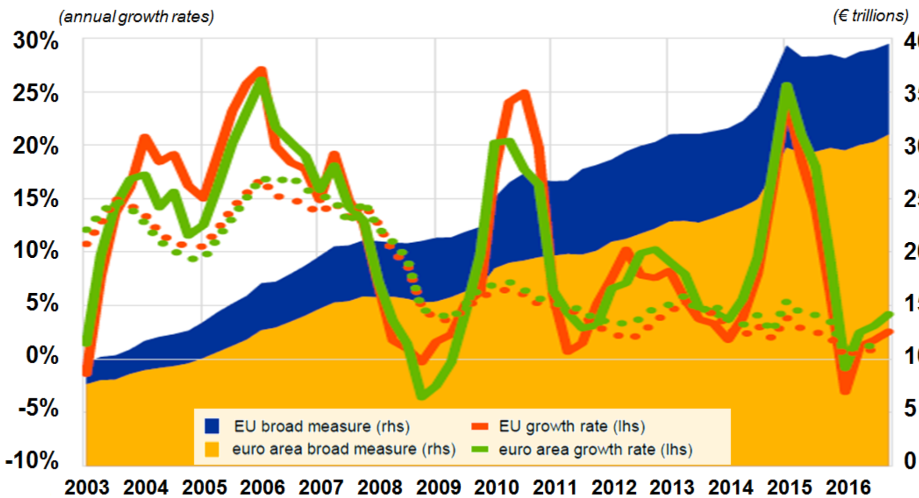
Narrowing down the focus of this definition given the variety of financial instruments included could prove to be very difficult (hence the lack of a unanimously recognized definition). In fact, some scholars consider that further association of shadow banking with repo markets ("a well-established instrument in financial markets since 1918, used by central banks, dealers and other regulated financial institutions") will not make the job less easy (Ursu, 2013).

3. THE SHADOW BANKING SECTOR DEVELOPMENTS IN ROMANIA

As recently has been pointed out in an ECB occasional paper (Doyle *et al.*, 2016), "the size and role of the euro area shadow banking sector within the euro area and global financial system has increased". And the source of growth of this sector (characterized by size, interconnectedness and opacity) seems to originate in the expansion of the non-bank and non-money market investment fund sector.

With regard to the European Union's shadow banking sector (comprising the total assets of investment funds, including MMFs, and other financial institutions or OFIs), economists estimated its size for the beginning of 2016 to almost 37 trillion Euros (ESRB, 2016), or 36% of the EU's financial sector (or approximately 250% of 2015 EU GDP). This amount has almost tripled when compared to the level registered in 2004 and mostly due to transactions and asset valuation as well as other effects (ESRB, 2016). According to the ESRB latest report (ESRB, 2017), the same broad measure of the EU shadow banking sector at the end of the fourth quarter of 2016 amounted to 40 trillion Euros, this representing approximately 38% of the EU's financial sector (or 272% of 2016 EU GDP). Moreover, the broad measure of shadow banking in the EU has expanded by 30% since 2012 (with a markedly slow in 2016 which was probably caused by a tempered growth in asset valuations backed up by decreasing of net transactions). By contrast, total assets of EU's credit institutions declined by 6% over the period 2012-16 (ESRB, 2017). The same development applies also to the shadow banking sector in the euro area (see fig. 1).

Figure 1. The shadow banking development in EU and Euro area (broad measure)



Source: ESRB (2017)

The main idea that derives from these numbers is that the EU shadow banking system (as well as the one from the Euro area) has grown in size, leverage and complexity in recent years (and foremost in terms of interconnectedness with the traditional banking sector) to an extent that now it forms an integral part of the EU regular financial system. This also advocates for the fact that the European shadow banking sector is not just a by-product of the American non-banking sector (which has been extensively researched as we have seen in the earlier section), but rather it has its unique and distinctive features. Jeffers & Plihon (2016) highlighted in their work the particular characteristics of the EU's shadow banking system.

The existing research on the shadow banking sector in Romania is limited. Some of the most visible research papers on shadow banking that look into the case of Romania are of the ones of Ursu (2013), Ghiță-Mitrescu & Duhnea (2015), Barbu *et al.* (2016), Ghiță-Mitrescu *et al.* (2016) and Munteanu (2016). There are also some authors affiliated to the National Bank of Romania (NBR) that have expressed their views on the existence and development of the shadow banking sector in Romania (e.g., Kubinschi, (2015b; 2015a); (Amza, 2012)). Overall, the existing works indicates a concern for studying the topic. Nonetheless, practice shows us that given the size and the current development of the shadow banking sector in Romania (relatively small and with a moderate pace), it seems that there are no immediate threats to financial stability, or the economy as a whole. On the contrary, Ghiță-Mitrescu *et al.* (2016) highlight the importance and benefits of non-bank financial institutions (shadow banks) for Romania's real economy.

NBR first tackled the shadow banking issue in the 2014 Financial Stability Report. Then, it highlighted the ongoing efforts made at international and European levels "to identify the main risks and to formulate recommendations for the shadow banking system aimed at reducing systemic risks and regulatory arbitrage" (NBR, 2014). In 2015, NBR considered that "although on the rise, the shadow banking sector in Romania is relatively small compared to other EU countries and its entities must comply with a regulatory and supervisory framework" (NBR, 2015). Two years later, NBR still admits its "rising importance" (NBR, 2017a) and the need to further monitor its evolution (in line with EU-wide concerns).

The NBR's approach in defining the 'shadow banking' concept is in line with the view of the Financial Stability Board (2011; 2012b). In other words, it includes non-bank financial institutions (NBFIs), investment funds (IFs) and money market funds – see NBR (2015) and EC (2012b). All these institutions have to comply with NBR's regulatory and supervisory framework. With regard to the market funds, although at the end of 2011, there were 14 such institutions, starting with February 2012 they were reclassified to other investment funds categories (Amza, 2012). At the end of 2015, only one money market fund remained and this with a low asset value. For this reason, when comparing the dynamics between NBFIs' total assets and those of the monetary funds, Barbu *et al.* (2016) noticed that the latter has recorded a gradual decrease in the post-financial crisis period. Considering all of the above, from here on, when referring to Romania's shadow banking system, we will refer strictly to its two representative components: NBFIs and IFs – an approach similar to the one of Ghiță-Mitrescu *et al.* (2016).

Although on the rise in the more advanced EU economies (an especially to the US economy, where the concept itself originates), shadow banking in Romania is "relatively simple" (Amza, 2012) and "relatively small" (NBR, 2015). It does not involve long, complex or opaque chains of intermediation. In fact, although it is big in numbers (see table 2), it is nonetheless quite small when analysing its assets, either as a share of the GDP (see fig. 2) or as a share in the total assets of Romania's financial system (see fig. 3). Its size pales even more when compared to other countries from Central and Easter Europe (see fig. 6) or from other regions of the European Union (see fig. 7).

Table 2. The structure of Romania's financial system (no. institutions)

Years	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	***2017***
Credit institutions	42	43	42	42	41	40	40	40	36	37	37
NBFI[1], of which	4502	4751	4742	5253	5489	5607	5767	5822	5915	5945	5947
▪*NBFI-general*	*218*	*238*	*228*	*210*	*203*	*187*	*173*	*170*	*172*	*177*	*147*
▪*NBFI-inventory*	*4284*	*4513*	*4514*	*5043*	*5286*	*5420*	*5594*	*5652*	*5743*	*5768*	*5800*
IF[2]	50	71	64	77	86	87	92	103	104	101	98
IC[3]	42	44	45	43	41	39	38	37	35	31	28
PPF[4]	25	23	25	22	20	20	18	17	17	17	17
SIF[5]	5	5	5	6	6	6	5	5	5	5	5
SSIF[6]	73	66	68	55	52	46	41	31	40	38	37
Insurance brokers	382	459	510	567	584	584	594	595	603	327	396

Notes: [1)] Non-Bank Financial Institutions (from the General Register and Inventory Register); [2)] Investment Funds (open-end bond funds and closed-end equity funds, including Fondul Proprietatea); [3)] Insurance Companies; [4)] Private pension funds (including Pillar II and III); [5)] Financial investment companies; [6)] Companies of financial investment services. The data for 2017 refers to the first trimester (March).

Source: author's elaboration based on data from NBR (2017b) and ASF (2017)

When analysing Romania's financial system, we can divide it into two general components:

a) the *banking financial sector*, which contains institutions that perform traditional banking activities (credit institutions);
b) the *non-banking financial sector*, where we could distinguish two main groups of institutions:

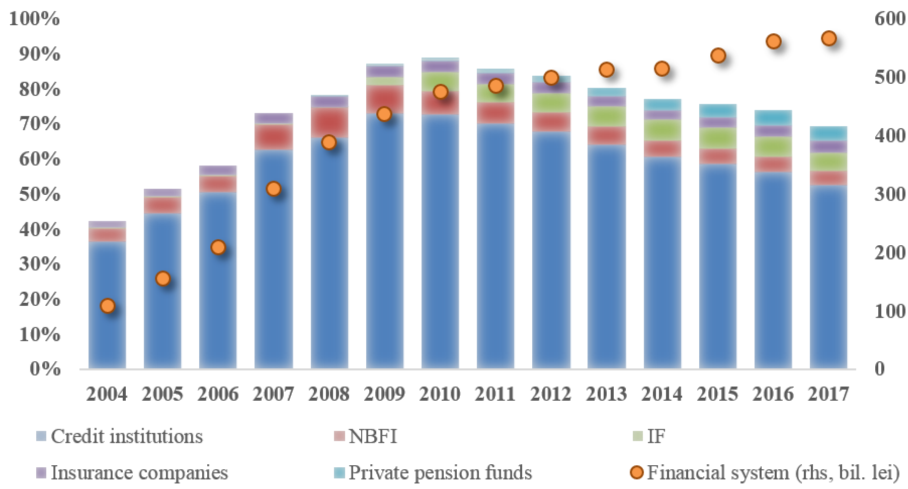
b_1) shadow banking institutions (the topic at hand), and we include here: non-bank financial institutions – those from the General Register as well as those from the Inventory Register – and the investment funds;

b_2) other financial institutions, with the following: insurance companies, private pension funds, financial investment companies and companies of financial investment services.

An analysis of the structure of Romania's financial system in terms of number of institutions, within the last decade, reveals a dominance of the non-banking financial sector (table 2). If the number of credit institutions has varied, from one year to another, by 1 entity in average (40 being the most dominant figure of Romania's traditional banking system), in the shadow banking sector the movements were much greater. In particular, NBFIs were set up or either were closed, in big numbers across the years, with a yearly average of 145 institutions in the analysed period. In absolute values, the most important changes were in the NBFIs' Inventory Register, whereas in relative values, the most visible shifts were in the NBFIs' General Register. Investment Funds were also set up and closed across the years registering a steady growth in numbers of institutions till the end of 2013, a stabilization in the 2014-1015 period and a slight decrease in the period afterwards. This was mainly due to the increasing numbers of open-end bond funds (these accounting for around 2/3 of all IF) accompanied by a continuous drop in the numbers of closed-end equity funds, especially after 2013. With regard the other financial institutions, their numbers are still beneath the EU average.

When looking into the structure of Romania's financial system in terms of assets as a share of the GDP, within the last approximately one and a half decade, we can notice that the traditional banking system, represented by credit institutions, is the predominant one (see fig. 2). A study performed by Deloitte Romania (2015) for the Council of Banking Employers in Romania highlighted that the post-communist period of development of the banking sector in this country can be divided into four main sub-periods, each characterized by a keyword: 1990-1998 (establishment), 1999-2003 (consolidation), 2004-2008 (expansion) and 2009-onwards (alignment).

Figure 2. The structure of Romania's financial system (assets-to-GDP ratio)

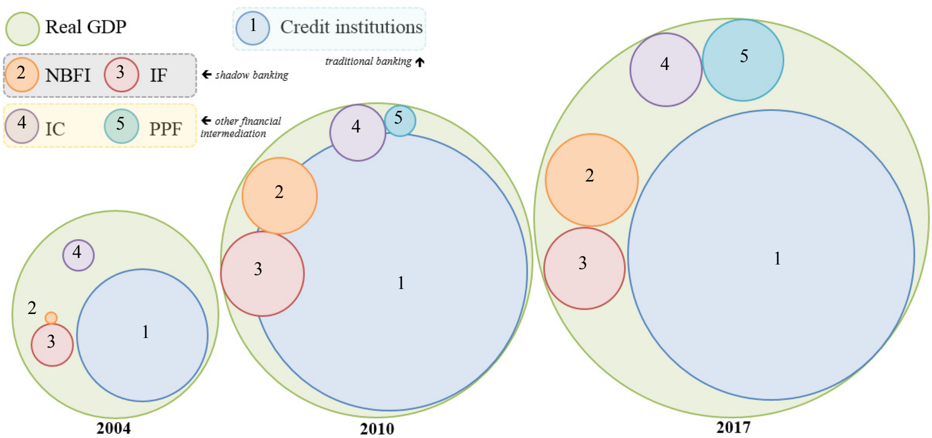


Source: author's elaboration based on data from NBR (2017b) and ASF (2017)

Figure 2 is in line with these findings confirming the expansion of traditional banking until 2009, when the total assets of the credit institutions in the GDP reached the pick of 73.1%. Soon afterwards, this ratio (assets-to-GDP) went on a downward slope reaching its current value of 52.5% (the total assets refer to the first quarter while the GDP of 2017 is forecasted). This moderate development of the traditional banking system (the increase of the marginal rise in the total assets of the financial sector being surpassed by the economic growth) occurs on the backdrop of a general decline in financial intermediation in Romania. Here, the deleveraging process is among the highest one in the EU after having recorded the fastest pace of decrease in the past four years (NBR, 2016) – see fig. 6 and 7.

A more visible differentiation in the banking system's development across 2004, 2010 and 2017 is provided in fig. 3. One can notice that while the real GDP has more than doubled in size (2.3 times to be precise) between 2004 and 2010, the total assets in the banking system quadrupled (4.3 times) – hence, the 'expansion' period. Seven years later, the real GDP slightly grew in size about 60% (between 2010 and 2017) while the total assets in the traditional banking system barely grew 10% – hence, the 'alignment' period, an alignment to the European requirements and practices. The good side of such a moderate development of the traditional banking sector in the last years is the strengthening of its resilience to better cope with destabilizing phenomena.

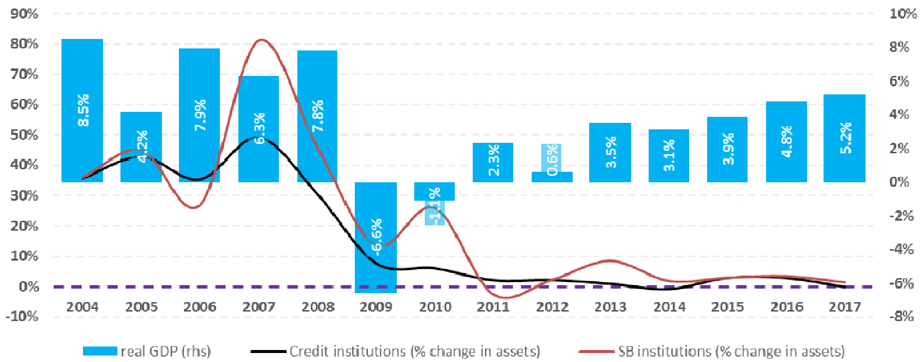
Figure 3. The total assets of the financial system components and economic growth in Romania in 2004, 2010 and 2017



Source: author's elaboration

With regard the evolution of the shadow banking system in Romania, we can notice an overall steady growth in the analysed period in terms of number of institutions (see table 2) and assets (see fig. 2) – although at various 'speeds' in certain times (see fig. 3). The overall non-banking financial sector grew over the entire period from a share of assets in the GDP of 5.7% in 2004 to an estimated figure of nearly 17% in 2017 (or from 13% to around 25% of assets in the financial system's total assets). In fact, as the total assets (in GDP) of the traditional banking sector started to decline (starting with 2010), the assets of non-bank financial intermediaries grew in size. Within the non-banking financial sector, shadow banking institutions grew impressively in the 2004-2010 period (see fig. 3) but these were soon afterwards caught up by the other financial institutions (insurance companies and private pension funds), in the 2010-2016 period. It is possible that the increase in assets of the shadow banking institutions (and especially NBFIs) was slowed down by the restriction of activity during the financial crisis (Ghiță-Mitrescu & Duhnea, 2015). Against the backdrop, the private pension funds grew significantly in the last decade most probably because of the increase in the number of participants, both in the mandatory private pension funds or Pillar II (from 4.2 million persons in May 2008 to around 7 million in May 2017) as well as in the voluntary pension funds or Pillar III (from 88 thousand persons in May 2007 to about 426 thousand in May 2017); the growth of the contributions is also one of the causes, Pillar II having registered an average monthly increase of around 2.03% (in the above mentioned period).

Figure 4. The dynamics of total assets in traditional banking vs. shadow banking (% change yearly) and economic growth, in Romania

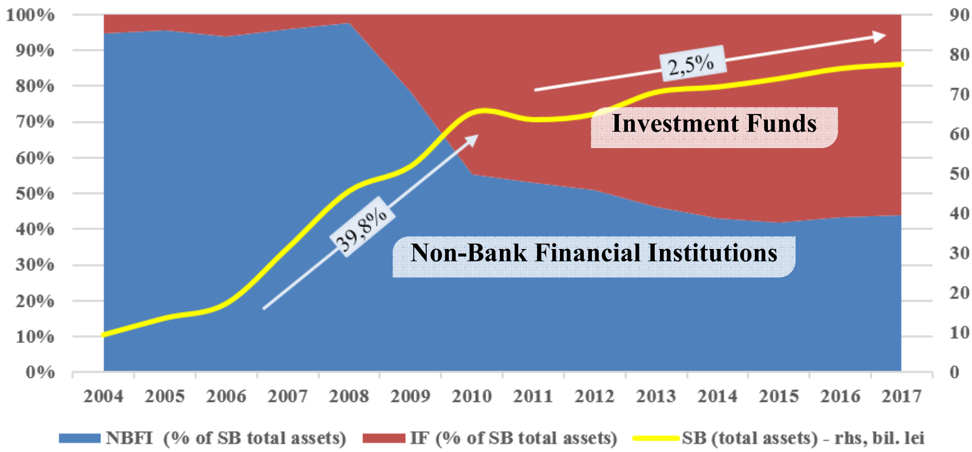


Source: author's elaboration based on data from NBR (2017b) and ASF (2017)

Another interesting fact could be noticed in fig. 4. The economic prosperity in Romania (within the 2004-2008 period) fostered the growth of traditional banks as well as the shadow banking institutions (as one can see in the yearly increases of their total assets). Nonetheless, as the real GDP decreased in the 2009-2010 period, these institutions reacted either by closing down (see table 2) or by slowing down the increase in the volume of assets. Of particular interest is the year 2008, when although there was a 7.8% increase in the real GDP, there was a tightening of the financial system, especially in the traditional banking sector (proving thus the sensibility and the fast reaction time of the financial channels to the general economic crisis, long before the economic channels). The figure also reveals that the traditional banking sector adjusts itself in an 'orderly' manner, while the shadow banking sector is more "untempered" (volatile), registering significant ups and downs in term of their total assets.

Within Romania's shadow banking sector the developments were very interesting, to say at least (see fig. 5). Up until 2008, the shadow banking sector was mainly defined by the NBFIs (in terms of total assets as well as in number of institutions). In fact, IF never surpassed the level of 5% in the shadow banking system's total volume of assets (in the 2004-2008 period). As the economic crisis started to show its presence, NBFIs began to lose ground while IFs grew in number as well as in assets. The harsh conditions that the population and companies were facing in the following period, made lending (via traditional or "shadowy" channels) either costly or inaccessible. In this context characterized by weak loan demand and poor portfolio quality, the quest for yield opportunities brought into the spotlight the investment funds as possible financial oases. If within the 2006-2010, period the shadow banking sector grew in assets in an accelerated pace (with an average of around 40% yearly increase), starting with 2011 this increase tempered down. In this context, the investment funds were the ones that fuelled the modest increase of the shadow banking sector's total assets of 2.5%, yearly.

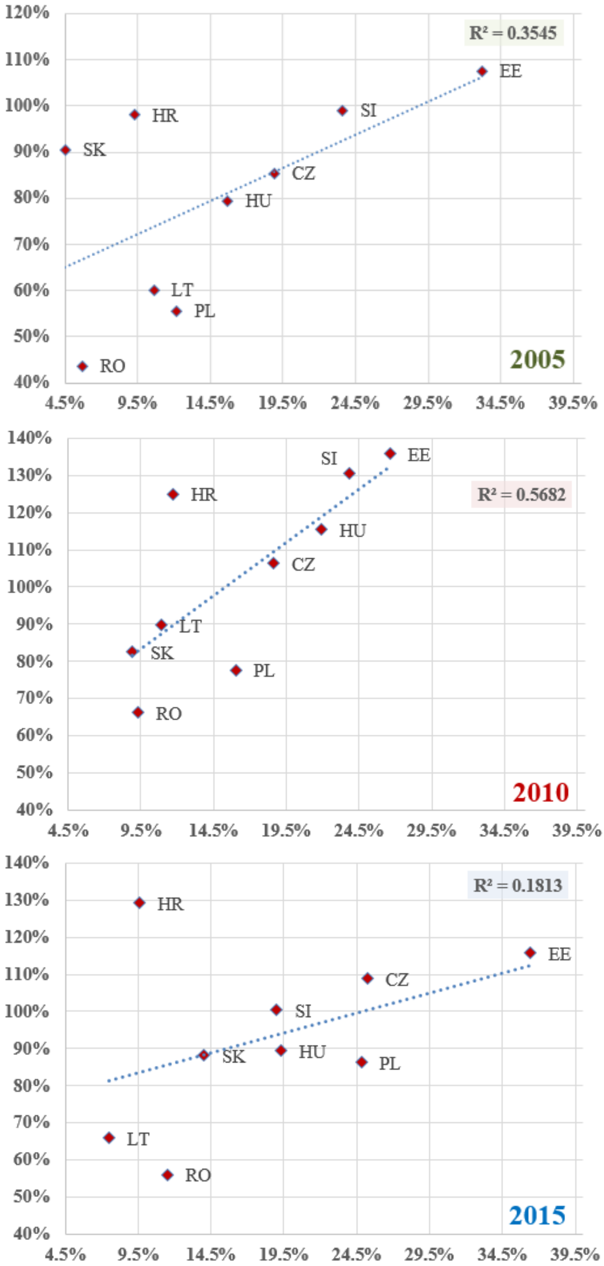
Figure 5. The developments within Romania's shadow banking system



Source: author's elaboration based on data from NBR (2017b) and ASF (2017)

Romania registers the lowest level of financial intermediation not only in Central and Easter Europe (see fig. 6), but also within the European Union (see fig. 7). When analyzing Romania's position within the CEE countries at a five year interval – within the last one and a half decade – with regard to the relative sizes of the traditional and shadow banking sectors one can notice that this tailed the rankings in all three situations. The year 2005 captures the growth in the leveraging process of all the analyzed economies. The prosperity within this period created the premises for a growth in the traditional banking system (more than in the shadow-banking system). Five years later (2010) most of the countries can be seen to have moved more vertically (reflecting an increase in the total assets of traditional banking) than horizontally. Nevertheless, as the economic crisis also hit these countries, shadow banking gained, in time, more ground in terms of total assets in the GDP, against a dropdown in traditional banking – hence the increasing concern of many international and EU bodies. The latest data available (2015) offers a clear proof that shadow banking is a real phenomenon in CEE and although it is rather small in size (when compared to traditional banking) it can take advantage of any imbalances in the traditional banking sector and attract yield seekers – of greater interest being the offer provided by IFs rather than of NBFIs.

Figure 6. Relative sizes of traditional and shadow banking sectors in CEE countries

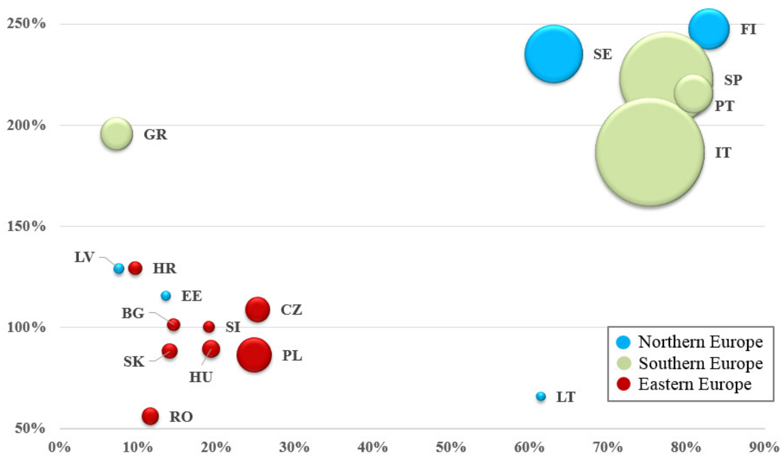


Note: Shadow banking total assets to GDP ratio is on the X axis while traditional banking total assets to GDP ratio is on the Y axis

Source: author's elaboration based on data from EUROSTAT (2017)

The latest data available (2015) shows clearly that Romania is in line with the deleveraging process that takes place both in the euro area as well as in the CEE countries. Within this ranking, Romania holds the lowest level of financial intermediation. More than that, it has one of the smallest financial systems in EU. In fact, this last feature is a representative one for almost all Eastern European countries (see fig. 7).

Figure 7. Relative sizes of traditional and shadow banking sectors as well as absolute sizes of national financial system in the EU, 2015



Note: Western Europe was excluded given the very high levels of financial intermediation behaving as outliers and distorting the figure. Cyprus and Malta (SE) as well as Denmark (NE) were excluded for the same reasons. The bubbles' sizes represent the volume of total assets of the national financial systems (in billions of euros).

Source: author's elaboration based on data from EUROSTAT (2017) and categories set up in accordance with the EU's official multilingual thesaurus EuroVoc (2017)

With regard to the EU countries from Northern Europe, these seem to have almost equal proportions of traditional vs. shadow banking sectors (with a slight inclination towards the last one). Lithuania is the single country that distinguishes from the others by having a more evolved shadow banking sector than the traditional banking sector. The Southern Europe countries from EU are almost all in the same group with the exception of Greece which has not only the smallest financial system (in terms of total assets) but also the smallest shadow banking sector in the EU, with a ratio of 7.2% share of assets in the GDP. Heterogeneity is thus the keyword that characterizes all three clusters of European countries – with outliers in all the groups (proving that geographical clustering is not a solution to analyze the data).

4. CONCLUSIONS

This paper provides evidence that not only we are struggling to define "shadow banking" – the existing literature offers a variety of definitions and theoretical approaches, at times contradictory, that claim to fully grasp the meaning of shadow banking (see Section 2) –, but we are also putting a lot of effort into gauging its size, complexity and foremost its implications on the well-functioning of the overall financial system and the economy as a whole (see Section 3). This paper builds on the existing limited research on shadow banking in Romania and offers a fresh perspective – mostly quantitative – into the level of development of this specific sector, since its earliest stages, against the evolution of the traditional banking sector and the national financial system, the progresses in the real economy (*via* the nominal and real GDP) as well as with regard to the EU's correspondent components.

The current analysis reveals the existence of a small and simple shadow banking sector in Romania. We believe it to be small in size given its' relatively low current share of shadow banking assets in the GDP (when compared to the share of assets in the Romanian traditional banking sector or to the share of assets of other shadow banking sectors in the EU) or in the financial system's total assets. Its simplicity is given by the lack of long, complex and opaque chains of intermediations – a specific feature of the more advanced economics – that were replaced by short and relative transparent intermediation chains built on a small (but growing nonetheless) and regulated number of financial institutions (the Romanian entities must comply with a regulatory and supervisory framework).

Another interesting finding is that, in the period that followed the most recent financial crisis till nowadays, the Romanian traditional banking sector kept losing ground to the shadow banking sector, in terms of assets-to-GDP ratio. The significant structural adjustments that the banking system is going through in the recent years prompted a slower dynamics of the total assets in nominal terms compared with the higher growth of the economic activity. Against this backdrop, NBFIs and IFs especially kept an uprising trend in terms of their cumulative assets percent in GDP, reaching around 10% in total. As within other EU countries, Romania's shadow banking system continued to expand in the recent years, entailing a slight rise in the share of the sector's assets in total assets of the financial system. Either because of the current low interest rate macroeconomic environment (which encourages the search for yield) or of the increasing demand for assets (especially from IFs as well as from the other non-bank financial institutions), one thing is clear: shadow banking is on the rise and it has the ability to adjusts itself in a much faster manner then the traditional banking sector.

Despite its increasing importance and size in the Romanian financial system, shadow banking continues to play a secondary role next to the main character: the traditional banking sector. It is its recent development that calls the attention of policymakers and requires a close monitoring. There are concerns at EU level about the potential risks that might stem from this sector, but the NBR considers that in Romania the systemic risks are relatively low (although on the rise). It is more probable that these will be generated *via* the adverse spillover effects from other shadow banking systems.

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Section III

EU FINANCIAL REGULATION AND ADMINISTRATIVE AREA

THE SYSTEM FOR TRADING GREENHOUSE GAS EMISSIONS CAN REDUCE ENVIRONMENTAL IMPACT IN A TRANSBOUNDARY CONTEXT

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Abstract
Awareness is growing that stopping climate change requires a shift towards building a low-carbon society that would provide substantial opportunities and ensure continued economic growth and sustainable development.
The implementation of the system of institutions, legal and procedural instruments established for trading greenhouse gas emission will contribute to balanced decision-making at the macroeconomic level, thus contributing to protection of the environment and public health; to minimizing the environmental impact of economic activities (such as in energy sector, industrial production, operation of transportation, fossil fuel burning in the institutional, commercial, residential sectors, in agriculture, forestry and fisheries, in industrial processes and products use, in agriculture, land use, land-use change and forestry and in waste sectors). There is no doubt that expenditure for combating negative consequences is much greater than expenditure for prevention of environmental pollution.
The analysis of national legislation allows highlighting a number of its elements which, to some extent, are specific to more efficient monitoring, reporting and verification of greenhouse gas emissions; however, these elements, as separate items can't reduce greenhouse gas emission, do not allow assessment of their application taking into account the provisions of the UNFCCC, the Kyoto Protocol, the Paris Agreement and the EU decisions adopted thereunder.
Keywords: *sustainable development, climate change, greenhouse gas emission, trading of emission*.
JEL Classification: K32, K 33, Q 25

1. INTRODUCTION

In order to address the concerns about the growing threat of global climate change resulting from increasing concentrations of greenhouse gases in the atmosphere, to honour the commitments undertaken by signing the United Nations Framework Convention on Climate Change (UNFCCC) (ratified by Parliament Decision no. 404-XIII of March 16, 1995), the Kyoto Protocol (Moldova joining by Law no. 29 of February 13, 2003) and the Paris Agreement

(Moldova joining by Law no. 78 of May 04, 2017), concentrations of greenhouse gases in the atmosphere should be stabilized at a level that would prevent dangerous human-induced interference with the climate system; to achieve this objective, the overall increase in mean annual temperatures at the surface should not exceed the pre-industrial levels by more than 2°C. The duty of the global society to achieve this objective is dependent on an accurate knowledge of emissions trends, and on our collective ability to alter these trends.

2. DEFINING DANGEROUS CLIMATE CHANGE

The question of which impacts might constitute "dangerous human-induced interference with the climate system" has recently attracted a lot of attention, but the literature on the problem remains deficient. By the opinion of Dessai *et al.* (2004), it is not possible to make progress on arriving at an operational notion of climate change danger or in developing the sustainable responses without recognizing the central role played by perceptions in defining "danger".

The Convention (UNFCCC) does not attempt to define the concept of dangerous interference with the climate system because precise statements of what is "dangerous" are not possible since a) the degree of harm from any level of climate change is subject to a variety of uncertainties and b) the extent to which any level of risk is "acceptable" or "dangerous" is a value judgement (Sanden & Azar, 2005, pp. 1557-1576).

Generally, the interpretation of "dangerous" is relative and contextual rather than absolute. What is dangerous in an actual situation is, in the end, often determined by a society`s capacity to cope with and to adapt to climate change. To add to the complexity, danger can be interpreted externally by objective measurements such as actual loss of physical property, or internally by perceived danger and subjectively experienced fear (Dessai *et al.,* 2004). If a society`s adaptive capacity is low, even minor climate changes might entail danger (Jerneck & Olsson, 2008, pp.170-182).

As long as no specific measures are taken for calculations of global trends and application of measures for reducing anthropogenic emissions, the concentration of greenhouse gas of anthropogenic origin will continue to grow in the atmosphere, thus contributing to enhancing the greenhouse effect and to additional danger warming of the atmosphere.

Zahran describes global climate change as a tragedy of the commons because, with the absent of coercive leverage to coordinate individual and group interest in use/ abuse of the common pool resource of climate, it is rational for an individual country to defect and ride the efforts of others (Zahran *et al.,* 2007, pp. 37-55).

Furthermore, future stabilization of concentrations of greenhouse gases in the atmosphere is a dynamic process involving the combination of scientific knowledge (factual and normative criteria), social values, political priorities in reduction strategies and economic forces for developing in a sustainable manner.

In this context, the national monitoring, detailed reporting and periodic assessment of greenhouse gas emissions is of great significance, along with evaluation of the efforts of Conference of the Parties to tackle climate change.

3. OBLIGATIONS OF THE REPUBLIC OF MOLDOVA IN THE FRAMEWORK OF THE CONVENTION ON CLIMATE CHANGE

During the Conference of the Parties to the UNFCCC, Decisions 1/CP.15 and 1/CP.16 were adopted, which contributed significantly to the achieved progress in addressing the challenges of climate change in a balanced manner. Those decisions have introduced new monitoring and reporting requirements that apply with regard to the implementation of ambitious emission reduction strategies, and propose provision of financial support to developing countries. The Decision 1/CP.16 calls for Signatory Parties to the UNFCCC to develop strategies or plans for low carbon emission development. It is expected that such strategies or plans will contribute to transition to a society with low carbon emissions and ensure continued high growth and sustainable development, as well as achievement of cost-efficient progress in terms of reaching the long-term climate objective, taking proper consideration of the intermediate stages.

Article 5 (1) of the Kyoto Protocol requires the Parties to establish and maintain a national system for estimating anthropogenic emissions by sources and removals by sinks of all greenhouse gas emissions not controlled by the Montreal Protocol, with a view to ensure the implementation of other provisions of the Kyoto Protocol.

Under the UNFCCC, the Signatory Parties have committed to develop, regularly update, publish and report to the Conference of the Parties the national inventories of anthropogenic emissions by sources and removal by sinks of all greenhouse gas emissions not controlled by the 1987 Montreal Protocol, on substances that deplete the ozone layer - to the Vienna Convention for the Protection of the Ozone Layer, using comparable methodologies agreed by the Conference of Parties. Parties have also committed to report periodically information on policies and measures in respect to climate change, as well as their projected effects on GHG emissions. The establishment of systems for monitoring and reporting of projections, combined with better guidance on reporting, will significantly contribute to achieving these objectives.

It is necessary that the each Party provides improved information in view of monitoring progress and undertaken actions on adaptation to climate change. Reporting of information on adaptation will enable the country to share the best international practices and to assess funding needs for adapting to climate change and preparedness needed to address adaptation to climate change at national, sectorial and local levels, including by attracting external funding through the UNFCCC mechanisms as provided for developing countries (Global Environment Fund, Adaptation Fund, Green Climate Fund, etc.).

The Environmental Authority of the Republic of Moldova need to create the Draft Government Decision on Establishing and Operation of the National System for Monitoring and Reporting Greenhouse Gas Emissions and Other Information Relevant to Climate Change in order to create the legal framework to strengthen the institutional capacities and to ensure the monitoring of all anthropogenic emissions of greenhouse gas emissions by sources and removals by sinks in respect to gases which are not controlled by the 1987 Montreal Protocol, to assess progress in fulfilling the commitments on relevant emissions and to comply with reporting requirements under the United Nations Framework Convention on Climate Change (UNFCCC), the Kyoto Protocol, the Paris Agreement and decisions adopted based on them.

By this draft of Governmental Decision, both Article 5 (1) of the Kyoto Protocol, and the Decision 1/CP.16, as well as relevant provisions and decisions taken under UNFCCC, calling for the establishment of national institutional arrangements for achieving these provisions, will be complied with.

In addition, Decision 1/CP.16 also provides for a new technology mechanism to enhance international technology transfer. This Governmental Decision aims at ensuring reporting, based on the best available data, updated information on activities concerning transfer of technologies to mitigate GHG emissions and adapt to climate change by industrially developed countries.

A number of technical elements related to reporting of emissions by sources and removals by sinks in respect to greenhouse gas emissions, such as global warming potentials, the scope of reported greenhouse gas emissions and methodological guidance from the IPCC to be used to prepare national greenhouse gas inventories, are currently being discussed under the UNFCCC process. Revisions of those methodological elements in the context of the UNFCCC process and subsequent recalculations of the time series of greenhouse gas emissions may change the level and trends of GHG emissions. The Environmental Authority of the Republic of Moldova, through the Climate Change Office, will monitor such developments at international level and, if necessary, will propose revising this Governmental Decision to ensure consistency with the methodologies used in the context of the UNFCCC process.

The Environmental Authority of the Republic of Moldova should follow the implementation of the monitoring and reporting requirements under this Government Decision, as well as future developments registered under UNFCCC, Kyoto Protocol and the Paris Agreement in order to ensure consistency.

4. MOLDOVA AND THE EUROPEAN UNION

While improving the legislation of the Republic of Moldova in view of its harmonization with the European Union legislation, the optimal solution for fulfilling the provisions of the Association Agreement the Republic of Moldova - European Union, (specifically referring to Article 77, letter g) of Chapter 14, “Cooperation in Energy Sector”, which provides for cooperation of parties in reducing emissions of greenhouse gases; art. 87, letter l) of Chapter 16, “The Environment”, which provides for cooperation of parties in systems for monitoring and information in the environmental area, art 93, letters a)-f) of Chapter 17 "Climate policies" which provides for cooperation of parties in mitigation of climate change, adaptation to climate change, trade with certificates of carbon dioxide emissions, research, development, demonstration, implementation and dissemination of technologies with low carbon dioxide emissions that are environmentally safe and sustainable, as well as technologies for adaptation to climate change, mainstreaming climate issues in the sectorial policies and in activities for awareness building, education and training, Art. 95, letters a)-i) of Chapter 17 "Climate policies", which provides for cooperation of parties in development and implementation of a Climate Strategy and an Action Plan for long term mitigation of climate change effects and adaptation to them, of assessments in respect to climate change vulnerability and adaptation to climate change, of a national strategy for adaptation to climate change, of a low carbon development strategy, of some long term measures for reducing greenhouse gas emissions, of some measures aiming at preparing for trading with carbon dioxide emission certificates, of measures for technology transfer based on an assessment of technology needs, of some measures aimed at mainstreaming climate considerations in sectorial policies as well as measures on ozone depleting substances) and in view of partial transposition of the Regulation (EU) No. 525/2013 of the European Parliament and of the Council of May 21, 2013 on a mechanism for monitoring and reporting greenhouse gas emissions and for reporting other information relevant to climate change at national and Union level and on repealing Decision No. 280/2004/EC (JO UE nr. L 165/18.06.2013), the adoption of a regulatory document establishing a mechanism for monitoring and reporting of greenhouse gas emissions and reporting at national and international levels of other information relevant to climate change would be appropriate.

The pressing need to develop the said Decision of the Government is seen in provisions of the Action Plan for implementing the Environmental Strategy for 2014-2023 approved by Decision of the Government No. 301 of April 04, 2014 (Official Gazette of the Republic of Moldova no. 104-109 of May 06, 2014), which provides for short-term priority actions in adaptation to and mitigation of climate change.

The content of the international norms largely coincides with the Regulation (EU) No. 525/2013. Given this fact, we can state that the harmonization process of the Moldovan legislation with the EU legislation in respect to implementation of a mechanism for monitoring and reporting greenhouse gas emissions, allows for concurrent improvement of the national legislation, taking into account the principles of the United Nations Framework Convention in Climate Change, the Kyoto Protocol, those of the Paris Agreement and the relevant decisions of signatory parties of the Convention.

5. ANALYSIS OF NATIONAL LEGISLATION

The analysis of national legislation allows highlighting a number of its elements which, to some extent, are specific to more efficient monitoring, reporting and verification of greenhouse gas emissions; however, these elements, as separate items, do not allow assessment of their application taking into account the provisions of the UNFCCC, the Kyoto Protocol, the Paris Agreement and the decisions adopted thereunder.

The current Law on Environmental Protection (No. 1515-XII of June 16, 1993) provides for a general obligation of the Central Environmental Authority regarding compliance with bilateral and international agreements, ensuring monitoring and public awareness building on the state of the environment, Art. 15.

We shall underline the pressing need to adopt a new version of the Law on Environmental Protection that would facilitate strengthening legal regulation in the area through special provisions in the following aspects: bases of the environmental information system; regulating climate change aspects and creation of the national system for inventory of anthropogenic greenhouse gas emissions by sources and removals by sinks, respectively establishing reporting systems and requirements for collecting data on fluorinated greenhouse emissions in the relevant sectors.

Item 27 of the Action Plan for implementation of the Environmental Strategy for the years 2014-2023 approved by Government Decision No. 301 of April 24, 2014, provides for institutionalization of the protective functions of forests, soil, air and climate change in the system of environmental protection.

The need to develop a national inventory of GHG emissions is mentioned in the Action Plan for establishing an energy statistics system approved by Government Decision No. 141 of February 24, 2014, Chapter 2.1 letter h) and respectively, Chapter 1.2, Action 6.4, Work Package 8.

Activities on data collection and processing of primary and aggregated data, data storage, dissemination of statistical information, submission of statistical data to international bodies are generally regulated by Law No. 412 of December 09, 2004 on Official Statistics.

Objectives related to mitigating greenhouse gas emissions are stipulated in several national regulatory acts including the National Development Strategy "Moldova 2020", the Energy Strategy of the Republic of Moldova up to 2030, the Law on Energy Efficiency, the Law on Renewable Energy, the National Strategy for Waste Management for 2013-2027 and others.

6. CONCLUSIONS

The national law comprises no provisions governing the relations in assessment of projection and mitigation policies related to anthropogenic greenhouse gas emissions by sources and their removals by sinks.

Moreover, no specific provisions exist in the national law regarding the management of the national inventory of greenhouse gas emissions, the procedures for selection of estimation methods and emission factors needed to estimate greenhouse gases emissions, procedures for data processing, archiving and storage, procedures for reporting the National Inventory under the Kyoto Protocol, Regulation (EU) No. 525/2013 and the Paris Agreement.

The development of the draft Government Decision was also conditioned by the need to promote state policies in harmonizing national legislation with EU legislation and to implement international agreements to which the Republic of Moldova is party, including in environmental protection and by the need to promote policies aimed at ensuring the transition to a low carbon society and sustainable development and working out a mechanism for monitoring and reporting of greenhouse gas emissions.

The short-term purpose is to bridge the existing regulatory gap in establishment of a timely, transparent, accurate, consistent and full monitoring and reporting of anthropogenic greenhouse gas emissions by sources and removals by sinks, in respect to greenhouse gases which are not controlled by the Montreal Protocol under the UNFCCC in order to reduce greenhouse gas emissions, as well as to project national greenhouse gas emissions beyond 2020.

The long-term purpose is to contribute to transparent and accurate monitoring of the actual and projected progress at national level regarding fulfilment of long-term commitments to limit emissions of anthropogenic greenhouse gas in the context of needed up to 80-95% reductions as compared to 1990 levels by 2050 as required according to IPCC.

Awareness is growing that stopping climate change requires a shift towards building a low-carbon society that would provide substantial opportunities and ensure continued economic growth and sustainable development.

The implementation of the Government Decision will contribute to balanced decision-making at the macroeconomic level, thus contributing to protection of the environment and public health; to minimizing the environmental impact of economic activities (such as in energy sector, industrial production, operation of transportation, fossil fuel burning in the institutional, commercial, residential sectors, in agriculture, forestry and fisheries, in industrial processes and products use, in agriculture, land use, land-use change and forestry and in waste sectors). There is no doubt that expenditure for combating negative consequences is much greater than expenditure for prevention of environmental pollution.

Republic of Moldova is highly vulnerable to climate variability and change. The impacts of climate change on agriculture are of particular concern – agriculture is a major source of income in the country, where more than half the population lives in rural areas and about one third of the labor force is employed in agriculture.

During the period 1984-2006, Moldova's average annual economic losses due to natural disasters were about US$61 million, or 2.13 percent of national GDP. More recent events have had a significant impact: the 2007 and 2012 year droughts caused estimated losses of about US$1.0 billion (MDL 12 billion) and US$0.4 billion (MDL 5 billion); the 2008 floods cost the country about US$120 million. The most recent floods in 2010 are estimated to have had an adverse economic impact on GDP of about 0.15%, with total damage and losses estimated at approximately US$42 million (Ţăranu, 2014, p.8).

The socio-economic costs of climate related natural disasters such as droughts, floods and hail are significant and both their intensity and frequency are expected to further increase as a result of climate change.

According to a range of studies, including the National Human Development Report (2009) and the Third National Communication (TNC) under the United Nations Framework Convention on Climate Change (2016), the impacts of climate change are expected to intensify as changes in temperature and precipitation affect economic activity.

The estimated impact of the approval of the Government Decision will be substantial, since it will introduce priorities for mitigating GHG emissions in the following sectors: agriculture, energy, waste and industrial processes, as well as in sectorial, branch and territorial strategies, plans and programs and can encourage emission reductions, allow to use European trading of emission (EU-ETS) allowances to help achieve emissions reduction targets.

Connection of Moldova to the EU-ETS shall be seen in the framework of Moldova's agenda for cooperation and, possibly, its future accession to the EU. Connection of Moldova to the EU-ETS will be consequential to this policy. Therefore, the following is recommended:

- Adoption of the legislative framework and administrative body on emissions trading is a key condition for starting of an ETS and its linkage to the EU-ETS;
- Moldova shall to adopt all instruments which aim to implement commitments under UNFCCC, including an inventory of installations and their GHG emissions, the establishment of a registry and provisions for monitoring,

verification and reporting. Upon a decision of the Moldovan Government to implement an ETS and to link to the EU-ETS, negotiations shall start shortly;

- Improving the competitiveness of the Moldovan industry and energy sector is key for successful linking to the EU-ETS;
- These provisions will be implemented in case of approximating Directive 2003/87/EC of the EU Parliament and Council of October 13, 2003 on establishing a system for trading greenhouse gas emissions allowances within the Community.

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LIABILITY OF THE MANAGEMENT BODIES OF THE DEBTOR INSOLVABILITY

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Abstract
The legal relations between the director and the company have a double relation: contractual and legal, insofar as they refer to obligations arising from the mandate or to obligations incumbent to the director according to the law. The double legal nature of the civil liability of the directors expresses itself both against the company and against third parties. Contractual liability, mainly against the company is when it arises from breaching the mandate or the provisions of the articles of incorporation or, even more importantly, if it refers to breaching the law referring to the mandate of the directors, while the liability is delictual when it refers to breaching other binding provisions of the law (mainly against third parties). Besides the civil liability, the director can be liable under the criminal law for his deeds during the exercise of his duties. The civil liability does not exclude the criminal liability for deeds such as: crime of mismanagement, deceit by issuing uncovered cheques, dilapidation, simple or fraudulent bankruptcy, tax evasion, forgery. As sanctions against the persons found guilty for the insolvability of the debtor, the special law provides for the disqualification of the debtor if it is found that the debtor has contributed, by his fault or by negligence, to the occurrence of his own insolvability, the guilty may be deprived, by decision of the insolvability court on the cessation of the proceedings, of his right: to be elected or appointed in public office or to continue to hold such office.
Keywords: *insolvency and bankruptcy, civil liability, damage caused by guilt, patrimonial liability.*
JEL Classification: K33, K12, F53

1. INTRODUCTION

An extremely important aspect of the law regulating the insolvency and bankruptcy is the regulation of the sanctions that can be given to the management bodies of the debtor in bankruptcy. These sanctions are very important when applied in practice, for this Law to be understood not only as a legal means to discharge the bankrupt debtors from their liability. The practice confirmed, in the absence of the application of such sanctions, the possibility for the companies that cannot fulfil their obligations towards the creditors, especially when this is willingly caused by the management and administration bodies of the debtor, to legally close the business, without any liability.

In the Romanian legislation, for example, the liability is civil and, as the case may be criminal. The wrongful deeds committed by the directors of the debtor company or by its management bodies may incur their patrimonial liability, in order to cover the debts of the company.

According to art. 169 paragraph (1) in the Law no. 85/2014, "Upon the request of the insolvency administrator or of the liquidator, the receiver may order for the liabilities of the debtor, a legal entity in insolvency, to be paid by the members of the management and/or supervising bodies of the company wholly or in part, as well as by any other persons having contributed to the insolvency of the debtor, by one of the following deeds (...)" (Ţăndăreanu, 2015, pp. 30-31).

2. LEGAL NATURE OF THE LIABILITY OF THE MANAGEMENT BODIES OF THE DEBTOR IN BANKRUPTCY

The liability for the debtor, legal entity, being in bankruptcy is, as the case may be, a liability in tort or a contractual liability, being classified as such depending on the nature of the committed deed. The request for the incurring of the patrimonial liability may be mainly filed by the insolvency administrator or by the liquidator, or, under special circumstances, by the creditor holding more than 50% of the amount of the receivables included in the creditors list, through a proxy – who may be the President of the Body of Creditors or any other appointed creditor. In the absence of the standing to bring proceedings, the request for incurring the liability, even if grounded, shall be rejected (College Decision civil, commercial and administrative jurisdiction of the Supreme Court, case no. 2ri-314/16 from 23.12.2016).

As it is an action based on liability in tort, the request shall comply with the general admissibility conditions regulated by the Civil Code: existence of the damage; existence of the illicit deed; existence of the causal relation between the illicit deed and the prejudice; existence of guilt.

In the legislation of the Republic of Moldova, the relevant provisions applying to the liability of the members of the management bodies of the debtor is the article 247-249 in the Law 149/2012. Thus, members of the management bodies of the debtor may be: the debtor, individual person, doing business individually as an entrepreneur, founder of the individual enterprise or of the farm (business of a farmer), directors of companies, members of the executive bodies, members of the supervising bodies (observers), liquidators and members of the liquidation commissions, accountants.

According to art. 5 (5) letter f) in the Law 149/2012, the court has the competence to judge the personal liability of the management bodies having contributed to the insolvency of the debtor, as well as to refer the matter to the criminal investigation bodies as concerns the reprehensible deeds they have committed.

The matter will be referred to by the court *ex officio*, otherwise, if it is referred to by a creditor there is no justification, given the legal possibility for the latter to file a complaint if he knows there are certain deeds, the insolvency procedures suspending only the civil matters against the debtor in insolvency.

Thus, if, during the judgement of the case certain persons to whom the occurrence of the insolvency of the debtor can be imputed, the court may decide, upon the request of the insolvency administrator/liquidator, for part of the debts of the insolvent debtor to be paid by the members of its management and/or supervising bodies, as well as by any other person having caused its insolvency by one of the following actions:

a) use of the assets or credits of the debtors in their personal interest;

b) doing business in their personal interests, under the cover of the debtor;

c) fictitious increase of the liabilities of the debtor and/or diversion (hiding) part of the liabilities of the debtor;

d) procuring funds for the debtor at exaggerated prices;

e) keeping fictitious accounting records or records breaching the law, as well as contributing to the disappearance of the accounting documents and of the incorporation documents; Art. 248 al. (1), letter. e) modified by **LP160 from 07.07.16, OJ 306-313/16.09.16 art.647**

f) instructing the continuity of the business of the debtor which obviously leads it to insolvency;

g) instructing, in the month prior to the ceasing of payments, to preferentially pay one creditor to the detriment of the other creditors;

h) non-submission of the request to initiate the insolvency procedure, according to the provisions of art. 14;

i) committing other actions that damaged the property of the debtor.

Art 27 (4) in the form amended through the LP160 on 07.07.16, O.J. 306-313/16.09.16, art.647, it is stipulated that whereas the members of the management bodies of the debtor do not correctly supply the information and documents, they can be held liable, under subsidiary patrimonial and/or criminal or contravention liability, in the manner stipulated by law, and the insolvency administrator shall recover, to the highest possible extent, the information and/or documents, the expenses being collected from the account of the guilty persons.

By comparison, in the Romanian legislation, the receiver (competent court) may order, upon the request of the liquidator, for the liabilities of the debtor, legal entity, to be paid wholly or in part by the members of the management and/or supervision bodies within the company, as well as by any other person having contributed to the state of insolvency, through one of the following deeds, provided for, in a limited manner, under art. 169 paragraph 1 letter. a – h in the Law no. 85/2014:

a) They used the assets or credits of the legal entity to their own interest or to the interest of third parties;

b) They carried out production, trade or service provision business in their personal interest, under the coverage of the legal entity;

c) They instructed, to their personal interest, the continuation of a business which was obviously leading the legal entity towards ceasing the payments;

d) They held fictitious accounting records, made some accounting documents disappear or did not hold the accounting records according to the law;

e) They diverted or hid part of the assets of the legal entity or fictitiously increased its liabilities;

f) They used ruining means to procure funds for the legal entity, in order to delay the cessation of payments;

g) in the month prior to the ceasing of payments, they paid or instructed the preferential payment to one creditor, to the detriment of the other creditors;

h) Any other deed wilfully committed, which contributed to the insolvency of the debtor.

Independently of the amount of the liabilities, the liability of each person is limited by the damage caused by guilt, through its individual deed or under a collective deed, a guilt whose existence must in the first place be proven and in subsidiary that it is intentional. The enumeration of the deeds incurring the liability for the liabilities of the debtor, legal entity, is limited, without being susceptible of extension.

In the judicial practice in Romania, the solutions of the jurisprudence were to reject the requests to apply the provisions of art. 138 paragraph (1) in the situations where the following deeds were invoked: improper management, failure to pay the relevant taxes, not making the appropriate diligence for the fulfilment of the obligations in the administration mandate, failure to record certain debts to the state budget in the accounting books; takeover of certain debts as a result of the division, particularities of the company business, elimination of the state subsidies; insufficiency of the funds required for investments, impossibility to reimburse the contracted loans; the contract partner imposing prices below the production costs, which led to losses impossible to cover; intermittent business, depending on the requirements of the competitive market, correlated to the lack of sufficient equities.

Another example is the regulating system in France, where the liability of the members of the management bodies can be extended over its partners or over third parties, i.e. an external liability based on the provisions of art. 1382 in the Civil Code (Vidal & Cesare, 2015, p. 400). The French law, as the Romanian practice, excludes the management errors from sanctions, provided that such errors should not involve fraud (the French jurisprudence offered examples of fraud bringing about criminal convictions: giving loans or advance payments to the debtor for other purposes than its business (Revue de Droit bancaire et financier, no. 6, Novembre, 2010, p. 92, note Legeais), interference in the management of the debtor or providing disproportionate guarantees. At the same time, the accountants, accounting experts or shareholders influencing (by majority) the business of the company, even if they do not have administration duties, can be held responsible for the liabilities of the company if they are found guilty of causing the bankruptcy of the debtor.

The lawmaker establishes a *presumption of guilt* as ground to engage the liability of the surveillance and control bodies of the debtor as concerns the illicit deeds listed in the frame law for this special procedure regulated by the Law 149/2012, as well as a presumption there is a cause-effect relation between the deed and the prejudice, the debtor being in charge to demonstrate the contrary. Of course, the provisions of the special insolvability law shall be completed with the general provisions of the delictual civil liability.

The volitional factor in delictual matters consists of the will of the perpetrator to commit the illicit deed, to choose a conduct contrary to the law, that is the guilt of the perpetrator is related to a deed which comes in conflict with the will of the lawmaker, breaching the obligations stipulated by him, thus the psychic attitude of the perpetrator of the illicit deed is analyzed starting from the objective elements of the liability. The issue of the objective liability is rather controversial, some authors supporting the solution of the subjective-objective ground, proposed in the legal doctrine for the cases of so-called objective liabilities to strengthen the idea of guilt – as a factor generating the legal liability. The literature outlines the close connection between the four elements of the delictual civil liability.

The literature also provides for opposite opinions. It mentions, for example, that the guilt of a legal entity cannot be reduced to the guilt of its collaborators, but represents the guilt of an entire group, collectively. Indeed, the qualities of a group cannot be reduced to a simple sum of the qualities of its components, but the guilt of the legal entities against the outer factors cannot express itself otherwise than by the guilty behavior of its collaborators (Ilana, 2015).

3. LIMITATION OF LIABILITY

When we refer to sanctions, we are speaking of those that can be imposed to the statutory administrator for the causes that have led or contributed to the insolvency of the debtor until the opening of the insolvency procedure. We shall not refer to the liability of the insolvency administrator during the insolvency period or of the special administrator as representative of the shareholders, persons having duties subsequent to the period we are now considering.

Another civil liability of the management bodies of the debtor in insolvency is also incurred for the passivity in submitting a statement of claim in the cases and within the deadlines stipulated by law, art 14 (4) in the Law 149/2012 under paragraph (3). According to art 15 (1) the executive bodies or the persons entitled to give mandatory instructions for the debtors, or who can influence in any other manner the actions of the debtor (wilful insolvency) bear joint subsidiary liability against the creditors to the extent where the assets of the debtor are insufficient to enforce the receivables of the creditors, which is also a civil liability.

According to art. 14 paragraph (1) in the Insolvency Law, the debtor must submit a statement of claim if there is one of the grounds stipulated under art. 10. The paragraph (3) of the same article stipulates that the debtor must submit a statement of claim immediately, but not later than 30 calendar days after the occurrence of the grounds indicated under this article, paragraph (2) and under art. 10 paragraph (2). According to paragraph (4) of the same article in the Insolvency Law, unless the debtor submits a statement of claim in the cases and within the deadline stipulated under this article, the person who, according to the legislation in force, is entitled to represent the debtor, the shareholders with unlimited liability and the liquidators of the debtors are liable in subsidiary against the creditors for the liabilities occurring after the expiry of the term provided for under paragraph (3). According to art. 248 paragraph (1) letter f) in the Insolvency Law, the subsidiary liability of the member of the management or supervising bodies, entitled to instruct the continuation (or cessation) of the activity of the debtor may be incurred only if the future business obviously leads to default (College Decision civil, commercial and administrative jurisdiction of the Supreme Court, case no. 2ri-24/17 from 25.01.2017).

The application of civil sanctions against the debtor does not exclude the application of another contravention sanctions or criminal punishments for deeds representing contraventions or crimes. In this respect, upon the request of the body of creditors, the administrator/ liquidator submits to the prosecutor's office all the documents to be investigated as concerns the existence of grounds (deeds) that could trigger the criminal pursuit against the debtor or against the members of its management bodies. The body of creditors may request the insolvency court to be authorized to file the patrimonial liability action against the management bodies of the debtor if the insolvency administrator/liquidator has omitted to file the action in the case, a liability which is object of prescription.

Within the legislation of other state this responsibility of the management bodies is regulated as well, for example in the Grand Duchy of Luxemburg, where the legislation regulates 5 types of insolvency procedures (European Commission – EJN, 2005). Three of them refer to individuals and legal entities doing trade, one of the procedures refers exclusively to individuals who are not traders, and the last one refers to professional categories (notaries). The sanctions that may be imposed to the guilty management bodies of the debtor in insolvency or bankruptcy may be of criminal nature (bankruptcy is sanctioned) or civil. The grounds for civil sanctions may be of general or special nature, i.e. art. 1382 and 1383 in the Civil Code or art 59 and 192 in the Companies Law. It is obvious that opening an insolvency procedure against a debtor is based on a certain imbalance between the assets and liabilities of the debtor, the latter being at least equal if not bigger than the former from the point of view of the amount.

Therefore, as the liquidities are lower than the receivables, the liquidation of the assets may often be a solution to observe the scope of the law, i.e. covering the liabilities of the debtor in insolvency. From the perspective of qualifying the action concerning the annulment of the fraudulent acts, this falls in the class of the special revocatory actions, which present special effects in annulling the legal acts. The effect of the action accepted in court is to revert to the initial situation, but protects the interests of the creditors who do not participate in the act whose annulment is required, who are third parties in this case. In order to enforce the purpose of the law, which is to maximize the assets of the debtor, the law confers the creditors who should manifest an active role, as well as the receiver, the possibility to carefully analysis the causes having caused the insolvability, they being able to require the court to annul the acts prior to starting the procedure. Thus, the action for the annulment of the fraudulent acts, the action to engage the liability of the guilty for the insolvency situation or of those having contributed to rendering this situation more serious, the right to waive the contracts with successive execution in progress, the benefit of stopping the accumulation of the accessories related to the receivables from the insolvent debtor are only a few of the institutions the lawmaker has included among the tools required to fulfil the purpose of the insolvability law.

Complementarily, the law in the Republic of Moldova (149/2012) provides for a limitation of the right to free movement under art 84, whose wording may raise questions on its legality, mainly on the presumption of innocence that the administrator of the debtor in insolvency should enjoy. Thus, art. 84 stipulates that:

"Article 84. Criminal liability of the debtor: (1) After the initiation of the insolvency procedure, the insolvency court may oblige the debtor, ex officio or upon the request of the administrator/liquidator, not to leave the Republic of Moldova without its express consent, if there is evidence that the debtor could hide or avoid the participation to the procedure. (2) If the debtor hides from fulfilling its obligations, according to this law, the insolvency court, upon the request of the creditors meeting or of the body of creditors, or ex officio, may withdraw the debtor its right to manage the assets, if the debtor can make use of them, may forbid the debtor to leave the place of residence without its express permission or may apply other security measures according to the legislation in force. (3) The interdictions stipulated under paragraph (1) and (2) are valid throughout the entire insolvency trial unless the insolvency court decides otherwise".

From the point of view of limitation of liability, this cannot exceed the extent of the uncovered liabilities – as a maximum limit, of course up to the damage being in causal relation with that deed.

The person against whom a final decision of liability has been made can no longer be appointed as administrator or, if such person is an administrator in other companies, he/she is denied such right for a period of 10 years after the decision of the court becomes final and binding.

4. PRESCRIPTION OF THE RIGHT TO CLAIM PATRIMONIAL LIABILITY

Some courts have considered that the action "shall be filed within 3 years after the person causing the insolvency becomes known or should have become known, but no earlier than 2 years after the decision of opening the procedure". Other courts have considered that both the 3 year and the 2 year term which art. 139 in the Law no. 85/2006 refers to are prescription terms. The interpretations are wrong. There can be no two prescription terms for the same action. The prescription term is 3 years. The 2-year term refers to the maximum moment since when the prescription term runs, as the second part of the text refers to the moment when such term begins to run. The prescription term starts since the deed and the person become known, but cannot start running later than 2 years after opening the procedure (Ţăndăreanu, 2015, p. 38).

As concerns the prescription, its term is 3 years and starts running since the deed became or should have become known. According to art. 170 in the Law no. 85/2014, the term of prescription for the action provided for under art. 169 is 3 years.

Paragraph 5 of art 248 apparently provides, just like the legislation in Romania, for 2 prescription terms: the general one of 3 years since the person having caused the insolvency became or should have become known, followed by the completion but no earlier than 2 years since the decision to initiate the insolvency procedure. The working may suggest an interpretation that the claim of liability cannot be filed in the first 2 years after opening the procedure, even if such deeds generating the insolvency are known.

In our opinion, the expression in the Romanian law requires an adaptation, a correction in the sense of a correct and speedy application of the legal provisions, a delay in this respect being not useful to the creditors, whose interests are mainly protected by the insolvency law.

5. CONCLUSIONS

In the Republic of Moldova the regulations regarding the personal liability of the management bodies for the liabilities of the debtor in bankruptcy are satisfactory. However, in practice, very few cases when the management bodies are sanctioned as a result of analyzing the situation of the debtor in insolvency and of the causes having led to such insolvency situation have been found. The sanctions, according to the legislation of the Republic of Moldova, are a matter of civil law, but may also refer to the restriction of the right to free movement, and can be also a matter of criminal law if documents that have no real basis are submitted. However, an adaptation of the internal legislation of the Republic of Moldova is desirable as concerns the harmonization with the relevant European principles, for the purpose of strengthening the national legal framework, which is particularly beneficial for the participants to internal and international trading relations. The subject (theme) referring to sanctioning the guilty persons, the persons that are responsible for or contribute to the occurrence of the insolvency of the debtor is extremely sensitive and important. Unless such sanctions are regulated, the purpose of the law regulating insolvency or bankruptcy may not be fulfilled, and moreover it could give the debtors the possibility to legally obtain a discharge of debts, irrespective of the causes having led to bankruptcy.

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LABOR RELATIONS EFFICIENCY
IN CENTRAL AND EASTERN EUROPE

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Abstract
This paper aims analyzing the relationship between labor market and economy competitiveness. The used variables describe both labor market flexibility and efficiency use of talents across Central and Eastern Europe, namely: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia between 2007 and 2015. The analysis encompasses the character of employment relations, employment protection policies and flexibility in determining wage settings, redundancy costs, professionalism of the management board as well as care about resources of appropriately qualified workforce and its use. The approach proposed is a transversal-comparative one, the static methods pertain to the uni/ multivariate analysis and the statistical modeling was performed using SPSS.
The role of human resources to economic competitiveness is influenced by the flexibility of the labor market and the efficient use of talent. Our research will help determine what types of labor market regimes are most efficient in enhancing competiveness.
Keywords: *labor market relations, efficiency, competitiveness.*
JEL Classification: E020, J500, J850

1. INTRODUCTION

The contribution of human resources to economic competitiveness is influenced by the size and skills and the flexibility of the labor market. When human resource is heavily under evaluated, it is harmful for cultivating of core firms competitiveness (Yao & Cui, 2010). On the other hand, labor market flexibility in very important in managing hiring and firing practices, and implicitly, business competitiveness. A flexible environment allows to shift workers from one activity to another at a low cost level and allows for wage fluctuations without much social disruption (Schwab & Sala-i Martin, 2009). This paper aims analyzing the major constraints on competitiveness in terms of cooperation in labor-employer relations, hiring and firing practices, flexibility of wage determination, redundancy costs, pay and productivity, reliance on professional management and women in labor force, ratio to men within Eastern and Central European member states between 2007 and 2015.

Starting with 2007, labor market efficiency represents one of the twelve pillars of Global Competitiveness Index. The methodology for calculating the labor market efficiency has changed over time. In 2007 a number of 12 variables were used in calculating labor market efficiency aggregate indicator, namely: Cooperation in labor-employer relations, Flexibility of wage determination, Nonwage labour costs, Rigidity of Employment, Hiring and firing practices, Firing Costs (known as Redundancy Cost from 2010 onwards), Extent and effect of taxation (Effect of taxation on incentives to work from 2014), Total Tax Rate, Pay and productivity, Reliance on professional management, Brain drain, Female participation in the labor force. From 2010-2011 onwards Total Tax rate was nor registered as variable in measuring Labor Market Flexibility, neither Nonwage labour cost, from 2009-2010 and Rigidity of Employment, from 2012-2013. Starting with 2013-2014 and 2014-2015 reports, the Brain Drain component was replaced by other two components “Country capacity to retain talent” and “Country capacity to attract talent”. The above variables were grouped into two categories, the ones that are related to labor market flexibility and the ones that describe the efficiency of using human factors (table 1).

Table 1. Labour market efficiency, 2007-2015

Component	**Type of data** (1-7 Likert scale questions or calculation)	**Scale**	**Source**
A. Flexibility			
Cooperation in labor-employer relations	In your country, how would you characterize labor-employer relations?	[1 = generally confrontational; 7 = generally cooperative]	World Economic Forum (WEF), Executive Opinion Survey
Flexibility of wage determination	In your country, how are wages generally set?	[1 = by a centralized bargaining process; 7 = by each individual company]	WEF, Executive Opinion Survey

Component	**Type of data** (1-7 Likert scale questions or calculation)	**Scale**	**Source**
**Nonwage labour costs*	*Calculation*	*Estimate of social security payment*[1] *and payroll taxes associated with hiring an employee in a fiscal year, expressed as a percentage of the worker's salary in that fiscal year*	*World Bank, Doing Business.*
***Rigidity of Employment*	*Hard Data*	*Rigidity of Employment Index on a 0 (best)-to-100*	*The World Bank, Doing Business*
Hiring and firing practices	In your country, how would you characterize the hiring and firing of workers?	[1 = heavily impeded by regulations; 7 = extremely flexible]	WEF, Executive Opinion Survey
Redundancy costs	Calculation	In weeks of salary (*Estimates the cost of advance notice requirements, severance payments, and penalties due when terminating a redundant worker, expressed in weekly wages*.)	World Bank, Doing Business, WEF Forum's calculations
Effect of taxation on incentives to work	In your country, to what extent do taxes reduce the incentive to work?	[1 = significantly reduce the incentive to work; 7 = do not reduce incentive to work at all]	WEF, Executive Opinion Survey
****Total Tax Rate*	*Calculation*	*Combination of profit tax (per cent of profits), labour tax and contributions (per cent of profits), and other taxes (per cent of profits)*	*The World Bank, Doing Business.*
*****Firing Costs –* (Redundancy Cost from 2010 onwards)	*Calculation*	*Cost of advance notice requirements, severance payments and penalties due to a terminated worker, expressed in weekly wages*	*The World Bank, Doing Business*

[1] retirement fund, sickness, maternity and health insurance, workplace injury, family allowance, and other obligatory contributions.

Component	**Type of data** (1-7 Likert scale questions or calculation)	**Scale**	**Source**
B. Efficient use of talent			
Pay and productivity	In your country, to what extent is pay related to worker productivity?	[1 = not related to worker productivity; 7 = strongly related to worker productivity]	WEF, Executive Opinion Survey
Reliance on professional management	In your country, who holds senior management positions?	[1 = usually relatives or friends without regard to merit; 7 = mostly professional managers chosen for merit and qualifications]	WEF, Executive Opinion Survey
Country capacity to retain talent	Does your country retain talented people?	[1 = the best and brightest leave to pursue opportunities in other countries; 7 = the best and brightest stay and pursue opportunities in the country]	WEF, Executive Opinion Survey For more details, refer to Chapter 1.3 of this Report
Country capacity to attract talent	Does your country attract talented people from abroad?	[1 = not at all; 7 = attracts the best and brightest from around the world]	WEF, Executive Opinion Survey
******Brain drain*	*Does your country retain and attract talented people?*	*[1 = no, the best and brightest normally leave to pursue opportunities in other countries; 7 =, there are many opportunities for talented people within the country)*	*Executive Opinion Survey, WEF*
Female participation in the labor force	*Calculation*	Ratio of women to men in the labor force	International Labour Organization, national sources

* In 2007-2008, 2008-2009, the Labor market efficiency was calculated based on 13 variables, including Nonwage labour cost which was removed afterwards.

** In 2007-2008, 2008-2009, 2009-2010, 2010-2011, 2011-2012 reports included Rigidity of Employment, as additional variable in measuring Labor Market Flexibility. The values were evaluated on a 0 (best)-to-100 scale.

*** In 2007-2008, 2008-2009, 2009-2010 reports included an additional variable in measuring labor market flexibility: Total Tax rate.

**** This indicator is reported as Redundancy Cost from 2010 onwards. In 2009-2010, reference is made to the worker profile with 20 years of tenure. From 2011 onwards, reference is made to the workers profile with 1, 5, and 10 years of tenure.

***** In 2007-2008, 2008-2009, 2009-2010, 2010-2011, 2011-2012, 2012-2013 reports the two components “Country capacity to retain talent” and “Country capacity to attract talent” were grouped into one variable titled ”Brain drain”.

Source: Based on the Global Competitiveness Reports from 2007-2008 until 2014-2015: Porter *et al.,* (2007); Schwab & Porter (2008), Schwab & Sala-i-Martin (2009); Schwab (2010), Schwab (2011), Sala-i-Martin *et al.,* (2012); Sala-i-Martin et al., (2013); Schwab, K. (2014).

Due to different methodologies used in analyzing labor market efficiency, our research will encapsulate only the variables that are subject to whole reference period. The analyzed countries are the Central and Eastern European Member countries, namely: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.

2. LABOR MARKET RELATIONS IN CENTRAL AND EASTERN EUROPE

In table 2 are described all the variables used in our analysis: Cooperation in labor-employer relations, Hiring and firing practices, Flexibility of wage determination, Redundancy costs, Pay and productivity, Reliance on professional management and Women in labor force, ratio to men.

Table 2. Labor market relations in ECE, 2007-2015

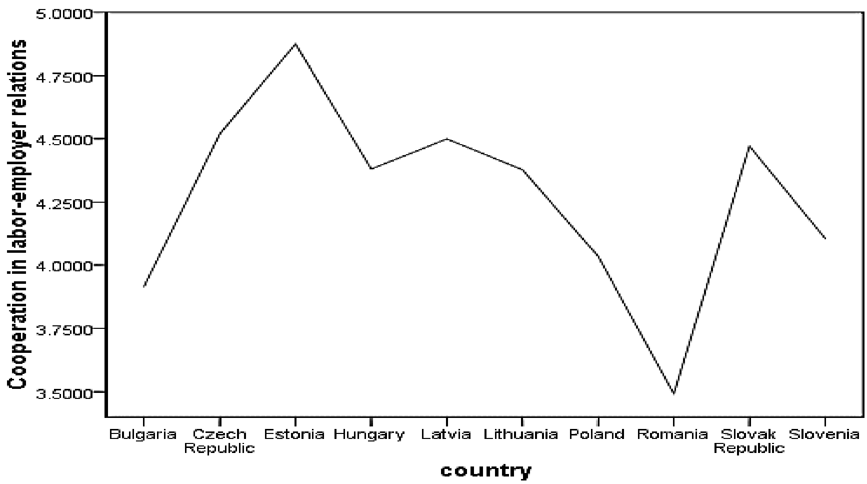
	Minimum	Maximum	Mean	Std. Deviation
Cooperation in labor-employer relations	3.1695	5.1723	4.267328	.4396404
Hiring and firing practices	2.2892	4.9488	3.647700	.5699465
Flexibility of wage determination	3.8429	6.2320	5.383565	.5616473
Redundancy costs	3.0000	40.0000	19.486843	10.6023962
Pay and productivity	3.4856	5.4520	4.467819	.4365938
Reliance on professional management	3.2741	5.5023	4.452163	.5674145
Women in labor force, ratio to men	.7801	.9490	.852812	.0490288

Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

The type of collective work relationships is an important mechanism that influences labor market productivity and competitiveness. In the literature, many specialists (Sala-i-Martin & Artadi, 2004; Ostoj, 2015) have found that a work relationship characterized by ***cooperation*** positively influences productivity, while a conflictual one generates a disadvantageous business environment which may lead to an endangered output.

In countries with high values for cooperation usually are dominated by the sense of joint responsibility for the entrepreneurship's performance and of the need of employees' participation in decision-making process and labor organization (Ostoj, 2015). This scenario brings on front two important postulates: first, employers consider that labor innovativeness is significant and, second, employees' participation in decision-making process brings business profits. As a consequences, an efficient communication between involved parties leads to an enhanced productivity. Moreover, any rapid changes in the management can be solved very quickly through an efficient cooperation between parties. On the other hand, confrontational collective work relationships are characterized by lower productivity, strike threatens and higher associated costs (Sala-i-Martin & Artadi, 2004; Ostoj, 2015).

Figure 1. Cooperation in labor-employer relations in ECE, 2007-2015 (mean)



Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

In the above figure (fig. 1.), cooperation in labor-employer relations mean, for 2007-2015 period, is calculated using the following question: In your country, how would you characterize labor-employer relations?. The responders' attributes values using a 7 points Likert scale, where ”1” represents generally confrontational relationships and ”7”, generally cooperative ones. An overall picture reveals that in Bulgaria and Romania respondents consider that the labor relations are characterized by a low cooperation environment while in, Czech Republic, Estonia and Slovak Republic the situation is reversed.

Table 3 reveals that in 2007, the smallest values were registered in countries like Romania (3.33), Bulgaria (3.97) and Poland (4.02). The highest values were recorded in Hungary (5.06) and Slovak Republic (5.17). In 2008, a notable improvement was registered by Estonia (5.06), which advanced two positions since 2007, occupying the first position within ECE countries.

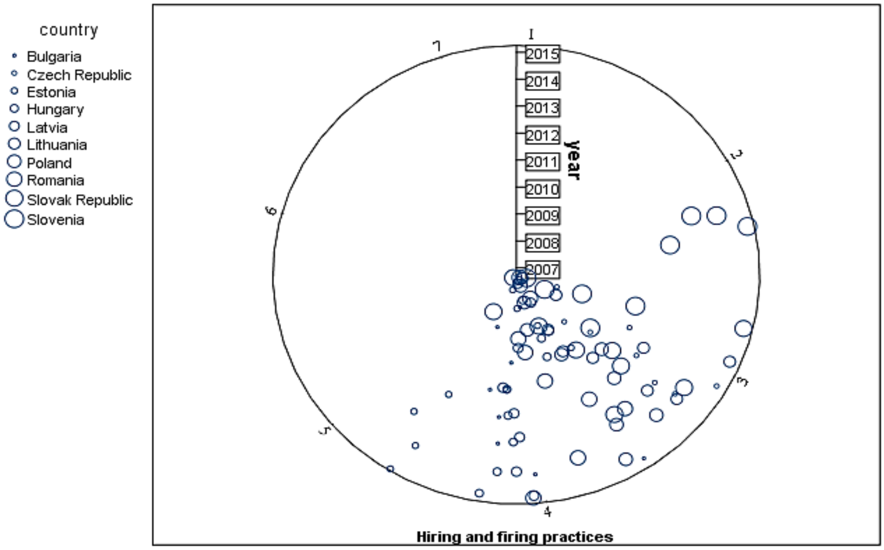
Table 3. Country change and associated values for cooperation in labor-employer relations in ECE, 2007-2015

Country	***2007***	*Country*	***2009***	*Country*	***2011***	*Country*	***2013***	*Country*	***2015***
RO	3.33	RO	3.65	RO	3.58	RO	3.17	RO	3.73
BG	3.97	BG	3.82	BG	3.85	SI	3.86	SI	3.74
PL	4.02	PL	3.86	PL	4.08	BG	3.94	BG	3.90
SI	4.35	LV	4.30	H	4.10	PL	4.01	SK	3.96
LT	4.49	H	4.39	LV	4.26	SK	4.04	PL	4.01
CZ	4.74	SI	4.49	SI	4.29	H	4.10	LT	4.12
LV	4.77	LT	4.55	LT	4.38	LT	4.30	H	4.29
EE	4.92	CZ	4.63	CZ	4.55	LV	4.31	CZ	4.52
H	5.07	SK	4.81	EE	4.55	CZ	4.37	LV	4.82
SK	5.17	EE	4.84	SK	4.79	EE	4.84	EE	4.92

Source: Authors' representation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

From 2009 until 2010, some small rank changes were registered only in the case of Latvia (increase of 1.02% value for cooperation, 1 rank higher), Hungary (decrease of 1.04% value, one rank lower), Slovak Republic (increase of 0.98% in value, 1 rank higher) and Estonia (1.02% decrease in value, 1 rank lower). In 2012, the majority of the ECE countries register small decreases (around 1%) in comparison with the previous year. Only Bulgaria, Slovak Republic, Latvia and Estonia have a small increase in people's perceived cooperation in labor-employer relations. In 2013 and 2014, Romania, Slovak Republic and Slovenia occupied the last positions although small values improvements were registered for the first two countries. In 2015, Bulgaria replaces Slovak Republic as one of the third countries with the lowest values for perceived cooperation in labor-employer relations. Estonia registered the highest values not only in 2015 but also in previous years (except 2007 and 2010) (table 3).

Figure 2. Hiring and firing practices in ECE, 2007-2015



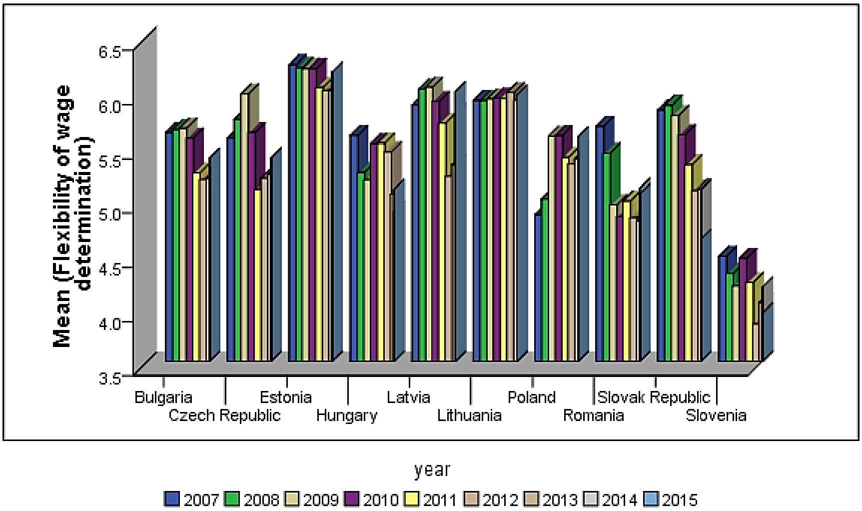
Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

„Hiring and firing practices” are illustrated using the following survey question: In your country, how would you characterize the hiring and firing of workers?. The respondents can assign values from 1 to 7, where “1” represents hiring and firing practices heavily impeded by regulations and “7”, very flexible operations. Hiring and firing practices reveal the presence of regulations within working relations, that can shape employer’s freedom in determine the number of employees. For instance, such restriction may be related to the necessity of explaining each dismissal or noticing trade unions or other forms of leading employee representation about future labor contract termination. The existence of such regulations slows down the matching process between entrepreneurships needs and labor market supply, and on the long run it may lower productivity (Ostoj, 2015).

In 2007, Slovenia (2.81), Lithuania (3.13), Czech Republic (3.19) and Romania (3.31) were considered to have the most rigid hiring and firing practices. From the ECE countries only Latvia, Bulgaria, Estonia and Slovak Republic register values greater than 4 and higher flexibility in hiring and firing workers. In contrast with 2007, Bulgaria (-0.13%), Lithuania (-0.05%), Poland (-0.09%), Slovak Republic (-0.41%) and Slovenia (-0.13%) register in 2015, a small decrease regarding people perception on hiring and firing flexibility practices. In 2015 a slightly increase were registered only in Czech Republic

(0.01%), Estonia (0.11%), Hungary (0.08%), Latvia (0.02%), and Romania (0.22%) (fig. 2.).

Figure 3. Flexibility of wage determination in ECE, 2007-2015



Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

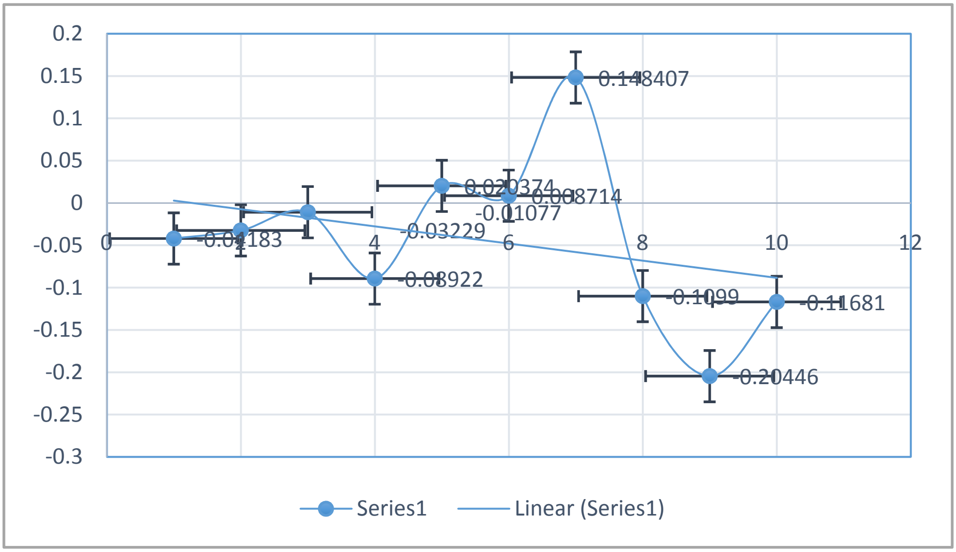
„Flexibility of wage determination” is set up using the following survey question: “In your country, how are generally wages set?”. The responders’ answers are situated between 1 and 7, where “1” represents centralized bargaining process setting and “7”, wage determination by individual company. Flexibility of wage determination strongly applies to the level of wage bargaining centralization. Collective Bargaining Centralization represents important assets in association of wage setting with economic and labor market performance measures (Bercu & Vodă, 2017). Decentralized negotiations are associated with higher levels of wage flexibility and more efficiency of the usage of labor factor. For instance in a flexible environment, negotiations or renegotiations are much easier to reach, and employees are aware of their salary standards. However, the degree of wage flexibility depends on the behavior of wage setters. For example, the ability of bargaining and parties willingness to compromise in order to reach an agreement are also important factors that influence wage determination.

Moreover, the flexibility of wages depends on the relations of labour and organised business. If unions are strong and powerful than wages are less likely to be flexible. In 2007, the values associated with the flexibility of wage determination where under 5 for Poland (4.84) and Slovenia (4.46) and above 6, only for Estonia (6.23). Values between 5 and 6 were registered in Bulgaria (5.60), Czech Republic (5.55), Hungary (5.57), Latvia (5.86), Lithuania (5.89), Romania (5.66) and, Slovak Republic (5.81) (fig. 3).

Figure 4 shows the percentage change in the flexibility of wages determination from 2007-2015. The higher increase was registered in Poland (0.14%), followed by Lithuania (0.008%) and Latvia (0.02%).

In all Central and Eastern European Countries the leading employee is represented by unions, except the cases of Poland and Slovakia where the division of tasks is between trade unions and works councils in setting terms of employment. Nowadays, the Central-Eastern system is characterized by the existence of 1 up to 6 union confederations and, in some cases, by individual unions marked with significant autonomy and impact.

Figure 4. Percentage change in Flexibility of wage determination in ECE, 2007 and 2015



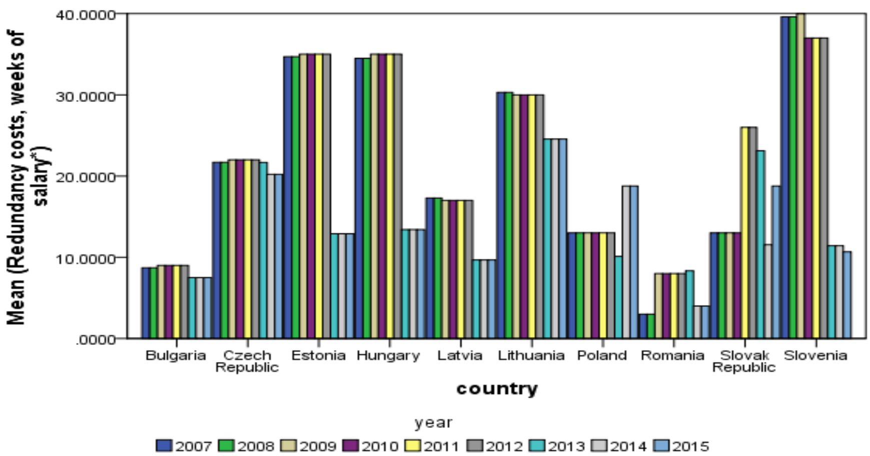
Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 and 2014-2015

According to Schwab (2014), in the Global Competitiveness Report (2014-15), the *redundancy costs* represent the estimates the cost of advance notice requirements, severance payments, and penalties due when terminating a redundant worker. The amount of benefits associated with the redundancy costs is calculated in proportion to the working time and expressed in weekly wages.

Redundancy costs are paid directly by the employer and are not included in the unemployment benefit system.

Holzmann *et al.* (2011) found an important relationship between national income and redundancy arrangements. The authors found that in low income countries the redundancy costs decreases with the income level. Betcherman (2013) and Calmfors & Holmlund (2000) identify that high redundancy costs reduce employer incentives to introduce new technology, therefore dampening production factors' productivity. Ostoj (2015) found that high redundancy costs may hold back the employment of workers. According to the author, „the higher they are, the more limited the employer is in his decisions about matching the number and structure of employment in a firm with the needs that are required by the market. He then refrains from dismissals, but makes decision about hiring new personnel very cautiously" (Ostoj, 2015, p.86).

Figure 5. Redundancy costs in ECE, 2007-2015

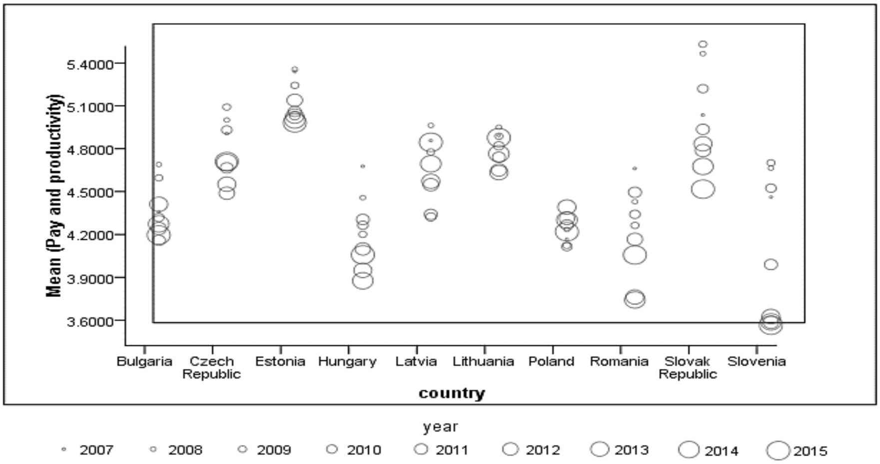


Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

In 2007, it was estimated that the cost associated with making a worker redundant were of 8.7 weeks of salary for Bulgaria, 21.7 for Czech Republic, 34.7 for Estonia, 34.5 for Hungary, 17.3 for Latvia, 30.3 for Lithuania, 13 for Poland, 3 for Romania, 13 for Slovak Republic and 39.6 for Slovenia In 2010, a small reduction (2.6 weeks) of the firing of redundant workers costs was register in Slovenia while Romania and Italy increase them from 3 to 8 weeks of salary, respectively from 1.7 to 11 for the last country. Starting with 2013 major decreases were register in Hungary (-61%) and Estonia (-62%).

In 2015, the estimates for the cost associated with making a worker redundant were of 7.5 weeks of salary for Bulgaria, 20.2 for Czech Republic, 12.9 for Estonia, 13.4 for Hungary, 9.6 for Latvia, 24.5 for Lithuania, 18.7 for Poland, 4 for Romania, 18.77 for Slovak Republic and 10.6 for Slovenia. In comparison with 2007, the major increase of redundancy costs wea register in Poland, followed by Slovak Republic.

Figure 6. Pay and Productivity in ECE, 2007-2015



Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

Pay and productivity is measured using the following question: In your country, to what extent is pay related to worker productivity? The respondents answerers were evaluated based on a 7 Likert scale (1=not related to worker productivity and 7= strongly related to worker productivity). For the ECE countries the responders' answers ranged from 4.27 up to 5.2 in 2007 and from 3.97 up to 4.90 in 2015.

„*Pay and productivity*" links pay to employee or company performance. Several studies (Fernie & Metcalf, 1999; Lavy, 2002) foster the widespread belief that incentive pay can raise productivity growth and augment profitability. For instance, Fernie & Metcalf (1999) analyzed the situation of 413 British jokers which some were employed on fixed retainers, while others were offered prizes for winning races. The results display large incentive effects- those facing prizes supply were making much more effort. Lavy (2002) find similar results but among Israeli teachers. The analysis reveal significant improvement in teacher performance due to the introduction of group bonuses

Table 4: Perceived change in Pay and Productivity, in ECE

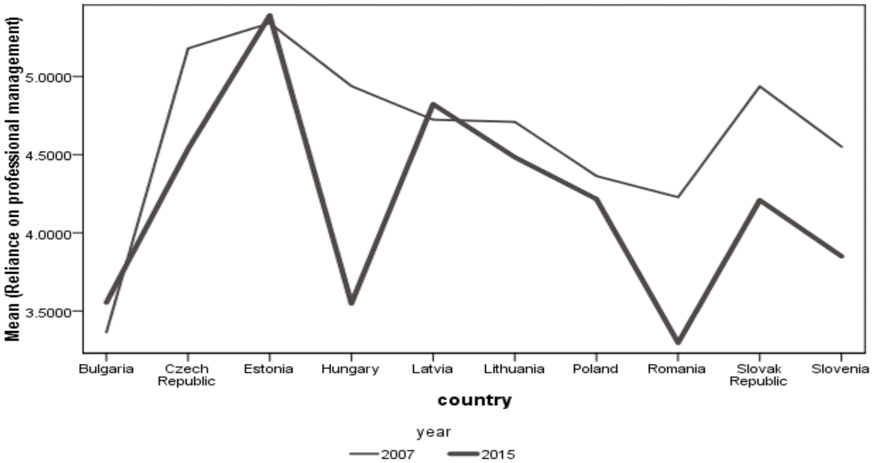
	2007/ 2008	*2008/ 2009*	*2009/ 2010*	*2010/ 2011*	*2011/ 2012*	*2012/ 2013*	*2013/ 2014*	*2014/ 2015*
Bulgaria	0.078	-0.020	-0.061	-0.038	0.020	0.041	-0.032	-0.018
Czech Republic	0.020	0.018	-0.032	-0.055	-0.039	0.014	0.034	0.001
Estonia	0.003	-0.021	-0.041	0.006	0.016	-0.022	-0.005	-0.004
Hungary	-0.048	-0.059	0.016	0.010	-0.049	-0.037	-0.019	0.048
Latvia	0.022	-0.038	-0.097	0.004	0.049	0.005	0.027	0.033
Lithuania	0.012	-0.013	-0.014	-0.017	-0.019	-0.004	0.029	0.024
Poland	0.017	-0.027	-0.002	0.038	0.011	0.019	-0.021	-0.020
Romania	-0.051	-0.038	0.019	0.036	-0.074	-0.099	-0.006	0.086
Slovak Republic	0.087	0.012	-0.057	-0.055	-0.030	0.010	-0.033	-0.035
Slovenia	0.046	0.008	-0.038	-0.120	-0.103	0.012	-0.011	-0.007

Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

Hoffer & Spiecker (2011) analysis encapsulates the importance of unit labor costs as an important determinant of competitiveness. The authors stated, „in the Euro zone, balanced trade involves that member states wages grow in line with national productivity in addition with the communally agreed inflation rate. Apart from that, countries with relative higher growth in unit labor costs will systematically lose market share and experience trade deficits. The case for a coordinated wage policy to avoid imbalances, beggar thy neighbour policies and a waste of potential growth is overwhelming: it is alarming that it has been ignored for so long. Those who let unit labour costs rise too fast are equally responsible for the explosion of imbalances after the abolition of the exchange rate mechanism as those who gained market shares through wage restraint" (Hoffer & Spiecker, 2011, p.2).

Figure 6 clearly shows the relationship between salaries and productivity for 10 European countries for the years 2007-2015. In the medium and long-term, the connection between productivity growth and wage increase may help achieve higher employment levels and reduce the competitiveness gap between economies especially hit by the recession (Meager & Speckesser, 2011, p.4). In other words such *wage moderation* can be achieved through institutional reforms targeted to facilitate the wages growth at a lower rate than productivity. In the above analysis in some European countries, the relationship between pay and productivity shows a declining rank (table 4). Restrictive labor regulations and high tax rates remain the most problematic factors for doing business according to the Executive Opinion Survey.

Figure 7. Reliance on professional management in ECE, 2007-2015



Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

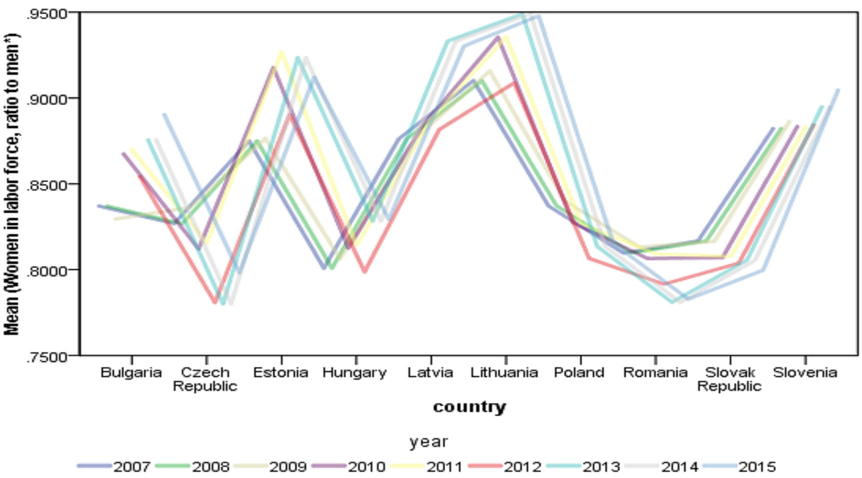
„Reliance on professional management” is an indicator that is measured on a scale of 1 to 7, using the following survey question: “In your country, who holds senior management positions?. On the scale, 1=“usually relatives or friends without regard to merit”, while 7 = “mostly professional managers chosen for merit and qualifications” (Schwab, 2014, p. 69).

The most competitive economies according to GCI, Czech Republic and Estonia occupy also the first two positions in the reliance on professional management indicator. Similar, in 2015 from the ECE countries, Hungary, Slovak Republic, Romania and Bulgaria and Slovenia register the lowest values at both competitiveness and reliance on professional management (fig. 7).

“*Female participation in the labor force*” indicates the economic consequences of unfair women participation in job resource for instance, it is one of the manifestations of discrimination (Ostoj, 2015, p. 88). Different studies reveal that inclusiveness and diversity of perspectives improve decision making about resource allocation (Chamlou, 2004).

Not only the different perspectives that women brings in the decision making process but also the significant investment in women’s education are important factors that need to be taken into consideration. Very low level of female participation in the labor force means that the country is not capturing a large part of the return on its investment (Chamlou, 2004).

Figure 8. Female participation in labor force, ratio to men in ECE, 2007-2015



Source: Authors' calculation based on the Global Competitiveness Reports from 2007-2008 until 2014-2015

Also, cross country data shows that increase participation of women in the labor force may contribute to achieve higher levels of per capita income, and implicitly, to faster economic growth. In most ECE countries the ratio of women to men in the labor force have increase in 2015, in comparison with 2007, expect the cases of Czech Republic, Poland, Romania and Slovak Republic where the values decrease up to 2-3 % (fig. 8.).

3. CONCLUSIONS

The paper analyze the relationship between labor market and economy competitiveness showing the role of human resource to economic competitiveness and the flexibility of labor market and the efficiency of using talents in countries form Eastern and Central Europe, namely: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia between 2007 and 2015. The methodology used is based on transversal and comparative approach using the uni/multivariate analysis and statistical modeling. Our research is based on the variables that are subject for the whole period analyzed. The main results reveal differences between the analyzed countries for each indicator used. The high values for *cooperation* indicator reflect a low cooperation in countries like Romania and Bulgaria and a strong cooperation in Czech Republic, Estonia and Slovak Republic. These means that in some countries exists a strong correlation between joint responsibilities, entrepreneurship's performance and the need of employees to participate in decision making process, until in other countries the level is very low. The *hiring and firing practices* are correlated with the pressure of regulation within working relations, determined by the employer's freedom to hire and fire people, taking account by the rules of collective contract or the rules established with employees representatives. States like Slovenia, Lithuania, Czech Republic and Romania have a rigid system of hiring and firing practices, until Latvia, Bulgaria, Estonia and Slovak Republic are more flexible. The indicator *flexibility of wage determination* determines the system used by the countries in establishing the level of salaries and the entire process of negotiation with unions or employees representatives. The results show that ECE countries an important assets is Collective Bargaining Centralization which reflect the wage-settings and its impact on labor market performance measures. Considering the *redundancy costs*, the ECE countries reveal that employers are limited to decide the number and the structure of the employment. Related, the *pay and productivity* of employees shows a decline rank due to the labor regulation and high tax. The indicator considering the *competitiveness and reliance of professional management* reflect a discrepancy between countries like Czech Republic, Romania and Estonia, where are registered high values, and countries like Hungary, Slovak Republic, Romania, Bulgaria and Slovenia, where the levels are low. These are direct correlated with the used of managerial practices in choosing the best managers based on performance and merit systems. The European principle of competence (as was describe by European regulation) means to prove high professional and moral qualities, consistent with the position held and the tasks assign to it (Tofan, 2013, pp. 256-257)

The role of human resource to economic competitiveness is an important indicator that reflects the capacity of states of taking the public policies in order to use and maintain the market flexibility, to increase work performance and to use the brains to create values and to be more innovative. For the policy-makers became imperative to design more favorable policies and procedures that can help improving the decentralization management process in countries form ECE leading to higher future local economic growth rates (Bilan & Cigu, 2015, p. 402). The analysis reflects different patterns for the ECE countries, due to different policies and decisions applied.

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THE ROLE OF INNOVATION AND CREATIVITY IN SHAPING THE FUTURE OF EU

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Abstract
Today, the world economy is increasingly focused on innovative development, which contributes to a competitive economy of individual countries and the progress of the world community as a whole. All countries try to establish and implement policies that would foster the innovation, creativity and entrepreneurship activity. EU countries are not an exception. The research shows that even if many EU member countries strive to develop comprehensive innovation policies (called in the specialized literature holistic approach), the existent performances in this field prove that linear approach in developing innovation policies still prevails in most of the European countries. The present research aims to analyze the main approaches of policymakers and researchers towards holistic and linear approach, by identifying reasons why one or another prevails in a certain country. The paper focuses on assessing the innovation performances of EU member countries. Therefore, best practices in promoting holistic approach of innovation policy and creativity promotion are researched and ways to overcome the challenges faced by EU countries in the field of innovation are identified.
Keywords: *innovation, innovation policy, holistic approach, linear approach, creativity, European Union member states.*
JEL Classification: O10, O32

1. INTRODUCTION

People are beings known for their striving to constantly improve what they've already accomplished and achieve new goals. It has been a long journey through the transition from the archaic human being to what we have today. Since humanity started understanding the meaning of progress, innovation became one of the most important aspects of development. If there wasn't for innovations, where would we be now? Starting with the invention of the wheel, the compass, printing press, internal combustion engine, the telephone, the light bulb, penicillin etc. and finally internet we have reached heights we didn't even hope for. Without the innovations, humanity wouldn't be able to pass so efficiently the information from generation to generation, moreover a lot of people wouldn't even survive without the medicinal discoveries.

Innovation leads to economic growth. Through new technologies, people can produce bigger quantities and better-quality products in less time, increasing the profit, which leads to economic growth. But there are also innovations that completely change the system. For example, at the beginning, people were exchanging goods; they used to use barter to get what they need, but it was a difficult and inefficient system. To find the perfect match between the demand and supply was not an easy task. Moreover, storing some goods for a long time was impossible because of their high degree of alterability as fish or other food. After that, money was invented and it became easier to pay for the goods. Later, when people understood that to carry a great sum of money with them is dangerous because of often robberies, the checks were invented. Finally, nowadays we have the greatest till now, innovation in finance and it is the credit card, which ensures the security of the possessor and it is easy to use. This is a great example of how an idea became an implemented product.

Today, the world economy is increasingly focused on innovative development, which contributes to a competitive economy of individual countries and the progress of the world community as a whole. An important aspect of any novelty is the need. The need is what pushes the man to act. This is how an idea appears, is being developed and finally implemented. So here we can notice the strong link between innovation, creativity and entrepreneurship. Creativity is the ability to think of something new and unusual. But in order to implement such an idea there are financial resources needed and often more research is needed, which also requires money. Here is where entrepreneurship can help, with investments and also finding the practical way to produce a certain product, or start an innovational process. When all these steps are behind, we have only to approve it legally, and it can be considered implemented.

According to Braunerhjelm and Henrekson, the small firms contribute quite a lot to the aggregate innovation, because they tend to exploit the already existing knowledge in a completely different, new and fresh way, compared to their larger and older competitors (Braunerhjelm & Henrekson, 2015, p.1).

Analyzing this fact, it can be noticed that creativity has a decisive role in the arena of innovation all over the world. As mentioned above, small firms tend to make the most out of the already existing knowledge. These entities lack large sums of money to afford R&D and additional research in different fields, this is why they are “forced” to be creative, in order to capitalize the potential of what they already have. This is how genius ideas are born.

Though the innovation process is completely different in small companies and in large R&D investing enterprises, it is clear that entrepreneurship and innovation are inseparable, moreover these are elements of a whole. Innovation cannot exist without creativity and entrepreneurship.

Entrepreneurship is the step of innovation, where the knowledge, either already existing or new, is combined with individual abilities, in order to create paths towards new market opportunities (Braunerhjelm & Henrekson, 2015, p.2). Not in vain, nowadays the brain drain is a reality. The most developed companies in the world know the value of human resources, and this is why headhunters are also becoming part of our reality. Innovation, and consequently economic growth, is not possible without the innovative minds of contemporary world.

Lately, the European Union is challenged in the global arena by emerging economies as well as by the US when it comes to innovation, especially in capitalizing the knowledge and technology in this context. Due to the fact that the innovation chain becomes more open and complex, it internationalizes, tending to globalization, EU is lagging, in comparison with other countries from the worldwide platform. In order to ensure high competitiveness on the global arena, EU increased their investments in the R&D field and also there were launched a few initiatives through the adopted EU 2020 strategy, of which 5 have to deal with innovation (Innovation Union, Digital Agenda, Resource Efficient Europe, A New Industrial Policy for the new globalization era and an Agenda for new skills and jobs). These are supposed to assist EU in increasing its competitiveness.

Despite the increase of investments and the attention paid to this issue, EU has so far not obtained positive results, furthermore EU is noticed to decline in the last time, it decreased its level of internationalization, and this is regarded as a step back by the worldwide competitors.

In addition, the situation on the implementation of innovative development policy is complicated by the ongoing EU enlargement vector dynamics due to the accession of new countries, which, in turn, complicate the task of the European institutions for the implementation of innovation policy. The last expansions showed that the new countries – newly EU member states, have their own negative experience of scientific and technological development.

Another issue that diminishes EU's innovational performance is the high complexity of the governance of the EU innovation policy. The problem is the overlap between funding instruments and too many decision-makers. This has led to chaos in the top level of EU's innovational system, causing it to become more complicated than it needs to be (Anvert *et al.,* 2010).

2. INNOVATION POLICY: CONCEPT AND REASONS OF ITS ESTABLISHMENT

In order to understand what innovation policy is, we must understand firstly what innovation really is, as this concept is often poorly understood. Innovation, is not just an idea, it is the idea that is already implemented, the product or process that was improved, or newly created. Creativity is the capability of conceiving something new and original, while innovation is the implementation of something new.

As Edquist C. (2014a) mentioned, innovation policy is all actions that influence innovation processes, including all policies that affect the innovation process as research policy, education, regional, defense policies and public innovation procurement. Analyzing this definition, we can notice that innovation policy includes several policies that have a certain degree of influence over the innovation process. This is why it appears logical that such a complex system must be approached only in a holistic way, in order to harmonize the interaction among all elements of this system as a whole functioning organism.

Innovation policy is a much more complex concept, than it may seem at first glance. In order to be efficient, an innovation policy has to take into account a lot of important elements. Researchers as Braunerhjelm P. and Henrekson M suggest that a successful innovation policy needs a strong framework, based on two pillars (Braunerhjelm & Henrekson, 2015, p.3):

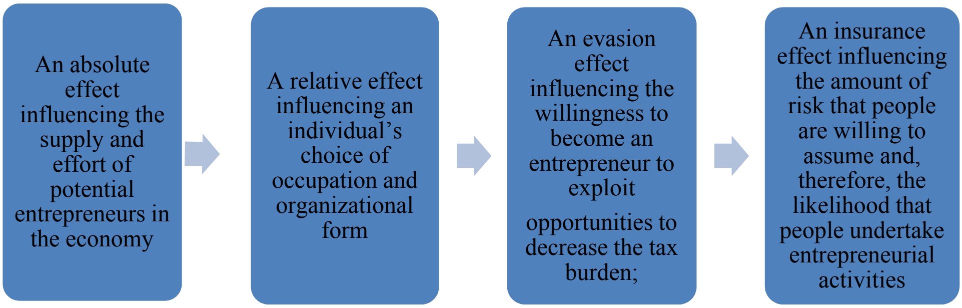
- The accumulation, investment, and upgrading of knowledge. The policy domains involved in this pillar are referring to the necessary institutions to promote excellence in education at all the levels, to promote top universities and the results of their research activity, and to establish the links between the higher educational institutions and business environment.
- The mechanisms of policy implementation that promote and foster the role of knowledge as to contribute to the economic growth and societal prosperity. The implementation of these mechanisms in carried out by other institutions, such as tax policies, the regulatory burden, competition, and the formation of clusters.

For a country to obtain results in the innovation area, it is important to foster and capitalize the main elements of an innovation system. It was already mentioned the importance of knowledge, creativity and entrepreneurship. But now it should be pointed out the importance of the institutions that regulate and manage these elements. It is easily noticed that in all the elements of the orchestration mechanism, the constant factor is the human resources. This is where lies the insatiable potential of discoveries.

Well trained labor force can take a company's economy to the next level, and if it is so at an entity's level, then it is obvious that it works the same for the country level. For an economy to develop and register continuous growth, it is absolutely necessary to have well trained human resources. The conclusion is self-explanatory, an innovative country must invest in educational system (Borras & Edquist, 2015). The educational institutions must fulfill the knowledge necessities of the nation, creating future entrepreneurs, researchers, innovators and preparing them for a highly competitive environment.

The next step is regulating the tax system, as it affects the entrepreneurial activity both directly and indirectly. The influence can be sensed in a chain of effects (fig. 1).

Figure 1. The influence of tax system upon the entrepreneurial activity



Source: designed by the author according to Braunerhjelm & Henrekson (2015, p.14)

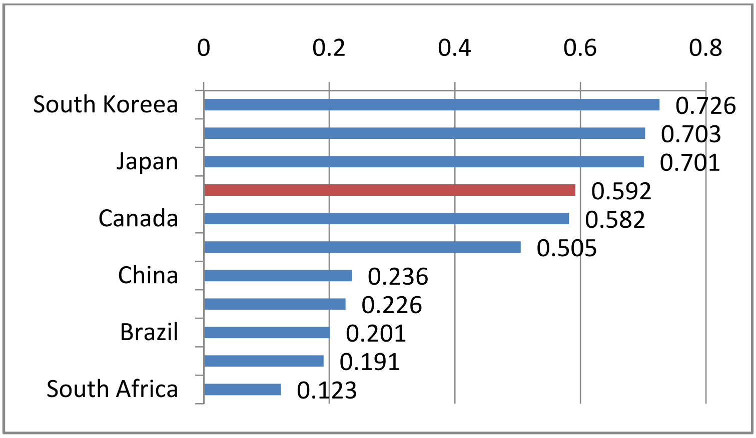
Since, innovation is such an important field in the economic growth and development, the researchers all over the world are looking for the formulas of successful educational, taxation systems, in order to find the features that will stimulate the creative and innovative entrepreneurship (Henrekson & Sanandaji, 2016).

Braunerhjelm & Henrekson (2015) also highlight the characteristics of a tax system that stimulates creative entrepreneurship, which are referring to a system of low taxes for capital or no taxes for equity holdings and neutral system across the finance sources and owner categories and a symmetric tax treatment of profit and losses.

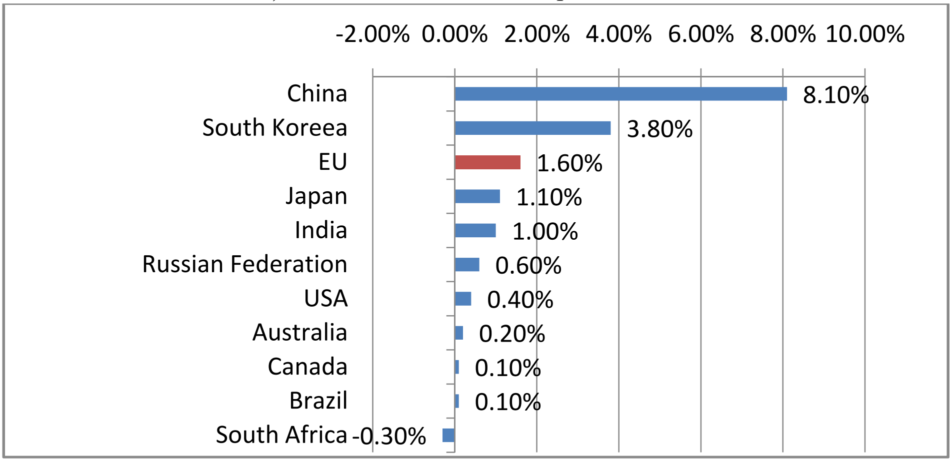
It is important to know, that often the government tends to get involved and orchestrate the innovation system. After C. Edquist (2014a, p. 3) this should only happen only under the fulfillment of 2 conditions: the first one is that the private actors must register a failure in obtaining the objectives established, which means that there should exist a problem, that needs a solution as soon as possible; and the second condition is that the public actors must have the abilities, knowledge and necessary experience in order to solve or mitigate the problem.

EU is now focusing on innovation more than ever. The results of its innovation performance are not the desired ones, as EU is less innovative than South Korea, the United States and Japan, if we regard the situation from a global point of view. Even if the discrepancy in the scores of innovative indicators is reducing between EU and USA, Japan, EU still lags at this domain. These results are caused by the relative low growth rates of EU's innovation indicators, but also by the rapid increase of South Korea's performance, as it develops innovation at a faster pace than EU, in the last 8 years (fig. 2).

Figure 2. Global innovation performance



a) Global Innovation performance



b) Growth rates for innovation activity
Source: European Commission (2016)

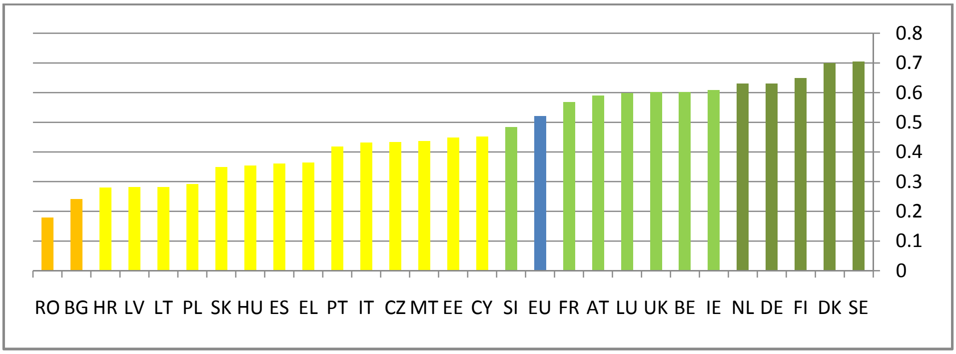
Although EU is still outpacing such important actors on the global arena, as China, this country is still catching up very fast, delivering a five times performance growth rate that of the EU.

According to the European Innovation Scoreboard there are 25 different indicators measuring the innovation performance of a country. These indicators are grouped in 3 main categories/types and also in eight innovation dimensions. The enablers capture the main drivers of innovation performance, which are external to the firm and cover three innovation dimensions: human resources; open, excellent and attractive research systems, as well as finance and support. Firm investments, linkages & entrepreneurship, and intellectual assets are the 3 innovation dimensions covered by the firm activities, which capture the innovation efforts at the level of the firm. Outputs cover the effects of firms' innovation activities in two innovation dimensions: Innovators and Economic effects.

Based on the indicators mentioned above, an average innovation performance is calculated, which further helps grouping countries in groups according to their performance. There are 4 categories of innovators (fig. 3):

- The first group is the Innovation Leaders, which consists of such countries as: Denmark, Finland, Germany, the Netherlands, and Sweden. These countries have an innovation performance high above the EU average.
- The next category is the one with innovation performance not much above or quite close to the one of the EU average, called Strong innovators. In this group are included: Austria, Belgium, France, Ireland, Luxembourg, Slovenia, and the UK.
- The 3rd group is composed of Moderate innovators, with an innovation performance lower than the one of the EU. From this group take part the following countries: Croatia, Cyprus, Czech Republic, Estonia, Greece, Hungary, Italy, Latvia, Lithuania, Malta, Poland, Portugal, Slovakia, and Spain.
- The last group is the Modest Innovators with innovation performance well below that of the EU average. Only 2 countries are included in this group: Bulgaria and Romania.

Figure 3. Innovation performance of EU member states, 2016



Source: European Commission (2016, p. 6)

The differences in innovation performance of EU member states varied in time. Until 2012, the divergence in this sense has become smaller. Nevertheless, in 2013, the process of convergence of innovation performance reversed, and differences in countries' innovation performance became more pronounced (European Commission, 2016). This volatility trend was repeated once again in the following years, by registering an increase in the innovation performance convergence in 2014, but a divergence growth in 2015. These increases in performance differences in 2013 and 2015 are directly linked to the increase in the number of Member States in both years for which performance declined (European Commission, 2016).

During the last decade, the EU observed the formation of innovation policy at three levels: regional, interregional and supranational. The importance of regional cooperation in the field of R&D and innovation has increased considerably in recent years, because the local authorities have a better understanding of the region's needs in the field of scientific and technological progress and innovation. In addition, the limitations of the EU budget make the regions to enter the world market in search of venture capital, which is also of great importance for EU integration in the global innovation sector. The regional component of the EU's innovation policy is of particular importance in the dissemination of knowledge, implementation of innovations, training of highly qualified scientific personnel and to conduct fundamental scientific research. Thus, the obvious need for effective implementation of the innovation policy on the base, the regional level so that the correlation occurred with the overall EU innovation policy.

Modern strategy of the European Union of "Europe 2020" sets out five key priorities: increasing employment, innovation, improve the quality of education, social inclusion and the solution to the problems associated with climate change and the lack of energy and other resources.

Over the past 10 years the EU has significantly increased the value of the regional scientific-technical and innovation cooperation. The emergence of new technologies and the globalization of the economy, as well as limited government budgets have increased the role of the regions in the implementation of economic activity and of enterprises. As a result, the regional authorities are increasingly establishing contacts with stakeholders abroad at the sub-regional level. At the same time, regional issues are addressed by close contacts of the central government and local authorities, since the latter is best known for the technical, economic and social needs of the regions. Thus, in recent years more and more are intertwined the three levels of regional policy (the policy carried out by the regions, the regional component of the federal innovation policy and supranational EU policy).

Innovation policy has become an integral part of the national regional policy, but, as a rule, national governments prefer to have developed in the scientific and technical relations between the regions. The state provides support to backward regions not only through direct financial investments, as by promoting the development of innovation policy and infrastructure development. Mitigating the technological disparities of regional development is primarily a function of the EU.

Main place of work in this area is given to the Network of Innovative Regions (Forum of Innovation Regions) and the local network of centers for the dissemination of innovation (Innovation Relay Centers - IRC). Network of Innovative Regions represent their national and transnational associations in the field of experience in developing and sharing in the innovation strategy for the dissemination of innovation centers. They have the status of independent consulting organizations in the field of technology and business, receiving assistance from the Commission for Enterprise. They support innovative businesses in the following areas: technology transfer; commercialization of R & D results, including intellectual property; the development of adaptive capacities of enterprises to new technology, including finding and bringing together potential cooperation partners; implementation of transnational innovation initiatives; dissemination of information on EU innovation policy.

3. HOLISTIC VERSUS LINEAR APPROACH

In order to understand better the difference between a linear and holistic approach, it is necessary to first understand very well what does "linear' and "holistic" mean. Below, are given the definitions of these terms.

According to C. Edquist (2014a), when research on innovation and innovation policy were only starting to develop, the dominant view over how should innovation develop, was the linear model. This model implied that innovations are applied scientific knowledge.

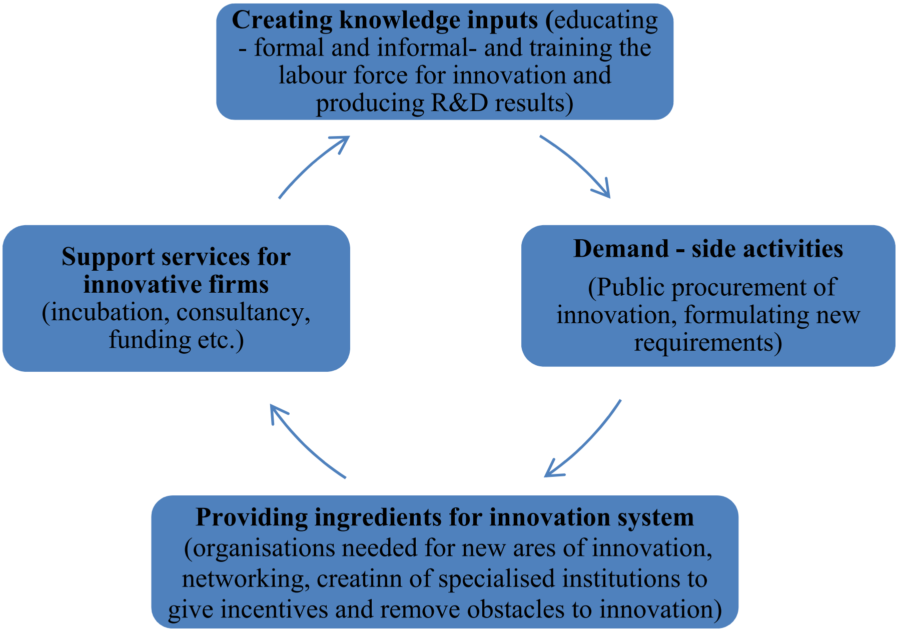
It was called "linear" because the process was seen as "*well-defined, consecutive stages that innovations were assumed to go through, e.g. basic research, applied research, and development work resulting in new products and processes that ultimately influence growth and employment. It was a supply-push view*" (Edquist, 2014a, p. 5).

The same researcher explains that a holistic innovation policy is an innovation policy that integrates all the different factors that influence innovation processes into one context, in other words it is a policy that combines in a whole all the public actions that can influence the innovation system. Such a system would address all the following activities in a coordinated manner, treating all of them as parts of a single and complex system of innovation (fig. 4).

Therefore, we have come to the conclusion that linear closed system is characterized by a pattern of innovative processes, which graphically displays the stage of industrial availability of new equipment.

Within the framework of linear models of innovation processes, no matter what was the source of innovation (internal logic of the development of technologies or request on the part of the market), the sequence of steps is represented as links in the chain, i.e., is linear, when the results of one stage is the input for the next. These innovative companies in the EU are part of the integrated innovation organizations (or occasionally work under the terms of the innovation outsourcing, that is, acquire and enjoy a valuable R & D from other companies, and purchase the products themselves).

Figure 4. Key Activities of an Innovation System



Source: designed by the author according to Edquist (2014b)

The time has proven that there is no theory or model that lasts forever, without being questioned. This is what happened to the linear model. The model started to rise questions about its efficiency. So, it is obvious that another, more logical model, was born and getting ripe to replace the old one.

Holistic approach to innovation means that innovation is seen not as a chain of successive units, but as a system of interaction and feedback between the whole complex of economic, social, political, organizational and other factors that determine the nature of innovation processes.

Innovation policy, which includes all of the different factors that influence the innovation processes in the same context, is called a holistic innovation policy. In other words, it is a policy which unites all the social activities that affect or may affect the innovation processes. To be worthy of the name, such a policy must be consistent with other policy areas, and in some cases, should be a higher priority than in other areas.

The main differences of holistic models of innovation processes from their linear analogues could be summarized as follows:

- Multiple sources, initiating innovative processes are not limited to research and development and market demand; on the contrary, innovative process management based on the premise that new ideas can and do occur and develop at any stage of the innovation process, including full-scale production;
- All stages of the innovation processes within the system models are characterized by a plurality of feedback loops, which implies non-linear nature of innovation processes, a plurality of paths from the emergence of new ideas to their commercialization.

4. EU EXPERIENCE IN TRYING TO ADOPT A HOLISTIC APPROACH

In trying to understand whether the EU countries are really switching to a holistic innovation policy, the researcher C. Edquist organized a complex study of the matter (Edquist, 2014a). He designed and sent a questionnaire to 23 EU member states that were interested in participating in this project. Out of these countries, 19 responded, which represents 83 % of the total. All the information obtained afterwards is based on the responses of these 19 countries.

The countries that admitted that their innovation policies are still linearly oriented are Belgium, Ireland, Netherlands, and others. But there are countries, as Switzerland, that admit that the government has restrained influence on the innovation policy, it has a limited role. At the same time, they admit that their innovation policy has never been fully linear oriented.

But the majority of the countries, including Cyprus and France recognize that the holistic approach started being used in the last couple of years. Even if these countries are trying to implement a more holistic approach in their policies, the linear model is still present.

The countries that are progressively trying to introduce a holistic approach in their innovational system, represent 84% of the 19 responding countries. These 16 countries are: Ireland, Cyprus, Norway, Lithuania, Finland, Estonia, Sweden, Denmark, Austria, France, Hungary, certain regions in Belgium, the Netherlands, Portugal, Slovenia, and the United Kingdom. Exceptions may be Switzerland, Czech Republic and Malta.

When asked about what demand-side policies are the most important, most of the responding countries answer that they don't pursue much innovation policy, which could be considered demand-side oriented. This answer also applies to the question about Public Procurement for Innovation (PPI) too. The only countries that have at least tried, or plan on trying PPI, are Estonia, Finland, Belgium and United Kingdom. These countries are more likely to using PCP, which is Pre-Commercial Procurement. PCP refers to the procurement of expected research results, which is not considered a demand-side policy instrument in relation to innovation, but it is a demand-side policy instrument in regard to research. Therefore, concluding on the results on demand-side policies, there are only 4 countries (21%) that use demand-side innovation policy instruments at least at a small degree, although not even these countries are striving towards a holistic innovation policy in the sense that it was described.

Meanwhile, 10 out of 19 countries reported that the most important innovation activity, on which there are spent financial resources is the "Provision of R&D results". (i.e. Sweden, Switzerland, Cyprus, Ireland, Czech Republic, Estonia, Hungary, Belgium, France and Slovenia). It can be clearly seen that 53% of the countries, consider investing in R&D, one of the most important aspects of a successful innovation policy (Edquist., 2014a, p.11).

This result reveals the problem of an appropriate way to measure the importance of an innovation policy instrument. Judging just by how much money is spent on an instrument like R&D is not right, as not all money spent on this will have an effect on innovation.

There is a similar issue with the resources spent on education, because not all education is oriented or meant to influence the innovation system. This is why we can't call all the resources spent on education and R&D or other policy instruments, an innovation policy. It is not correct, neither efficient to measure the innovation policy instruments by the amount of financial resources spent on them, a much better way to measure the efficiency of these instruments would be to measure their consequences.

5. CONCLUSIONS

Innovation became a huge element of the nowadays economy. Every country in the world is trying to achieve development and progress in this domain, as this is the future. Innovations can open new horizons for economic growths and development, bringing better technologies, better products and of course, better lifestyle.

It is impossible to deny the role that innovations played in the evolution of humanity. Besides the economic growth that it brought, it made life easier and gave the possibility to lengthen it for those who depend on medicines.

In order to achieve an efficient innovation system, countries try to find the best innovation policies and instruments. Governments try to find ways of stimulating creativity, as this is one of the basic elements for innovation, as well as stimulating the entrepreneurship, which also is a huge player in the innovation system. Innovation only works when combining, creativity with entrepreneurship, which allows it to implement new processes or products through which economic growth is achieved.

It is known that countries all over the world are in a continue "fight" to be the best innovator, and have the most amazing results in this domain. This is also the case of EU, but unfortunately it remains behind such countries as South Korea, USA and Japan.

In order to overpass this impediment, the countries are in search of a new theory, system or model that would change up the game. Such a solution seems to be the holistic approach to the innovation policy, which implies seeing the innovation system as a whole, and all the policies (educational, financial, economic, innovation, etc.) working together harmoniously for the goal of achieving good innovation performance, in contrast to the currently applied linear model, which was regarding the innovation process as consecutive stages that innovation is supposed to go through.

Research shows that the EU countries have been attempting to switch to a holistic approach for the last couple of years, but despite the efforts, the linear model is still present. This is definitely proved by the responses of the 19 countries participating at the project meant to study this matter. However, there is still a chance that things will change as the linear model prevails in the field on innovation policy, but not so much anymore in the field of innovation research.

As a conclusion, it can be said that in the EU, there are now 3 categories of countries, regarding their attitude towards holistic innovation approach. The first is the group that purposely pursues a linear innovation model and don't see any reason to change this. The second category is the one that strive towards a holistic approach, but haven't registered any results. And finally, the last group is formed out of countries that could pursue a holistic innovation policy, but none of the 19 countries have achieved this yet.

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COMPATIBILITY OF THE HEAD OFFICE THEORY WITH THE EUROPEAN UNION LAW

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Abstract
The essential role that companies play in the contemporary economy leads to the limitation of the freedom of their founders and to the protection of third parties, making the creation and functioning of the company the object of a law with they are objectively bound.
The attempts to define the "foreign" companies, as well as the rights conferred upon them, culminated with the appearance of two theories for the establishment of the nationality, which refer to the theory of the "incorporation" and to the theory of the "head office".
Therefore, starting from this double determination, there are two main conceptions within the Community, based on which lex societatis is established. A first theory applied by the member states of the European Union is the incorporation theory, based on which a company is established and operates according to the law of the state on whose territory it has declared its statutory offices, the place where it does business or the place where the decision-making bodies are locate being irrelevant. This theory has been adopted in the Community, among others, by Great Britain, the Netherlands and Ireland (Drury, 1999, pp. 354-358).
According to the second theory, the real seat theory, head office theory or siege réel, and respectively sitztheorie in the German law – promoted in its pure form by Germany, the law applicable to a trading company is the law of the state on whose territory the central management bodies of that company are located. Therefore, a state applying the real seat theory shall recognize a trading company as being subject of its own legal system if that company has its central management bodies in its territory, independent of the state where it has declared the statutory office. As we shall see further, the real seat theory is a form of excessive limitation of the freedom to establish trading companies within the internal market (Menjucq, 2001, pp. 19-26).
Keywords: *trading companies, corporate seat, lex societatis, incorporation theory, real seat theory, European Court of Justice.*
JEL Classification: K2, K29

1. THEORETICAL MILESTONES REGARDING THE HEAD OFFICE THEORY

The head office theory dates back from the middle of the 19th century. According to this theory, the law of the state where the company has its head offices (e.g. the management and control bodies) is the law applicable to the relations the company enters into. Conceptually, this refers to the applicable objective law: those in charge with the management of the company are not free in choosing the law governing the relations of the company (*lex societatis*). For instance, a business enterprise in Germany, using the legal form of an English limited liability company, cannot be considered as such. The autonomy of the parties thus being excluded, the legal order with which the company seems to be closes related or, more precisely, the location of the real seat has to be identified.

The essence of this theory is the sanctions applicable if the requirements in the country where the company has its head office are not complied with. The possible consequences are: 1. The company itself is not considered subject of law and 2. The management is limited to the most important benefits of the company. At first sight, the identification of the head office may be an easy task, in numerous situations the real seat is obvious. However, how should the transnational corporations be considered? The general formula of "head office" does not provide a clear answer to this phenomenon: most legal systems having adhered to the head office theory tend to consider the "management and control bodies" as being the head office of the company. It is however clear that this management does not coincide necessarily to the centre of the business.

The head office theory has double consequences: it affects both companies incorporated within a foreign law system, having though its office in the national territory, and companies incorporated based on the national law, with their management and control bodies abroad. However, this principle has been softened by means of international private law operations, such as renvoi: the state where the head office is located allows the companies to have their management and control bodies abroad, only if the laws of such country adhere to the incorporation theory as well, as to settle thus the legal conflict. The head office theory has been predominantly influenced by the control policies.

The head office theory justifies the application of no legal system except but a predominantly interested one. This results from the attitude of the law making bodies laying at the foundation of such legal conflict, therefore existing (almost) always a binding connection between the cosmopolitan factors and the system applying thereto. Therefore, this is considered to be the strong point of the head office theory, almost all forms of abuse of a foreign legal system, of those in charge with the management of the company, being excluded: the head office theory thus promotes an equal treatment of everybody and the protection of a fair competition. At the same time, this concentration over the control seems to be the weak point of the head office theory: mainly, in a globalized business world, it is difficult to determine where the company has its head office, its management bodies (Rammeloo, 2001, pp. 11-14).

In the end, the need for protectionist measures operates more as an orientation in the process of establishing the national law governing the company. However, this intrinsic aspect seems to be one of the weak points of the head office doctrine: the trading companies continuously do not operate in one single place. For example, the capital market, the labour market and the consumption market are not necessarily concentrated in one territory. Besides, it could be complicated to establish a single head office or to enact a law settling the legal conflict involving all the intrinsic factors.

2. DETERMINATION OF THE NATIONALITY OF THE LEGAL ENTITY BASED ON THE CRITERION OF THE HEAD OFFICE AND ON THE CRITERION OF THE INCORPORATION

According to the criterion of the head office (territoriality of the management), the legal entity has the nationality of the country where it has its head office, i.e. the place where its management is located. The head office must be really established within that that, not fictitiously, thus the legal entity shall have its administrative centre, i.e. its main management bodies within that territory. If the legal entity has several management bodies located in different countries, the head office of the legal entity is in the country where the highest body managing the entire legal entity. The head office must also be serious, i.e. established in a country with which the legal entity has a significant connection (Filipescu & Filipescu, 2008, p. 260).

If the head office is in a country that has no sufficient connections with the legal entity, but has been established there only for certain advantages taken into consideration, the head office, although it would be real, it is not serious and therefore could not serve for the determination of the nationality of the legal entity. In supporting this criterion one invoked, among other arguments, the fact that the majority of the legal acts binding that legal entity are made by its management bodies and therefore, for the settlement of the issues binding that legal entity are made by its management bodies the law in the country on whose territory such bodies are to operate should apply. This criterion is adopted in the French, Belgian and German practice.

The criterion of the place of registration of the memorandum of the company (or of the place of incorporation) requires that the legal entity has the nationality of the state where the formalities related to its establishment have been carried out, even if the head office would be in a different country (Diaconu, 2002, p. 170) (including the prior approval, publicity, etc.) (Băieșu & Căpățână, 2000, p. 188).

This criterion is practiced in the USA, Great Britain and the Netherlands. It allows the legal entity to be object of the law of the state based on which it has been established and to enjoy the protection of that state, irrespective of the place of business of that legal entity or of its head office (Filipescu, 1999, p. 246).

If we are to compare to the head office theory, the incorporation theory refers to the applicable subjective law. Based on his theory, the company is governed by the law adequately enacted. In other words, those in charge with the management of the company are free to choose which legal system shall apply to the relations of the company (*lex societatis*). If, according to the chosen legal system, the company complies with all the requirements, such company is also recognized in the other state. From the perspective of the legal conflict, one may say that the incorporation theory, at lease in its pure form, arises from the principle of will autonomy (Rammeloo, 2001, p. 16).

As concerns the law of the Republic of Moldova, the determination of the nationality of the legal entity shall be made as follows:

The international private law issues referring to the legal entities are regulated by art. 1596 - 1600 in the Civil Code of the RM. (Law no. 1107 on 06.06.2002, in the OJ no. 82-86 on 22.06.2002).

In Legal Assistance and Legal Relations Concerning Civil and Criminal Matters Treaties, such as that signed between the Republic of Moldova and Ukraine on 13.12.1993 (Decision no. 261 on 04.11.1994), the place of registration is also consecrated. According to art. 21 paragraph 2 *The capacity of the legal entity is determined by the legislation of the Contracting Party on whose territory it is founded*, which is also stipulated in the Treaty between the Republic of Moldova and Azerbaijan concerning the legal assistance and the legal relation concerning the civil, family and criminal matters on 26.10.2004, in art. 22 paragraph 2, as well as in other bilateral treaties signed by the Republic of Moldova.

According to other treaties, such as the Legal Assistance and Legal Relations Concerning Civil and Criminal Matters Treaty signed between the Republic of Moldova and Romania (Treaty no. MOLROM on 06.07.1996), another criterion for the establishment of the nationality is provided, thus, according to art. 24 paragraph 4 *The capacity of the legal entity is determined by the legislation of the Contracting Party on whose territory it has its head office,* i.e. according to the head office criterion.

According to the Multilateral Convention concerning the legal assistance and the legal relations in civil, family and criminal matters of the C.I.S. states on 22.01.1993 (Decision no. 42 on 16.03.1995), according to art. 23 paragraph 3 *the nationality of the legal entities is established based on the legislation of the state in which they are founded*.

According to the Vienna Convention on contracts for international sale of goods (1980), art. 1 paragraph 1 letter a), the convention shall apply to the contracts for the sales of goods between parties having their head office in different states: when such states are contracting parties. (in force for the Republic of Moldova on November 1, 1995)

If the international conventions the Republic of Moldova is party of establish another criterion for the determination of the nationality of the legal person, one of the criteria stipulated in the convention shall apply.

Given that this is a qualification issue, the nationality of the legal entity is determined by *lex fori*. Thus, the nationality falls in the rule situation regarding the law applicable to the qualification of a judicial institution. […] As concerns the international private law, the criterion of determination of the nationality is the connecting point of the conflicting norm concerning the legal entity (Babără, 2016, pp. 170-171).

The provisions of article 1596 in the Civil Code of the Republic of Moldova determines the law applicable to the legal entity (paragraph 1), the extent of this law (paragraph 2), as well as the protection of the third parties in the legal acts made by the company (paragraph 3). Although paragraph 1 is formulated in the sense of determining the law applicable to the foreign legal entity, the real will of the lawmaker in this article has been to determine the law which the memorandum of any legal entity is to be object of. The lawmaker has not wished to establish two different criteria for the determination of the law applicable to the legal entity, which is the criterion of the establishment for the foreign legal entities, and possibly the criterion of the location of the head office, for the legal entities in the Republic of Moldova. Is such a situation some confusion might arise at theoretical and practical level, as a legal entity may be founded in another state, and the head office may be in the Republic of Moldova or the other way round and in this case there would be two national laws. Therefore, this article shall be interpreted as applying to all the legal entities.

According to paragraph 1, the law of the state under whose power the legal entity has been duly incorporated is the law regulating the memorandum of that legal entity. In order to apply this law, the legal entity has to be registered and must have complied with other publicity requirements according to this law, as be otherwise organised based on this law. The term of "establishment" (or incorporation) shall be interpreted broadly, as the law right based on which the legal entity is established remains valid, even if the publicity or registration formalities are missing. However, in this case, it is necessary for the organization of the company to be visible externally for third parties, due to its bodies or memorandum. If the organization/company does not comply with the requirements concerning its foundation in the law of the state where it is established, then it has no legal personality.

A different issue is related to the documents to be submitted as a proof for the establishment and existence of the company. The applicable law stipulated the admissibility of the evidence and their force as such in order to make the proof of the establishment and existence of the foreign legal entity.

The law applicable to the memorandum of the company/organization mainly regulates its capacity, its legal nature, the manner of establishment, the acquiring of the rights and obligations, the competences and the functioning of the of the management bodies, its representation by its own bodies, the name and the company denomination, the organization, the internal relations between the participants/shareholders, as well as between them and the company/ organization, the manner of acquiring and losing the quality of shareholder/participant, the rights and obligations arising from the quality of shareholder/participant, the responsibility for the breach of the legal provisions concerning companies/ enterprises/organizations, the liability for the debts, the power of representation of the persons acting on behalf of the company/organization, the modification of the deeds of incorporation, the dissolution and the liquidation of the entity. The scope of the memorandum of the company has to be conceived in the broadest sense and shall comprise, as a principle, all the possible legal issues, irrespective whether they refer to intra-company relations of to external relations (between the company and third parties). The list under article 1596 paragraph (2) is not exhaustive.

If an issue is related to right of the company, it is to be qualified according to the applicable law. The law governing the memorandum of the legal entity regulates the volume of the powers of representation of the persons acting on behalf of the company, the limitations, the vices of representation and possibilities of remedy, for example by subsequent approval. The conditions and effects of the approval are however regulated by the law applicable to the legal act. If the company gives a power of attorney or powers of representation to the persons who are not members of the company management bodies, the power of attorney and the powers of representation fall under the incidence of the law applicable to the representation.

In Romania, the qualification of the term of head office is in line with the Romanian law, as *lex fori*, according to the rule related to the qualification of the legal institutions (art. 2558 Civil Code).

Depending on the qualification of the head office, which is the connecting point of the conflicting norm concerning the legal entity, without changing the applicable conflicting norm, the applicable law (*lex societatis*) is to be modified, as the head office is considered to be in Romania and abroad, and therefore the legal entity has Romanian or foreign nationality.

The qualification of the nationality and of the head office in line with the Romanian law, as *lex fori*, is important mainly in the case of the companies with foreign participation established in the country and of those with Romanian participation established abroad, of the branches, subsidiaries and representative offices of the foreign companies in the country and respectively of the Romanian companies abroad, as these are to be taken into consideration by the Romanian or foreign law depending on their head office – determined according to art.

2571 Civil Code, in the absence of derogatory provisions in special laws – irrespective whether the foreign state recognizes or not the nationality thus assigned to the said legal entity (Sitaru, 2013, pp. 168-169).

The article 2571 paragraph (1) Civil Code opts, as a solution of principle to determine the nationality of the legal entity, for the criterion of the statutory head office. The advantages of this position cannot be neglected: the statutory head office is unique, must be recorded in the deeds of incorporation, is legally object of publicity and enjoys relative stability. Moreover, establishing the head office, the shareholders also indirectly choose the law applicable to the legal entity, depending on their needs and expectations; at the same time, to the extent where this head office can be relatively easily identified, the legal security and the protection of the interests of the minority shareholders, of the employees, of the creditors of the legal entities or of other third parties are favoured (Oprea, 2011).

According to article 2571 paragraph (1) Civil Code "if there are head offices in several states, the real seat is determinant in identifying the nationality of the legal entity ".

It is to be noticed that, in the context in which it is employed by law, the notion of “real seat” is not necessarily antonymous to that of fictitious seat (simulated through fiction). This, if the legal entity has seats in several countries, in establishing its nationality the real seat is to be considered, which does not mean that the seats in the other states would necessarily be simulated (Sitaru, 2013, p. 168).

Despite these clarifications, one may discuss that, in order to disqualify the statutory office, it is sufficient to prove that the legal entity has management or administration offices in several countries or something more is needed for that, such as, possibly, the demonstration of the fictitious character of the statutory office.

The strict application of the real seat criterion may generate practical complications. Considering the bilateral approach in the Romanian Civil Code as concerns the establishment of the nationality, the courts might consider that a legal entity has the nationality of a certain state (as its real seat is located there), while the latter consecrates a different solution (as it considers the criterion of the place of incorporation in establishing the nationality). As the nationality determines the applicable law, the national law being considered to appreciate the valid existence of the legal entity, the analyzed texts incur, in case of dissociation between the real seat and the place of incorporation, the competence of another law than that based on which the legal entity has been established and operates, having as a consequence the refusal of the recognition of the legal personality (in the states consecrating the real seat theory) (Oprea, 2011).

In the Polish law, the matter of the law applicable to the legal capacity of natural persons and legal entities is regulated in the Act on the international private law. The general rule is stipulated under article 9 paragraphs (1) and (2). According to this provision, the legal capacity of a natural person and its capacity to conclude legal acts is object of the national law of such person, while the legal capacity of a legal entity is object of the law in the country where its head office is located. By head office of a legal entity the legal doctrine understands the real seat of its main management bodies (board of directors).

The connecting points of the nationality and of the head office as concerns the personal status of the natural persons and of the legal entities respectively are object of certain exceptions. First, as concerns the legal capacity of a legal entity, certain bilateral conventions stipulate the application of the law in the country where that legal entity has been established.

Second, if a legal entity or natural person concludes a legal act related to an enterprise, the legal capacity of such a person or entity is regulated by the law of the country in which the head office of the enterprise is located (article 9 paragraph (3) din act).

In principle, the French doctrine believes the nationality of a company is determined depending on the place of the head office. It is not only about a simple sentence in the memorandum, as this office can be purely formal or fictitious. This has to be the "real seat", defined as the place where the "top management and control" of the company is exercised, i.e. the place where the management bodies, mainly the board of directors, gather. More precisely, the Plenary Assembly of the Court of Cassation mentioned particularly that "the nationality (...) of a company results, in principle, from the location of the real seat, defined as the place of effective management and presumed by the statutory office" (Niboyet & de La Pradelle, 2007, pp. 677-678).

The head office is an abstract concept, which can cover diverse realities. It can be understood either as statutory head office – freely chosen by the founders and mentioned in the deeds of incorporation, as well as in the public registries in which the legal entity is registered – or as real seat – objectively and imperatively established by the judge, after having verified the concrete, real situation (Menjucq, 2005, pp. 499 et al.).

3. CHANGE OF THE NATIONALITY OF THE LEGAL ENTITY

During the existence of the legal entity, it is possible that some events may occur leading to the change of its nationality (Babără, 2016, p. 172). The change of the criteria based on which the law of the legal entities is established may also trigger the modification of the initial nationality (Macovei, 2001, p. 154). The modification of those elements of the legal entity the establishment of the nationality is based on, which are connecting points, involves as well the modification of the nationality (Dumitrache, 1999, p. 60). Such events may be independent from the will of the parties and depend on the will of the legal entity (Diaconu, 2002, p. 173).

As the establishment of the nationality of a legal entity is made according to *lex fori,* the change of its nationality has to be analyzed, in its turn, from the perspective of a legal system having the value of *lex fori* (Băieșu & Căpățână, 2000*,* p. 191).

The modifications of nationality occur in the following situations:

a) Change of office as a result of change of sovereignty

In such a case, the legal entity loses the previous nationality and acquires the nationality of the state that exercises its sovereignty in the future. This situation is independent from the will of the parties (Babără, 2016, p. 172).

The change of sovereignty poses a problem of succession of states (Macovei, 2001, p. 154). It is accepted that, in the lack of a special provision in the treaty based on which the transfer of territories takes place or in the absence of such a treaty, the legal entity maintains is quality of subject of law, but loses its previous nationality and acquires, by law, the nationality of the new state. In 1918, the companies with the offices in Alsace became French as a result of the transfer of this territory under French sovereignty. This also happened after Algeria had become independent in 1962. The French courts accepted that the French companies with the offices in Algeria had changed their nationality by law as this country had become independent, which the French controlled companies having opted to transfer their head office in France preserved their French nationality (Dumitrache, 1999, pp. 65-66).

b) Change of nationality as a result of the modification of the nationality of the majority in the capital share (or of the shareholders)

A change of nationality occurs from the point of view of the legislative systems embracing the control criterion. From the perspective of the law systems using other criteria (head office, incorporation, etc.), the nationality remains the same.

c) Modification of the nationality as a result of the change of the head office

This change of the head office triggers the modification of the national law of the legal entity thus arising a mobile conflict of law in time and space, which raises the question of determining the scope in time of the two laws in conflict. This case of changing the nationality depends on the will of the legal entity. The change of the head office from the territory of one state to another is decided by the management bodies of the legal entities. The decision to change the head office is taken in compliance with the provisions of the deeds of incorporation (Macovei, 2001, p. 155).

There are several situations related to this:

1) The transfer of the legal entity occurs between two states using both the head office criterion. The first state no longer recognized the legal entity concerned as one of its nationals, while the new state grants it its nationality (Dumitrache, 1999, p. 61). If the legal entity transfers its head office from a state

where its nationality is determined according to the head office criterion to a state where the nationality is determined according to the incorporation criterion, the situation is as follows: from the point of view of the legislation of the first state, the legal entity loses its nationality and obtains the nationality of the state where it has established its new head office, and from the point of view of the legislation of the state where the head office has been transferred, the nationality of the company suffers no change. Thus, the change of the nationality of the legal entity occurs only from the perspective of the new state.

2) In the case when the legal entity transfers its head office from a state where the nationality is determined based on the incorporation criterion into a state where the nationality is established according to the head office criterion, the situation is as follows: from the point of view of the legislation of the first state, the legal entity preserves the nationality of the that state, while from the point of view of the legislation of the second state, the legal entity acquires is personality. Thus, the change of the nationality of the legal entity occurs only from the perspective of the state where the head office is transferred to (Babără, 2016, pp. 172-173). The new head office shall comply with the general conditions referring to the head office, in the sense that it must be serious and real. By changing the head office, no illicit purposes are to be considered, resulting from fraud against the law (Diaconu, 2002, p. 173).

3) In the specialized literature, the issue of the admissibility of the transfer of the head office abroad is controversial. The opinions expressed have been influenced by the theory of the fiction and by the theory of the reality concerning the legal personality. One opinion claims that the transfer of the head office from one country to another is not valid. This change can only take place only by dissolving the legal entity and establishing another one. The new legal entity is distinct from the old one. Due to the modification occurred; the legal personality of the company cannot be determined by the law where it has originally been established. Moreover, the parties cannot make the company subject of another law than that initially chosen by the articles of incorporation, as this would mean a substitution of the initial contract with a new one. Another opinion claims that the transfer of the head office into another state does not have an impact on the quality of subject of law of the legal entity. The preservation of the legal personality is possible, as the role of the law is to set the conditions for granting the quality of collective subject of law and not for creating the legal entity. At the same time, in some legal systems, the essential modifications of the deeds of incorporation are accepted without the movement of the legal entity. The head office is transferred abroad in compliance with the requirements of the law at the previous head office and with the law of the new head office. The continuation of the legal personality must be stipulated in both laws. The formal conditions for the change of the head office are subject of the law of the previous head office, and the conditions for the adoption of the deeds of incorporation are

governed by the law of the news head office. The transfer of the head office triggers a mobile conflict of laws and a change of legislative competence (Macovei, 2001, pp. 155-156).

4. ROLE OF THE JURISPRUDENCE OF THE EUROPEAN UNION

As all this is about legal entities in the European Union, these are assimilated to the "nationals" of the member states, if the following conditions are complied with: the company must be established according to the law of a member state and, besides, it has to have either its central management bodies, its main seat or its statutory office in that state. In this latter case, the European Court of Justice has decided that, besides that, the company must have an effective binding relation with a member state.

The European Court of Justice has decided that a member state may require the companies established in compliance with its national law to keep their head office in that state as long as it is subject to its laws. The Court has ruled that, if such change of head office involves as well the amendment of the applicable national law, the states from which the company transfers its head office cannot request the dissolution of the liquidation of the company.

The decision was made in the Case C-210/06, which was brought in front of the Court by *Cartesio Oktató és Szolgáltató* ("Cartesio") and was expected with great interest by the European business community, as it involved the right to free establishment within the Community.

Cartesio, a Hungarian company, intended to transfer its head office from Hungary to Italy, wishing at the same time to remain governed by the Hungarian law. The registration was rejected by the court in charge with maintaining the Companies Registry, due to the provisions of the Hungarian law, which stipulates that a company may be governed by the Hungarian law only if it has its head office in Hungary. Besides, the court has decided that such a transfer would require in the first place for the company to cease its existence and then to be re-established according to the law of the country to which it intends to transfer its new head office.

Cartesio appealed at the European Court of Justice, claiming that the rejection of the registration is a breach of its right to free establishment, consecrated by articles 43 and 48 in the Treaty of the European Communities.

The Court has ruled that a member state has the right to define both the requirements for a trading company to be regarded as registered in compliance with the law in that state and, therefore, as being capable of benefitting from the right to free establishment, as well as the requirement for a company to keep on having the same deeds of incorporation. This right includes the possibility for the member state not to allow a company governed by its law to maintain such deeds of incorporation if the company wishes to reorganize itself in another member state, by transferring the head office, thus breaching the connection factor required by the national law of the state it is registered in.

However, the Court has made the distinction between the situation in the Cartesio case and the situation in which a company changes both its head office and the applicable national law. The Court has decided that in this latter case, the company turns into a company which is governed by the law of the state to which it transfers its head office.

Thus, the state in which the company is established cannot require the dissolution or the liquidation of the company to prevent that company from turning into a company governed by the law of another member state, if such transformation is allowed by the law of the state to which the company intends to transfer its head office.

According to the Romanian law, the possibility for a company to transfer its head office to another member state by acquiring the nationality of the member state in which the company wishes to be established is expressly regulated only as concerns a European company. In the proceedings of the Court, the Commission argued that the rules applicable to the European company should apply as well, *mutatis mutandis*, to the cross-border transfer of the companies established in compliance of the national law of the member states.

The opposite situation, in which a Romanian company wishes to transfer its head office to another member state, whose legislation allows for this change, could be supported by the opinion of the Court in the Cartesio case. In this case, according to the decision of the Court, the Romanian authorities cannot claim the dissolution or liquidation of the Romanian Company. (Decision of the CJEC (Grand Chamber) on December 16, 2008)

In any case, this change of a company established in compliance with the national law of a member state into a company established according to the national law of another member state would be difficult to implement in the Republic of Moldova, as a state where the company is to transfer to, as the law has no specific provisions in this respect.

5. CONCLUSIONS

The ongoing process of economic globalization has led to major changes in the business and trade world, as well as in the reaction of the states against these changes. Today, more than ever, the traders in the markets are aware of the fact that making business with foreigners involves more than a simple exchange of goods and services. A more dynamic attitude is needed, either through more active participation against foreign companies or by transferring a company from one country to another. This is not a simple issue of maximizing profit. The freedom to establish the head office, as well as the abolishment of national barriers has led to intensified competition. Therefore, managers have to take daring initiatives: complete transfer of business, that could become a necessity to survive (Rammeloo, 2001, p. 3).

The real seat theory requires serious adaptation in the light of the European jurisprudence; the destination countries have to recognize the legal entities from other member states as such, with the legal personality conferred upon them by the law based on which they have been established.

The evolution of the jurisprudence of the European Court of Justice as concerns the freedom of establishment of the companies within the common market is another proof that, in the absence of a legislative harmonization at Community level, the member states continue to promote, through various legal norms, the protection of their own legal system against the trading companies established according to the legislation of another member state. Although the means are each time different, the result aimed at remains the same, i.e. the indirect obligation of the trading companies established in a member state to also comply with the conditions of the receiving state as concerns the establishment of companies, despite the fact that the companies concerned by these conditions already enjoy the status of legal entities by virtue of the provisions of the EC Treaty.

The theory of the head office has not been formally declared contrary to the law of the European Union, therefore the lawmaker may be free to consecrate it; however, it is quite true that its application is object of strict limits as long as it concerns legal entities originating from other member states.

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THE IMPACT OF BOARD GENDER DIVERSITY ON CORPORATE SOCIAL RESPONSIBILITY: PANEL DATA EVIDENCE FOR LISTED COMPANIES IN ROMANIA

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Abstract
Gender diversity is a powerful source of competitive advantage for corporations, bringing a wider spectrum of perspectives and professional expertise. Likewise, women are stereotypically good communicators, being capable of empathy, thus providing support in the quest to develop a corporate social responsibility (CSR) vision that is at the core of a business goals and strategies. This study examines the impact of board gender diversity on CSR for listed companies at the Bucharest Stock Exchange, over 2007-2011. Even if the frequency analysis emphasizes that the number of companies adopting CSR has increased, the CSR in Romania is still at an incipient stage. The parametric investigation via independent samples t test reveals that there are significant difference as regards the number and the share of women on boards, as measures of board gender diversity, between CSR and no CSR companies, but only in 2007 and 2008. Further, by estimating logistic regressions, alongside mixed effects logistic regressions, the results provide support for a negative impact of the number, as well as the share of women on boards on CSR. The empirical evidence also shows that board size has a positive impact on CSR, whilst the link between the gender of CEO and CSR was not statistically validated. However, current investigation supports that women directors encounter barriers that limit their capacity to contribute to an effective decision-making process.
Keywords: *board gender diversity, corporate social responsibility, parametric research, panel data, logistic regression.*
JEL Classification: J16, M14

1. INTRODUCTION

CSR regards the understanding and management of the relationship between business activity, local economies, environment and communities where companies operates (Scott, 2007). According to Morrisons, CSR focuses on “managing the social, ethical and environmental issues that are material to our commercial performance, through a programme of continuous improvement” (Morrisons, 2005). CSR is related to companies’ decision-making and their ethical behavior as well as moral issues (Kahreh *et al.*, 2014). Continuing their argument the same authors underline that the central question for a company is to know which activities to undertake or to refrain from whenever the society benefit or its harmed (Kahreh *et al.*, 2014). Nowadays CSR is associated with concerns regarding environmental protection, safety at work, health, local communities and consumers (Branco & Delgado, 2011).

Researchers have showed that CSR activities are linked with companies managers and directors motives, values and choices (Healy & Palepu, 2001) who carefully decides on chosen items to be revealed in CSR reports (Luo *et al.*, 2012). As a result, the company board plays a significant role in determining if companies adopt CSR practices (Harjoto *et al.*, 2015; Barako & Brown, 2008). Companies including CSR in their business strategies’ can improve or increase reputation (Brammer & Pavelin, 2006; Tullberg, 2005), lower financial risk related with environmental and social issues (Cheng & Courtenay, 2006), improvement financial performance (Aguinis & Glavas, 2012; Malik, 2015). Therefore, companies should adopt CSR activities not for maximizing shareholders wealth or just to comply with laws and regulations; they should take into consideration stakeholder needs and requirements as well in their decision-making process. A company role should be more of a citizen in a society, associated with economic, ethical and social responsibilities (Davidson, 2009). Study made by Alonso-Almeida *et al.* (2015) has found that differences in CSR awareness are given by the company’s board gender. Research focusing on CSR and gender regards inequality between woman and man in companies and how this gap can be closed through CSR activities development (Braun, 2010; Jamali *et al.*, 2007). Another line of research analyses the role of women on companies’ boards. Researchers have found that whenever are more women on board, the company tends to adopt, develop CSR activities (Soares *et al.*, 2011; Zhang *et al.*, 2013).

This paper aim is to identify if number and share of women on boards influence company to adopt CSR activities. Best on our knowledge this is the first research approaching the relation between board gender diversity and companies implementing CSR activities in their business strategies on all listed companies at BSE. The rest of the paper is organized as follow: section 2 presents the literature review, section 3 details research methodology, in section

4 are discussed the regression results and last section gives the summary and conclusion of our research paper.

2. LITERATURE REVIEW

CSR are activities adopted by the companies on voluntary basis and regards social, economic and environmental practices beyond profit maximization and legal responsibilities (Piacentini *et al.*, 2000). According to Khoury & Rostami (1999) CSR is the relationship between corporations and all their stakeholders. Freeman (1970) said that employees, customers, communities, shareholders, investors, competitors' government and suppliers represent the stakeholders. Social responsibility includes employee relations, investment in local community, environmental practices, attracting and retaining talented employees and company financial performance. As stated by the Marsden (2001) CSR is reflected through company' behavior and its responsibility toward overall impact on societies where operates. CSR is not a philanthropic activity or an option that can be added on. A socially responsible company is a profitable businesses whose decision were taken accounting for all positive and negative economic, social and environmental effects that may impact a society. Van Marrewijk (2003) argued that CSR and corporate sustainability are about a company activities, respectively the insertion of environmental and social concerns in business strategies and in communications with stakeholders. World Business Council for Sustainable Development (2000) affirmed that CSR represents the company's continuing commitment to be ethically and to contribute to economic development while they improve employees quality of life and their families, local communities and society as a whole. Companies adopting CSR into their business strategies' may benefit of increased financial performance (Lev *et al.*, 2010), enhance their brand image (Cheng *et al.*, 2014), reduce risk exposure (Strike *et al.*, 2006), improve trust, competitive advantage (Porter & Kramer, 2006), reduce their costs (Flammer, 2014; Madsen & Zachariah, 2015; Martínez-Ferrero *et al.*, 2016), increase recruitment and retain skilled employees (Hillman & Kleim, 2001; Palazzo & Scherer, 2008).

According to Kolodinsky *et al.* (2010), women value CSR more than male. However, when every CSR dimension is studied independently, the results are mixed. In the last decade, stakeholder relationship has grown in importance for both men and women, and now it is considered the most significant CSR dimension (Aspen Institute, 2002, 2008; Alonso-Almeida *et al.*, 2015; Lämsä *et al.*, 2008). Aspen Institute (2008) showed that women give more importance than men in maintaining community and society healthy. Research made by Prasad *et al.* (1998) sustained these results. Thus, women tend to adopt socially responsible activity from which society can benefit (Pearson, 2007). Additionally, Hudson & Miller (2005) research have revealed that women are more responsive to CSR activities, mainly in relation with environmental concerns. The authors' findings were in line with those of Freedman and Bartholomew (1990) and Lämsä *et al.* (2008). Therefore, environmental and social concerns are more significant to women than stakeholder orientation.

Another line of research is the relationship between gender and companies' business ethics which was widely debated. Empirical studies have showed that females' managers or directors are more ethical than males. Other studies have showed contradictory results or no ethical difference between female and male (Atakan *et al.*, 2008). Empirical evidence on relationship between gender influence and CSR activities based on ethical points of view continues to be confused and contradictory in regard the results. Reviewing empirical articles that have studied business ethics subjects, Ford and Richardson (1994) found 14 studies on gender differences where 7 out of 14 studies found a positive relation between female and company ethical behavior. Hyun *et al.*, (2016) said that women's are a key element in determining companies to implement CSR activities into their business strategies. Same authors further empirically showed that women independent directors are positively and statistically significant with company performance and market share. Moreover, female directorship not only enhances the CSR performance but also strengthen the stakeholder orientation relationship with the company (Hyun *et al.*, 2016).

In the literature on CSR was empirically demonstrated that females are less tolerant on company misconduct than males (Ameen *et al.*, 1996), respond in a more ethical manner to consumer claims (Dawson, 1997), female business students tent to be predisposed to a more ethical behavior than males (Gill, 2010). It has been observed that males demonstrate less diversity regarding the ethical decision making whereas females showed in different business scenarios a wide range of solution concerning ethical dimensions. According to Marz *et al.* (2003) women have a considerably higher level than males for social orientation.

Researchers suggests that companies with a higher share of women on boards tend to perform better in CSR activities than companies with fewer female on boards (Bear *et al.*, 2010; Ali *et al.*, 2014; Boulouta, 2013; Isidro & Sobral, 2015). These findings are not surprising because women are more empathetic and compassionate than men. Previous research have underlined that the impact of CSR enhanced by female directors derive from the literature on gender differences (Azmat& Rentschler, 2015; Rao & Tilt, 2015; Ben Amar *et al.,* 2015). However, it is possible that the positive and significant influence of women on board of a CSR company may be determined by their reputational concerns (Hyun *et al.*, 2016). This paper extend the literature on CSR in relation with bord size and diversification on listed companies at BSE. Although this relation have been widely reseach in developed countries, in developing countries such as Romania was not yet approached.

3. RESEARCH DESIGN

3.1. Dataset and variable description

Our unbalanced dataset comprises all listed companies on the BSE over 2007-2011, except financial sector stocks, as follows: 63 companies in 2007, 67 companies in 2008, 68 companies over 2009-2011, thus resulting 334 firm-year observations. The data was hand-collected from the BSE webpage. Also, we notice that the companies from our sample come from various industries such as: wholesale/retail, construction, pharmaceuticals, manufacturing, plastics, machinery and equipment, metallurgy, food, chemicals, basic resources, transportation and storage, tourism, utilities.

The variables employed within current study are revealed in Table 1. This study uses one dependent variable and two groups of independent variables: board gender diversity variables and firm characteristics. The dependent variable has a value of 1 for CSR companies and of 0 for non-CSR companies.

Table 1. Definitions of variables

Variables	Definition
Panel A: Corporate social responsibility variables (Dependent variable)	
(1) CSR	Dummy variable which has a value of one if the firm has adopted corporate social responsibility and a value of zero if it has not
Panel B: Board Gender Diversity variables (Explanatory variables)	
(2) Board_size	The number of members on board of directors
(3) Women (No)	The number of women on board of directors
(4) Women (%)	The percentage of women on board of directors
(5) CEO_gender	Dummy variable which has a value of one in case of female CEOs and a value of zero in case of male CEOs
Panel C: Firm-level control variables	
(6) Employees	The total number of employees (logarithmic values)
(7) Debt/Equity	Financial leverage, computed by dividing a company's total liabilities by its stockholders' equity
(8) Turnover_growth	Year-over-year turnover growth
(9) ROA	Return on assets, computed by dividing a company's annual net income by its total assets
(10) Current_ratio	Current ratio, computed by dividing a company's current assets by its current liabilities
(11) Years_listing	The number of years since listing on the Bucharest Stock Exchange (logarithmic values)

Source: authors' own work

However, various firm-level characteristics are likely to influence firm CSR involvement. As such, the study includes several control variables towards firm size, indebtedness level, growth opportunities, profitability, liquidity, and tenure since listing. Large firms are more visible to the community, being subject to greater political and regulatory pressure to follow the societal expectations (Jackson & Apostolakou, 2010), therefore suggesting that larger companies are more likely to involve in CSR. Besides, larger firms would be more likely to launch and concentrate on sustainability activities, as well as sustainability reporting due to more varied and influential stakeholders (Gallo & Christensen, 2011). Udayasankar (2008) and Erhemjamts *et al.* (2013) find a U-shaped relationship between firm size and CSR participation, indicating that very small or very large firms display high levels of CSR strengths and concerns.

Further, firms with good CSR performance enjoy reduced credit risk, corporate bond spreads, and bankruptcy risk (Hsu & Chen, 2015), as well as lower cost of equity capital (El Ghoul *et al.*, 2011). Also, Goss & Roberts (2011) document that banks view CSR concerns as risks and react with less attractive loan contract terms, consequently firms with social responsibility concerns pay between 7 and 18 basis points more than firms that are more responsible.

Older companies may invest more in CSR undertakings to uphold and increase their reputation as their profit margins fall, whilst younger firms may strive to be more socially responsible to differentiate themselves (Erhemjamts *et al.*, 2013).

3.2. Model specification

Primarily, we will perform a parametric research via t-test (independent samples) in order to examine whether companies that has adopted CSR and no CSR companies have different means as regards the number of members, the number of women, as well as the percentage of women on boards. Also, we will check if there is any difference between CSR and no CSR companies with respect to the gender of CEO. The null hypothesis supposes that $\mu_{CSR-Yes} = \mu_{CSR-No}$, respectively there is no difference between the means of CSR and no CSR companies, whereas the alternative hypothesis reveals that $\mu_{CSR-Yes} \neq \mu_{CSR-No}$, namely the means of CSR and no CSR companies are significantly different from each other. In fact, when two independent datasets are expected to be picked from populations with equal variances, the test statistic t is calculated as below:

$$t = \frac{\mu_{CSR-Yes} - \mu_{CSR-No}}{s_p\sqrt{\frac{1}{n_{CSR-Yes}} + \frac{1}{n_{CSR-No}}}} \qquad (1)$$

$$s_p = \sqrt{\frac{(n_{CSR-Yes} - 1)s^2_{CSR-Yes} + (n_{CSR-No} - 1)s^2_{CSR-No}}{n_{CSR-Yes} + n_{CSR-No} - 2}} \quad (2)$$

where:

$\mu_{CSR-Yes}$ = mean of CSR companies;
μ_{CSR-No} = mean of no CSR companies;
$n_{CSR-Yes}$ = sample size of CSR companies;
n_{CSR-No} = sample size of no CSR companies;
$s_{CSR-Yes}$ = standard deviation of CSR companies;
s_{CSR-No} = standard deviation of no CSR companies;
s_p = pooled standard deviation.

Afterwards, the computed t value is compared to the critical t value from the t distribution table with degrees of freedom df = $\mathbf{n_{CSR-Yes} + n_{CSR-No} - 2}$ and 5% confidence level. If the calculated t value is greater than the critical t value, then the null hypothesis is rejected.

Further, we will explore the impact of board gender diversity on CSR by means of logistic regression, having the following general form:

$$\ln\left(\frac{p}{1-p}\right) = \beta_0 + \beta_1 X_{1it} + \beta_2 X_{2it} \quad (3)$$

where p denotes the probability that the firm has adopted CSR, X_1 is the vector of variables board gender diversity, X_2 is the vector of firm-level control variables, i stands for the cross-sectional unit, whilst t stands for the time period.

4. EMPIRICAL RESULTS

4.1. Summary statistics, frequency examination and correlation investigation

Table 2 presents the summary statistics of our sample. We notice that the mean board size of listed companies is Romania is nearly five members, whereas the share of women on boards is only 14.33%. However, the examined companies are in line with the European peers inasmuch as the European Commission revealed the fact that just one in seven board members (13.7%) at Europe's top companies is a woman (European Commission, 2012b). Nevertheless, the surveyed companies are far away of fulfilling the European Commission target of achieving a 40% share of the underrepresented sex in non-executive board-member positions in publicly listed companies, with the exception of small and medium enterprises, by 2020 (European Comission, 2012a).

Table 2. Descriptive statistics

Variables	Obs.	Mean	Std. Dev.	Min.	Max.
Panel A: Corporate social responsibility variables					
CSR	334	0.4491	0.4981	0.0000	1.0000
Panel B: Board Gender Diversity variables					
Board_size	334	4.9042	1.5929	3.0000	10.0000
Women (No)	334	0.6497	0.7866	0.0000	3.0000
Women (%)	334	0.1433	0.1832	0.0000	0.6700
CEO_gender	334	0.1198	0.3252	0.0000	1.0000
Panel C: Firm-level control variables					
Employees	334	2.7246	0.6069	1.0000	4.0000
Debt/Equity	334	0.8933	10.6742	-93.9511	157.7399
Turnover_growth	334	0.0706	0.3566	-0.9136	2.5031
ROA	334	0.0055	0.1243	-1.2347	0.2720
Current_ratio	334	2.8990	4.8575	0.2053	53.1973
Years_listing	334	0.9683	0.2530	0.0000	1.2041

Notes: Description of the variables is provided in table 1.

Source: Authors' computations

The frequency of undertaking CSR, as well as the CEO gender prevalence is disclosed in table 3. We notice that the number of companies implementing CSR activities has increased, circumstance that denotes the enhancement of the awareness towards social practices. Howbeit, we acknowledge an overwhelming predominance of male CEOs.

Table 3. Frequency table towards corporate social responsibility and CEO gender diversity

Variables	Values	2007		2008		2009		2010		2011	
		Freq.	**%**	**Freq.**	**%**	**Freq.**	**%**	**Freq.**	**%**	**Freq.**	**%**
CSR	Yes	25	39.68	27	40.30	31	45.59	33	48.53	34	50
	No	38	60.32	40	59.70	37	54.41	35	51.47	34	50
CEO_ gender	Female	6	9.52	7	10.45	10	14.71	9	13.24	8	11.76
	Male	57	90.48	60	89.55	58	85.29	59	86.76	60	88.24

Notes: Description of the variables is provided in table 1.

Source: Authors' computations

Further, table 4 exhibits the awareness towards CSR based on the industry membership. We ascertain that all the pharmaceutical companies listed in Romania have implemented CSR, whilst the companies from transportation and storage are not conscious with regard to social practices.

Table 4. Frequency table towards corporate social responsibility according to industry membership

Industry	2007		2008		2009		2010		2011	
	Freq. CSR Yes	Freq. CSR No	Freq. CSR Yes	Freq. CSR No	Freq. CSR Yes	Freq. CSR No	Freq. CSR Yes	Freq. CSR No	Freq. CSR Yes	Freq. CSR No
Wholesale/retail	1	3	1	3	1	3	1	3	1	3
Construction	0	8	0	8	0	8	0	8	1	7
Pharmaceuticals	3	0	3	0	4	0	4	0	4	0
Manufacturing	7	12	7	12	8	11	9	10	9	10
Plastics	1	1	2	1	2	1	2	1	2	1
Machinery and equipment	3	4	4	4	4	4	4	4	4	4
Metallurgy	2	2	2	2	3	1	3	1	3	1
Food	1	2	1	2	1	2	1	2	1	2
Chemicals	3	1	3	1	3	1	3	1	3	1
Basic resources	3	1	3	1	4	0	4	0	4	0
Transportation and storage	0	2	0	2	0	2	0	2	0	2
Tourism	1	1	1	2	1	2	1	2	1	2
Utilities	0	1	0	2	0	2	1	1	1	1
Total	**25**	**38**	**27**	**40**	**31**	**37**	**33**	**35**	**34**	**34**

Source: Authors' own work

Table 5. Correlation matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(1) CSR	1.00										
(2) Board_size	**0.16**** **(0.00)**	1.00									
(3) Women (No)	**-0.22***** **(0.00)**	0.05 (0.41)	1.00								
(4) Women (%)	**-0.21***** **(0.00)**	**-0.19***** **(0.00)**	**0.92***** **(0.00)**	1.00							
(5) CEO_gender	-0.02 (0.74)	-0.05 (0.33)	**0.18**** **(0.00)**	**0.20***** **(0.00)**	1.00						
(6) Employees	**0.16**** **(0.00)**	**0.33***** **(0.00)**	**-0.15**** **(0.01)**	**-0.20***** **(0.00)**	**-0.09**† **(0.10)**	1.00					
(7) Debt/Equity	0.00 (0.98)	0.01 (0.79)	-0.03 (0.63)	-0.02 (0.65)	-0.02 (0.68)	**-0.13*** **(0.02)**	1.00				
(8) Turnover_growth	-0.04 (0.44)	0.05 (0.32)	-0.04 (0.43)	-0.05 (0.35)	**-0.11*** **(0.04)**	0.02 (0.71)	0.01 (0.88)	1.00			
(9) ROA	-0.05 (0.35)	**0.14*** **(0.01)**	0.02 (0.68)	0.02 (0.72)	0.07 (0.22)	**0.12*** **(0.03)**	-0.01 (0.92)	**0.19***** **(0.00)**	1.00		

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(10) Current_ratio	-0.03 (0.58)	-0.05 (0.35)	**0.21*** (0.00)**	**0.25*** (0.00)**	**0.23*** (0.00)**	**-0.15** (0.01)**	-0.01 (0.87)	-0.05 (0.37)	**0.13* (0.01)**	1.00	
(11) Years_listing	-0.08 (0.14)	0.00 (1.00)	**-0.18*** (0.00)**	**-0.17** (0.00)**	-0.04 (0.47)	**-0.10† (0.07)**	0.04 (0.49)	0.01 (0.86)	-0.01 (0.80)	-0.07 (0.17)	1.00

Notes: p-values in parentheses. † $p < 0.10$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$. Description of the variables is provided in table 1.

Source: Authors' computations

The correlation coefficients are revealed in table 5. We notice low correlations between the considered variables, except the number and the percentage of women on board of directors, which will be employed in distinct regression equations. As such, the potential issue of multicollinearity is minimized.

4.2. Parametric research of board gender diversity and corporate social responsibility

The outcome of independent samples t-test, for each examined year, is conveyed within table 6.

Table 6. Independent samples t-test results

Variables	Mean CSR Yes	Mean CSR No	t-value	df	p	N CSR Yes	N CSR No	Std. Dev. CSR Yes	Std. Dev. CSR No	F-ratio Variances	p Variances
2007											
Board_size	5.32	4.76	1.30	61.00	0.20	25.00	38.00	1.63	1.68	1.07	0.87
Women (No)	**0.28**	**0.74**	**-2.43**	**61.00**	**0.02**	**25.00**	**38.00**	**0.46**	**0.86**	**3.52**	**0.00**
Women (%)	**0.06**	**0.16**	**-2.38**	**61.00**	**0.02**	**25.00**	**38.00**	**0.11**	**0.19**	**3.18**	**0.00**
CEO_gender	0.12	0.08	0.54	61.00	0.59	25.00	38.00	0.33	0.27	1.47	0.28
2008											
Board_size	5.37	4.73	1.59	65.00	0.12	27.00	40.00	1.67	1.60	1.08	0.80
Women (No)	**0.33**	**0.80**	**-2.44**	**65.00**	**0.02**	**27.00**	**40.00**	**0.48**	**0.91**	**3.60**	**0.00**
Women (%)	**0.07**	**0.18**	**-2.52**	**65.00**	**0.01**	**27.00**	**40.00**	**0.11**	**0.20**	**3.51**	**0.00**
CEO_gender	0.07	0.13	-0.66	65.00	0.51	27.00	40.00	0.27	0.33	1.58	0.23
2009											
Board_size	5.19	4.59	1.64	66.00	0.10	31.00	37.00	1.74	1.26	1.92	0.06
Women (No)	0.45	0.81	-1.96	66.00	0.05	31.00	37.00	0.57	0.88	2.38	0.02
Women (%)	0.10	0.18	-1.68	66.00	0.10	31.00	37.00	0.16	0.20	1.71	0.13
CEO_gender	0.13	0.16	-0.38	66.00	0.71	31.00	37.00	0.34	0.37	1.20	0.61

Variables	Mean CSR Yes	Mean CSR No	t-value	df	p	N CSR Yes	N CSR No	Std. Dev. CSR Yes	Std. Dev. CSR No	F-ratio Variances	p Variances
2010											
Board_size	5.09	4.63	1.18	66.00	0.24	33.00	35.00	1.70	1.52	1.26	0.51
Women (No)	0.58	0.80	-1.16	66.00	0.25	33.00	35.00	0.71	0.87	1.50	0.25
Women (%)	0.13	0.18	-1.12	66.00	0.27	33.00	35.00	0.17	0.21	1.47	0.28
CEO_gender	0.12	0.14	-0.26	66.00	0.80	33.00	35.00	0.33	0.36	1.15	0.70
2011											
Board_size	5.06	4.62	1.17	66.00	0.25	34.00	34.00	1.65	1.46	1.28	0.48
Women (No)	0.59	0.88	-1.49	66.00	0.14	34.00	34.00	0.70	0.91	1.70	0.13
Women (%)	0.13	0.19	-1.36	66.00	0.18	34.00	34.00	0.17	0.21	1.61	0.18
CEO_gender	0.12	0.12	0.00	66.00	1.00	34.00	34.00	0.33	0.33	1.00	1.00

Notes: Bold figures highlight p-level for 0.05. Description of the variables is provided in table 1.

Source: Authors' computations

We establish that there are significant differences between CSR and no CSR companies, but only in case of the number and the share of women on boards, and just in 2007 and 2008. As regards, board size and CEO gender, the results provide support for a lack of significant differences.

4.3. Regression analysis

The output of logistic regressions is provided in table 7. We acknowledge that board size positively influences CSR undertakings (Eq1 and Eq5), whilst the number (Eq2 and Eq6), as well as the percentage of women on boards (Eq3 and Eq7) negatively influence CSR practices. Besides, the relationship between CEO gender and CSR engagement was not statistically validated (Eq4-Eq7).

Table 7. Logistic regression results

Variables	Eq1	Eq2	Eq3	Eq4	Eq5	Eq6	Eq7
_cons	**-1.709*** **(-2.178)**	-0.255 (-0.315)	-0.239 (-0.294)	**-1.258**† **(-1.651)**	**-1.710*** **(-2.161)**	-0.272 (-0.335)	-0.256 (-0.314)
Board_size	**0.180*** **(2.352)**				**0.180*** **(2.350)**		
Women (No)		**-0.636***** **(-3.894)**				**-0.642***** **(-3.912)**	
Women (%)			**-2.580***** **(-3.577)**				**-2.616***** **(-3.600)**

Variables	Eq1	Eq2	Eq3	Eq4	Eq5	Eq6	Eq7
CEO_gender				-0.026 (-0.073)	0.005 (0.014)	0.144 (0.374)	0.158 (0.412)
Employees	**0.442*** **(2.096)**	**0.482*** **(2.375)**	**0.452*** **(2.218)**	**0.584**** **(2.897)**	**0.442*** **(2.092)**	**0.485*** **(2.386)**	**0.454*** **(2.229)**
Debt/Equity	0.004 (0.339)	0.004 (0.334)	0.003 (0.325)	0.005 (0.473)	0.004 (0.339)	0.004 (0.343)	0.004 (0.334)
Turnover_growth	-0.237 (-0.708)	-0.242 (-0.717)	-0.241 (-0.724)	-0.208 (-0.624)	-0.237 (-0.702)	-0.230 (-0.678)	-0.228 (-0.682)
ROA	-1.334 (-1.328)	-1.089 (-1.064)	-1.101 (-1.093)	-1.108 (-1.103)	-1.335 (-1.326)	-1.115 (-1.085)	-1.128 (-1.115)
Current_ratio	-0.001 (-0.023)	0.015 (0.600)	0.016 (0.605)	-0.001 (-0.021)	-0.001 (-0.026)	0.014 (0.536)	0.014 (0.532)
Years_listing	-0.588 (-1.309)	**-0.930†** **(-1.957)**	**-0.906†** **(-1.910)**	-0.544 (-1.216)	-0.588 (-1.308)	**-0.930†** **(-1.959)**	**-0.905†** **(-1.910)**
McFadden R-squared	0.040	0.064	0.058	0.028	0.040	0.064	0.058
LR statistic	**18.494***	**29.214*****	**26.661*****	**12.829†**	**18.495***	**29.354*****	**26.831****
Prob(LR statistic)	**0.010**	**0.000**	**0.000**	**0.076**	**0.018**	**0.000**	**0.001**
Observations	334	334	334	334	334	334	334

Notes: z statistics in parentheses. † $p < 0.10$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$. Method: ML - Binary Logit (Quadratic hill climbing). Covariance matrix computed using second derivatives. Description of the variables is provided in table 1.

Source: Authors' computations

Besides, all the estimated equations show a positive influence of the total number of employees on CSR activities. Consequently, the CSR implementation is driven by the size of the company. Also, the negative link between the number of years since listing on the Bucharest Stock Exchange and CSR (Eq2, Eq3, Eq6, Eq7) suggests that older companies are less interested in CSR practices.

Table 8. Mixed-effects logistic regression results

Variables	Eq1	Eq2	Eq3	Eq4	Eq5	Eq6	Eq7
_cons	-0.156 (-0.0858)	1.976 (0.8768)	2.102 (1.0064)	1.030 (0.5081)	0.256 (0.1250)	2.120 (0.9129)	2.227 (1.0389)
Board_size	**0.264*** **(2.1954)**				**0.259*** **(2.2463)**		
Women (No)		**-0.849**** **(-2.9547)**				**-0.817*** **(-2.5104)**	
Women (%)			**-3.805**** **(-2.7704)**				**-3.670*** **(-2.2775)**
CEO_gender				-0.879 (-1.0113)	-0.898 (-1.0377)	-0.597 (-0.6036)	-0.599 (-0.6297)

Variables	Eq1	Eq2	Eq3	Eq4	Eq5	Eq6	Eq7
Employees	-0.0183 (-0.0466)	0.0106 (0.0228)	-0.0466 (-0.1053)	0.0505 (0.1058)	-0.118 (-0.2502)	-0.0317 (-0.0629)	-0.0828 (-0.1736)
Debt/Equity	0.00498 (0.4769)	0.00514 (0.5440)	0.00477 (0.4994)	0.00616 (0.5710)	0.00409 (0.3760)	0.00469 (0.4844)	0.00433 (0.4440)
Turnover_growth	-0.348 (-0.6041)	-0.424 (-0.7361)	-0.413 (-0.6862)	-0.387 (-0.7037)	-0.417 (-0.7408)	-0.463 (-0.7966)	-0.452 (-0.7461)
ROA	-0.589 (-0.3501)	-0.239 (-0.1640)	-0.325 (-0.2153)	-0.224 (-0.1487)	-0.491 (-0.2866)	-0.177 (-0.1214)	-0.265 (-0.1750)
Current_ratio	**-0.0432**† **(-1.7045)**	-0.00746 (-0.3179)	-0.00697 (-0.2664)	-0.0294 (-1.1946)	-0.0342 (-1.2085)	-0.00191 (-0.0814)	-0.00126 (-0.0446)
Years_listing	-1.734 (-1.6231)	**-2.390**† **(-1.7584)**	**-2.362**† **(-1.8789)**	-1.683 (-1.4872)	**-1.760**† **(-1.6550)**	**-2.374**† **(-1.7451)**	**-2.341**† **(-1.8691)**
Industry var(_cons)	4.361 (1.5074)	4.200 (1.5066)	4.294 (1.5285)	4.341 (1.4602)	4.712 (1.4721)	4.405 (1.4838)	4.495 (1.5103)
Wald chi2	185.38	696.24	1634.56	68.02	294.93	4888.51	10414.90
Prob > chi2	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Observations	334	334	334	334	334	334	334

Notes: z statistics in parentheses. † $p < 0.10$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$. Std. Err. adjusted for clustering on industry. Year dummies included. Description of the variables is provided in table 1.

Source: Authors' computations

Onward, table 8 points out the results of mixed-effects logistic regression. Thereby, we reach similar outcomes with those out from table 7, respectively positive association between board size and CSR (Eq1 and Eq5), whilst negative connection between women on boards, both as number (Eq2 and Eq6) and share (Eq3 and Eq7), and CSR, as well as the lack of any statistically significant link between CEO gender and CSR (Eq4-Eq7).

Therewith, Eq1 shows a negative association between corporate liquidity and CSR undertakings, signifying that CSR implementation is dependent on company liquidity. Likewise, the negative relation between company tenure since listing and CSR is reinforced (Eq2, Eq3, Eq5-Eq7).

5. SUMMARY AND CONCLUSION

Current paper aimed at exploring the impact of board gender diversity on CSR for listed companies at the Bucharest Stock Exchange, over 2007-2011. The empirical estimations via logistic regressions provided support for a positive impact of board size on CSR practices, whilst the number, as well as the percentage of women on board of directors negatively influences CSR activities. However, we notice the lack of any statistically significant relationship between CEO gender and CSR undertakings.

Further research is considered an analysis of the relationship between CSR and board diversity based on female directorship characteristics'. This paper enhances the literature on CSR for developing countries by offering an additional and a complementary explanation of the impact of female directorship on CSR company.

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DISCRIMINATION IN TERMS OF REMUNERATIONS. THE PRINCIPLE OF EQUAL REMUNERATION IN ROMANIAN LAW

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Abstract
Discrimination consists in acts or deeds which determine differences regarding the legal treatment of individuals for the purpose of affecting the use of their fundamental rights and freedoms.
The applicable criteria of discrimination acts are not expressly set out in the relevant law; they could be extended to the situation of seemingly neutral practices that, however, seek to limit, eliminate the recognition, the enjoyment or the exercise of fundamental human rights and freedoms.
The article discusses the legal manner of notification to institutions which have the powers to ensure protection of persons' rights who consider themselves victims of discrimination with reference to the competent courts, applicable law as well as the assessment of criteria underlying such actions.
Keywords: *discrimination, right, notification, remuneration, appeal.*
JEL Classification: K31

1. INTRODUCTION

Discrimination as juridical institution presumes the apparition, if people are in a comparable situation, of some juridical situations of inequality, but also related to the opposite situation of treating equally people in different situations, being excepted cases of positive discrimination.

In effect, acts of discrimination involve total or partial reduction or exclusion of rights and freedoms acquired by individuals subsumed to discriminatory criteria laid down in national law.

Although international regulations (Popescu, 2008, pp. 340-341), particularly Conventions of International Labour Organisation initially included limiting criteria regarding discrimination, relative to race, nationality, ethnicity, language, religion, social status, belief, sex, sexual orientation, age, disability, illness, membership in a particular disfavoured category, etc., which were subsequently laid without limitations into national law, respectively in the

Labour Code (Ţiclea, 2015a, p. 21) and the Government Ordinance no.137/2000 on preventing and sanctioning all forms of discrimination.

The legal grounds of the discrimination concept is made in national law for the protection of individual fundamental rights and freedoms and also of all the rights recognized by law, with reference to the political, economic, social and cultural fields, as well as any other relevant areas of public life.

2. FORMS OF DISCRIMINATION

According to the law, discrimination can be defined as a set of acts or deeds taken by a person who causes a situation of distinction, exclusion, restriction or preference regarding the rights and freedoms of individuals, categories or groups of persons in comparable situations, due to the application of different treatments.

But the concept of discrimination will not be either extended to the situation of a reasonable and objective justification of the facts involved and neither to the situation of positive discrimination when certain persons considered disadvantaged receive more favourable treatment than people in comparable situations.

Forms of discrimination are found defined both in international law and in national law, primarily direct discrimination and indirect discrimination. As a result, direct discrimination includes acts or facts related to objective criteria of discrimination (Ţiclea, 2015b, p. 22) involving direct intention of the author.

Thus, under Community law (Diaconu, 2007, pp. 266-267), Council Directive 2002/73/EC defines direct discrimination as a situation when a person is subject to the application of a less favorable treatment based on sex, than that enjoyed by another person in a comparable situation. Indirect discrimination is also defined in the content of Council Directive 2002/73/EC as constituting a form by which a provision, criterion or neutral practice, indirectly related to a specific ground of discrimination provided for in the law it causes a similar effect to direct discrimination.

In conclusion, we find that direct discrimination involves applying less favourable treatment to a person directly referring to the discriminatory grounds established by law, aimed at denial, restriction or elimination of the recognition, enjoyment or exercise of individual rights compared to other such person, with the direct intent of the author to provoke a situation causing exclusion, distinction, restriction or preference, and indirect discrimination is to follow a similar purpose, but resulted from the exercise of apparently neutral acts, performed in a form of active or passive behaviour (Muscalu, 2015, p. 17).

3. DISCRIMINATION IN TERMS OF REMUNERATION. PROCEDURAL ISSUES

In this case, the civil servants (Iorgovan, 2005, p. 589) within decentralized public services of the Ministry with legal personality representing locally the public authority formulated by the workers' union complaint against both the employer and coordinator ministry at the competent court, requesting the issuance of new orders / provisions on remuneration to recalculate the base salar (Ţiclea, 2015b, p. 332)

Petitioners held functions by order of 1st class senior inspector, grade 5, payment gradation 48, and 1st class senior advisor, grade 5, payment gradation 48.

Petitioners held functions by order of 1st class senior inspector, grade 5, payment gradation 48, and 1st class senior advisor, grade 5, payment gradation 48.

In this case, the National Union of Civil Servants submitted to the employer a notification, registered at the Authority, in which were exposed general aspects on the unnamed situation of civil servants in the institution. Given that the issues raised can only target certain civil servants occupying positions within the institution and whose remunerations could be subject to increase as provided in, respectively Government Emergency Ordinance no. 83/2014 on remuneration of personnel paid from public funds in 2015 and other measures in public spending and Law no. 285/2010 on personnel' salaries paid in 2011 from public funds, finding that direct unnamed of the civil servants in the union notification does not establish the preliminary procedures within the meaning of legal framework. As a result, although the employer answered to the union notification in legal terms, mentioning that without identifying the concerned civil servants cannot verify their situation and cannot give a conclusive answer, then the preliminary procedure was not fulfilled either directly by applicants, or by the union on their behalf, which attracts the inadmissibility of summons addressed to the court under the provisions of Law no. 554/2004 on administrative contentious.

So even the demand to the lawsuit is brought in own name by the petitioners and not by the union on behalf of them, the notification attached to the application as proof of fulfilment of the preliminary procedure was introduced by the National Union of Civil Servants, which contravenes the law provisions. In this sense, the question is if the civil servants petitioners were aware at the time of union's notification and if they have mastered this notification, based on the fact that it does not individualize concerned civil servants.

This is, at one hand, the meaning of Law no. 554/2004 on administrative contentious, as in Article 7 (1) provides that "before addressing the competent administrative court, the person who considers to be injured in a self right or in a legitimate interest by an individual administrative act must request to the issuing public authority or to the hierarchically superior authority, if any, within 30 days from the date of the act communication, the whole or in part repeal of it", within a 6 months period.

On the other hand, in accordance with Article 193 (1) Code of Civil Procedure, the notification to the court can be done only after fulfilment of a prior procedure, if the law expressly provides for this, and is necessary the proof of the procedure completion to be annexed to the application for summons.

As a result, related to the issues noted above raising the plea of breach of the preliminary procedure was required, as a peremptory and relative background exception to the object of the summons, namely to grant the salary differences resulting from rates application and payment classes application to the civil servants who went into a new class of service/office seniority, petitioners complaint was to be dismissed as inadmissible.

Moreover, for the provisions issued by the defendant employer as individual acts since 2010 and annexed by the applicants to the summons, collective labour contract (Dimitriu, 2005, p. 34) and mainly Law no. 284/2010 regarding the unitary remuneration of personnel paid from public funds which in Article 30 shows that the resolution of the appeals in relation to determining individual base salaries, bonuses, premiums and other rights are under this law in the competencies of the credit authorising officers. The appeal may be lodged within 15 working days from the knowledge date of the administrative act establishing the salary rights, at the premises of the credit authorizing officer who will consider complaints within 10 working days. Against taken measures, the discontent person may appeal to the administrative court or, where appropriate, to the competent court according to the law, within 30 calendar days from the date of communication in writing of the litigation settlement.

Likewise, for the dispositions issued from 2014 and annexed by the applicants to the summons' application, Government Emergency Ordinance no. 83/2014 on remuneration of personnel paid from public funds in 2015 and other measures in public spending provides in article 11 that the resolution of the appeals in relation to the establishment of basic salaries, and monthly employment allowances, military payments for basic functions/remuneration for basic functions is provided by this law to be in the responsibility of the credit authorising officers. The appeal may be lodged within 5 days from the date of knowledge of the administrative act establishing the salary rights, at the premises of the authorizing officer who will handle complaints within 30 days. Against ordered measures, the discontent person can address to the administrative court or, where appropriate, to the competent court according to the law, within 30 days from the date of appeal's resolution communication.

Going through the provisions of special laws listed above we can conclude that it must also raise the objection of belated application for summons, as a peremptory and absolute procedure exception, in relation to the deadline of filing the complaint, namely in 2017 and the compulsion of the defendant to issue payment orders/dispositions that take into account and include the percentages since 2010 related to function and work seniority rates and according to the date of promotion.

As regards the summons of the coordinator ministry, was required raising the objection of lack of passive procedural capacity of it, provided that employer has the quality of decentralized public service of the ministry with legal personality thus representing public authority locally, exception determining the lack of procedural quality of the ministry.

The demand of the claimants had as object issuing new payment orders/ dispositions to recalculate the base salary, the legal service relation being between employer public service and them. In conclusion there is no legal obligation relationship between them and the ministry and there was no fault (Deleanu, 2013, p. 372) of the ministry under this aspect.

Grounds for the objection consist in the analysis of Article 222 of the Civil Code, where the legal person having in subordination another legal person is not responsible for the latter defaults and also the subordinated juridical person is not liable for the legal person to which is subordinated.

On the grounds of the case

The object of civil servants petitioners' claim was represented by granting from 2013 until the date of actual payment under High Court of Cassation and Justice Decision no. 32/19.10.2015 and Article 1 paragraph 5 of the GEO no. 83/2014 on staff salaries paid from public funds in 2015 and other measures in public spending and the salary differences resulting from rates application and payment classes' application to the civil servants moving into a new seniority tranche of service/office, subsequent to January 1, 2011.

The applicants also asked the court to request to the employer to issue payment orders/dispositions that to take into account and include in 2010 the percentages related to seniority in function/work and according to the date of promotion, even if function/work seniority has been fulfilled later to the mentioned date.

Thus, according to petitioners' allegations, they work in similar conditions to those of employees performing functions that would be remunerated at the maximum within the same institution, alleging a situation of discrimination at work, being in a situation comparable with the respective employees.

In this regard, according to the provisions of article 1 (1) of Government Emergency Ordinance no. 83/2014 on remuneration of personnel paid from public funds in 2015 and other measures in public spending in 2015, the gross basic salaries/military payment for base function/base function remunerations/ allowances of employment enjoyed by staff paid from public funds maintain at the same level as that granted in December 2014 in the extent to which the staff operates under the same conditions and it does not apply the reference value and the coefficients of classes hierarchy listed in the annexes to the Framework-Law no. 284/2010 regarding the unitary remuneration of personnel paid from public funds.

Notwithstanding, according to Article 1 paragraph (51) of GEO no. 83/2014 on remuneration of personnel paid from public funds in 2015 and other measures in public spending, the staff receiving an amount of basic salaries and lower allowances than the maximum level set out in the same public authority for each function/grade/class gradation will be paid at the maximum level, if is operating under the same conditions. However, according to Article 1 (53), the local government authorities can determine salary increases for all categories of staff, depending on specific conditions, and Article 5 (3) stipulates that if newly employed and promoted civil servants, salary levels for similar positions in payment is appropriate to class 3 of remuneration used in 2010.

Moreover, the petitioners also refer in the action to the provisions of Article 2 of Law no. 285/2010 regarding the personnel remuneration paid in 2011 from public funds which stipulates that, in 2011, for newly employed staff on functions, for the personnel assigned/employed in the same public institution/ authority on similar functions and also for the staff promoted in grades/classes, the remuneration is done to the level of payment for similar positions in the public institution/authority where the staff is employed.

Interpretation of the aforementioned article by the petitioners is made considering HCCJ Decision no. 32/2015 which provides that actual payment of salaries are to be made in relation to the level of payment for similar functions, namely by reference to the remuneration granted to a people with the same professional grade and the same seniority-based and class of functions for the staff who passed the seniority classes after the entry into force of Law no. 285/2010 regarding the remuneration in 2011 for the personnel paid from public funds.

As a result, if the petitioners will demonstrate that they fall under an exception to the law, their request for salaries recalculation from 2013 is unfounded given that the GEO no. 83/2014 on remuneration of personnel paid from public funds in 2015 and other measures in public spending, and Law no. 285/2010 entered into force and produced legal effects after 2013.

As regards the petitioners' reference to the content of Decision no. 32/10.19.2015 of HCCJ, their motivation is again unfounded.

Therefore, we are also considering Article 23 of the Law no. 554/2004 of administrative contentious respectively "final and irrevocable judgments by which there were annulled in whole or in part a normative administrative act shall be generally binding and effective only for the future. They are mandatory published after motivations, at the request of courts in the Official Gazette of Romania, Part I …".

Producing legal effects after its publication in the Official Gazette and not retroactive is also specified in Decision no.2 3/2015 of HCCJ in the content of point 75 respectively “decisions pronounced in the rule of law only effects for the future, as the decisions of the Constitutional Court, which, in turn, are mandatory for courts in order to give efficiency to the constitutional principle of non-retroactivity, which means that their effects can not affect some won already rights or legal positions definitively established”.

Regarding a potential discrimination in the way of remuneration setting we have in mind that for an act to be qualified as discriminatory it must involve different treatment of persons in analogous and comparable situations who to be subjects to distinction, exclusion, restriction or preference as ground of discrimination; these issues are non-existent in the concerned case.

4. COMPLAINT ADMISSION. MEANS OF APPEAL

The Court, as material competent instant, ordered to the defendant employer to issue new orders/dispositions of payment in accordance with Article 1 paragraph 5 of GEO no. 83/2014 on the salaries of staff paid from public funds in 2015 and other measures in public spending, depending on seniority class in the profession and work, professional grade and function performed within the institution and covering the resulted salaries gap beginning with the ongoing year until the date of effective payment.

The Court partially upheld the complaint and ordered by civil sentence to the defendant employer to recalculate each salary to the maximum level in the institution for the same function/grade/class and gradation, for the work in the same conditions and to issue new decisions to pay wage differences between the recalculated and paid salary since 2015 and until the date of issuing of decisions to recalculate salaries. The Court dismissed the claim for the defendant to be obliged to issue remuneration orders/dispositions taking into account in the promotions in functions and appointment to senior positions of civil servants of the percentages related to seniority in work and position, held on the date of promotion, even if the respective seniority/function class was met after this date.

The Court’s decision was appealed (Tăbârcă, 2005, p. 13) by the defendant, motivated by the provisions of Article 488 point 6 and point 8 of Civil Procedure Code, namely that the judgment does not content the reasons on which it is based or when it includes contradictory reasons or only reasons foreign of the case nature, and therefore decided with the infringement or misapplication of the rules of substantive law.

Under the first issue related to the provisions of Article 488 point 6 was stated that, as regards the reasons on which the decision of first instance is grounded, they are contradictory, as the considerate aspects are specified to be insufficient to prove the resolution.

In grounding their request the petitioners showed that they are public servants employed by the defendant and until the issuing of Law no. 284/2010 on the unitary remuneration of staff paid from public funds, the basic salary of a public servant was differentiated by classes of salaries.

So, it is violated the principle provided by Article 1 paragraph 2 of GEO no. 137/2000 on preventing and sanctioning all forms of discrimination, according to which the principle of equality between citizens, exclusion of privileges and discrimination is guaranteed in the exercise of the right to work, to free choice of employment, to just and favourable conditions of work, to protection against unemployment, to equal payment for equal work, to just and favourable remuneration.

Thus, according to Article 1 paragraph 5 of GEO no. 83/2014 regarding the remuneration of staff paid from public funds in 2015 and other measures in public spending "the staff paid on the same level who benefits of a sum of basic salary and lower bonuses than the maximum level set out in institution for each professional grade (assistant, principal and superior) will be remunerated at the maximum level provided to carry out the work under the same conditions". Following there is eliminated wage discrimination that they are subjected since 2011 from the entry into force of Law no. 284/2010 regarding the unitary remuneration of personnel paid from public funds, Law no. 285/2010 regarding the remuneration in 2011 of personnel paid from public funds and all normative acts issued later in the sense that for identical employment of public officials regarding professional grade and class, they were given different wage rights.

The first instance court motivated its decision by GEO no. 83/2014 regarding the salaries of staff paid from public funds in 2015 and other measures in public spending and also other measures in public expenditure which was introduced paragraph 51 to Article 1 of GEO no. 83/2014. However, as reference to the text of the law, the only condition imposed by the law for the application of Article 1 paragraph 5 GEO no. 83/2014 is that for all staff to be paid on the same salary level and to enjoy the remuneration rights set out in the respective maximum level for public functions required the effective conduct of function in the same conditions as other employees, condition which was not present in the case.

The trial court mentions that thus the opportunity was created for staff employed in public institutions and authorities that have a lower level of base salary and bonuses than that set at the maximum level within the same institution or public authority for each function/ grade/ class and gradation, to be remunerated at a maximum level if they work under the same conditions, the dispositions being applied to all applicants/appellants employed by the defendant.

To these considerations, the trial Court found that the remedies dispositions provided for in Article 1 paragraph 51 of GEO no. 83/2014 also applies to the petitioners in the situation considered by the legal norm hypothesis, so it will admit in this sense the application and will bind the defendant to recalculate each salary of the complainants at the maximum level within the institution for the same function/grade /class and gradation for work carried out in the same conditions and to issue new decisions in this regard.

From this point of view, the trial court erroneously ordered to the employer to recalculate the salary of each applicant at the maximum level within the institution for the same function/grade/class and gradation, for their work in the same conditions, without existing in the cause the proof of comparable situations. Basically, the petitioners requested increase of salaries alleging non-existed similar situations in the defendant premises, obvious aspect at least for one of them whose job is unique in the organizational unit. Thus, under this aspect of discrimination, work is equal where the job or function are identical, situation not found in this case, or the provisions of article 27 paragraph 4 of the GEO no. 137/2000 require to the concerned persons/petitioners to prove the existence of facts that allow to suppose the existence of direct or indirect discrimination.

On the other hand, article 27 paragraph 4 of the Government Ordinance no. 137/2000 requires that on the grounds of the application lodged in, petitioners must provide as much detail about the circumstances of acts of discrimination, indicating discrimination criteria and people comparable to which was applied arbitrarily applied a different treatment, which is not found in the concerned cause. Thus, the trial court did not ask any motivations from the complainants in terms of whether there is some other officials with comparable situations in terms of discrimination in matters of remuneration within the defendant employer, pronouncing a judgment that cannot be implemented because, as was noted, at least for one of the petitioners position held is unique in the structure of the employer.

Under the second issue of the appeal, namely the misapplication of the rules of law, in accordance with Article 193 (1) of Civil Procedural Code, the notification to the Court can be done only after the fulfilment of a preliminary procedure, if the law expressly provides it. The proof of the preliminary procedure is to be attached to the application for summons.

In this case, the National Work Union of Civil Servants submitted to the defendant employer an address where exposed general aspects about the unnamed situation of civil servants within the institution and not the officials occupying positions whose salaries may be subject to increase under the GEO no. 83/2014 and Law no. 285/2010.

As a result, there were not met the mandatory provisions of art. 7 (1) of Law no. 554/2004 on administrative contentious, namely that "priori addressing to the competent Court, a damaged person by an individual administrative act is obliged to request the issuing public authority within 30 days the date of the document, to revoke the act, in whole or in part thereof", which attracts the inadmissibility of the proceedings.

5. CONCLUSIONS

In the national legal system, general regulation of discrimination is represented by GD no. 137/2000 on preventing and sanctioning all forms of discrimination, norms which takes in the national legal system the regulations contained in Directive 2000/43/EC aimed at promoting the principle of equal treatment between persons irrespective of racial or ethnic origin and Directive 2000/78/EC that requires equal treatment in employment and work.

The regulation object of the Ordinance is included in Article 1 (2) letter e, namely guaranteeing the right to work, to free choice of employment, to just and favourable conditions of work, to protection against unemployment, to equal pay for equal work, to just and favourable remuneration and social security.

As regards the provisions on discrimination, the ordinance impose comparable situations exist among people considered subjects of discrimination, issues related to the application of criteria, namely the admissibility of the existence of discrimination.

For the purposes of regulation, discrimination involves a situation where a person is treated in a less favourable manner than another person in a comparable situation as well as the existence of any apparently neutral provisions, criteria or practices might have the purpose or effect of disadvantaging certain people.

As regards the categorization of acts of discrimination is specify that the cause do not constitute discrimination deeds or acts as a genuine and determining occupational requirement, relative to objective and legitimate needs for the grant of salary rights of certain persons due to additional responsibilities which the employee has compared to another person on a similar function.

On the other hand, the Romanian Constitution provides in Article 41 (4) the equal payment principle, that is took over and further developed by the Labour Code.

Thus, Article 6 (3) of the Labour Code stipulates that, for equal work or equal value, any discrimination based on sex on the conditions and elements of remuneration is forbidden, and Article 159 (3) states that in the establishment and providing the remunerations, any discrimination on grounds of sex, sexual orientation, genetic characteristics, age, nationality, race, colour, religion, political opinion, social origin, disability, family status or responsibilities, affiliation or trade union activity is also forbidden. Likewise, article 39 (1), point a, stipulates that the employees are entitled to remuneration for their work; salary constitutes an essential of individual employment contract.

In conclusion, following the imposition of the principle of equal treatment in question it was considered that granting the employer a salary equal to employees performing the same activities within the same branch, field or level, in terms of similar professional training is conditioned by the same functions and the lack of necessary requirements and objectives that could lead to the granting of differentiated salaries.

Regarding the conditions of preliminary complaint was ordered that the work union request was conducted in the name of its members therefore it can be accepted, including when the request for summons was lodged on their behalf, provided the complaint and the request are subsequently confirmed by the petitioners, aspect present in the cause.

On the other hand, to indicating by the petitioners of other officials who are in a comparable situation as regards similar activities, for the purpose of proving the existence of discrimination on the basis of salary, the Court has used its active role and requested to the defendant employer to submit an extract comprising all employees of the unit that achieved similar activities, in terms of comparable functions and grades with the complainants, and ordered to the employer to send lists indicating salaries and bonuses granted to them, and the solution to confirm or deny the existence of discrimination will be took afterward.

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THE HOLDER OF THE RIGHT TO RECOVER THE "POLLUTION TAX" AFTER THE SALE OF THE VEHICLE

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Abstract
This paper aims to analyze the legal framework of the tax also known as "pollution tax" unlawfully paid nationwide, focusing on the holder of the obligation to pay said tax and the holder of the correlative right to redeem the tax collected in violation of European Union law.
The academic and practical importance of this approach lies in the fact at this point the jurisprudence of the national courts is still inconsistent from the point of view of the person who justifies an active procedural quality in proceedings for the recovery of pollution taxes.
The premise of this analysis is the payment of a pollution tax owed by a taxpayer, followed by the sale of the vehicle for which he paid the tax. The emphasis falls on the taxpayer's right to recover the unlawfully paid tax after the alienation of his property.
The purpose of this paper is to point out that the tax paid is inextricably linked to the person who paid that fee and is not automatically transmitted with the outflow of the asset from the patrimony. Thus, the basic idea of the paper focuses on the taxpayer's right to recover an unlawfully paid tax, although he no longer owns the vehicle for which he paid that fee.
Keywords: *pollution tax, taxpayer, European law, unlawfull tax.*
JEL Classification: K23, K34, K40

1. FACTUAL SITUATION

The premise of this academic approach is the registration of a car in Romania by a commercial company, context in which the Romanian state required a registration fee also known as "pollution tax".

Given that the tax imposed by the legislator was likely to create discriminatory situations, the Court of Justice of the European Union was called upon to rule on the compatibility of this tax with European law.

In this respect, the European Court of Justice ruled against Romania, a series of decisions in which stated that the tax levied by Romania on the registration of cars is incompatible with the provisions of the Treaty on the Functioning of the European Union.

Subsequently, having regard to the constant jurisprudence of the Court of Justice of the European Union and the European Court of Human Rights, the national courts faced an avalanche of claims for the refund of the tax paid in breach of European law.

The issue under discussion in the present paper is the hypothesis of a taxpayer requesting the tax refund, but without having the patrimony or the vehicle for which he paid the tax.

In the practice of the national courts, two opinions emerged:

- Most Romanian courts have found that the right to claim the tax is linked directly to the person of the taxpayer who had to pay the registration fee, and it is irrelevant if at the time of the judging of his request for restitution he still owns the good;
- Another part of national jurisdictions reflects a completely different approach. Thus, some courts have found that the right to claim the refund of the tax paid in breach of European law as it was paid in respect of a car is inextricably linked to that property and implicitly to the taxpayer's ownership of the car at the time of the case.

While we are in favor of the opinion expressed by most national jurisprudence, we will present and analyze a situation where a national court has definitively rejected an application for a refund of the unlawfully paid tax, the only reason being that the car is no longer in the patrimony of the taxpayer and that in this context, the taxpayer no longer has the right to recover the tax because it was transmitted with the ownership of the vehicle.

The erroneous character of this reasoning is derived both from the punctual interpretation of incidental law texts and from arguments of legal logic.

2. JURISPRUDENTIAL ANALYSIS

As we have shown, the national jurisprudence is not unitary in this matter, being likely to create a discriminatory situation which contradicts the European law and the jurisprudence of the Court of Justice of the European Union.

Thus, in the present case, subject to review, the court has wrongly retained that *"the evidence given in court resulted that some cars have already been disposed of by the applicant. Whether the pollution tax and the polluting emissions tax are taxes on property and therefore the right to the refund of the unlawfully paid tax is intimately linked to the existence of the right to ownership of the car for which that tax has been paid."* (Iasi Court of Appeal, Decision No. 334/2015).

The majority opinion, however, is that the alienation of the car has no effect on the refund of the pollution tax, as the restitution is made taking into account the discriminatory character of the tax and not the ownership of the property.

Therefore, the majority of the courts noted that *"the applicant justified a personal and current legitimate interest in promoting this action as long as he* *paid the first registration tax and made the first car registration in Romania. The fact that he subsequently sold the car does not conclude that he "alienated" his status as a taxpayer entitled to a refund from the state budget.*

The tax authorities did not provide legal and factual arguments to justify their appreciation that the price with which the applicant sold his car included the amount of the first registration tax or the pollution tax." (Pitesti Court of Appeal, Decision No. 1256/R).

In fact, this is also the position expressed by the High Court of Cassation and Justice, which, being invested with the resolution of an appeal in the interest of the law, noted that *"therefore, according to the consistent jurisprudence of the Court of Justice of the European Union, taxpayers are entitled to the repayment of the tax levied by a Member State in breach of European law and, correlatively, the State has the obligation to return it."* (Appeal in the interest of the law/Decision No. 24/2011 of 14 November 2011 on the unitary interpretation and application of certain legal provisions referring to the pollution tax, published in the Official Gazette no 1/2012 - M. Of. 1/3 January 2012).

However, although the Supreme Court itself held that the person entitled to the tax refund is the taxpayer who paid said tax, there are still national courts that ignore this aspect and pronounce contrary decisions.

3. LEGAL FRAMEWORK

To point out that the person entitled to the tax refund is the taxpayer who paid it, we will also analyze the normative acts in force at that time, but it is obvious that the legislator's intention was to give procedural legitimacy to the taxpayer and not to the owner of the car.

In accordance with art. 7 par. 1 and art. 12 of the Law no. 9/2012 regarding the tax on the pollutant emissions from motor vehicles, it is obvious that, even in the situation in which the car is sold, the legislator has understood to give legal legitimacy to the taxpayer who paid said tax as the holder of the of the payment obligation, and not to the potential buyer.

Thus, art. 7 of Law no. 9/2012 stipulates expressly that *"the taxpayer who paid the tax shall be reimbursed at its residual value if a motor vehicle for which the motor vehicle pollution tax has been paid in Romania or the tax provided by this law is subsequently deducted from the National car fleet"*.

We also have the situation of art. 12 of the Law no. 9/2012 which expressly states that in the hypothesis in which between the tax paid according to GEO no. 50/2008 and the tax calculated according to the new law there is a difference, it is returned *"only to the holder of the payment obligation, at the request of the taxpayer"*.

We see therefore that transpires the obvious intention of the legislator, by using the term "holder of the payment obligation" and not the vehicle purchaser or owner of the vehicle.

Moreover, to consider that a taxpayer who has paid the tax and subsequently has alienated the car is not eligible to claim his restitution because of the fact that the property is no longer in his possession, is contrary to the recent case law of the Court of Justice of the European Union. Thus, we would find ourselves in the situation where the taxpayer who paid the tax would not have the possibility to recover it because of the fact that he no longer owns the car, but the buyer could not make such a request, motivated by the fact that he is not the holder of the payment obligation and as a consequence can not justify active process legitimation.

Also, to consider the contrary would be inconsistent with the provisions of the Civil Code which expressly states in the art. 1341 par. 1 as *"the person who pays without due is entitled to restitution"*.

Thus, irrespective of the way in which the car has left the applicant's patrimony, sale, donation, or if the car has been destroyed in its entirety, the first registration fee is always refunded to the payer or to the company that has paid an unlawful tax.

Relevant is that including the Court of Justice of the European Union has clearly stated that the pollution tax governed by Government Emergency Ordinance no. 50/2008, approved by Law no. 140/2011 including the amendments made by the Government Emergency Ordinance no. 117/2009 for the application of some measures regarding the pollution tax for motor vehicles, approved by Law no. 17/2011 (in accordance with paragraph 27 of the preliminary ruling in the Case C-263/10 Nisipeanu) is contrary to the provisions of Art. 110 of the Treaty on the Functioning of the European Union.

Restitution of the tax levied under the Government Emergency Ordinance no. 50/2008, as under any national legislation, can be justified, first of all, on a general common cause consisting in the incompatibility of national law with Community law, namely infringement of Community law and under no circumstances on the ownership of the taxpayer's property.

4. CONCLUSIONS

In conclusion, we maintain the point of view expressed in the sense that the holder of the right to restitution of the registration tax remains the taxpayer who paid it, even if he subsequently alienated the car and at the time of the trial of his request, the car is no longer in its patrimony.

Practical importance of this approach is to highlight the jurisprudence in this area nationwide by exposure of legislative arguments, aimed precisely to the unification of national courts opinions and to create a legal framework according to which the taxpayers who have paid a fee, any fee, paid in violation of the

European Union's substantive rules of law, to be able to recover it, irrespective of whether or not he is the owner of the goods subject to tax.

As we have shown, the maintenance of the minority opinion of the national courts is likely to create a procedural vacuum, as a result of the impossibility of recovering the illegal registration tax, which contradicts not only European law but also general principles of law.

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SIGNIFICANT CHANGES IN THE LEGAL RULES PERSPECTIVE ON FISCAL DECENTRALIZATION IN ROMANIA

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Abstract
This paper focuses on the legislative changes regarding fiscal decentralization in Romania set within the EU fiscal surveillance framework. We chose this area because of the proeminence (and recurrence) of the field of fiscal decentralization in Romania after 1998. We attempted to look on fiscal decentralization in Romania from the perspective of regulation and some stylized facts, highlighting its significance to the present and future. We believe that the paper provides a sufficient depth and breadth of legal perspective and a starting point for further research.
Keywords: *fiscal decentralization, decentralization regulation, local government.*
JEL Classification: H7, K34

1. INTRODUCTION

The public administration in Romania was subject to over 30 reforms since 1989. The current structure of local public administration in Romania is the result of the step-by-step approach in institutionalizing the local and regional administrative structures. Although Romania built a legal framework for fiscal decentralization, local governments are not able to generate sufficient autonomy of local expenditure and/ or revenue. The breadth of fiscal decentralization topic area is quite expansive in literature, but studies for understanding regulation on fiscal decentralization in Romania are still poor less.

2. THE SUBJECT OF THE RESEARCH, METHODOLOGY AND STATE OF KNOWLEDGE

The scope of this study is to emphasize the state of fiscal decentralization in Romania as resulted from legislative changes. The approach of the research paper will be first on the background offered by literature regarding fiscal decentralization, second will present the reform cycles in time In Romania with strong impact on fiscal decentralization and third will be combined the quantitative analysis, primarily based on processed data from the National Institute of Statistic's reports, The Directorate for Fiscal Policies and Local Budgeting's data, Eurostat data, with the analysis and monitoring of the involved qualitative issues. In interpreting results and formulating public policy recommendations, the analysis has permanently related to the legal framework in work over the considered period of time.

The fiscal decentralization represents the subject of distinctive research in international theoretical literature, originally centered around the works of Tiebout (1956), Musgrave (1959), and Oates (1972), characterized by efficiency in producing goods and delivering of public services and greater transparency in relation to the citizens, later being seen as a policy strategy by Bahl, 1999; Bahl & Linn, 1992; Bird & Vaillancourt, 1998; Martinez-Vazquez & McNab, 1997, etc. Bahl (1999) synthetizes the main twelve rules for fiscal decentralization implementation, mostly possible from the perspective of regulation, as following: i) Fiscal decentralization should be viewed as a comprehensive system; ii) Finance follows function, mining first should come the assignment of the expenditure responsibility to local governments, and then the assignment of revenue responsibility should be determined; iii) There must be a strong central ability to monitor and evaluate decentralization, which mean a uniform system of financial accounts, audit rules, disclosure requirements for borrowing, and determination of when to relax spending mandates, how to adjust grant distribution formulae, and how to impose proper limits on borrowing; iv) On intergovernmental system does not fit the urban and the rural sector; v) Fiscal decentralization require significant local government taxing powers; vi) Central government must keep the decentralization rules that they make; vii) Keep it simple, because local government system cannot handle complicated intergovernmental fiscal arrangements; viii) The design of intergovernmental transfers system should match the objective of decentralization reform; ix) Fiscal decentralization should consider all levels of government; x) Impose a hard budget constraint; xi) Recognize that intergovernmental transfers are always in transition and plan for this; and xii) There must be a champion for fiscal decentralization.

3. THE VISION ON DECENTRALIZATION REGULATION IN ROMANIA

Local public finances regulation in Romania after 1989 based on democracy principles, have at least five reform cycles with strong impact on fiscal decentralization: 1991-1997, 1998-2000, 2001-2005, 2006-2010, 2011 - present.

The first phase (1991-1997) is characterized by laws as a starting point in domain reglementation, important steps which were made with regard to the administrative structure and financing of public local authorities (including the local tax system), all having a statutory basis in the New Fundamental Act (Constitution) adopted in 1991. During this period, was adopted first Public Finance Act (Act no. 10/1991), followed by the Local Public Administration Act (Act no. 69 /1991). In this context, there were initiated first changes in the administrative structure and funding of local authorities based on local autonomy. These laws have introduced new system of local taxes, subsequently regulated by Local Tax Act (Act no 27/1994). A very important role in fiscal decentralization belongs to the Act ratifying the European Charter of Local Self-Government (no. 199/1997) adopted in Strasbourg on 15 October 1985. In terms of the control applicable to local public finances especially is the Organization and Functioning of the Court of Auditors Act No. 94/1992.

The second phase *(1998–2000)* creates a more clearly legal framework marked by the first Local Public Finance Act (no. 189/1998). This law was a fundamental step in the process of decentralization and strengthening the local financial autonomy. A new aspect of local financial autonomy was to regulate the competence of local governments to contract loan from commercial banks or other financial institutions. A strong impact in decentralization process had Act no 213/1998 on Public Property and its Legal Status.

The third phase *(2001-2005),* was dominayed by the attempt to transpose the *Acquis Communautaire* into national legislation, as a candidate state to the European Union. In this regard, aslo the Constitution adopted in 1991 was amended in 2003. The phase started with the presentation of a new form of Local Public Administration Act (no 215/2001) that set out the general conditions for self-government, autonomy and organisation at public level.

During this period, have been made many amendments to the Local Public Finance Act (e.g. Government Emergency Ordinance (GEO) no. 45/2003, Act no. 108/2004 approving GEO no. 45/2003, GEO no. 9/2005 amending GEO no. 45/2003, Act no. 114/2005 for the approval of GEO no. 9/2005 amending GEO no. 45/2003), depending on the economic conjuncture of the country and his status as candidate country to the European Union, leading to significant changes by clarifying the confusing aspects of the previous law and introducing new aspect specific to the process of fiscal decentralization and financial autonomy. Thus, art. 55 (para. 2) removes the interdiction of local government to open accounts at commercial banks to carry out receipts and payments. Art. 57 para. 1 given the opportunity to local government to use internal and external loans and short-term investments of local interest and local government debt to refinance. It also removes the restriction that the local government can only borrow short-term from the Treasury.

In order to continue the reform of fiscal decentralization was adopted

Government Ordinance no. 36/2002 on local taxes, and in 2003 was adopted Tax Code (Act no. 571/2003 regarding the Fiscal Code) and the Fiscal Procedure Code (GO no. 92/2003 regarding the Fiscal Procedure Code). These established the system of local taxation. They have changed substantially over the years depending by a number of both political and economic factors (Bercu *et al.,* 2015).

Regulations on the regime of local public services are found in Act on Services of Public Utilities no. 51/2005, O.G. on Local Public Transport no. 86/2001, etc.

In terms of the control is amended the Act on the Organization and Functioning of the Court of Auditors by Act 72/2002, and is adopted GO on Internal Audit and Financial Control no. 119/1999.

The fourth phase (2006 -2010), is marked by the adoption of the Decentralization Act no. 195/2006, new amendments to Local Public Administration Act (Act 286/2006 amending and supplementing the Local Public Administration Act no. 215/2001). The most important impact on fiscal decentralisation had the new Local Public Finances Act (no. 273/2006), with additions and changes, of which the most important is GEO 63/2010. The new Local Finances Act bring substantial changes and additions designed to increase the financial autonomy and support local government capacity to borrow in terms of efficiency.

Following the experience and directions for reform of the EU member states regarding local public finances, the Romanian legislator has established in 2010 the requirement that in local budgets drafting to use appropriate instruments such as forecasts of key macroeconomic and social indicators for the budget year for which it drafts the local budget for the next 3 years. Establishing medium-term budgetary projections is undoubtedly a positive measure to ensure balanced and realistic local budgets. Law no. 273 of 2006, which provided that the local budgets draft are developed taking into account the fiscal and budgetary policies, national and local, without giving a concrete direction on how to take them into account, was likely to create a favorable environment for local various interpretations and questionable decisions. In this context, the regulation in 2010 of instruments such as fiscal and budgetary local strategy, the fiscal and budgetary framework with budget forecast and a framework for medium-term expenditure has a positive impact on budgetary stability and public budgetary system, creating the favorable framework to increasing economic and financial local performance.

Regulations governing the operation system local area, such as public procurement and public services of local interest found in GEO 34/2006 on Public Procurement, GEO 54/2006 regarding the Concession of Public Property, Act 51/2006 on Community Services of Public Interest, Act 101/2006 regarding the Sanitation Service of the Localities, Act 241/2006 on Water and Sanitation

Services, Act no. 230/2006 on Public Lighting Service etc.

In terms of the control applicable to local public finances especially the Act on Organization and Functioning of the Court of Auditors is amended by Act 217/2008.

These changes were mainly driven by the need to increase the performance of local governments, as well as to assure a high level of transparency and stability of the inter-governmental fiscal relationship.

Fifth phase, 2011 onwards, is characterized by significant legislative changes on fiscal decentralization. In 2015 was adopted the new Fiscal Code by Act 227/2015 and the Fiscal Procedure Code by Act 207/2015, which regarding local taxes, provides a a bigger financial autonomy of local government, increasing the additional quotas and setting values taxable within certain limits. It entered into force on 1 January 2016. Thus, according to art. 489 on increase local taxes by the local or county councils, the deliberative authority of local government at the proposal of the executive authority, may establish additional quotas to local taxes according to the following criteria: economic, social, geographical, and local budgetary needs. Additional quotas can not be set higher than 50% from the maximum levels set in the tax code.

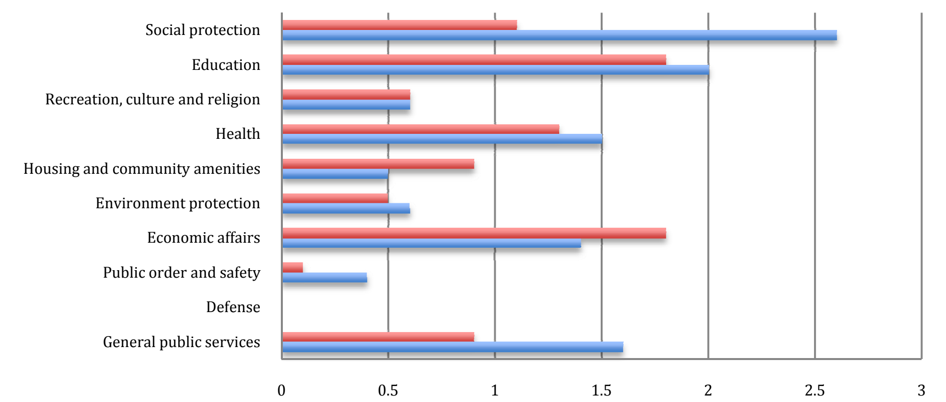
Regarding local financial system, there are two main fiscal rules currently applying in Romania. These are 'The budget balance rule' and 'Debt rule', both having a statutory basis in the Local Finance Public Act. The first one, budget balance rule, is applicable to local governments since 1990, but as an exception to this rule are loans used to finance public investment and debt refinancing which are excluded from the scope of this rule. Debt rule is in force since 1999 and provides that local government cannot contract or guarantee loans if their annual public debt service (e.g. principal payment, interest, commissions) including the loan they want to contract, is greater than 30% of their own revenue. As an exception to this rule, the loans for co-financing EU projects are excluded. Local lending is subject to authorization by a Central Commission organized at the level of the Ministry of Public Finance.

4. STYLIZED FACTS ON DECENTRALIZATION AND FISCAL OUTCOMES IN ROMANIA

Romania is a unitary national state, where the territorial administrative framework consists 41 counties and the capital city of Bucharest, which has a dual status of municipality and county, according to the NUTS-3 criteria. The counties are formally grouped into 8 development regions, according to the NUTS-2 criteria. The regions are not territorial-administrative units with legal status, but rather created as a group of counties, aiming to facilitate the implementation of the European regional development policy. A second-tier local administration is made out of 217 towns and 103 cities/municipalities. A third-tier local administration is made out of 2861 communes. Local governments are defined by limited autonomy, both in terms of decisional power, and financial and fiscal areas.

The responsibilities of local government mainly concern exclusive, shared, and delegated competencies according to the Decentralization Act 195/2006. In this regard, municipalities exert some management control on specific public utilities (e.g. water supply, sewerage, waste, district heating, and in larger cities public transportation), their responsibilities increasing in the management of public services over the years. Local governments in Romania exert some autonomy in particular over capital expenditure for the supporting local infrastructure and other public investments, while their regulation is conducted by the law. The majority of local discretionary spending is devoted to local infrastructure, maintaining the road network and public transportation, cultural programs, school operating and maintenance, and social assistance programs (see fig. 1). Over the last years, local investment in Romania has been on the rise, mainly as a result of the decentralisation process., but the current expenditure still represent more than 70% of local public expenditure.

Figure 1. Local expenditure by economic function in the EU countries in GDP (%) in 2014



	General public services	Defense	Public order and safety	Economic affairs	Environment protection	Housing and community amenities	Health	Recreation, culture and religion	Education	Social protection
Romania	0.9	0	0.1	1.8	0.5	0.9	1.3	0.6	1.8	1.1
European Union	1.6	0	0.4	1.4	0.6	0.5	1.5	0.6	2	2.6

Source: computed by the authors using data provided by Eurostat

Grouping expenditure on functions and departments allows being more clearly identified costs of local authority policies. According to the functional classification in most EU states are classified by sector spending, while in Romania the parties. Sectors are relatively the same in all EU countries. Local government budgets in Romania are dominated by spending on education and economic affairs (both amounted 1,8% of GDP), closely followed by health with 1,3% of GDP (see fig. 1).

Local government responsability in education is rather limited, mainly acting as paymasters, as well as for operating and maintaining school buildings (financed from discretionary revenues). Similarly, they act as agents of centrally-financed social assistance programs (e.g. guaranteed minimum income).

The source of local governments revenues are divided into several categories established by Local Public Finances Act: (i) current fiscal revenues (e.g. taxes on properties, land and transportation vehicles); (ii) current non-fiscal revenues (e.g. transfers and grants from the state budget); (iii) capital revenues (e.g. through the privatization process); and (iv) revenues from special sources (e.g. taxes and unused expense allocations for year t, which are carried forward to year t+1). Local budgets are still highly dependent on the transfers received from the central budget, represented almost 8% of GDP, around 19% of total public expenditure. Transfer and grants fall into two categories: grants and subsidies for current spending and compensation for transfer of responsibilities, and grants and subsidies for capital expenditure. Only a part of larger cities/municipalities generate sufficient revenues by their own. Local authorities also have the possibility of borrowing money within a total annual ceiling approved by the central government.

Following an ever increasing budgetary autonomy of local governments, the equalization plays an important role and implies a greater responsibility with regard to efficiency and rationality of utilizing local resources. That is why budgetary correcting mechanisms and equalising transfers are set in place by Local Public Finances Act. Their aim is to correct imbalances that occur locally both vertically (e.g. local taxes do not cover the public expenditures), and horizontally, because not all local communities are financially sound.

The largest local government revenue (i.e. almost 28% of the total local revenues) is consisted by earmarked grants for decentralized functions, followed by the personal income tax (i.e. almost 25%) and local taxes and fees (almost 14%). Subventions amount almost 10% of total local revenues.

Expenditure and revenues in local budgets have a higher share in GDP as an expression of widening the powers of local government (Rusu & Petrișor, 2016), as can be seen in table 1.

Table 1. Local public expenditures and revenues in GDP

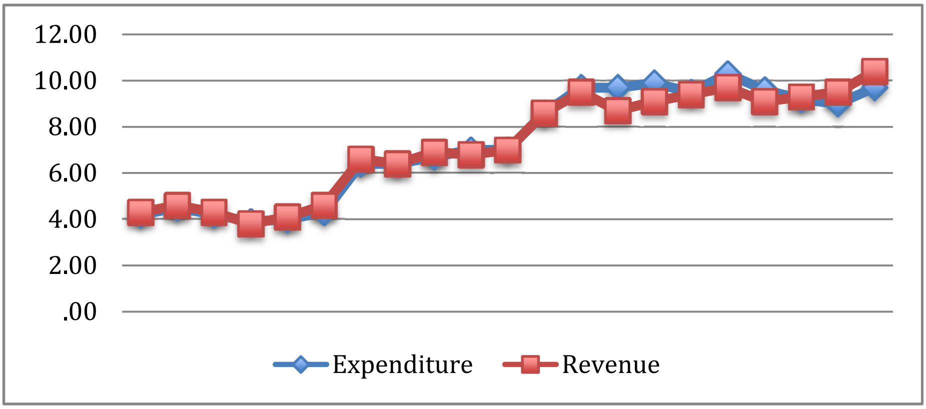
Year	Expenditure	Revenue
1995	4,2	4,3
1996	4,5	4,6
1997	4,2	4,3
1998	3,9	3,8
1999	4,0	4,1
2000	4,3	4,6
2001	6,4	6,6
2002	6,4	6,4
2003	6,7	6,9
2004	7,0	6,8
2005	7,0	7,0
2006	8,6	8,6
2007	9,7	9,5
2008	9,7	8,7
2009	9,9	9,1
2010	9,5	9,4
2011	10,3	9,7
2012	9,6	9,1
2013	9,2	9,3
2014	9,0	9,5
2015	9,7	10,4

Source: computed by the authors using data provided by Eurostat

The evolution of local public expenditure and revenues in GDP for the period 1995-2015 involves significant increases (total spending by local government amounted to 4,2% of GDP in 1995 to 9,7% of GDP in 2015 and total revenue of local government amounted to 4,3% of GDP in 1995 to 10,4% of GDP in 2015), including influencing EU average (around 10% of GDP over the period 2001-2015).

For expenditure the minimum was registered in 1998 (3,9% of GDP) and the maximum was in 2011 (10,3% of GDP), and for revenue the minimum was registered in 1998 (3,8% of GDP) and the maximum in 2015 (10,4% of GDP) (see fig. 2).

Figure 2. Local public expenditures and revenues in GDP



Source: computed by the authors using data provided by Eurostat

To describe the extent and main characteristics of fiscal decentralisation in Romania, I will use some indicators such as: *Expenditure decentralisation* - defined as the percentage of local governments' expenditures in total expenditures of the general government; *Own revenue decentralisation* - defined as the percentage of local taxes and fees (i.e. subnational own revenues) in general government revenues; *Revenue decentralisation* - defined as the percentage of local revenues (including transfers) in general government revenues; *Local autonomy* - defined as the percentage of tax revenues in local revenues; *The percentage of transfers from the central government in local revenues of local budget*; *Local expenditure coverage by own revenues* - defined as the percentage of local expenditures covered by subnational taxes and fees; and *Transfer dependency*, defined the percentage of local expenditures covered by transfers.

Dynamically, the share of state budget revenues and expenditures in the total expenditure and revenue of general consolidated budget decrease, while in local government budget, the share of revenue or expenditure in the general consolidated budget increased. To highlight the important role of local budgets in the public financial system during 1992-2015, table 2 provides a snapshot of the weight of each public budget over time in general consolidated budget. The numbers show an increase of local budget in the general consolidated budget.

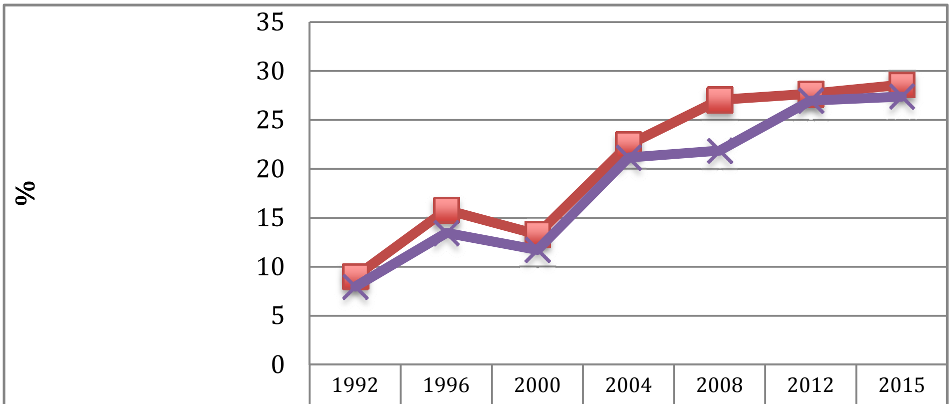
According to the table, by revenue and expenditure mobilized, in 2015 local budgets represents about half of specific weight of the state budget in consolidated general budget, which shows that the central government still retains a large number of tasks and competencies. Also, the data in the table shows that the state social insurance budget represented throughout the review period, an important component in the budget, comparable to local budgets.

Table 2. Public Budget System in Romania during 1992-2015

Years	Consolidated General Budget (CGB)		State Budget (SB)				Local Budget (LB)				Budget of state social insurance (BSSI)			
	Revenue CGB	Expenditure CGB	Revenue SB		Expenditure SB		Revenue LB		Expenditure LB		Revenue BSSI		Expenditure BSSI	
	Mil. RON	Mil. RON	Mil. RON	% of CGB	Mil. RON	% of CGB	Mil. RON	% of CGB	Mil. RON	% of CGB	Mil. RON	% of CGB	Mil. RON	% of CGB
1992	221,67	249,77	136,39	**61,53**	162,7	**65,14**	19,97	**9,01**	19,94	**7,98**	46,85	**21,14**	40,43	**16,19**
1996	3159,7	3681	1837,28	**58,15**	2373,22	**64,47**	499,85	**15,82**	495,52	**13,46**	591,02	**18,7**	609,69	**16,56**
2000	25109,54	28314,05	12034,2	**47,93**	14916,8	**52,68**	3344,5	**13,32**	3.321,70	**11,73**	5101,6	**20,32**	5562,7	**19,65**
2004	70994,62	73423,17	32195,4	**45,35**	34073,5	**46,41**	15955,8	**22,47**	15.540,70	**21,17**	16167,1	**22,77**	16166,5	**22,02**
2008	161266,58	193128,5	61151	**37,92**	80886,4	**41,88**	43629,1	**27,05**	42210,2	**21,86**	32832,6	**20,36**	33704,6	**17,45**
2012	193148,2	207922,1	87171,5	**45,13**	104569,8	**50,29**	53441,7	**27,67**	56080,8	**26,97**	48858,3	**25,3**	48609,1	**23,38**
2015	209675,7	210582,9	97868,9	**46,68**	104322,6	**49,54**	59955,1	**28,59**	57653,5	**27,38**	50425,3	**24,05**	50121,8	**23,8**

Source: computed by the authors using data provided by The Ministry of Public Finance (2017)

Figure 3. Evolution of local public revenue and expenditure as % of CGB



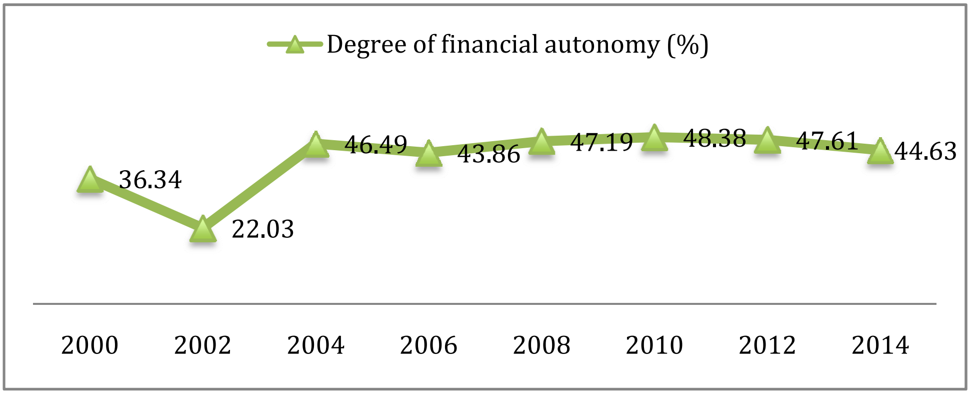
	1992	1996	2000	2004	2008	2012	2015
Revenue % of CGB	9.01	15.82	13.32	22.47	27.05	27.67	28.59
Expenditure % of CGB	7.98	13.46	11.73	21.17	21.86	26.97	27.38

Source: computed by the authors using data provided by The Ministry of Public Finance (2017)

Evolution of local public revenue and expenditure as % of CGB indicates an increase in time (see fig. 3).

The largest local government revenue is consisted by earmarked grants for decentralized functions, followed by the personal income tax and local taxes and fees. Subventions amount almost 10% of total local revenues. In this context, *local autonomy,* defined as the percentage of tax revenues in local revenues, is almost 45% (see fig. 4).

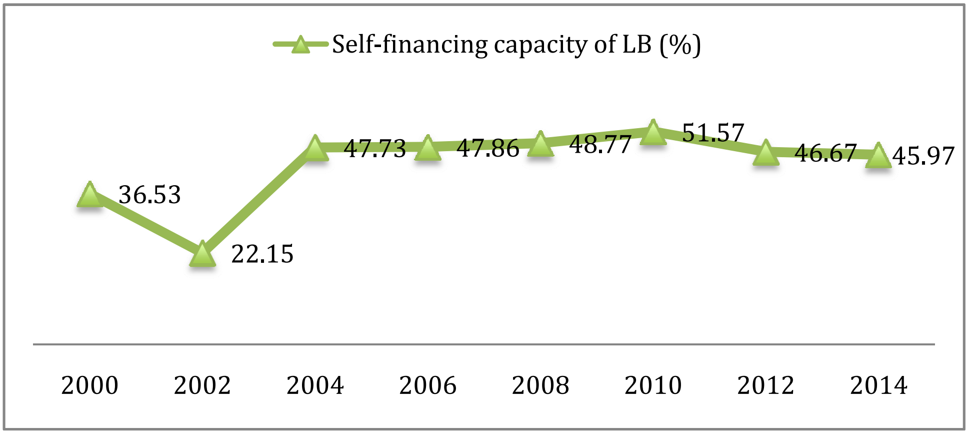
Figure 4. The degree of financial autonomy



Source: computed by the authors using data provided by The Directorate for Fiscal Policies and Local Budgeting, Ministry of Regional Development and Public Administration and European Grants (2017)

Self-financing capacity, defined as the percentage of local expenditures covered by local taxes and fees, is almost 46% (see fig. 5).

Figure 5. Self-financing capacity



Source: computed by the authors using data provided by The Directorate for Fiscal Policies and Local Budgeting, Ministry of Regional Development and Public Administration and European Grants (2017)

5. CONCLUSIONS

The main conclusion of this study is that Romania made great steps in decentralization process, but the process is still in progress because there is a relatively low degree of local fiscal autonomy for both revenue and expenditure side. In this context, an important role belongs to the legal framework that must be improved by central authorities through removing the inconsistencies in its design. At the same time by being in use will conduct to increase the local managerial capacity.

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MICROECONOMIC DETERMINANTS OF FIRM INDEBTEDNESS. EMPIRICAL EVIDENCE FROM ROMANIA

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Abstract
The paper aims to analyze and evaluate empirically how the indebtedness of Romanian firms is affected by their specific characteristics during 2009-2014. Our research uses panel data estimation techniques and considers as a dependent variable the debt ratio of firms. As explanatory variables, we considered the company's specific characteristics, represented by firm size, asset tangibility, growth opportunities, profitability and volatility earnings. The results of our analysis are generally consistent with the findings of other empirical studies. From the investigated factors, almost all had a negative impact on the indebtedness of the firms in the sample. Overall, the debt ratio of Romanian firms is consistent with the pecking order theory, so that profit-making firms, with better growth opportunities and those with higher business risk lend themselves to a lesser extent and finance their investments using internal resources. The added value of our study comes from providing evidence of key microeconomic factors that could influence the indebtedness of Romanian companies.
Keywords: *financial structure, indebtedness, determinants, panel data, pecking order theory.*
JEL Classification: D22, G32, C33

1. INTRODUCTION

The problem of how a firm is choosing its capital structure continues to be a major preoccupation of the researches in the field. In the last years, many studies have focused on empirical analyses which aim to identify which are the factors that have influence on the decision of firm to use borrowed funds to finance their activity and investments.

The specialized literature analyzing the determinants of the firm's leverage is wide. The empirical studies in the field have shown that are a series of factors that determine the decision of firms to used borrowed funds. Between this factors are mentioned: firm size, asset tangibility, growth opportunities, profitability, and earnings risk (Fama & French, 2002; Delcoure, 2007; De Jong *et al.*, 2008; Dragotă *et al.*, 2008; Frank & Goyal, 2009; Gungoraydinoglu & Öztekin, 2011). How these factors influence the indebtedness of the firms depends on the theory we analyze: the static trade-off model or the pecking order theory. There are also many studies testing which theory (the trade-off or the pecking order) is more efficient in analyzing the financing decision of firms.

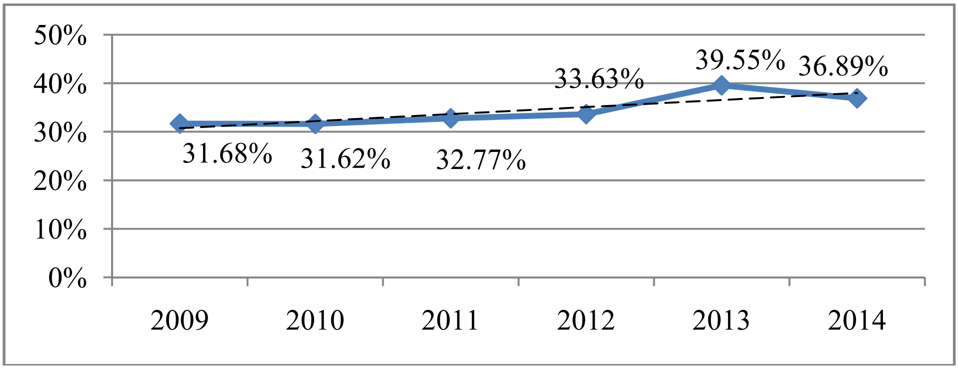
Each of the identified factors could affect the indebtedness of the firm with different intensity depending on the country, but also on the global economic situation (for example, in the context of an economic crisis, the effects might be different). The differences between developed and developing markets are significant. Thus for our study, we analyze firms from Romania, which has a developing economy. There are only a couple of studies that analyze the factors which determine the firm's indebtedness in the case of Romania (Dragotă *et al.*, 2008; Brendea, 2014; Vatavu, 2014). So, through this paper, we investigate which are the determinants of the Romanian listed firm's indebtedness. The major objective of our study is to test which one of the capital structure determinants identified in specialized literature in the field is determining the debt ratio of the Romanian firms. In order to perform the empirical analyse, we have collected financial data from 62 firms listed on the Bucharest Stock Exchange. The period of analysis covers five years between 2009 and 2014.

In order to reach the objective, we have structured the paper as follows: after the introductory remarks, we have present the methodology, realizing a brief literature review regarding the factors determining debt ratio of the firms, followed by a presentation of the methods used. The second part of the paper, presents the results of the empirical analysis and discussions based on these results. The paper ends with conclusions.

2. METHODOLOGY

In order to test which are the determinants of the firm indebtedness for the companies listed on Bucharest Stock Exchange, we have analysed the data from 62 firms for a period of five years between 2009 and 2014. The financial data for the firms are retrieved from the Bucharest Stock Exchange. We have excluded from the analysis the financial firms because their balance sheet is different from those of non-financial enterprises, and their leverage is being influenced by several exogenous factors. For our analysis, we have chosen as dependent variable the *debt ratio (debt)* of the firms calculated as the ratio of total debt to total assets, expressed as percentage same as Ozkan (2001), Chen (2004) and Delcoure (2007). The evolution of the debt ratio can be observed in figure 1. The rising trend of debt ratio has registered a leap in 2013 (an increase of almost 6%) followed by a decrease of 2.5% in 2014.

Figure 1. Average debt ratio of Romanian listed firms, 2009-2014



Source: the authors' own calculation after data from Bucharest Stock Exchange

We have also chosen five explanatory variables. The first variable is represented by the *size of the company* (*size)* and it is calculated as natural logarithm of the firm's assets. The size of the firm is a factor that has an important influence on the financial structure of firms. The relationship between firm size and leverage is presented both by trade off theory and pecking order theory. Examining this relationship, some authors (Diamond, 1991; Rajan & Zingales, 1995; Mazur, 2007; Byoun, 2008) showed that large firms may have a higher debt capacity, because are more transparent tend to have higher debt levels. They have a better reputation on the market and a lower probability of bankruptcy, and can access debt more easily (Myers, 2003). While for smaller firms financial institutions must allocate more resources in order to monitor them, so they may demand higher interest rates (Alves & Ferreira, 2011). Other authors (Bas *et al*., 2010) have shown that if for large firms, size is positively correlated with leverage, in the case of small firms, firm size is negatively correlated with leverage. The relationship we expect between company size and the debt ratio is a positive one.

As in most prior studies (Cornelli *et al.,* 1998; Nivorozhkin, 2002; Daskalakis & Psillaki, 2008), tangible assets intensity (*tang*) is measured by the ratio of tangible fixed assets to the book value of total assets. Tangible assets are considered to be used by the firms as collateral in the case of financial distress. The empirical studies in the field (Rajan & Zingales, 1995; Titman & Wessels, 1988) showed a positive relationship between tangibility of assets and the debt ratio of firms. Other studies (Nivorozhkin, 2005; Malinić *et al.*, 2013) found that for firms that activate in emerging economies the relation between assets tangibility and debt ratio is negative. Romania being an emerging economy, as a result of our analysis, we expect a negative relationship between tangibility and debt ratio.

Another determinant of the firm's capital structure identified in the specialized literature is represented by the growth opportunities (*grow)*. This indicator is measured by the increase of assets compared to previous year reported to total assets (used by Titman & Wessels, 1988). The impact of this indicator on the capital structure of firms depends on the considered theory. Thus, the pecking order theory considers that firms with great growth opportunities use mostly internal resources and little debt for financing their activities (Myers & Majluf, 1984). The trade-off theory, considers that firms with great growth opportunities tend to borrow less than firms that hold more tangible assets, because growth opportunities cannot serve as collateral for debt (Myers, 2003). According to the relationship considered by the specialized literature, we expect a negative correlation between growth opportunities and the debt ratio.

Another explanatory variable considered as an important determinant of the capital structure is profitability (*prof*). According to other studies in the field (Rajan & Zingales, 1995; Booth *et al.,* 2001), we measure profitability through net profit divided by the book value of total assets. The same as the other variables, the relationship between profitability and debt ratio of firms differ by various theories in the field. For our study, we consider a negative relationship between profitability and debt ratio, adopting the approach of Drobetz & Wanzenried (2006).

The trade-off theory considers that companies listed on risky markets are more probable to experience financial difficulties. Thus, this theory argues a negative relationship between risks and leverage; this is also the result that we expect from our analysis. Therefore, the last explanatory variable considered for our study is earnings volatility (*risk*) calculated as annual earnings scaled by the value of a firm's total assets, same as other studies in the field (Booth *et al*., 2001; Hong & Xiao, 2006; Vatavu, 2014).

In order to statistically analyze the data, we use regression models. Regression has been used frequently as the empirical methodology to investigate the determinants of capital structure (Rajan & Zingales 1995; Barbosa & Moraes 2004; Antoniou *et al.* 2008; De Jong *et al*. 2008*).* To maximize the use of all available data, we will use in this research panel data methods, which are suitable for analyzing multi-dimensional data (cross-section and time series), and a recently developed unbalanced panel regression method (Antoniou *et al*. 2008; Ozkan, 2001). Taking into account that we use short time series, we decided to use panel regression (Hsiao, 2003), and to obtain more information on the analyzed parameters.

Before realizing the regression analysis, we have applied unit-root tests on every variable included in the panel data, to test if data is stationary. The null hypothesis is that all panels contain unit-root. This hypothesis was rejected in almost all the cases (the hypothesis was not rejected for the variable *size* so we have determined the first difference). Following, for analyzing the data we have realized, after a descriptive statistic, the correlations between variables considered in the analysis and panel regression analysis by using Pooled Ordinary Least Squares (OLS) method. The results obtained are presented in the following section.

3. RESULTS AND DISCUSSIONS

The descriptive statistics of the variables considered for our study are summarised in table 1 presented below.

Table 1. Descriptive statistics of the variables for the period 2009-2014

Variable	Min	Max	Mean	Std. dev.
debt	.00	4.10	.345	.381
size	12.99	24.48	19.194	1.711
tangibility	.00	1.55	.514	.235
growth	-.08	12.45	.115	.825
profitability	-.69	.22	.015	.085
risk	-.70	.26	.022	.091

Source: authors' calculations using the data provided by Bucharest Stock Exchange

So, the values obtained for the *debt ratio* indicate that listed Romanian firms prefer using equity as a source of finance, fact highlighted by the fact that the borrowed funds represent only a third of their capital. For the period of five years considered in the analysis there were registered only small variations of the debt ratio (small value of standard deviation). Regarding the *size* of the companies, the results of descriptive statistics confirm that average companies are rather large (the mean being much closer to the maximum value), being actually firms listed on the Bucharest Stock Exchange

The results obtained for *tangibility* show that the companies considered for the analysis use in large extent tangible assets and the fixed assets are based on their activity. The *growth* ratio shows an average of 11%, with a relatively high standard deviation.

The results for the *profitability* indicator show an average around 2%, with a relatively low standard deviation, fact that can be explained by the manifestation of the recent financial crisis. In the period of the financial crisis many firms have registered negative values of their net income. The average *risk* and standard deviation of risk are very low fact that shows that Romanian companies have stable earnings and did not faced unstable earnings in the five years period considered for the analysis.

Before applying the regression analysis, we have tested the variables against autocorrelations. The results of the correlation analysis show that, except size, all the other independent variables are negatively related to the debt ratio of the firms. We have also taken into account the problem of multicollinearity. The results of the correlation test applied to our variables show that according to the considered reference point (0.80, Bryman & Cramer, 2001) there exists multicollinearity between some of the independent variables which may influence the results of our analysis. Because of these we have avoided including in the same regression the highly correlated variables.

The purpose of the regression analysis is to determine which of the considered indicators are between the main determinants for the leverage ratio of the Romanian listed companies. In order to test this we use a regression model of this form:

$$debt_{it} = \alpha_i + \beta_1 size_{it} + \beta_2 tang_{it} + \beta_3 grow_{it} + \beta_4 prof_{it} + \beta_5 risk_{it} + \varepsilon_{it} \quad (1)$$

Where α_i (i = 1…62) represents the unknown intercept of every company, t (t = 2009...2014) represents the year, β_s are the coefficients for every independent variable and ε_{it} is the error term.

The results of regression analysis are presented in table 2 below.

Table 2. Determinants of debt ratio[1] in Romanian listed companies

Variable	*Constant*	*Size[2]*	*tang*	*grow*	*prof*	*risk*
Coefficients	0.167 (0.863)	0.016 (1.585)	-0.175** (-2.259)	-0.045** (-2.167)	-2.386** (-2.199)	-0.039 (-0.039)
R-squared	0.26		F-test	33.00***		

*** and *** denote that coefficients are significantly 95% and 99% level, respectively. The numbers in parentheses are t-values.*
[1] *the first difference of debt ratio*
[2] *the first difference of the size of the company*

Source: authors' calculations using the data provided by Bucharest Stock Exchange

Based on the results of the regression models applied and their statistically significant coefficients presented in table 2 above, we can affirm with a probability of 95% that assets tangibility, growth opportunities and profitability are the microeconomics determinants of the firm's indebtedness. The other considered variables (size of the company and earnings volatility) do not have a statistically significant influence on the debt ratio of Romanian listed firms.

The coefficient of *assets tangibility* shows that this variable has a negative relationship with debt ratio, the coefficients being statistically significant at 5% level. These results can be explained by the fact that in emerging economies, such as Romania, the use of tangible assets as collateral is limited, the cause can be the inefficient and really underdeveloped legal system but also the illiquid secondary market for firms' assets. The results obtained for this variable are in line with our expectations and with the results from specialized literature (Nivorozhkin, 2005).

Growth opportunities have a negative relationship with debt ratio, the coefficients being statistically significant at 5% level. Thus, Romanian listed companies which have bigger growth opportunities are using especially internal resources and just a small part of debt for financing their activities. These results are in line with our expectations.

The coefficient of *profitability* show that this variable has a negative relationship with debt ratio (the coefficients being statistically significant at 5% level), fact that shows that if a firm has a higher profitability, when will decide to finance will first use the internal founds and, only as a last resort, will apply for a loan. When a firm has a profitable activity is registering bigger earnings which it can use to finance the activity and can keep the borrowed funds to minimum. These findings are in line with specialized literature (Drobetz & Wanzenried, 2006) and also with our expectations.

The coefficient of size shows a positive influence on firms indebtedness and the coefficient of *risk* shows a negative one (in line with our expectations), but they are not statically significant.

The F-test is statistically significant at 1% level, thus we accept with a very small error that there is a linear dependence between the level of indebtedness of the analyzed firms and the microeconomic analyzed variables, this confirming the relevance of the model in determining the indebtedness of the firms listed on Bucharest Stock Exchange. However, we observe that the model used could be improved by adding variables with potential impact on the debt ratio, because we observe that the value of R-Squared indicates that only 26% of the variance in debt ratio can be explained by the variance of the considered variables.

As a concluding remark we can affirm that the debt ratio of the companies listed on the Bucharest Stock Exchange is consistent with the assumptions of the pecking order theory, which consider that profitable companies, with better growth opportunities borrow less and finance their investments using especially internal resources.

4. CONCLUSIONS

Through this paper we aimed at identifying which are the microeconomic determinants of the debt ratio of the Romanian companies listed on the Bucharest Stock Exchange. For our sample we have chosen listed companies due to their obligation of publishing their financial data, and thus resolving the problem of availability of data. We have analysed 62 non-financial companies listed on the Bucharest Stock Exchange during five years, between 2009 and 2014. For the econometric analysis we have used panel data regressions.

The results of the empirical analysis show that assets tangibility, growth opportunities and profitability are the microeconomics determinants of the firm's indebtedness. These indicators have a negative influence on the debt ratio of firms. The other considered variables do not have a statistically significant influence on the debt ratio of Romanian listed firms.

These results are in line with the assumptions of the pecking order theory which considers that profitable companies and with better growth opportunities are using less borrowed funds and finance their investments through internal resources.

The model considered explains only a quarter of the indicators variation, thus in further research we intent to extend the sample and to consider also other determinants of firm's indebtedness.

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HUMAN RESOURCE MANAGEMENT IN ROMANIA: STRATEGIC OR UTOPIA?

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Abstract
Since 1990, Central and Eastern European countries have gone through major changes, in their attempt to successfully compete in the international environment. One of the major aspects which has been particularly challenging is human resource (HR) management. Even though organizations acknowledge the importance of HR policies and practices, we cannot help but wondering if organizations actually believe in the strategic role of HRM and create HR strategies integrated into organizational strategies in order to prove it. The current study is based on in-depth interviews with general managers / HR managers from 10 companies present in Romania - 5 multinational companies (MNC) and 5 local companies - in an attempt to identify similarities and differences between MNC and local companies from the point of view of their HR strategies. The research methodology is a qualitative type, relying on sociological inquiry, as method and semi-structured interview, as technique. Results show that all companies included in the study have HR policies and practices in place, but differences reside mainly in the industry specificity and in the importance awarded to HR strategies. Results can be used both by Romanian companies to improve their HR strategies by using 'best practices' from MNCs and also by foreign companies entering Romania in order to improve their knowledge concerning HR specificity in the country.
Keywords: *human resource management, strategy, Romania, case study.*
JEL Classification: M510, M520, M530, M540, R23

1. INTRODUCTION

Generally, human resource management (HRM) tends to be declared as a priority by HR managers in Romania. The investment in people and in HR practices should therefore be a very significant one. Still, many companies use well qualified but less expensive workforce mainly to increase profit without truly putting HR strategies into practice. On the other side, a significant number of companies (small and medium enterprises (SMEs) in particular) do not understand the importance of creating company strategies and particularly HR ones, derived from company strategies. Even though some authors (e.g. Kramar, 2013) may consider strategic HRM (SHRM) an outdated concept, we are wondering if companies present in Romania (especially local companies (LCs)) have moved from HRM to SHRM or if they are still lagging behind.

SHRM is not a new concept. It developed in the late 1970s and the 1980s as a means of addressing the challenges of a turbulent and fast-changing environment from an HR point of view (Kramar, 2013). Research in the SHRM field expanded a lot starting 1994 when studies in this field started to address the issue of relationship with organizational performance. Even though a lot of progress was made, gurus of the field ask for more empirical proves, and recommend to address the ‘what’, ‘why’, ‘how’ and ‘to whom’ questions (Boxall & Purcell, 2011). While in other cultural contexts the problem of explaining the link between HRM and performance exists, trying to answer the ‘why’ and ‘how’ questions, we still need to focus on the first one: what features that describe most the HR system are present in the Romanian business context.

2. ADVANCES IN STRATEGIC HUMAN RESOURCE MANAGEMENT

Strategic HRM appeared as an organizations’ management request for gaining competitive advantage through human resources (Allen & Wright, 2007), being considered a relatively young field of study. Therefore, SHRM appears as a link between HRM and strategic management processes of an organization, incorporating the ‘S’ into the ‘HRM’. Sondhi & Nirmal (2013) support the idea of HR activities being created and intentionally linked to the internal and external environment of the organization.

SHRM emphasizes on coordination and congruence among various HRM practices like HR planning, recruitment, selection, training and development, reward and compensation. These elements are to be considered as crucial in the achievement of strategic goals (Chew & Chang, 1999; Sondhi & Nirmal, 2013). According to Nel & Little (2006, p. 6), “HR practices are only effective if they are aligned with the strategic direction of the organisation and are focused on business operations and executed professionally”, therefore only SHRM can be effective, whereas HRM can only be a framework.

As Becker & Huselid (2010, p. 383) put it, “strategy is about finding a way to earn profits above and beyond what might be expected from operational excellence (i.e., good basic management)”. Therefore, HR strategy “should be understood as composed of a mix of HR systems with a variable degree of overlap among them” (Boxall & Purcell, 2008, pp. 59–60). Back in 1992, Wright & McMahan (1992, pp. 295–320) stated that SHRM is “a series of planned human resource activities and deployments designed to achieve an organisation’s goals”, a definition that has become very popular over time.

Researchers have been advocating the importance of addressing HR at strategic level for a while now, meaning that managers should stop seeing HR function or department only as a reaction and an implementer of management strategy. HRM should be approached strategically because human resources represent a competitive resource (e.g. Tracey & Nathan, 2002) and they are considered to be “a unique and differentiating asset, playing an increasingly important role in organization” (Chandra & Shen, 2009). Furthermore academics, practitioners and consultants argued that if HRM wants to create added value for the organization, it has to become a strategic partner with the business in achieving its business goals (Sondhi & Nirmal, 2013). However, looking into literature in the field, research in SHRM seems to be a result of the resource-based view approach (Barney, 1991) which encourage organizations to look also inside, at their own resources and capabilities when making strategy (Wright *et al.,* 2001), considering that HR comply with the VRIN concept (they are valuable, rare, inimitable and non-substitutable).

SHRM is seen as being created from HRM systems, rather from individual HR practices, having impact on performance at organizational level (while traditional HR functions looked for impact on individual performance) (Farndale *et al.,* 2010). Also, SHRM is considered “an approach to management” which includes HR strategies, the purpose being the overall performance of the organization and, ideally, to measure the impact of the HR strategies on performance (Boxall *et al.,* 2007; Kramar, 2013). The role of HR has become strategic with the increased competition, creating a motivating workforce, facilitating change management and recruiting & retaining the most efficient employees (Sondhi & Nirmal, 2013). Much research was made on discovering what type of HR system is best: universalistic, contingent or configurational approach (Delery & Doty, 1996). More recently, there are authors who advocate that all of these approaches seem like “best practices” and they won’t meet the ‘inimitable’ feature requirement (Becker & Huselid, 2010). They support the idea that identifying strategic jobs into organization and developing SHRM for these kinds of jobs will bring the necessary competitive advantage. In terms of strategy implementation, SHRM theory has argued that an appropriate match between the HR architecture and strategic choice results in effective implementation (Becker & Huselid, 2006).

Lengnick-Hall *et al*. (2009) identified seven themes across time in the SHRM literature: (1) explaining contingency perspectives and fit, (2) shifting from a focus on managing people to creating strategic contributions, (3) elaborating HR system components and structure, (4) expanding the scope of SHRM, (5) achieving HR implementation and execution, (6) measuring outcomes of SHRM, (7) evaluating methodological issues and they argue that each of these themes played a significant role in the evolution of the field.

It's not news that organizations should invest in HR in order to increase their performance. Literature and practice have proven that for long. Still, Brinkerhoff (2005) stated that most organizations fail to evaluate the impact and return on training investments that they could and should. Also, the study shows that the performance achieves (or does not achieve) results, and thus the evaluation of the impact must inquire more broadly into the performance management context and not on the Human Resource Development, linking HR to overall company management. Moreover, sometimes organizations tend to provide benefits for their employees without measuring the impact of such measures on organizational performance. Therefore, as Nel & Little (2006, p.6) put it, "being strategic therefore means being involved in productivity and not focusing on being an *employee champion*".

Sondhi & Nirmal (2013) link strategic HR to talent management, the first being part of the latter. They argue that, being involved in talent management proves a deliberate strategy on the entire HR chain, therefore generating benefits in the critical economic areas of the organization (revenue, customer satisfaction, quality, productivity, cost, cycle time, and market capitalization). More recently, authors have been interested in the impact people management policies have on both human and financial outcomes, discussing about 'sustainable HRM' as a replacement for SHRM (Kramar, 2013). Sustainable HRM acknowledges the complexities of workplace dynamics and explicitly recognizes the need to avoid negative impacts of HRM practices, therefore Kramar (2013) states that SHRM and personnel management (PM) are part of sustainable HRM, but differences between SHRM and sustainable HRM are still not big enough to be considered different orientations. Ehnert provided probably one of the most complex definitions of sustainable HRM so far, stating that it is 'the pattern of planned or emerging human resource strategies and practices intended to enable a organizational goal achievement while simultaneously reproducing the HR base over a long-lasting calendar time and controlling for self-induced side and feedback effects on the HR systems on the HR base and thus on the company itself' (Ehnert, 2009, p. 74).

Moving to the international environment, SHRM is treated as part of the international human resource management (IHRM). Taylor *et al*. (1996) consider that IHRM need to be connected and to evolve along with the organization, top management view and goals and the IHRM systems themselves. Also, there can be addressed the level of dependence in terms of mutual intra-organizational reliance between remote subunits and the HQ based on three levels: independence, dependence and interdependence (Farndale *et al.,* 2010), therefore different HR roles and activities.

3. IS THE HR STRATEGY 'FIT' FOR ACHIEVING ORGANIZATIONAL GOALS?

HR systems are designed in order to respond to one or more organizational goals that may be in contradiction (Boxall & Purcell, 2011), and that is how the problem of 'fit' occurs. The implication for HR specialists is that the corporate agenda presents a significant challenge and opportunity for senior HR professionals. HR will require a more expert understanding of these corporate-level concepts, organizational identity and identification, and their potential in building and sustaining corporateness. They will also need to be aware of the tensions between best practice and best-fit approaches to talent management, employer branding and employer of choice schemes (Martin, 2009).

A very good answer to the issue of fit between HRM and organizational goals is given by Lepak *et al.* (2006). The authors approached the importance of creating a specific type of organizational climate (e.g. customer oriented, quality-orientated) as a means for achieving organizational goals. However, the HRM strategy, the strategic focus on the organizational climate chosen to be developed and the organization' strategic goals need to be all aligned in order to gain effectiveness.

Authors like Delery & Doty (1996), Delery (1998), Kepes & Delery (2006, 2007) approached the problem of fit, both internal (between HR practices) and external (between HR practices and organizational strategy). More recently, Kepes & Delery (2007, pp. 390-392) identified four types of internal fit (this type of fit was exhaustive debated because it is considered to represent a significant source of sustainable competitive advantage):

a) "*Within-HRM system vertical fit*" (p. 390) – alignment between different HR activities from different levels of abstraction, for example between policies, practices and processes (even though this type is rarely exploited into research, it is somehow mutually recognized);
b) *horizontal* – "*inter-HRM activity area fit*" – alignment between different activities from different HR areas; this type implies those "powerful connections" or "deadly combinations" between practices defined by Becker *et al.* (1997) (e.g. alignment between recruitment and selection practices on one hand and training and development on the other hand);
c) *horizontal* - "*intra-HRM activity area fit*" – alignment between HR activities from the same HR functions in order to gain synergetic effects of those practices;

d) "*between-HRM system fit*" – it answers the questions "do the systems fit together in order to support the overall HR strategy?"; "do they express the common philosophy of the HR architecture?" – the problem of fit in this case appear specially when there are many HR systems with contradictional goals (Boxall and Purcell, 2011), but an organzation needs "to balance these possibly conflicting demands" (Kepes & Delery, 2007, p. 392).

Interconnected with the above-mentioned approaches, we can consider Krishnan & Singh (2011)'s view, who developed a three-stage process model, taking into consideration five key elements (external environment, business strategy, internal environment, SHRM and the outcomes of the SHRM process), while integrating them into three regular stages of the strategic management process: strategy formulation, implementation, evaluation/review, their contribution being linked to the third stage. By enabling a process to self-correct, this should also help maintain a better fit between intended and actual strategy (Krishnan & Singh, 2011).

Considering the goals that HR systems need to respond to, we have identified six types of HR systems, out of which the first three seems to be more used in the literature of the field:

1. The concept of "high performance work system" was first introduced by researchers in industrial field and afterwards became very popular in the SHRM field of study, regardless of the industry (Boxall, 2013). A wide variety of HR practices seem to be proposed as being part of this system, Becker & Gerhard (1996) illustrating five researches with five different approaches;
2. High involvement work systems imply practices that 'influence the nature and the scope of the jobs employees perform' (Lepak *et al.,* 2006, p. 227). These systems usually promote HR polices that value respect, responsibility, mutual involvement in order to improve the relationships between employees and obtain higher organizational performance (Gollan, 2005);
3. High commitment work systems encourage employees to identify themselves with the organizational goals in order to achieve them (Whitener, 2001).

The two latter ones are considered to be more meaningful (Boxall & Macky, 2009) because they offer more details about the scope and principles guiding managers' actions (Boxall, 2013).

1. Control human resource systems aim at reducing labor costs or improving efficiency using procedures and specified rules (Arthur, 1994);
2. HR systems for customer service deal with creating service climate (Liao & Chuang, 2004);

3. HR systems for occupational safety (Zacharatos *et al*., 2005);
4. Supportive HR practices (participation in decision making, fairness of rewards, and growth opportunities) (Allen *et al.*, 2003).

A wide variety of HR practices seem to be proposed as being part of this system, Becker & Gerhard (1996) illustrating five researches with five different approaches. They looked at five studies and the number of practices varies between four and eleven. However, four of them are reached in most of them: the existence of self-directed work teams, the existence of problem solving groups, contingency pay, number of hours per year of training, except initial training.

Even though the problem of fit was debated in the literature in the field, there are some authors that ask for more evidence and more consensus of what "fit" means (Paauwe *et al.,* 2013). An impressive critical review of "fit" literature is made by Paauwe *et al.* (2013), when classifying approaches to conceptualizations of fit. Considering the focus that researchers take into consideration they identify eight typologies: content, process, strength of interaction, alignment of dominant goals, organizational systems and work systems, institutional setting, dynamic capabilities and implementation on HR strategy. However, they argue that despite the variety of these approaches, there is still something missing and they emphasize the need to integrate "line manager", "person-environment fit" and "interaction between intended and actual HR practices" along with studying the temporal order in achieving fit (Paauwe *et al.,* 2013). As a conclusion they propose a "two-stages" of fit and encourage the future research to analyze the way the approaches of fit are related, and the relationship between fit and performance.

4. RESEARCH METHODOLOGY

This exploratory-type study aims at identifying similarities and differences between multinational companies (MNCs) and local companies (LCs) present in Romania from the point of view of their HR strategies. This paper was mainly inspired by the work of Chew & Horwitz (2004), who investigated eight multinational companies in Singapore. In order to ensure comparability, we maintained most of the structure of the research while adding the specificity of the Romanian environment and choosing two different types of companies (5 MNCs and 5 LCs) from seven industries (automotive, banking and finance, IT, wholesales, wood, pharmaceutical, construction materials).

The qualitative approach was preferred for two main reasons: 1. it allows for unstructured exploratory research, based on small samples that provides insight and understanding of the problem setting (Malhotra, 2010); 2. no other type of research provides a better way of attaining an in depth-understanding of the underlying motivations and feelings driving the respondents (McDaniel & Gates, 2005).

The semi-structured interviews were conducted with at least one top manager (general manager (GM), HR manager) and at least one current/former employee. This dual approach was considered more appropriate in order to ensure accuracy and consistency, having known that strategies that look perfect on paper are ineffective in practice or are not known/believed to be effected by the employees. All interviewees are Romanian, the number of international managers in multinational companies currently being very low as companies move from an ethnocentric to a polycentric approach and foreign managers are being replaced by host country nationals (see table 1).

Table 1. Structure of interviewees in the study

Nationality	Position	Years of experience for top managers (operational, including HR)
Romanian	GM: 2 HRM: 10 Employee: 12	0-5 years: 5 6-10 years: 12 + 10 years: 7

Source: authors' own study

The interview guidelines were based on Chew & Horwitz (2004)'s interview guidelines and adjusted to fit the reality of LCs, as well as MNCs present in Romania (see Appendix 1). Interviews were conducted in the biggest city in the North-Eastern region of Romania (Iasi), where most of the companies have offices. Besides being interviewed, GMs and HR managers provided documents that would enable us to reach a better understanding of their company. For five interviews we were granted approval to record and very detailed notes were taken by two researchers in order to ensure coverage of all matters and nuances.

Following Chew & Horwitz (2004)'s methodology for comparable results, McKinsey's seven S framework was used for grouping the information resulted from interviews and secondary data. Also, information was grouped based on the ten high performance human resource practices identified by Chew & Horwitz (2004).

Presentation of companies

All ten companies included in the study are present in the North-Eastern region of Romania with head-offices, secondary offices, production sites, administrative or service offices. Based on the specific request of some companies and also in order to better protect their competitive advantages, we chose not to disclose their company names.

Case 1: This company was established in Europe about 150 years ago and it has become one of the top five suppliers for the automotive industry in the world. It has an extremely diversified portfolio, ranging from tires to software, all for the automotive industry. Since the year 2000, the company has established several locations in Romania, investing both in production and research & development facilities.

Case 2: The second company included in the study is one of the other leaders of the international automotive industry present in Romania. Established in the United States of America, the company has been present in Romania since 1995, where it has built four production sites for various technologies and types of products targeted to the automotive industry.

Case 3: Out of the two banking & financial institutions included in the study, one is the local subsidiary of an MNC (case 3) and the other one is a local company majorly owned by a foreign bank (case 6) and this is not the only difference between the two. The company in case 3 originates from Europe, mainly targets SMEs and is fully engaged in the development of the local economy, fact that has helped it become one of the most important banks in Romania, promoting a visionary and creative approach also for its employees.

Case 4: The European group that owns this company has several divisions generated through successive mergers and acquisitions on the European market and it focuses on two major markets: wholesale and retail. This company is in the wholesale business and it has been present on the Romanian market since the second half of the 1990s, currently being considered one of the major suppliers for the business sector in Romania.

Case 5: The company presented in this case is originally a family business established about 50 years ago in Europe, which has grown into a group of companies, that range from wood, wood derivatives, adhesives to agriculture and gas. It is currently present in several European countries and it has entered Romania in the second half of the years 2000 with an investment in a wood derivatives factory.

Case 6: This bank is one of the top three banks in Romania, the majority of share being acquired by a major European bank, established about 150 years ago and owning an impressively diversified portfolio in Romania and abroad. The bank is extensively present in every major city or village in Romania and is highly trusted by its customers.

Case 7: This company established in Romania is the result of an European investment, which aimed at creating an excellence center for software design and development. It was inaugurated in the first half of the years 2000 and ever since it has been targeting the European market with tailor-made IT solutions.

Case 8: The company is one of the Romanian factories from the pharmaceutical industry with a large tradition and it was established in the 1950s. Going through major changes (after the revolution of 1989), after renewing the technology and obtaining all international quality certificates in the industry, in 2013 the portfolio includes 150 products, out of which 70 are registered for export. The enterprise is the world leader for a bulk active substance (more than 40% market share for the product) and its products are distributed in 40 countries. The enterprise has about 1500 employees and most of the shares are detained by the Romanian state

Case 9: This privately-owned, local software company was established around the year 2000 by two IT specialists and has grown into one of the most dynamic IT companies in their field of interest – IT business solutions, acquired from major international players or developed in-house, tailored based on customer needs. It targets both private and state-owned organizations with a variety of IT solutions and it has developed an impressive portfolio of customers.

Case 10: This local company is one of the major companies in Romania that produces construction materials. It was acquired by foreign entities in the second half of the years 2000 and ever since it has gone through major investment plans, which have put it back on track and in one of the best positions on the Romanian market.

Research questions

Being a qualitative-type research, using sociological inquiry as method and semi-structured interview as technique, we attempt to answer four research questions instead of formulating hypotheses, which would be more appropriate for quantitative research.

RQ1: Are there any similarities between MNCs and LCs in terms of applying their HR strategies in Romania?

RQ2: Are there any differences between MNCs and LCs in terms of applying their HR strategies in Romania?

RQ3: What processes and tools are used by LCs in order to implement HRM strategies?

RQ4: Are the HR strategies of LCs truly embedded into company strategies?

5. RESULTS

Our research outcomes can be considered partly expected and partly surprising. Grouped in tables 1, 2 and 3, they differ slightly from Chew and Horwitz's results, reasons being at least the following: 1. research in a different setting and in a significantly different culture; 2. tendency of Romanian managers to mainly provide the 'official version' of the strategy, not necessary the reality implemented in the organizations; 3. since LCs were also included in the study, they may impact differently on the research; 4. different researchers, with potentially different backgrounds and interview abilities, which may impact positively or negatively on the end result of the study. In the last column of table 1, we preferred to state that the outcomes are 'expected', as they cannot be granted as an end result of implementing high performance HR initiatives.

Interestingly, all companies included in the study have implemented performance-based, flexible pay systems. Statistically, we consider this surprising as the percentage of companies who have put such systems in place is not 100%, especially in the case of LCs. Our study being performed ten years after Chew and Horwitz's, it may also collect the results of the current economic crisis (2008-2014), in which companies became more aware of the need to implement flexible pay systems as a means to both stimulate employee and ensure organizational performance.

From other points of view, all organizational values were collected from company documents and they seem to be strongly implemented in the day-to-day activity of the organization. Also, the investment in HR development programs is considered to be at least 'significant' in 80% of cases, even though we encountered one clear exception: case 10. Since the economic crisis has begun, the company has focused mainly on providing the compulsory training for directly productive staff and, therefore, their investment cannot be considered as being 'significant'. Not surprisingly, in the case of MNCs, processes, systems and their integration (with each other and in the overall strategy of the company) is present in all companies, therefore aiming at obtaining the expected results (job/work commitment, satisfaction/ motivation, productivity, high performance standards). Roughly half of LCs have managed so far to create integrated systems that could actually work and provide them with competitive advantages especially in terms with competing with MNCs (see table 2).

Table 2.Ten high performance human resource practices (according to Chew & Horwitz, 2004)

High performance HR initiatives	Frequency MNC ($N_1 = 5$)	Frequency LC ($N_2 = 5$)	TOTAL (N=10)	Human resource (expected) outcomes
Performance-based, flexible pay	5	5	10	Clear performance standards, high motivation, retention
Strong values / principles driven and value creating culture	5	4	9	Cohesive culture, individual identification / organizational commitment
Significant investment in human resource development	5	3	8	High retention, (global) competencies, business and social skills

High performance HR initiatives	Frequency MNC (N_1 = 5)	Frequency LC (N_2 = 5)	TOTAL (N=10)	Human resource (expected) outcomes
Organizational & work process design, supporting HR systems	5	3	8	Job commitment, satisfaction, productivity
Integrated alignment of staffing, performance management & career development	5	2	7	High-performance standards, motivation, work commitment
Targeted recruitment for individual-culture fit	3	3	6	Staff stability, motivation and retention
Distinctive managerial styles aligned with core values	4	2	6	Integrated individual & organizational goals, job commitment
High employee involvement	3	2	5	Organizational commitment, better communication & teamwork
Promoting global staff diversity	3	-	3	Improved inter-group relations, perceived equity / workplace justice
International staffing policy for career planning	2	-	2	Career & succession plans for required global competencies

Source: authors' own study

We would expect that, in the case of MNCs, to encounter more targeted recruitment for individual-culture fit. Surprisingly, only about half of both MNCs and LCs are concerned about it. While in the case of LCs it is not a surprise, them not being truly generally concerned about the issue, in the case of MNCs it raises a question mark. The major reason behind that is probably linked to the HR approach of MNCs approached in this research. Some of them have quite recently moved from an ethnocentric approach to a polycentric approach (e.g. 2 years ago in Case 1; 3 month ago in Case 2 etc.), while others still use the ethnocentric approach (e.g. Case 5). Therefore, their employees lack the opportunity of becoming expatriates in the near future and they only need to adjust to the host country realities.

HR development (HRD) is another key issue that seems to differentiate MNCs from LCs. While all MNCs make significant investments in HRD, only about half of LCs seem interested to do it. Unfortunately, some HR managers in Romania still struggle with the fact that HRD can be considered by some as an expense rather than an investment. Proof stands the fact that, since the beginning of the current economic crisis, in 2008, one of the two major fields in which expenses were cut off was the training and development budget.

In the case of the two MNC-specific initiatives ('promoting global staff diversity' and 'international staffing policy for career planning') only about half of the companies formally put them in place and promote them at the forefront at what they do.

In tables 3 and 4 we detailed the SHRM factors based on the 7S framework for MNCs and LCs.

Table 3. A profile of strategic HR factors using McKinsey's 7S framework (for MNCs)

	Case 1	Case 2	Case 3	Case 4	Case 5
Company type & field	MNC Automotive industry	MNC Automotive industry	MNC Banking & financial services	MNC Wholesaler	MNC Wood industry
HRM strategy	International staffing policy High HRD investment Performance-oriented culture and rewards	Local staffing policy HRD investment 'No vacancies' policy Quality-based training Devoted to professionalism	Global staffing policy Performance – based rewards High HRD investment Diversity management	High HRD investment Performance-oriented culture and rewards Local staffing policy Committed to developing employees careers Focus on internal recruitment	High HRD investment (e.g. Spirit, Inpuls, StartKlar programs) Performance-oriented culture and rewards Local staffing policy, in line with the international strategy
Shared values	Trust, passion to win, freedom to act, for one another	Integrity, excellence, team work, responsibility	Transparency, a culture of open communication, social responsibility and tolerance, service orientation, high professional standards, a high degree of personal integrity and commitment	The customer = the core; competence; team; community	Sustainable development for future generations; respect, trust, partnership & loyalty; keep our promise; professionalism and effective decision making processes.

	Case 1	Case 2	Case 3	Case 4	Case 5
Structural support	International strategic divisions Decentralized, regional Encourage learning and development Employee recognition and rewards Foster teamwork, collaboration, communication Informal Low status differentiation, open door	International strategic divisions Decentralized, regional Encourage learning and development Employee recognition and rewards Formal (‘military’) culture High status differentiation Transparent system of recruitment, selection, promotion	Decentralized, local Achieving best fit: individuals & culture Transparent system of recruitment, selection, promotion Technology impacts the traditional lines of communication Formal and informal communication Flat organizational chart	International strategic divisions Decentralized, regional Foster teamwork and cooperation Employee training and development Technology impacts the traditional lines of communication Formal and informal communication	International strategic divisions Decentralized, regional Encourage learning and development Employee recognition and rewards
Staffing	Integration of staffing, performance & career development plans HRM principles: Optimum labor costs; global growth; fluid organization; culture of high performance; preferred employer; strategic skills management; employability; a culture of trust; active public positioning; efficient, high-value processes & services.	Specialized industry skills Trainability and performance orientation Fair and equitable chances for everyone	Non - discriminative policies Integrity and ethic values ‘Young bankers’ program for attracting young, valuable professionals (under 32)	Priority to internal recruitment External recruitment mostly at junior level Development potential = the main selection criterion	Priority to internal recruitment Knowledge, experience and loyalty are precious Trainability and performance orientation
Systems & skills (particularly HRD)	Focus on both HR recruitment and development Performance-linked pay	Rewards based on tenure and performance HRD for product quality	Soft-skills training ‘HR Service Center’ Regional academies (Colombia, Germany, Macedonia)	Rewards based on performance, experience and tenure Predominantly internal training HRD for service quality Variable pay	Predominantly internal training HRD for service quality Variable pay + financial and non-financial stimuli

Source: authors’ own study

In the case of MNCs, we can identify some common traits for the five companies included in the study:

- they all have a significant commitment to HRD, 4 out of 5 making ‘high’ investments in HRD and truly seeing HR as a strategic investment (fact also identified through Chew and Horwitz’s study);

- they all have organizational cultures that value performance and this is at the heart of their entire philosophy;
- they all have strong values, that are able to push the company forward and their employees proved that they live through those values (consistent with Chew and Horwitz's study);
- even though most of them have international strategic divisions, they all benefit from decentralized structures, that allow them to make local decisions while still being anchored to the international environment;
- regardless of their culture type, all MNCs in this study foster teamwork and encourage communication (be it only formal or formal and informal).

Table 4. A profile of strategic HR factors using McKinsey's 7S framework (for LCs)

	Case 6	Case 7	Case 8	Case 9	Case 10
Company type & field	Local company, majorly owned by foreign entities Banking & financial services	Local company, majorly owned by foreign entities IT	Local company Pharmaceutical industry	Local company IT	Local company, majorly owned by foreign entities Construction materials
HRM strategy	Performance-oriented culture and rewards HRD investment Centrally developed HR strategy Strive for diversity in the workforce ('talent diversification')	Highly innovative and highly qualified HR Important HRD investment Customer-oriented training	Management by objectives (pay for performance) HRD investment Do not let go, rather reallocate HR Care for the employees and their families	Fair and equitable chances for everyone Devoted to professionalism Committed to developing employees careers Focus on internal recruitment	Moderate investments in HRD (since 2010) Strong focus on product quality, not so much on HR quality
Shared values	Professionalism is the core culture; team spirit is the future; innovation is the state of mind.	Listen, understand and deepen customers' requirements	Efficiency, knowledge, spirit of cooperation, customer orientation, the right person at the right place, care for the others.	Partnership, team, performance, innovation	Quality, safety and comfort for the customer.
Structural support	Local organization, independent decision making structures based on external input Centralized HR	Local organization, independent decision making structures based on external input Employee	Local organization, independent decision making structures Strict, pyramidal structure	Local organization, independent decision making structures 'Play Point'	Local organization, independent decision making structures Predominantly formal

	Case 6	Case 7	Case 8	Case 9	Case 10
	structure Culture – employee fit Externalized HR services Friendly social climate Open communication (formal and informal)	recognition and rewards Foster teamwork and cooperation	Predominantly formal communication Employee training and development		communication
Staffing	Search for talent: team spirit, proactive, flexible, initiative spirit, dynamic, adaptable. Focus on attracting young specialists (under 35)	Talent attraction for innovation Recruitment mostly at junior level IT-specific selection and development programs	Specialized industry skills HR systems to support staffing Integration of staffing, performance and succession plans	Focus on aptitudes and personal qualities (especially initiative, creativity and innovation), on level of studies rather than on experience Focus on attracting fresh university graduates	Externalized HR recruitment process Predominantly non-financial stimulants and support for innovation Pay for performance
Systems & skills (particularly HRD)	Integrated HRD and career planning Performance-linked pay Constantly innovate to differentiate	Pay for performance Distinctive skills acquired and developed	Performance / productivity - linked pay Constant HRD programs (e.g. summer school)	High HRD investment Soft skills training Pay for performance	HRD through individual performance management Variable pay + non-financial stimuli.

Source: authors' own study

In what the LCs are concerned, there is much larger variety of approaches. We can identify some common grounds between the IT companies (cases 7 and 9) or between the companies owned by foreign entities (cases 6 and 7, not so much 10). Differences probably reside also in the field of activity, being well-known that IT, banking & finance and pharmaceuticals each have specific traits as industries and, therefore, in terms of HR.

The common traits identified for the LCs are:

- most obviously, they are independent structures, who can make independent decisions and external input on decision making processes may be received especially in the case of organizations owned by foreign entities (cases 6 and 7);
- their values are oriented towards the outside more than the inside, valuing the customer more and the employee less, which may allow us

to conclude that SHRM is not necessarily their main concern and that it may rank behind other objectives, such as financial objectives;

- only one of them makes 'high' investments in HRD, which may prove a lack of vision in what the strategic investment in HR is concerned;
- four out of five organizations are keen on innovation, which is a very positive trait, considering that one of the main tasks of SMEs is to innovate and some two LCs out of five are SMEs.

6. DISCUSSIONS

The current study has attempted to answer four research questions that are tailored to the Romanian reality and who can provide insight for MNCs, LCs, HR specialists, as well as academics in view of potential future research. While the answers to research questions number 1 (RQ1) and number 2 (RQ2) is obviously "yes" based on the above-mentioned common traits, we need to provide answers as we focus on LCs in an attempt to help them identify what actions they could take and what processes they could implement in order to be more competitive on their own markets.

The processes and tools used by LCs in order to implement HRM strategies appear to be resumed in three major guidelines: 1. recruit and select young, adaptable and innovative employees; 2. provide recognition and rewards (pay for performance); 3. train and develop HR, but do not make extensive investments in this field. As simplistic as it may seem, the system apparently works for some LCs, but the difference between success and failure is determined by very fine lines, related to the 'how' and not to the "what".

In two out of five LCs, the HR strategy seems to be truly embedded into the company strategy and generating valuable outcomes for these companies (cases 6 and 9). In case 7, employees seem to have trouble understanding how certain things work in terms of HR, as they are not fully aware even of how the evaluation system is put in place. In case 8, the HR strategy seems moreover declared than embedded and the restrictive organizational culture seems to prevent rather than facilitate communication. In case 10, the HR activities are predominantly externalized and, since the company does not have a strategic investor from its industry, it probably cannot hope for a strong strategic vision in terms of HR in the near future.

We could ask ourselves *which came first: the chicken or the egg?* Are MNCs successful because they developed strong organizational cultures, which value performance or invest in HRD? Or have they developed strong organizational cultures after having become strong MNCs? Even if evidence shows that the answer to the first question is most often 'yes', LCs (and especially SMEs) tend to believe that they need to obtain strong financial results first and only afterwards to invest, for example, in HR. The differences identified between the MNC and the LC's approaches stand proof of this potential gap between the two company types.

The MNC group is much more homogenous in terms of traits, while the LC group is much more heterogeneous, therefore we could wonder if there is (maybe) a common 'recipe' for MNCs in Romania or, moreover, worldwide. Could we define some common traits that could make an MNC successful regardless of the industry/industries in which it is involved?

We could conclude that HRM in Romania can be approached strategically if there is vision and desire to do so. The MNC approaches stand proof of this reality and, at least on the long term, LCs will not have other choices especially if they desire to compete in the international environment. HR become more valuable and valuable employees are rare, highly inimitable and difficult or expensive to substitute. Therefore, in a competitive market organizations have no other choice but to treat HR as being strategic and, if they desire, even to make them become sustainable. Fortunately, SHRM in Romania is not utopia, but at the same time, it is not as present in our everyday business reality as we would desire.

7. LIMITATIONS AND FURTHER RESEARCH

The major limitations to this study refer mainly to the region where the study was performed (North-Eastern region of Romania), to the number of companies included in the study (10) and to the fact that interviews were at a certain point in time (June-July 2014), not allowing for continuous observation. The study focused on identifying HR practices and not on how they are implemented. For this reason we cannot sustain that certain HR outcomes (like those in Table 1) are obtained in the companies studied. Also, Romanian managers are generally reluctant to participating in interviews and to providing information about their company, most of them considering that they may lose competitive advantage if they disclose every little thing about the company. This was a particularly difficult challenge when selecting the companies and the employees (managers or subordinates) to participate in the study. Their reluctance is proven also by the very small number of interviewees who accepted to be recorded (5 out of 24) and by the fact that most companies asked for their company names not to be disclosed.

In order to overcome the limitations, the research could be extended to the international environment, providing a base of comparison for Romania and other (neighboring or not) countries. Also, the study could become more similar to the one performed by Chew and Horwitz, approaching MNCs in more depth and trying to evaluate how HR strategies are developed and diffused from headquarters to host country environment.

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Appendix 1
Semi-structured interview themes

1. Do you have an established HR strategy?
2. How would you describe your company's human resource strategy (or set of practices, if not strategy)?
3. What are its key features?
4. What priorities does it seek to address?
5. What processes and tools do you use in order to implement HRM strategies?
6. What specific human resource processes or initiatives are used to enhance performance?
7. How effective are they?
8. Is /(how is) the HR strategy aligned to the firm's business strategy?

Specific questions for MNCs

9. How /where is your HR strategy developed?
10. What issues were important in implementing it in Romania?

EMPLOYER BRANDING: MATCH MAKER OR BREAKER FOR IT COMPANIES IN ROMANIA?

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Abstract
Lately, employer branding has become an attractive and fashionable topic. Beyond its proven benefits for the attraction and retention rates within organizations, we cannot help but wonder if companies present in a developing country (such as Romania) truly apply its principles accurately and use it for becoming employers of choice (EOC). Also, we are interested to find out what candidates or current employees look at when evaluating the employer brand of an organization and if their perceptions are in line with what organizations present in social media. The current paper is an introductory study for employer branding in the IT sector of Romania, a study performed in the third largest IT hub in Romania (the city of Iasi).
Keywords: *employer, brand, IT, Romania.*
JEL Classification: D23, E24, F23, J24, M12, M31, M54, O15

1. INTRODUCTION

In a world in which technological, informational and financial advantages can be easily overcome by competitors and become history, the ultimate added value of an organization is a performant human capital. Easily to say, more difficult to attract and retain, as some would say. Therefore, competitors move to the talent frontline.

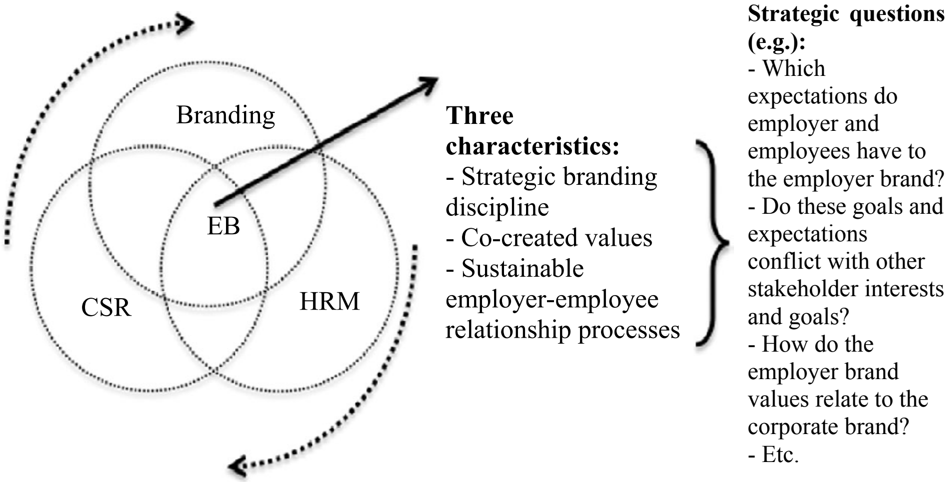
One of the most significant actors in social media is LinkedIn and its network has become one of the strongest environments to promote employer brand. According to LinkedIn, the investment in employer brand has increased significantly since 2013 and organizations rely more on proactive strategies by using professional networks and social media (Abbot *et al*., 2015).

2. THE EVOLUTION OF THE EMPLOYER BRAND CONCEPT

The concept of "employer brand" was introduced in 1996 by Barrow and Ambler, this being considered the first trial of applying branding techniques to the HR field. They defined the concept as the "package of functional, economical and psychological benefits offered upon employment and identified with the employer" (Ambler & Barrow, 1996, p. 191). In 1997, Chambers *et al.* introduced the term "war for talent" and soon after they realized that they had defined a phenomenon that many managers were experimenting, but no one had theorized it (Chambers *et al.*, 2008). Later on, in 2005 Minchington defined employer brand as "the image of your organization as a <great place to work> in the mind of current employees and key stakeholders in the external market (active and passive candidates, clients, customers and other key stakeholders)" (Employer Brand International, 2014). Therefore, employer brand refers to the attraction, engagement and retention of employees for the organization by strengthening employer brand. Still, employer brand should not been seen as separate from the company brand but moreover as a facet of the overall brand adapted to the needs of the current or potential employees (Mosley, 2014, p. 44).

Kryger Aggerholm *et al.* (2011, p. 116), offered a re-conceptualization of the employer branding concept, considering it as "a holistic and processual discipline" that includes branding, HRM and CSR (see fig. 1).

Figure 1. Employer branding processes in sustainable organisations: characteristics and reflections



Source: Kryger Aggerholm *et al.* (2011, p. 116)

Also, they have proposed a new definition of employer branding as "strategic branding processes which creates, negotiates and enacts sustainable relationships between an organization and its potential and existing employees under the influence of the varying corporate contexts with the purpose of co-creating sustainable values for the individual, the organization and society as a whole" (Kryger Aggerholm *et al.*, 2011, p. 113). Another opinion belongs to Martin *et al.* (2011, p. 3634), who argue that "we have come to regard employer branding as a key topic for integrating HR policies and practice, and for helping build much needed bridges between HR, reputation management, marketing, communications and information and communications technologies", therefore creating an even broader picture.

Fifteen years later after their initial conceptualization, McKinsey & Co concluded that HR processes still failed to keep up with changes in the environment and suggested four opportunities for human capital (HC) executives to "better manage the global talent pool in an unpredictable business environment: 1. anticipate and plan for HC of tomorrow; 2. secure a steady, reliable pipeline for skilled workers and tomorrow's leaders; 3. develop strategies to reenergize your employees' attitudes toward what they do and what the organization stands for; 4. ensures that HC becomes much more agile" (McKinsey & Co, 2012).

3. THE EMPLOYER BRAND EFFECT

Ever since the 1980s, organizational psychologists argued that one of the best ways to boost the company efficiency is to select employees with superior abilities and a track of good results. In the past decade, this has become more important than ever from several reasons: quick technological shifts, therefore the need to have employees with various abilities and especially flexible; the growth of knowledge-based companies, who crate value mainly through the intellectual capital of their employees (Quinn-Trank *et al*, 2002, p.332).

Moving from the HR perspective to the organizational perspective, some benefits of companies investing in their employer brand can be identified. Separate studies by *The Economist*, *The Conference Board* or *Hewitt Associates* (Mosley, 2009, p.5) identified three major benefits from the HR point of view: talent attraction, talent retention and talent engagement. The Corporate Leadership Council concluded, in 2006, that a strong employer brand provides 20% more access to talent (Mosley, 2009). Also, companies with a good employer brand are able to attract new employees by offering them an 11% pay increase compared to at least 21% for the average companies.

From the retention perspective, nowadays more people know what they are worth. Information about the labor market is much more accessible than a decade ago and they know what to ask for if they were to change their jobs. On the other hand, happy employees don't just bring happy customers, but tend to be more loyal – they spend more years with the company and recommend company products to their friends and family, which ensures free publicity and

PR. A report by Grant Thornton (Thornton, 2012) identified three factors that generate talent engagement: autonomy (self-direction at work); mastery and managing competencies needed for the role; the conscience of purpose (ability to see a future for the company and of self in it).

In another classification, the most relevant benefits of building an employer brand are considered to be the following: recruitment costs decrease and retention rates increase – it is estimated that replacing an employee costs half his/her annual salary (Ionescu, 2008, p. 102); employees are transformed into promoters of the brand and in recruitment agents, recommending the employer to their groups of friends; reduced absenteeism – in UK, sick leaves cost the government approximately 13 billion pounds per year (Barrow & Mosley, 2005, p. 70); loses caused by wasting resources and stealing are much lower in the case of top employers; customer satisfaction – a Gallup study revealed that businesses classified as top 25% employers in terms of employee satisfaction also have an increased customer satisfaction (by 39%) (Barrow & Mosley, 2005, p. 72). Since 2010, we have observed an increasing tendency of companies creating job descriptions that include working with / for an employer brand strategy – 10% from 2011 to 2013 (Wowzer, 2013) and it was estimated at 39% (La Motte, 2013) for 2013. Still, many initiatives do not prove to be effective. In another study, some of the indicators used by international companies to evaluate employer brand are retention rate (38%), employee engagement (33%), quality of hire (29%), cost per hire (27%) and number of applicants (26%) (La Motte, 2013).

Regardless of how we would classify and theorize them, benefits brought by building an employer brand focus around the same concept: a more prosperous business, medium and long-term oriented (retention, engagement), more ethical, with happier employees and bigger profits. Creating an employer brand is not easy – the offer on the employer market is large and the competitors list is very long, while the characteristics that can be emphasized through employer brand are just a few (career opportunities, pay and compensation, training and development). The differentiation rules are the same as in classic branding – one or two characteristics from the employment offer for the company excels must be found and outlined.

The pioneers of the "war for talent" concept, the McKinsey & Co. opinionate that, just like companies carefully select a value proposition or a unique selling proposition (USP), they should also create an employee value proposition (EVP). The EVP should answer the question "why would a talented person work for us?". Its elements are interesting work, company quality, pay, training – all of these leading to employee satisfaction and retention (McKinsey & Co., 2001, p. 5). Also, the EVP should support the customer brand by 'clarifying what is expected of employees in delivering the desired customer experience, as well as defining what employees can expect to gain in return from the employment practices' (Mosley, 2014, p. 44).

Except for creating this value proposition for the employees, these companies should respect four exigencies: 1. setting a company-wide mentality that talent management is critical for reaching the company ambitions; 2. continuous talent recruitment: successful companies understand that, in nowadays' economic reality, talent recruitment must be approached like marketing and sales rather than as acquisitions (Mosley, 2014, p. 44); 3. developing leaders within organizations – mentoring needs to become an implicit parameter; 4. employee differentiation and assertion – managers should resist temptation to treat all employees the same, as top performers and non-performers must be differentiated and treated as such. The employer brand mix also reveals the integration of a few dimensions: organizational culture, leadership style and corporate social responsibility. They are not important just because they are fashionable, but because they truly make the difference on a highly competitive market (Moroko & Uncles, 2008).

The conclusions of a recent report (Employer Brand International, 2014) reveal that social media (58%) outranks career website (56%) in terms of main activity for employer branding purposes, followed by recruitment advertising/ employer marketing (51%), recruitment branding (45%), induction programs (42%), developing an employer brand strategy (39%) and defining an EVP (39%). Visionary organizations invest in employer branding with the purpose of becoming 'employer of choice' (EOC). The criteria that are considered landmarks for evaluating companies classified as EOC are various and specific, but can be included in one of the following categories: management and leadership, employee relations, values and organizational culture, employee development, employee policies (Gill, 2013, p. 4).

4. METHODOLOGICAL FRAMEWORK

The current study is an introductory one, meant to establish some initial conclusions on the alignment of candidate perception and the company actions in terms of employer branding. The study was performed in the third largest IT hub in Romania (Iasi). The IT industry is the strongest one in the area, benefitting from the biggest investments and growth rate, as well as from a positive image.

Method & instrument. We chose both a *qualitative* (semi-structured interview, case study, content analysis) and *quantitative* (questionnaire) approach, trying to capture a broader view of the picture and moving beyond quantitative statistics. The quantitative research aimed at synthesizing some opinions regarding the efforts of creating an employer brand and the preferences of the target group (below 30, considered to be "talents" and "valuable acquisitions" for companies). The qualitative research was targeted at checking if company mentality and strategy overlaps the vision of young people (their potential candidates and future employees).

Therefore, we established **three research questions**:

1. What are the benefits of a strong employer brand?
2. What do candidates and current employees look at (in terms of employer brand)?
3. How are employer brand actions put into practice by IT companies in Iasi?

The first question was answered from a theoretical, literature-based perspective, while the second and third one were directly linked to the current research.

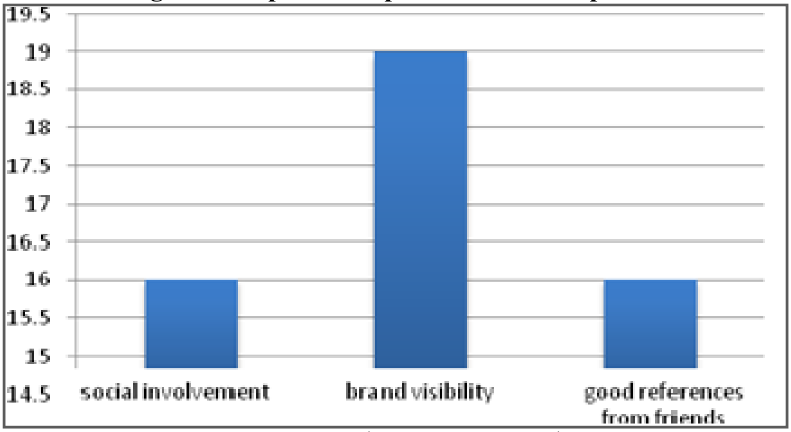
Sample (quantitative research). The sample of employees/candidates used for this introductory study consists of 25 high potential young people (current or former AIESEC members, who have obtained Erasmus or other scholarships/internships abroad), all Romanian, 3 universities and 11 fields of study. They are below 27 years (average age 22.3 years) and gender-balanced (13 women, 12 men). They are students (60%) or recent graduates (40%) from bachelor or master programs and most of them (72%) have work experience.

Qualitative research. The Talent Manager of an IT company from Iasi was interviewed in order to identify activities that the company puts into practice in order to consolidate its employer brand. The company was chosen because it is very well known on the local market and is recognized for putting people first. Also, for the case study on social media the participants at the most important IT conference in Romania (CodeCamp) that took place in Iasi on the 7th of November 2015 became the sample. Their LinkedIn and Facebook pages were analyzed for the period July 1st to October 31st 2015. We were interested in how many posts (how active they are) and what kind of posts they publish.

5. PRELIMINARY RESULTS FROM THE QUANTITATIVE STUDY

For this first stage of our study, one of the most interesting conclusions is the fact that brand visibility is the most important criterion for Romanian candidates when choosing to apply for a job. Good references from friends and social involvement (the latter being very important in other countries) only come second/third (see fig. 2).

Figure 2. Important aspects for brand reputation



Source: authors' own research

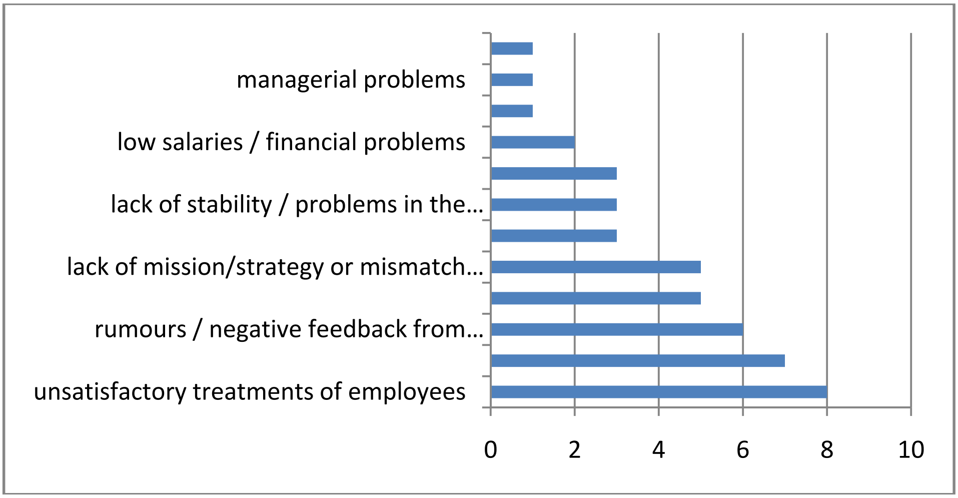
Still, when asked to provide a list of factors that would make them work for a company they consider employer of choice (EOC), brand only comes on the fourth place (see fig. 3). This implies that social involvement and good references from friends are so unimportant for Romanian candidates that they make the brand visibility stand out.

Figure 3. Facts contributing to candidate choice of employer

Source: authors' own research

Out the top of reasons which may prevent candidates from working for a certain company (see fig. 4), we find some general and obvious ones (unsatisfactory treatment of employees, imoral/illegal activities, rumours/negative feedback from current or former employees, lack of transparency/communication), but also a surprising one from the Romanian candidate point of view: lack of mission/strategy or mismatch with candidate values. This is suprising due to the fact that Romanians do not generally pay attention to such factors. Therefore, we may be talking about another generation of employees, who are much more open to international trends, who are going to analyze companies from a more thorough perspective and who may provide strong objections in case companies fail to meet their requirements.

Figure 4. Reasons for avoiding working for a certain company



Source: authors' own research

Asked whom they would choose as preferred employer, Romanian young people chose Google, Microsoft, Adobe, Apple, Accenture, Endava, CISCO, Continental, Amazon, Norton, BitDefender, Ciplex, HP, ThinSlices, Ubisoft, Sendgrid, Weta Digital, XWiki, Emagic, therefore setting a standard in how the other companies should use employer branding of they were to attract them. The same respondents tend to find out about job vacancies from job websites (80%), friends and family (72%), company websites and social media (both 68%), newspapers and magazines (24%), alternative sources (AIESEC and recruitment agencies) (12%). Also, they would be strongly influenced (very much or somehow) by company reputation when choosing their next employer (see table 1).

Table 1. How much are you influenced by company reputation when choosing your future employer?

Very much	Somehow	Not at all
44%	56%	0%

Source: authors' own research

6. PRELIMINARY RESULTS FROM THE QUALITATIVE STUDY

The talent manager of the IT company (which we will call Company) who was interviewed described talent as "a beautiful combination of passion and knowledge that is developed until the personal perspective reaches the maximum potential". Passion is extremely important, being even considered as *passion management*. From the company perspective, passionate persons stay with the company, develop themselves and get promoted. They build the employer brand based on an employee engagement program, which is highly emphasized by participations to events and development programs. Beyond competitive salaries, they also promote some policies dedicated to engagement. Dedicated teams propose new ideas that they implement, such as programs of optimizing and personalising work spaces, relaxation and sports spaces. Their professional training is supported by the Company University. Moreover, they participate at local and national events, offer internship trainings, go to meetings with students in universities and give press interviews or write articles about how it feels to work at Company. The KPIs used for employer branding are the retention rate and number of applicants per job add (especially after participating at events).

The case study performed on the social presence of companied on LinkedIn and Facebook revealed some interesting conclusions (see table 2).

Table 2. The company presence on social media channels

LinkedIn	Facebook
• 7 MNCs have a very active presence and rely much more on their international profiles and less on their Romanian profile (only 2 also have profiles dedicated for Romania); • only 1 Romanian company has an active presence on LinkedIn (23 posts in 90 days); • 5 companies (4 MNCs and 1 Romanian) have an average presence on LinkedIn (6 to 16 posts in 90 days);	• 7 MNCs use Facebook for their presence on social media, but rely more on the international profiles (4 out of 7); • 2 Romanian companies have a constant presence on Facebook (1 places at least 2 adds per day, while the other one has posted 25 times in 90 days); • 4 companies (2 MNCs and 2 Romanian) have an average presence on Facebook (up to 20 posts in 90 days);

LinkedIn	Facebook
• 6 companies (1 MNC and 5 Romanian) barely have any presence on LinkedIn (from empty profiles to maximum 5 posts).	• 7 companies (4 MNCs and 3 Romanian) are not focusing on their Facebook presence (0 to 7 posts)

Source: authors' own research

In their attempt to be present in social media, companies tend to use Facebook more (9 out of 20) than LinkedIn (5 out of 20), while 5 seem to consider that Facebook and LinkedIn are equally important and 1 does not post on any of them. Given the fact that LinkedIn was established as a professional network and it is very much concerned with the employer brand processes, we believe that there is a gap between general tendencies and local practices.

Also, we have been interested to see what company posts are about and on what they would build their employer brand (assuming that they are interesting in building one) (see table 3).

Table 3. Topics of company posts on social media

<table>
<tr><th>LinkedIn</th><th>Facebook</th></tr>
<tr><td>Training (9)
Technology & products/solutions (7)
Prizes, achievements & rankings (7)
Recruitment – job adds (7)
Partnerships (4)
Vision (3)
Values & culture (3)
Leadership (3)
CSR (3)
Company evolution (3)
Image (open doors, new offices) (3)
General HR issues (3)
Team spirit (2)
Events (1)</td><td>Events (19)
Training (17, out of which 5 for internship)
Recruitment – job adds (11)
Technology & products/solutions (9)
Team spirit (8)
Image (open doors, new offices) (7)
Prizes, achievements & rankings (5)
Leadership (5)
Partnerships (4)
Vision (3)
CSR (3)
General HR issues (3)
Values & culture (2)
Company evolution (2)</td></tr>
</table>

Source: authors' own research

Even though the general themes posted on both social media are rather similar, we can observe that on Facebook companies post more topics regarding events, team spirit and image. These are general topics that are generally very well addressed through Facebook. Still, there is one topics which appears rather odd on Facebook compared to LinkedIn: recruitment and job adds. LinkedIn is specialized in this sense, therefore targeting potential candidates through Facebook may seem unrealistic.

7. INTERMEDIATE CONCLUSIONS, LIMITATIONS AND FURTHER RESEARCH

Up to this level of our research, we can outline a few intermediate conclusions, such as:

- Romanian companies do not seem to be aware of the importance of having a strong presence in social media, which MNCs seem to be more active on both channels included in the study. In a further study, we could aim at determining what MNCs know and Romanian companies are not aware of;
- candidate/employee answers are not in line with company actions – candidates / employees need to be informed, the vision/strategy to be shared, the employer brand of the company is important for them. As a continuation of the study, we could look at what should Romanian companies do to increase their further chances of attracting valuable employees?
- another potential direction for further study would be the estimation of ROI for the employer brand strategies / activities, but it would be a difficult task due to the fact that we would need classified data, which companies are not generally interested to share.

We acknowledge several limitation of our current study. First of all, respondents for the questionnaire are juniors, therefore the pool was not extended to all potential candidates. Secondly, only one company was included in the qualitative study, which implies that it is just a start, not necessarily relevant at industry level. Thirdly, study performed only in Iasi in a limited amount of time (July – October 2015).

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NEW APPROACHES TO COMPARISON OF LEASE CONTRACT WITH OTHERS CONTRACTS

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Abstract
It is the equipment of enterprise that has always raised special financial problems, gaining new valences on the eve of the Second World War, in connection with the need to replace the destroyed materials, used or technologically outdated.
The high cost of materials generally outweighs the possibilities for self-financing of enterprises, which is why they were interested in obtaining credit from the financial institutions. When the latter obtained from the borrower a series of new guaranties/securities (so the bank-lender owned the property purchased by credit, and the borrower remained a mere usufructuary of the purchased asset) the sale in installments was replaced by the sale on credit. Thus, signing the act of birth of the leasing contract. Starting from these observations, this article aims to highlight the main differences between the leasing contract and the sale-purchase, rental loan and mandates to draw conclusions about fiscal benefit of leasing contract for both the businessman and natural person-who does not carry out commercial activities.
Keywords: *leasing, sale-purchase, rental, loan, mandate.*
JEL Classification: K20, K22

1. INTRODUCTION

The reason to choose this matter, which is at its beginnings in Romania, originates in a close observation and full understanding of the complex mechanism of the market economy: ownership right over fixed assets generates profit for the company and maximal productivity of the assets.

Appropriate use of the capital resources, permanent investment of availabilities in new business “opportunities”, allocation of funds for marketing and advertising, continuous training and high level training ensured for the staff are strategies and policies that determine progress in a company.

Leasing is the solution that allows overcoming the difficulties generated by an inappropriate economic environment – limited and expensive financing, bureaucracy in the banking system – and allows companies to receive the use right, with minimal initial financial effort, over machinery, tools, technological equipment that allows increased productivity, rentable activity and therefore increased profit.

The increased weight of the private sector in Romania, and the enhanced competitive environment where these companies operate caused a more careful and reasonable organization of the financial resources and their orientation towards several sectors of activity.

2. SUMMARY OF THE SPECIALIZED LITERATURE

The intersection of the concept of business, lack of technical and material resources of the business promoter and the possibility, seen by financiers, to launch a new product gave birth to the institution of leasing. The approach of financing according to the doctrine *"The fundamental principle underlying the financing decision is to find a happy combination between the financing source, the way to use the funds and the way in which the investment creates future economic advantages able to allow reimbursement of the borrowed money*" (Nişulescu, 2006) confirms the statement.

Starting from the fact that leasing has emerged and expanded during the last decades as a medium term and long term means of financing and therefore as a factor to promote sales – the economic aspect (accounting), the legal aspect of the operation called leasing contract should not be omitted – legal aspect. One of the major aspects regarding the leasing contract is found in the sensitive matter of risk, namely the requirements stipulated or not in the wording of the contract *"art. 10 letter f) in G.O. no. 51/1997 regarding the leasing operations and leasing companies institutes a relative assumption (iuris tantum) of the user's taking the risk of the leasing contract. The user shall bear the risk of loss, destruction or damage of the asset used due to fortuitous causes, continuing to effect payments as leasing installment, until the full value of the contract is paid, unless otherwise stipulated* (G.O. no. 51/1997 republished) (see also Cărpenaru, 2016, pp. 132-150).

The wording of the law says that the user can be exonerated from the fortuitous disappearance of the asset only in case this was expressly stipulated in the leasing contract, and the risk is borne by the financier. An extremely interesting fact about risk has been noticed by the doctrine, after corroborating art. 10 letter f) with art. 2 letter e) point 1 in the G.O. no. 51/1997- "*financial leasing is the leasing operation in which risks and benefits related to the ownership right are transferred to the user from the moment when the contract is concluded- taking into account the 2 laws, the issue of identification of the rule applicable to risk in leasing contracts arises, and there is still to establish if this rule is valid both in case of financial leasing contract and operational leasing contract. The risk of the leasing contract is borne by the creditor of the obligation to give, namely the user, except for the case where the financing party was placed in delay by the user, in which case the financier shall bear the risk, as debtor of the obligation to give.*" (Gruiescu, 2006).

Financial leasing has an impact upon the financial equilibrium of the company. In this regard, the doctrine reveals, by analysing the influence financial leasing has through the diagnosis of financial equilibrium, the advantages (based on indicators: net balance, working capital, the working capital need, net treasury) of the financial leasing for the company "*after analysing the influence of the financing terms and conditions through financial leasing upon the equilibrium of the company we can conclude that this product is susceptible to provide all needed preliminaries to develop an efficient framework for the leasing activity of the beneficiary*" (Vasilache, 2008).

The current economic context, marked by fierce market competition, implies competitive products, new technologic and well-trained human resources, briefly, a major investment effort from the company. Leasing is a very useful tool, in most cases, to ensure the needs for rapid development of the companies. According to the doctrine "For leasing companies the attractiveness of the contract derives from the income resulted from the operation: rent for the use of the asset during the availability of the assets for use, interest for medium/long term financing, cost of services provided by the leasing company to the beneficiary, bonus for intensive use, risk bonus. These costs are borne by the beneficiary, and their high level may limit these *operations*" (Munteanu, 2005) (see also Cristea & Jianu, 2010). We consider however that the user receives from such contract enough advantages needed to make him overcome the corresponding disadvantages.

The first instances of this contracting technique appear in the USA in the 1950s, in 1962 in France where it was regulated under a law in 1966.

While in the common-law system, the main idea was to consider that the leasing creates a temporary right to use assets, resulting into the fact that the user of the asset bears all risks that normally lie with the owner and pertain to personal property, in the civil law (European countries) it is part of the obligations law, and the trend is to consider it a new, complex, modern and original contracting technique.

The importance of the institution of leasing and the extension of the regulations in several countries were the starting point for the UNIDROIT decision to make a draft of uniform laws in this field. This explains the signing in Ottawa, on 28 May 1988, of the UNIDROIT Convention on international leasing.

For the leasing operations, the Romanian doctrine uses the following terms: financier, considered by the Ordinance no. 51/1997 on leasing and leasing operations to be the lessor (Fran. = le credit bailleur), user-lessee, (Fran. = le crédit-preneur) and supplier (Fran. = le fournisseur).

As trilateral operation, the UNIDROIT Convention defines leasing as the institution by which a party, the financier, concludes, upon the indication of another party, the user, a supply contract with a third party, the supplier, by virtue of which he acquires a material under the terms and conditions approved by the user, in what it concerns him, and concludes a leasing contract with the user, by which he gives him the right to use the material in exchange of a rent.

According to the G.O. no. 51/1997 republished, the leasing operations are those by which a party, called the lessor/financier, gives for a fixed duration the right of use over an asset that he owns to the other party, called user, upon his request, in exchange of a regular payment, called leasing installment, and at the end of the leasing time, the lessor/financier shall comply with the right of the user to buy the asset if he wants to, to prolong the leasing contract, or to end the contracting relations.

Jurisprudence tried a definition of the leasing contract in a given case saying: „(...) the leasing contract is the financing of a productive investment, guaranteed with the ownership right of the lessor financier over the asset, and the user has the option to buy the asset for the price established when it was leased, taking into account the amounts of money already paid as lease (leasing installments)” (the International Commercial Arbitrage Court attached to the C.C.I.R., decision no. 79 of 28 April 2000).

3. COMPARISON WITH OTHER CONTRACTS

What makes the difference between the leasing contract and other contracts can be summarized as follows (Cristea, 2008, p. 294):

- Unlike the sales-and-purchase contract, in case of the leasing contract: the seller is the supplier who supplier and installs the asset straight to the user/lessee; the supplier is responsible for the conformity of the asset; the lessor/financier only has the nude ownership, the use belongs to the user; the lessor shall conserve the ownership of the asset due to the irrevocable nature of the leasing (in case the lessor transfers the asset to a new financier, the liability of the financier transferor shall stay engaged together with the liability of the financier transferee);
- A comparison between leasing and sale with payment in installments is summarized in table 1;

Table 1. The comparison between leasing and sale with payment in installments

LEASING	Sale with payment in installments
Ownership right	
Stays with the lessor (leasing company) and only the right of use and all risks and obligations shall be transferred.	Ownership right and all risks by the buyer.
Option right	
At the end of the leasing contract, the lessee has the right to **opt** either to buy the asset or as the case may be to prolong the leasing contract or to end the contractual relations.	Once the last installment is paid, the asset **automatically** becomes the property of the buyer.

LEASING	Sale with payment in installments
Duration	
The duration of payments for leasing is **longer**, the idea is to finance the client (in Romania, the leasing duration is at least 1 year).	The duration for payment in installments is usually **shorter,** as the goal is only the acquisition of the asset by the beneficiary.
Interest	
In case of sale with payment in installments, when the installments are calculated, a **relatively low interest** for the installments not paid yet is calculated, implying a simpler calculation formula and contents than in case of the leasing.	
Fiscality	
Beneficiary can include the royalty directly in expenses.	Beneficiary can include in expenses not the value of installments but the regular depreciation calculated by deduction from the taxable mass of a certain percentage established under the normative acts in force.

Source: avocatnet.ro

- Unlike the *loan contract,* in case of leasing: the user shall not return assets of the same nature and quality (like in case of consumption loan) and even not the borrowed asset (like in case of use loan) since he has the possibility to exercise the option to buy; the leasing interest shall be always higher than the bank interest since it includes both the bank interest and a profit for the lessor; by comparing the 2 contracts, we can summarize the following advantages for the loan contract:
  - The borrower is from the beginning the owner of the bought asset;
  - The borrower (in case of physical persons) can request a loan that does not need guarantees, so the costs related to the asset insurance can be saved;
  - The loan can be returned when the borrower has the necessary means.
  - For most categories of loans, no advance payment is requested;
  - Regarding the granting, the loan is granted in money while the leasing is in equipment.

Compared to the leasing, the loan contract has the following disadvantages:

- Moral depreciation of the asset is borne by the borrower, as he is the owner of the asset;
- Long time for analysis and approval of the financing request as a detailed analysis of the financial status over the last years is performed;
- Documents for loan grating are many, financial data for many years are needed;

- Small companies stand low chance to receive loans because during the first years they usually don't make profit;
- In case of investment loans, the guarantees required are more than the assets to be bought with the loan.

- Unlike the *mandate contract*, the leasing contract: the user, although acting as mandatory of the lessor, taking over the asset from the supplier – seller, does not has an express mandate in this regard; the user cannot be considered a commissioner since he does not conclude the sale-purchase with the supplier for himself, and the ownership right over the asset is transferred to the lessor.

4. CONCLUSIONS: THE LEASING CONTRACT– ADVANTAGES AND DISADVANTAGES

The leasing operations have **advantages** for both the financier and the user. Among the advantages of the financier:

- Financing through leasing is much more specialized than granting a loan, and risks are easier to control by the leasing company than by the bank.
- The financier has ownership right over the asset, so the acquired assets can be re-possessed easier when a client is in incapacity of payment or does not fulfill one's payment obligations.

The user also has advantages when accessing a leasing operation:

- Accessibility of the client to several sales channels to request a leasing operation: banks, leasing companies, brokers or dealers of movable assets/ immovable assets.
- The analysis of the financial documents in case of leasing operations stipulates the analysis of the rentability of the project to be financed, while in case of loans, the financier pays attention to the financial status over the last years.
- The time to analyse and grant a leasing is lower as against the analysis and granting of a loan. The documents requested for leasing operations are simpler than the loan file.
- The leasing contracts are more flexible regarding the need of the consumer: the option to give up the leasing before the due date of the contract, the possibility to renew through additional periods of time, the option to acquire the asset at the end of the contract.
- The customs, the registration and the insurance of the assets related to the leasing operation are done by the leasing company, so the user no longer wastes time to register the assets.
- The only guarantee to conclude a leasing contract is the leased asset.
- Legal person can deduct the VAT.

Regarding clauses that refer to the leasing operation:

- The lease time can be established so that the company could have all the time the most modern and most efficient equipment.
- The balance of legal persons does not change because both the leased assets and the obligations arising from the payment of the lease do not appear in the balance, the lease being considered expense of the company, not investment.
- By contracting a leasing, the user has access to high quality assets.

Disadvantages:

- In case of financial leasing, the user becomes owner in the end, so depreciation of the asset is registered in the accounting records by the user.
- Reimbursement can be done only after 12 months at least after the end of the leasing contract.
- The expenses related to the asset shall be borne by the user.
- The advance payment is compulsory to conclude a leasing contract (in most cases).
- The financier shall have the right to terminate the leasing contract if the user does not execute the full payment obligation for the leasing installment for 2 successive months, and the user shall return the asset and pay all the due amounts of money, until full payment under the leasing contract.
- The user shall take responsibility for the full duration of the contract, unless otherwise stipulated, all the obligations arising from the use of the asset, either direct use or through intermediaries, the risk of loss, destruction or damage of the used asset, for fortuitous cause, and continuity of payments as leasing installments, until full payment of the value of the leasing contract.
- Expenses with interests and other expenses arising from the leasing operation are higher (in most cases) than for the contracting of a loan.
- Although it is their object of activity, financiers sometimes lose after concluding a leasing operation.
- According to the operational leasing contract, the financier shall bear the risk of residual value of the financed asset. The financier transfers not only the use, by preserving the ownership, but sometimes the assets can become deteriorated by inappropriate use. After the first lease, no more users may be found.

To conclude, as against the legal technique adapted to the practice of the business environment, leasing in Romania would expand if: equipment leasing and immovable assets leasing developed, which implies a banking policy that supports high financing; a specialize market of second – hand equipment appeared; more attention were paid to training of experts to assess such tools and equipment. Some estimates make us believe that there is an increasing trend of leasing in the future in constructions and infrastructure (especially roads), agriculture and medical sector.

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AN ANALYSIS REGARDING THE LEVEL AND THE DETERMINANTS OF LEVERAGE – EMPIRICAL STUDY ON THE ROMANIAN MARKET

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Abstract
Leverage is a cornerstone in the field of finance and there are many studies in the literature attempting to determine the factors that influence companies' decisions. The results are diverse and in many cases inconclusive, which makes this subject still to be of great interest, especially for the emerging countries.
This study analyses the level and the factors that influence the leverage of the Bucharest Stock Exchange listed companies, basing and relating the analysis with the main theories identified in the literature. The database is formed by annual observations collected through the Reuters Eikon platform, for the period 2005-2014. The analysis was performed in SPSS.23, using multivariate regression, for an unbalanced panel data. The dependent variable, represented by leverage, was calculated in accounting indicators.
The motivation of this study was testing the factors previously identified and analyzed especially on US and others big countries. Taking into account that the researches performed on the Romanian economy are hampered by the limited database, which is available for short term periods, this study may contribute to complete and validate the hypotheses. The conclusions of the models have partially validated our hypothesis. Thus, a positive impact generated by the company's size was noticed, while factors such as assets tangibility, performance or liquidity have a negative impact. Also, it had been noticed that the leverage variation in a certain period of time is strongly correlated with the initial leverage level, thereby supporting the idea that firms adjust their leverage in a certain range, or even to a target level. According to our results, it can also be said that the assumptions of the pecking order theory particularly applies on the analyzed sample.
Keywords: *leverage, information asymmetry, trade-off theory, pecking order theory, agency costs.*
JEL Clasification: C23, G31

1. INTRODUCTION

The importance of financing decisions has generated substantial interest in academic debates, the researches on this topic generally leading to the idea of an "optimal capital structure" that determines firm value maximization. But, as pointed out by Ting (2016), there are no outlined methods to support managers in choosing the optimal capital structure. This is why managers are more concerned about the situations when the companies are under or over-levereged, than determining the optimal level of debt (which would be expected to have a positive effect on performance).

It is commonly accepted that the optimal leverage level is achieved when the difference between the net value of tax benefits and the net value of bankruptcy cost is maximized. Firms adjust their target leverage level depending on these two elements. Since these conditions are changing over time, some authors argue that the target leverage also changes (Sabiwalsky, 2010). Lo & Hui (2012) consider that maintaining the optimal leverage involves adjusting debt level according to the changes of the value of assets. This fact leaded Hovakimian *et al*. (2001) to consider that the target level changes over time depending on the evolution of profitability and shares price, and Korajczyka & Levy (2003) showed that the changes of the target leverage also depend on the macroeconomic factors. In contrast, Welch (2004) concluded that firms do not adjust the leverage to a target level, but the leverage evolution itself is very similar with the variations of the companies' stock price.

De Haas & Peeters (2006) performed a study that included ten countries from the Central and Eastern Europe, including Romania, for the period 1993-2001. They noticed that the development of the financial systems in this region has determined firms, regardless of their size, to major the leverage, but the level is still below the average from the developed countries.

The aim of our study was testing on the Romanian market the factors that were previously observed in the literature. As Rajan & Zingales (1995) noticed, different studies - mainly conducted on the US (or other large states, as is the case of the above-mentioned article, conducted on the G7 countries) - have highlighted various correlations, but the fact may be accidentally. The validity of these results should be also tested outside the environment in which they were initially discovered. Besides, it is obvious that the factors which influence the capital structure, and implicitly the indebtedness, are influenced by the macroeconomic conditions and the economic cycles. Since there are few studies conducted on the Romanian economy analyzing this issue, and because the investigations are facing the problem of a limited database, collected for short periods of time, this study may contribute to the improvement and validation of previous results. By comparing the outcomes, we can make observations on the theory that best applies to our economy.

2. LITERATURE REVIEW

Studying the current knowledge on this topic, it can be seen that the determinants of the capital structure have been generally grouped around three dominant theories: the pecking order theory, the trade-off theory and the agency theory.

Some authors have even asserted that these theories are interfering with each other. Thus, Graham & Leary (2011) say that any decision took by a company can be seen as a cost-benefit compromise. Therefore, the specific aspects of the trade-off theory will have implications regardless of the pattern that the company follows.

The main assumption of the trade-off theory is finding a balance between the benefits and the costs associated with leverage, which means mainly the bankruptcy costs and the benefits from tax deductions (Myers, 1977). Companies will choose the indebtedness if it reduces the tax burden. And the higher the profit of a company, the higher the tax burden is. From this perspective, according to trade-off theory, profitable companies will benefit from increasing leverage (Barclay & Smith, 2005). This applies as long as the indebtedness does not affect the stability of the company, increasing the bankruptcy risk. In other words, firms should increase their leverage up to the point where tax savings offset the bankruptcy costs.

On the other hand, the agency theory takes into account the relationships between the stakeholders and the "agency" problems that may arise between them. Harris & Raviv (1991) identified four aspects, which, in the context of agency costs, may lead to changes in the capital structure and, ultimately, may have an impact on the value of the companies. They showed that the capital structure can be used to smooth the conflicts among stakeholders, to diminish the problem of adverse selection, to increase the competition level on a certain market and also they found that the capital structure can be influenced by corporate governance mechanisms.

In the context of the agency costs, of the impact caused by the informational asymmetry and the ability to use indebtedness as a mechanism to send signals to the capital market, a second dominant theory regarding the capital structure had been developed – the Pecking order theory (Myers, 1977; Myers & Majluf, 1984). The pecking order theory starts from the assumption that there is no optimal capital structure, but rather a hierarchical approach of the financing sources, where the internal funds are supposed to be the first ones used by the companies, given the fact that these resources are not subject to informational asymmetry issues. Then, firms use the financial debt and, as the last resort, the issuance of new shares. In Romania, due to the illiquidity of the capital market, this is an option for very few listed firms. Romanian companies finance their assets using internal funds, then commercial debts. Lastly, financial debts are used.

An analogy between the explanatory capacity of trade-off and peking order theories was made by Shyam-Sunder & Myers (1999). They tested each theory individually and then corroborated the results. For the trade-off theory, the authors considered the deviation from the average indebtedness level, considering that the average value represents the stable level. As for the pecking order theory, they used a model that analyzes leverage in relation with a variable correlated with four factors: the capital costs, the increase of working capital, the dividend payments and debt re-payments, and finally, with the operational cash flow. The results of the study have shown that the pecking order theory explains to a greater extent the decisions made by the companies regarding the capital structure.

The result obtained by Shyam-Sunder & Myers (1999) is also supported by Myers (2001), who performed a study on the American companies and concluded that these companies firstly uses their own funds. The same study also showed that if the two theories are tested on very large samples, neither one of them can strictly explain the results. For this reason, the authors recommend that the empirical testing should be performed for homogeneous intervals of the samples.

Despite the lack of consensus among the dominant theories regarding the optimal capital structure, some authors have concluded that the firms have a target leverage level (Harford *et al*., 2008) and tend to adjust their leverage towards the target (Leary & Roberts, 2005; Flannery & Rangan, 2006; Kayhan & Titman, 2007). Lemmon *et al*. (2008) showed that the leverage variation in a certain period of time is strongly correlated with the initial level. Moreover, Graham & Harvey (2001) analized the answers of a questionnaire survey applied to managers from 500 Fortune companies and concluded that 80% of these companies have a target range or even a strict target level as concerning debt to capital ratio. The same study also shows that managers mainly follow the trade-off pattern, the funding sources being selected comparing the benefits and the costs. The same authors draw attention to the fact that financial managers do not take into account the theories that are debated in academic environment and consider that the hypotheses and implications of the main theories need to be reevaluated.

One of the few studies that included Romania in a cross-country analysis that had the objective to develop a dynamic model in order to test the factors that influence the capital structure target of the companies, was conducted by Nivorozhkin (2005). The study included five developing countries: Romania, Poland, Estonia, the Czech Republic and Bulgaria, for the period 1997-2001. The results of the study revealed that, throughout the analyzed period, the companies from these countries recorded average leverage levels below those from the EU countries, but in Estonia, Poland and the Czech Republic, countries where the transition process was more advanced at that time, also the values of debt to equity ratio were closer to those from the EU countries. The study also showed that Romania and Bulgaria registered the lowest level of indebtedness, but over period under review, the number of the companies that registered 0 debt has declined.

3. DATABASE AND METHODOLOGY

The sample employed in this study if formed by companies listed on the Bucharest Stock Exchange (BSE), the period under analysis being 2005-2014. The sample does not include companies from the financial and insurance sector because of their particularities in terms of capital structure and regulatory requirements. An unbalanced panel data was used for the econometric analysis, performed in SPSS.23. To reduce the negative effect caused by the outliers (defined as observations recorded at a distance from the median greater than three multiplied with the distance between the first and the third quartile of the sample), the winsorization method was applied, at the level of the first and the 99th percentile. This method is applied in many studies (Nissim & Penman, 2003; Faulkender *et al.*, 2012), with the objective to reduce the risk of obtaining biased coefficients. Subsequently, the variables were standardized.

1.1 Defining the variables and developing the models

For the econometric modeling, the starting point was the factors tested by De Jong *et al.* (2008) through a model applied on an international database. The next step was adapting the variables to the available information. OLS method was employed, starting with the model described by equation 1.

$$LEV_i = \beta_0 + \beta_i TANG + \beta_i RISK + \beta_i SIZE + \beta_i TAX + \beta_i GROWTH + \beta_i PROFIT + \beta_i LIQUID + \varepsilon_i \qquad (1)$$

I = 1…52;

β_i = the constant;

ε_i = the term error, independently and identically distributed.

The leverage (LEV) was calculated in accounting indicators as the ratio between total debts and total assets. According to Fosu *et al.* (2016) and Campello (2006), this approach eliminates the effects of a bivalent relationship between the market value and the leverage. This method of calculating leverage is extensively applied in literature (Opler & Titman, 1994; Rajan & Zingales, 1995; Artikis & Nifora, 2011). Rajan & Zingales (1995) state that this approach highlights the shareholders wealth if the company is liquidated, but the main disadvantage of this indicator is that it does not measure the risk that a company may face in the near future.

Variable TANG was calculated as fixed assets to total assets ratio. This indicator is seen in literature as a proxy for the bankruptcy costs. On this point, some authors (De Jong *et al*., 2008) consider that a higher value of this indicator reduces the bankruptcy costs and lead creditors to believe that those firms have a lower risk.

Risk (RISK) was calculated as the variation of the operating income margin.

Company size (SIZE) was defined as the natural logarithm of total asset. Regarding this indicator, researchers have obtained divergent results, but we started from the hypothesis that there is a positive relationship between the size of the company and the leverage (Rajan & Zingales, 1995). As regards Romania, a positive correlation was previously observed by De Haas & Peeters (2006) and Sumedrea (2015) and a negative one was obtain by Klapper *et al*. (2002).

The impact of taxation was analyzed through the effective tax rate (TAX). For the followers of the trade-off theory, this is a fundamental indicator as it is correlated with the benefits obtained from the deduction of interest expenses (Krishnan & Moyer, 1997). The effective tax rate was introduced as an explanatory variable based on the conclusions of various studies (Graham & Harvey, 2001; Brounen *et al.,* 2006), which concluded that the taxation level and the bankruptcy risk are factors more important in establishing the capital structure than the agency costs and the signal theory. Fan *et al*. (2004) also noticed the positive impact generated by the effective tax rate.

The growth opportunities of the company (GROWTH) have been addressed through the variation of sales. Gomes & Schmid (2010) noted that the relationship between leverage and performance significantly depends on the investment opportunities a company may have. It is necessary to correlate these issues with several factors. Thus, the companies that have various investment opportunities, expected to generate positive results, are generally large firms and in their case, a high level of leverage does not implies a significant increase of the associated risk. Fosu *et al*. (2016) consider that firms with growth opportunities will also have higher external financing needs. On the other hand, Jensen (1986) considers that the firms that have growth opportunities have a tendency to expropriate the wealth of the creditors. Klapper et al. (2002) conducted a study which also included Romania, the database being collected only for the year 1999, and found a positive relationship between the development opportunities and the leverage, whether short-term, long-term or total debt ratio is considered.

The performance of the company has been addressed through ROA. Zeitun & Tian (2007) argue that this indicator should be chosen according with the development level of the capital market where the firms operate. Therefore, the authors consider that if the capital market is not strongly active and developed, using a market size indicator to asses performance will not lead to optimal results. So we chose an indicator in accounting sizes. As concerning the relationship between performance and leverage, the results of previous studies are divergent. Bae *et al*. (2016) believe that this situation could be generated by the fact that the analyzes were carried out over different periods of time and different countries, and the models had different specifications. Thus, Abor (2005) noticed the existence of a negative relationship between performance and total debt ratio, while Chakraborty (2010) found a positive correlation on the case of Chinese companies. On the other hand, Ebaid (2009) found no statistically significant relationship between these indicators. On Romania's case, Vătavu (2015) noticed a negative correlation between leverage and performance after conducting an analysis for the period 2003-2010, which among other factors, considered the impact of the leverage on performance, analyzed through return on assets and return on equity.

Finally, liquidity (LIQUID) was calculated as the ratio between current assets and short-term debt.

In line with the above-mentioned aspects, the following assumptions have been established (Table 1).

Table 1. Hypotheses of the econometric models

TANG	+	Dittmar (2004) Deesomsak *et al*. (2004)	H1: Asset tangibility has a positive impact on leverage.
RISC	-	De Miguel & Pindado (2001) Delcoure (2007)	H2: The risk of the company is negatively correlated with leverage.
SIZE	+	Titman & Wessels (1988) Rajan & Zingales (1995)	H3: The size of the company is positively correlated with leverage.
TAX	+	Faulkender & Smith (2016)	H4: There is a positive relationship between the level of taxation and the level of leverage.
GROWTH	-	Delcoure (2007)	H5: The relationship between growth opportunities and leverage is negative.
PROFIT	+ - +/-	Kraus & Litzenberger (1973) Goddard *et al*. (2005) Campello (2006)	H6: Performance has a positive / negative impact on leverage.
LIQUID	- -/+	Ferreira & Vilela, 2004 Guney *et al*. (2007)	H7: The liquidity level has a negative / positive impact on leverage.

In the following models, fixed temporal effects have been included. This type of model helps to mitigate possible negative implications caused by the existence of unobservable variables, correlated with the explanatory variables. The year 2005 was considered the benchmark and was not introduced into the models.

$$LEV_{it} = \beta_0 + \beta_{it}TANG + \beta_{it}RISK + \beta_{it}SIZE + \beta_{it}TAX + \beta_{it}GROWTH + \beta_{it}PROFIT + \beta_{it}LIQUID + \mu_{it} \qquad (2)$$

$t = 2005,\ldots, 2014$;

$\mu_{it} = \phi_t + \varepsilon_{it}$, where ϕ_t = unnoticed time specific effect.

$$LEV_{it} = \beta_0 + \beta_{it}TANG + \beta_{it}RISK + \beta_{it}SIZE + \beta_{it}TAX + \beta_{it}GROWTH + \beta_{it}PROFIT_{it-1} + \beta_{it}LIQUID + \mu_{it} \qquad (3)$$

Aiming to test if the leverage adjusts to a target level, we started from the approach employed by Castro *et al*. (2016), but without considering the speed adjustment to the target. Thus, leverage was also considered as a lag dependent variable (t-1).

$$LEV_{it} = \beta_0 + \beta itLEV_{it-1} + \beta_{it}TANG + \beta_{it}RISK + \beta_{it}SIZE + \beta_{it}TAX + \beta_{it}GROWTH + \beta_{it}PROFIT + \beta_{it}LIQUID + \mu_{it} \qquad (4)$$

Last but not least, in order to capture the non-linearity of this relationship, a dummy variable has been introduced. It takes the value of 1 if the leverage level is smaller than 30%, 0 otherwise. This method came from the approach of Bae *et al*. (2016). Supporting this idea, the authors observed that the relation between leverage and the value of the companies follows a curvilinear trajectory. Thereby, until leverage reaches 30% of total assets, it has no positive impact on performance, but after this level, the leverage contributes to the increase of companies' value.

$$LEV_{it} = \beta_0 + \beta_{it}TANG + \beta_{it}RISK + \beta_{it}SIZE + \beta_{it}TAX + \beta_{it}GROWTH + \beta_{it}PROFIT + \beta_{it}LIQUID + \beta itDUMMY + \mu_{it} \qquad (5)$$

3.2 Descriptive statistics

The main descriptive statistics of the variables are synthesized in the next table (table 2).

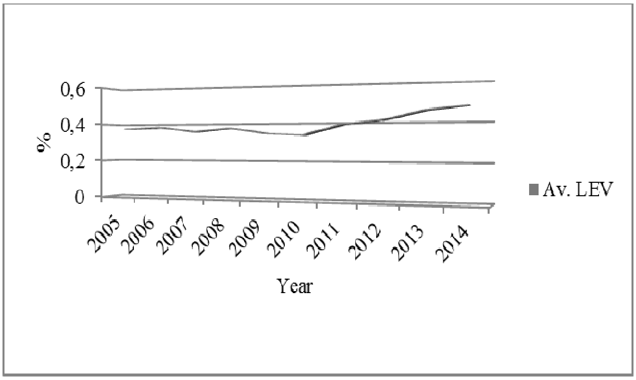
As concerning leverage, the average value was 38%, while the median value was 30%. This fact must be related with two aspects generated by leverage, which can reduce, or on the contrary, increase the risk of a company. That is, as Kraus & Litzenberger (1973) observed, the indebtedness is beneficial from the perspective of tax benefits, but in the same time, it can increase the bankruptcy risk.

If we make the analysis on the structure of leverage of the firms included in the sample, we can notice that the average of long term debt ratio was only 8%. The result confirms the idea of Booth *et al*. (2001). They found that long-term debt ratio in developing countries is much lower than the average from high developed economies. Vătăvu (2015) found that Romanian companies operated without using long-term debt, sometimes for several consecutive years, which according to the author, may cause the missing of investment opportunities that could support the development of the companies.

Table 2. Descriptive statistics

		LEV	LEVTL	TANG	TAX	PROFIT	LIQUID	SIZE
N	Valid	506	503	504	378	497	501	506
	Missing	14	17	16	142	23	19	14
Mean		0,384	0,080	0,590	0,193	0,039	2,536	11,025
Median		0,307	0,010	0,595	0,170	0,021	1,550	10,841
Std. Deviation		0,309	0,135	0,201	0,144	0,047	3,207	1,4317
Skewness		1,823	2,465	-0,244	1,877	1,542	4,154	1,078
Std. Error of Skewness		0,109	0,109	0,109	0,125	0,110	0,109	0,109
Kurtosis		5,153	6,405	-0,328	6,049	2,136	21,458	2,186
Std. Error of Kurtosis		0,217	0,217	0,217	0,250	0,219	0,218	0,217
Minimum		0,01	0,00	0,10	-0,18	0,00	0,19	8,22
Maximum		1,82	,68	0,96	0,85	0,22	23,81	16,21

Figure 1. The evolution of the mean leverage on the sample, within 2005-2014



On the chart from above (fig. 1), it can be noticed the decreasing tendency of the leverage between 2008-2010, followed by an upward trend. Starting with 2011, the average leverage has overcome the level from the previous years included in the analysis. This fact could suggest that the leverage is influenced by macroeconomic factors. Thus, the decrease of leverage during 2008-2010 can be ascribed to the tightening of credit conditions in 2008 and the GDP diminishing with 6.6% between 2008-2009. Actually, there are several studies that are warning regarding the fact that leverage determinants are becoming more important is times of decline and tightening of credit conditions (Sánchez Vidal, 2009).

Table 3. The frequency distribution of total leverage and long term debt ratio on the sample

	LEV				LEVTL			
	Frequency	%	Valid %	Cumu-lative %	Frequency	%	Valid %	Cumu-lative%
≤Q20	101	19.4	20.0	20.0	183	35.2	36.4	36.4
≤Q40	101	19.4	20.0	39.9	19	3.7	3.8	40.2
≤Q60	102	19.6	20.2	60.1	100	19.2	19.9	60.0
≤Q80	101	19.4	20.0	80.0	101	19.4	20.1	80.1
≤Q100	101	19.4	20.0	100.0	100	19.2	19.9	100
Valid	506	97,3	100,0		503	96.7	100	
Missing	14	2,7			17	3.3		
Total	520	100			520	100		

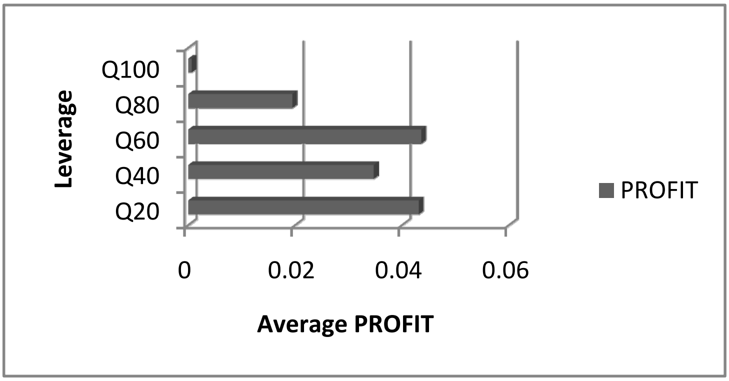
In order to have a clear view regarding the leverage level, the sample has been divided in five groups, using as boundary points the 20th, 40th, 60th and 80th percentiles. It can be noticed that, as concerns leverage, the distribution is relatively steady. If the size of the database would enable, it would be interesting to test the impact of the same factors on the leverage from each percentiles, treated as a distinct sample, as it was indicated by Fattouh *et al*. (2008), that observed a non-linear relationship on a study performed on British companies.

If instead, we are analyzing only the long term debt ratio, we can notice that for more than a third of the companies, the level of long term debt is below the 20th percentile of the sample. For Romania, this frequency distribution may not be exclusively the choice of the companies, but it could be also notably influenced by the fact that the banks tend to grant especially short term credits. In a study about the Jordanian companies, Zeitun & Tian (2007) warns that this type of credit policy can have a negative impact on the capital structure of the companies, forcing firms to maintain a lower leverage than the optimal level, which make them vulnerable to short-term interest rate. The same authors appreciate this situation as being more difficult for the small firms that also have a higher risk of insolvency.

Farther, the leverage from the five groups was corroborated with profitability, calculated as ROA. We can notice that the average leverage is associated with the highest level of profitability, while the highest level of leverage (above the 80th percentile) is associated with the lowest level of profitability. Therefore, on this sample are not applicable the conclusions of Bae *et al*. (2016) who stated that a leverage level below 30% does not support performance.

Regarding the assets tangibility, we can notice that fix assets represent more than a half of the total value (fig. 2).

Figure 2. Companies performance analysis related with leverage



On average, the effective tax rate was 19.3%, which exceeds the statutory rate of 16%, applicable from 1st of January 2005, the beginning of period under analysis. As regard companies performance, it can be noticed the low level of ROA, the average value being 3,9%. Besides, the positive skewness indicates that the majority of the companies registered a lower level than the average.

In the next table, the Pearson correlation between the variables are presented (table 4).

Table 4. Correlation matrix

	LEV	RISK	TANG	TAX	GROWTH	PROFIT	LIQUID	SIZE
LEV	1	0,07	-0,16**	-0,07	0,02	-0,24**	-0,43**	0,13**
RISK	0,07	1	-0,00	-0,05	-0,06	0,04	-0,03	-0,01
TANG	-0,16**	-0,00	1	0,02	0,05	-0,14**	-0,13**	0,15**
TAX	-0,07	-0,05	0,02	1	-0,03	-0,25**	-0,01	0,01
GROWTH	0,02	-0,06	0,05	-0,03	1	0,23**	-0,046	0,10*
PROFIT	-0,24**	0,04	-0,14**	-0,25**	0,23**	1	0,12**	0,03
LIQUID	-0,43**	-0,03	-0,13**	-0,01	-0,04	0,12**	1	-0,20**
SIZE	0,13**	-0,01	0,15**	0,01	0,10*	0,03	-0,20**	1

** Correlation is significant at the 0.01 level (2-tailed);
* Correlation is significant at the 0.05 level (2-tailed).

4. RESULTS

Regarding the assets tangibility, the results does not confirm the hypothesis, the impact on leverage being negative, but this situation is consistent with other studies previously carried out for Romania (De Haas & Peeters, 2006). This situation could be explained by the low level of bank loans. Thus, we can conclude that Romanian firms generally use the commercial debt in order to finance their current assets, while the fix assets are mainly financed using own sources.

Table 5. The results of regresion models

Dependent variable	**LEV**				
	(1)	(2)	(3)	(4)	(5)
CONSTANTA	-0.965*** (-2.899)	-1.037*** (-2.986)	-0.763** (-2.186)	-0.346** (-2.183)	-0.065 (-0.228)
LEV(T-1)				0.878*** (34.668)	
TANG	-0,400*** (-10.089)	-0.416*** (-10.307)	-0.358*** (-8.991)	-0.060*** (-2.840)	-0.249*** (-6.918)
RISK	0.067 (1.116)	0.081 (1.319)	0.026 (0.422)	-0.003 (-0.119)	0.047 (0.938)
SIZE	0.073*** (2.465)	0.089*** (2.920)	0.067** (2.195)	0.023* (1.654)	0.045* (1.764)
TAX	-0.120*** (-3.212)	-0.131*** (-3.453)	-0.059 (-1.599)	-0.024 (-1.344)	-0.067** (-2.096)
GROWTH	0.039 (0.911)	0.025 (0.508)	-0.006 (-0.117)	0.004 (0.186)	-0.027 (-0.676)
PROFIT	-0.249*** (-5.780)	(-0.289)*** (-6.360)		-0.068*** (-3.150)	-0.150*** (-3.847)
PROFIT (T-1)			-0.297*** (-5.678)		
LIQUID	-0.285*** (-8.394)	-0.265*** (-7.658)	-0.278*** (-7.959)	-0.018 (1.040)	-0.145*** (-4.811)
DUMMY					-0.335*** (-14.718)
Fix Annual Effects	NOT	YES	YES	YES	YES
N	325	325	322	325	324
Adjusted R^2	0.380	0.381	0.361	0.873	0.581
F	29.459***	14.310***	13.108***	140.500***	29.069***

Note: T-stat values are presented in brackets; F is the F Fisher test; ***, **, * indicate the coefficients significant at 1%, 5% and 10%.

De Haas & Peeters (2006) explains this situation also by the fact that in developing countries, fix assets are more difficult to liquidate because they are firm-specific assets, which determine the firms to finance them mainly through internal sources. Along the same lines, Nivorozhkin (2005) considers that in such an economic environment, tangible assets are not seen as guarantee against bankruptcy, and this is why firms with high tangible assets ratios have lower leverage targets.

Regarding the firm size, the results show a positive correlation with leverage. The assumed hypothesis is confirmed, bigger companies are more stable and, in their case, an increase of leverage does not cause an increase of the risk.

In the same time, in opposition with previously mentioned studies, it can be noticed that the hypothesis that predicted a positive relationship between the taxation level and the leverage was not confirmed on the Romanian market. Sumedrea (2015) concluded that fiscal policy does not adequately explain the leverage, but on the contrary, our results show a negative and statistically significant relationship. The result could be explained by the low level of performance on the sample. For firms to use the fiscal deductions to increase their performance, they firstly need to have positive results.

As regarding ROA, the relation is negative, so the less indebted, the more profitable the company is. This situation can be analyzed in accordance with the theory of information asymmetry. Thus, profitable firms use firstly the profit to finance new investments and then the leverage (De Jong *et al*., 2008). As Fosu *et al*. (2008) concluded, this result can also be motivated by the fact that after the crisis from 2007-2009, the information asymmetry has become more obvious.

As regards liquidity, the results showed a negative relationship with leverage, so liquidity needs should be established considering the benefits and costs of each funding source.

Despite the assumptions, on this sample, the hypothesis according to which risk and growth opportunities have a negative impact on leverage has not been confirmed, the results are not statistically significant.

Finally, the positive correlation between the leverage from period t and t-1 was confirmed. This fact can suggest that firms tend towards a target level, or as Lemmon *et al*. (2008) state, the capital structure is relatively stable on time, the companies that are under or over-leveraged remain in this situation for a long period.

Given the negative impact as concerning taxation and the negative correlation with the financial performance, it could be said that the Romanian market generally follows the fundamentals of the pecking order theory.

5. CONCLUSIONS

This study has analyzed the factors that influence the leverage level of the companies listed on the Bucharest Stock Exchange, using annual data, for the period 2005-2014.

In the first part of the study, the leverage evolution within this period and the frequency distribution inside the sample was analyzed. Thus, it could be noticed that the firms that registered the highest leverage level, had the lowest profitability. We can also notice that during the period 2008-2010, the average leverage has reduced, but after that period it has followed an upward trend. The result also revealed that firm use especially short-term debt.

In the second part of the study, the established hypothesis were tested through econometric modeling, and only part of them were not confirmed on the Romanian market. Thus, the results show a negative relationship between assets tangibility and leverage, the same situation being registered as regard the effective tax rate. On the other side, the hypothesis according to which the size of the company has a positive impact on leverage was confirmed, while leverage adversely affects performance.

Last but not least, it is important to note that companies' decisions in terms of financing and leverage are significantly influenced by the overall economic development of the country, which is reflected also on the financing conditions.

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ACTUAL AND FUTURE ECONOMIC, SOCIAL AND ECOLOGIC PROBLEMS OF HUMANITY IN THE CONTEXT OF SUSTAINABLE DEVELOPMENT: ACHIEVEMENTS AND PERSPECTIVES

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Abstract
The article describes the promotion of green Economy in the Republic of Moldova which is coordinated by the interministerial Working Group on sustainable and green Economy and it is focused on the development of Road Map on Green Economy energy efficiency, organic agriculture sustainable production and consumption greening SIMES, RECP sustainable transport, green cities, green Office, green Meeting etc.) implemented within the EUEaP GREEN Program (NEP, OECD, UNECE and UNITAR).
Keywords: *green economy, sustainable development, sustainable production and consumption, Bioeconomics, Eco-Economy.*
JEL Classification: Q50, Q58

1. INTRODUCTION

The concept of Ecoeconomy development marks a new stage - transition from development model that treats environmental protection as an economic burden, to a model that uses environmental protection as one of the main priorities of economic growth. In the context of sustainable development and poverty reduction, Ecoeconomy must be perceived as one of the basic mechanisms in achieving sustainable development and as a means of efficient use of resources and energy, implementing cleaner technologies, carbon emissions and reduce pollution and to minimize significant environmental risks.

The promoting of the concept of economy (green economy) in Republic of Moldova will be achieved by integrating the principles of economy, environmental protection and climate change adaptation into policy papers so that by 2020 they would be primarily integrated in training, transport, construction, trade, services and other areas of economic and social development of the country. This process involves changing patterns of sustainable consumption and production and the change can be made with national and international regulations, taxation, legal decisions, the requests from the public, etc.

2. THE PROMOTION OF A NEW ECO-ECONOMY IN REPUBLIC OF MOLDOVA IN THE CONTEXT OF A SUSTAINABLE DEVELOPMENT

Humanity is looking for new solutions. This takes place for more than half a century, and it must be based on a new "revolution" which should occur very quickly, under our eyes. This is an "information revolution" that promotes a knowledge society. It requires profound economic, educational, intellectual and psychological transformations.

The new economy must rely on its own means, whether new or old, but which are in a new stage of knowledge. New techniques and technologies are related to information technology and will determine a new configuration of the economy which should be based on the following assumptions:

1. as long as the nature had no people, it didn’t pass through crisis situations, nor it has destroyed its material and energetic basis;

2. the human, by removing from his natural regularities, has altered relations human-resources, and had no interest in the recovery, recycling and self-cleaning, so as the nature did before him;

3. when retrieving nature models, we have to prevent and annihilate all the negative effects;

4. all human existence must be conceived in the specific nature conditions that operate according to closed or almost closed circuits (like a tight evolutionary spiral), where the resources should be used and recovered with minor losses and waste is fully reused;

5. the use of new material resources only need to fill up those ones that are in circulation, but even then without exceeding natural regenerative capacity of the planet;

6. the "civilizing mission" of man over nature must be abandoned, a mission that proved being an catastrophic one and to act on the idea that mankind must accept the need of significant changes in behavior so as it could be within the operating parameters available to our planet;

7. it is necessary for humanity to ensure coherent activity at global level to halt continuous growth of negative effects triggered by the human actions until now to reach their halting and then decrease their effects.

The new economy must be based on a series of principles that have been outlined in numerous studies in recent decades by a host of people grouped in certain clubs (Rome, Budapest, etc.), or who have acted alone or in international bodies and, for practical reasons, reflect the immediate requirements and aspirations of mankind in these crucial moments. These principles can be summarized as follows:

1. The principle of human existence in closed circle on the level of our planet;
2. The principle of human reintegration in nature;
3. The principle of not harming nature;
4. The need to preserve and even increase the biomass, biodiversity and bio-productivity of the planet;
5. The principle of ensuring the permanent existence of the necessary human resources;
6. The principle of concomitant existence of economic, environmental and social efficiencies;
7. The principle where the social existence is interactive with the environment;
8. The need to pass from an uncontrolled demographic growth to one based on everyone's responsibility to fit in the social needs and real economic potential;
9. The principle of social equity;
10. Empowering of the governors for the way they manage and increase resources to ensure the future of next generations.

The human and his needs must be prevailing in this new economy. It doesn't have to rely on the play of supply and demand in the current economic market. It must move its center of gravity to the benefit of all, so it has to promote a policy based on collective needs, not individual. It must be an information society, a democratic society based on specialists in different fields, so a theocratic society that will ensure priorities in education and scientific research.

Concerns for the future economic development of mankind occurred long time ago, while the exhausted oil prospects have accelerated this process, within the meaning of rethinking the human society` s future in the post-oil era.

So there occured a need to return to reconsideration of the planet's resources. Thus, the concept of the BIOECONOMY appeared. It emerged about five years ago. On its shaping and structuring work people from very different countries, such as US, Canada, Australia, England and of course, specialists from almost all EU countries. Even its definition, that is changing from one moment to another and seems to be incomplete to us, proves that we're still at the beginning (Godeanu, 2013).

The material that we present below is based on the conference "New Skills for a European Bioeconomy," held in Brussels in November 2012.

The bioeconomy means "the production of renewable biological resources and their conversion into food, feed, biological products and bioenergy. It includes areas such as agriculture, forestry, fishery, food production, pulp and paper, as well as parts of chemical, biotechnological and energetic industries" (Guy, 2012).

Bioeconomy prepares the post-oil era by developing a concept of multidisciplinarity and interdisciplinarity with the aim to provide chain activities that connects the production of renewable biological resources of economic systems which converts them to goods and new energy sources, but which has to take the environment into unconditionally account. In consequence in the bioeconomy concept cooperates education, training, research, innovation activity, agriculture and the environment in all its complexity (physico-chemical, biological and ecological) and also various ecological systems from soil and water, more numerous industrial sectors. Thereby a sustainable economy is ensured. Therefore, it’s a new phase in the evolution of the old concept of sustainable development by setting the biological resources in the forefront, with all their corollary of issues, and their improving through the latest achievements of science in all its fields.

The bioeconomy implies profound political, legal, social, educational, moral changes, an enhancement of information alteration between people who are involved in this activity, the creation of mixed research teams on a worldwide level, and the creation of a modern education, suitable for a new economic vision.

Bioeconomy has a predictable future, wherein oil refineries will be replaced by biorefining and the renewable raw biomaterials will alter the ones made by chemical methods. It will lead to the use of fossil nonrenewable materials, that eventually, by a superior qualitative step, will return to natural products out of which are made food, products of common use and various goods. An important aspect is provided to waste recovery, their reuse and recycling and keeping the environment quality, so that it could ensure the indefinitely production of renewable material goods.

Bioeconomy is inspired by natural processes, using more solar energy and seeking to run processes without residues.

Bioeconomy is involved in realization of major and various production of renewable biological resources necessary for creating new technologies, value-added products’ addition by new innovation in life sciences and also by creating new aspects of goods in the economy, by avoiding the pollution and development of new environmental protection systems (Godeanu, 2013).

Bioeconomy can provide humanity with:

- Food security;
- A permanently and better management of the renewable natural resources;
- Reducing the dependence on non-renewable resources;
- A more equilibrated economy;
- Human society mitigation and adaptation to climate changes;
- Creation of new jobs in new or modified industries;
- A new lifestyle.

Realization of a new real bioeconomy needs:

- elaboration of a creation and implementation plan of bioeconomy;
- realization of some coherent research programs in all implied fields;
- evolving an application coherent policy;
- national and international legal changes;
- great investments in knowledge, inovation and participative activity;
- information dialogue with society;
- multidisciplinary education programs focused on creation of new specialties for bioeconomy implementation;
- new infrastructure creation;
- international cooperation through intense exchange of information;
- development of bioeconomic activities based on circuits, with interactions and self- regulating retroactions;
- social innovation boosting.

Bioeconomy will become an important component of the sustainable development, because it has a positive impact on the environment, on the economic activities and on the social life as a whole.

The experts from the European Community have estimated that the bioeconomy can be realized rather quickly. From now the limit term for its maturity reaching is expected to be achieved by 2030, when the fuel will be replaced by 68% of biofuel, when the bioeconomy will create 1.18 million new jobs,when a production of 62 billion EUR in domestic engineering, construction and food will be achieved by bioeconomy. At the same time, it is provided that carbon dioxide emissions are reduced by 54% .

3. PROBLEMS AND SOLUTIONS RELATED TO BIO- ECONOMY AND SUSTAINABLE DEVELOPMENT IN REPUBLIC OF MOLDOVA

Related to sustainable development and its implications upon people and environment we treated in some scientific articles (Aşevschi, 2012). Besides those already exposed we bring some additions which are made as a result of the Eco-economy concept introduced by L. Brown (Brown, 2002) and the newest concept of bioeconomy.

After 30 years of experience in the global supervision field of the world economy and of the way the human and natural resources of materials and energy are used, L. Brown establishes that:

- there is a big gap between theory and facts in ongoing actions related to the implementation of sustainable development concepts;
- current economy, as it is planned for now, will certainly lead to economic, environmental and social collapse;
- current economy takes into account only the market needs and it does not take into account many other qualitative and ecological parameters; it also undervalues the price of products, services and environmental rehabilitation costs damaged by numerous human activities, that have no realistic and forward looking. He concludes that "through our short-sighted efforts with no support of global economy so as it is now, we exhaust the planet's natural capital" (Brown, 2002).

This state was also notified by L. Brown, who establishes that "the current economic policies, which have produced tremendous global economic growth are those ones that determine support systems ravage of global economy; that's why these policies are now bankrupt" (Brown, 2002). Withal he concludes that: "ecological deficits are threatening long-term future." He reaches the following conclusion: "Restructuring or fall (...) The economy must be integrated into ecology. This option reflects the reality, because economy is a subsystem of the planetary ecosystem" (Brown, 2002). In the same study (suggestively entitled "Eco- economy - creating an economy for our planet"), the author demonstrated that nowadays there is no alternative for economic reorganization if it is really wanted a continuation of economic progress. Considering that we are at the limit beyond which the economy may transform into chaos, he proposed a strategy for available remained time.

According to L. Brown, eco-economy concepts (we highlight - of bioeconomy) are as follows:

- changing the basis of energy resources (transition from fossil fuels to natural renewable energy resources - wind, sun, geothermal energy, tidal, hydrogen and water);
- the redesign of economy materials on the principles of recovery and recycling;
- generalize dupgrading on ecological bases;
- restoring and increasing of agricultural land productivity (rehabilitation of soils' creditworthiness, changing of existing agricultural technologies, restructuring of proteins economy, saving and a new redistribution of products);
- protection of forest products and services (by plantations of fast breeders, recovery and recycling of pulp, raising of timber usability);

- redesigning of cities (buildings, transport, greenspaces) that are for people, not for cars.

Brown proposes the next ways to follow (to which we have a lot of doubts, because this way should be discussed and perfected by specialists in different fields and a long-term view, keeping in mind not only the current concepts of competition):

- Stabilizing human population;
- Restructuring global economy;
- Using eco-certificate of all products;
- A tax restructuring;
- Implementing the ecological education for a new economy by all means.

Brown provides some examples of current activities he considers successful and professions which will expand in the future.

The state that humanity starts to recognize the need for action is proved by concern for the restoration of forest massifs in different countries where they were severely affected.

To achieve this new type of development, L. Brown (Brown, 2011) identified 11 ecological indicators, so 11 trends that have to be continuously pursued, trends that are very far from the current economic concepts, can lead to disruption of the global economy or it's bringing to an irreversible collapse, in a directly or indirectly way.These indicators are:

1. *The rate of human population growth* at thelocal, regional and global level. This indicator must be known because on it depends the rates of fertility and mortality, the intensity of people migration from a poor region to a rich one,the intensity of urbanization process, the efficiency of decreasing birth rates' activities, causes of mortality, the percentage of the working population within a nation, the level of education and health, the effectiveness of family planning programs, etc.

2. *Economic growth rate* at local, country, regional, global level, of economically developed countries and the backward ones, the danger of economic collapse, the establishing the economy in general.

3. *The rate of cereal crops growth*, so the humanity possibility to feed a growing number of people. This growth is dependent on climatic conditions, the existence and intensity of agricultural land usage, the capacity and crop irrigation technologies, the decrease of pests and diseases appearance risk. Due to the decrease in grain production the prices grow up, ample fluctuations in the economy, dependence on food from other countries, increased circulation of agricultural products (including meat products and other food), economic uncertainty at state and regional levels, etc.

4. *Decrease in fisheries and aquaculture development*. Until 20 years ago, the planet's fish production almost was based exclusively on fishing (ie the "hunting" in the aquatic environment). At that time aquaculture also upsarged,

that can offset an emphasized reduction of the fresh water and ocean fish quantity and quality. Regional and global fishery production is an indicator, because the fish and birds are those ones who tend to replace the pork or beef, whose production is limited by the impossibility of extending pastures and the agricultural land holding for the production of animal feed.

5. *The forest area restriction.* The total area of forests is a key indicator of the planet health, because of the known role of forests in the climate regulating, hydrological balance, soils stabilization, nutrients recycling, oxygen intake to the atmosphere, erosion processes reduction, as well as for the global ecology of our planet. A grown wood consumption needed to meet the satisfaction of various mankind necessities causes an acceleration of deforestation, which in result stimulates the appearance of erosion processes, soil degradation, increased water runoff from the slopes, forest ecosystems biodiversity loss, etc.

6. *Fresh water deficiency.* For human needs, for agriculture and industrial development, the human population growth represents increased amounts of water taken from surface and underground fresh water, but which are returned with low and very polluted flow rates. Purge and self- regeneration water quality outgoings continue increasing and lien the economy, because the "polluter pays" principle is applied.

7. *The amount of carbon dioxide emissions.* Industrial transport development, excessive consumption of fossil fuels causes rising gas emissions, CO2 being of the greatest importance. Its presence represents one of the major reasons of global warming process. The amount of CO2 emissions increased by four times in the last 50 years, and the capacity of the ground vegetation, especially of the forest one, was significant diminished, as well as expanding desertification processes needed to counteract this process.

8. *Global warming.* Reported by specialists working for several decades, this problem becomes increasingly obvious for mankind. Last years were characterized by excessive heat, growth of the frequency and magnitude of hurricanes and typhoons, phenomenon "El Niño" enhancement, occurence of the ocean currents modification risk, etc. The following are the essential to slow this process: reducing the consumption of fossil fuels, switching to achievement of other forms of energy (unconventional ones), reduction of heat losses derived from various human activities, development and massive reforestation, especially in the places where forests have been cut too much (particularly in tropical regions), vegetation expansion and maintenance on larger areas.

9. *The intensification of glaciers melting process.* This process is generated by the increase in global warming and air pollution and determines the decrease of polar icecaps, eternal glaciers relief shortening, the shortening of the periods in which the snow and ice covers the mountain areas. The most dangerous consequences of this process are the rising sea and ocean levels (ie coverage of huge land areas that are used nowadays for agriculture and where the most cities

are placed), changing the direction of ocean currents, the emergence of climate changes with unpredictable consequences, albedo reduction at planetary level, accelerating of global warming process, etc.

10. *The upsurge of unconventional energy production.* The expansion and diversification of new energy sources that do not rely on fossil fuel consumption have a beneficial role in reducing greenhouse gas emissions. This eco-economic indicator is represented by the percentage of unconventional energy used by each country from the total energy used.

11. *Bicycle production.* According to the concept of L. Brown, the bicycles' production and their use at local level indicate the transition from mechanical to personal transport accessible to all, that doesn't require a lot of space, specially built roads, reduces accidents, stimulates people return to nature, and thus favors human health.

4. CONCLUSIONS

1. The indicators presented above are various and also hard quantifiable due to the complexity and way they interconnect as well as their effects. They reflect the current economic situation in Republic of Moldova and transition trends to an eco- economy of the future. In addition they highlight the human health and environmental quality.
2. The status of qualitative and quantitative indicators based on eco-green economy indicators, as well as monitoring systems is an advantage, but they can't be used properly if the access to information, quality of information, data collection and exchanging, and cooperation between institutions is not effective.
3. The development, consultation and approval of the plan of measures for the effective promotion of green Ecoeconomy have as primarily objections- the national program launch of coordinating and appropriate implementing that will lead to achievement of green Ecoeconomy objectives in Republic of Moldova.

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STATE-OF-THE-ART OF PUBLIC INNOVATION IN A CHALLENGING EUROPEAN UNION

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Abstract
Globalization, climate and demographic changes, the focus on enhancing the public value, the economic and financial crisis impose the governments to solve complex social and economic issues, as well as to apply adequate and relevant policies and strategies.
The public organizations need to re-think their mission, values, culture, strategies and to apply innovative institutional processes and mechanisms in view to increase their performance, efficiency and effectiveness.
For the time being, innovation and creativity in the public sector have become a necessity, being crucial for performance improvement and delivery of high quality public services.
Innovation represents a dynamic process in light to identify problems, challenges, to implement new and creative ideas, to select and implement new solutions.
Innovation in the public sector means ICT-centred activities, optimisation of working processes through innovative technologies, continuous adaptation to changes interfering in the communication channels and instruments, as well as adaptation of the image of public organizations to the citizens' realities and needs.
The paper aims to present the main successful factors and barriers for public innovation and to achieve a comprehensive analysis on public innovation performance in the EU Member States.
Keywords: *challenges, innovation, performance.*
JEL Classification: O30, H1

1. BACKGROUND

For the time being, we are witnessing continuous changes at economic, social, technological, cultural, political-legislative level as well as increasing global interactions and interdependencies.

Whenever debating about the main sources of change, we have to take into consideration the following issues:

- The evolution in the field of technologies: expansion of the internet network; use of increasingly sophisticated technologies in a customized manner; complex production equipment; occurrence of high-performance methods for information gathering, storage, transmission and use, which allows a significant reduction of costs, increasing the quality of the products and services; use of robots and artificial intelligence in the production process;
- Economic factors: market globalization, economic crises, significant differentiation of the market segments, free movement of (human, financial) capital at the global level;
- Socio-cultural factors: demographic situation, polarization of society, changes in the system of values and aspirations, the corruption level inside the country;
- Political-legislative factors: state attitude towards entrepreneurship, attempts to nationalize the organizations, political instability, inefficient legislative basis;
- Ecological factors: climate change, negative influence on the ecosystem.

The European Union, as a global actor is facing several challenges in times of dynamic development of the strategic and geopolitical context: competitiveness of countries outside the borders of the EU, demographic changes, constraints of public finances, economic and social stability, uncertainty about the future stability of the banking sector climate changes, rapid and exponential pace of information technology, high level of migration, threats of terrorism, security, including cyber security.

One modality to address the economic recovery and to achieve inclusive and sustainable long-term growth should concentrate on co-creation together with citizens, businesses, on active citizen participation in decision making, on involving the final users of public services, of academia, public organizations and social entrepreneurs in co-designing and co-implementing social innovations.

Concerning the young generation we should be more pro-active in job creation, providing customized education and social engagement of young people.

According to Horizon 2020 (European Commission, 2017):

- "By 2020, public administrations and public institutions in the European Union should be open, efficient and inclusive, providing borderless, personalised, user-friendly, end-to-end digital public services to all citizens and businesses in the EU.
- Innovative approaches are used to design and deliver better services in line with the needs and demands of citizens and businesses.

- Public administrations use the opportunities offered by the new digital environment to facilitate their interactions with stakeholders".

Consequently, the public administration should foster to be creative, innovative in providing the best solutions in light to overcome the above challenges, should address the current needs of various stakeholders.

At the same time, the public administration has to adapt and to turn into account the opportunities provided by new technologies, as well as to develop new services, it should focus on openness, transparency and citizen participation.

The public administration has an important role in boosting innovation in the economy and at the same time, it should trigger innovation itself in the public organisations in order to increase productivity, to improve efficiency, to enhance the creation of public value and thus to meet the society challenges.

Worldwide, the public sector innovation has become an important issue for governments, as they are trying to solve community problems.

"Innovation although not new can be seen as one of the many 'magic' concepts that policy makers continuously use to demonstrate that governments are in an almost permanent struggle to show that they are willing and capable – through reforms – to be responsive to the changing needs of society" (Pollitt & Hupe, 2011).

Innovation represents a concept inspiring academics, managers and staff as it provides the challenge of radical change.

Progress means constant innovation, so innovation represents a continuous process, and the public organisations should be open to new ideas and processes and thus should involve in networks, share knowledge and cooperate with various social partners.

"In view to collaborate with various networks of partners, beneficiaries, customers, the public organizations can turn into account various instruments such as crowdsourcing, field officers, open-source databases, online community platforms, citizen centric services, digital platforms, new health care systems, intelligent transport systems etc.

Learning from best practices is worldwide acknowledged as triggering a positive impact. The examples of good practices could represent a source of inspiration for the public sector organisations in view to draw up their strategies for innovation" (Săvulescu, 2015).

New forms of innovation in the public sector could include open government, business model innovation, social innovation community, ICT for training.

According to Bekkers *et al*. (2013) four developments emerge:

- "How to meet new societal challenges, like global warming, (youth) employment, growing elderly population? Responsiveness of governments;
- How to deal with needs that really matter to citizens and companies? Efficacy and legitimacy of governments;

- How to deal with the budgetary crisis of government? Austerity and efficiency;
- How to make use of the self-organizing power in society? How to use this power of individuals and communities?".

When approaching innovation as a process we should focus on "learning, trial and error, experimenting, on qualitative discontinuity with the past (radical, transformative change), on co-evolution between different environments, interaction between various stakeholders" (Bekkers e*t al*., 2013).

Innovation, under its various forms – technological, social, etc. represents the result of the organizational culture, being directly determined by the intellectual or social capital of an organization. Innovation acquires features of complexity, sometimes being considered as "an adaptive complex system".

2. DRIVERS AND BARRIERS FOR PUBLIC SECTOR INNOVATION

According to the field literature (Bekkers *et al*., 2013), innovation in the public sector takes place in a specific environment, distinguishing several actors who are collaborating in the area of disseminating relevant resources aimed at developing and applying new ideas, new modalities of organisation or new modalities of operation.

In this context, the characteristics of environment could be considered successful factors or barriers for innovation.

"The pressure to innovate and search for new combinations aimed at making efficient the public organisations is also provided by the rationality of public administration, which generates competition between the public values" (Moore, 1995).

It is moreover asserted that the inter-organisational networks could represent successful factors for innovation. In the field literature, the discussion is about 'collaborating innovation networks' (Gloor, 2005; Sörensen & Torfing, 2011). Collaboration within these networks could facilitate the exchange and dissemination of resources, thus stimulating innovation.

At the same time, leadership is important as it ensures an organisational culture of trust, respect and good communication. Relevant studies and analyses highlight the importance of leaders for innovation in the public sector and also for change management (Hartley, 2005; Bason, 2010; Osborne, 2011; Kuipers *et al*., 2013).

Also information and communication technology and social media represent important sources for innovation, through infrastructure and potential of innovation, thus triggering the accomplishment of several types of innovation.

It may be asserted that information and communication technology and social media represent successful factors for innovation, recognising the vital importance of information and the modality of communication in public service provision.

According to the field literature, key barriers to innovation relate to the lack of methods and tools used. In this context it is important to mention the lack of tools, methods, experience and competences for developing innovation processes from problem identification to implementation; scarce knowledge about the type, nature and effectiveness of public policies; inefficient use of evidence and benchmarking as successful factors of innovation; unavailability or inaccessibility of information systems for the identification of potential local, national or international partners in innovation projects; difficulties in the establishment of criteria for the launch, implementation and evaluation of new solutions, governance structures or systems.

Also other relevant barriers refer to the lack of collaboration. In this respect it is worth to mention: significant lack of citizen participation during the innovation stages (design, implementation, evaluation); lack of systematic approach for citizen participation in the co-creation of public value; lack of policies and criteria for the establishment, management, evaluation of partnerships aimed at the implementation of innovative projects; powerful technical, administrative and political boundaries between different sectors and administration levels; cultural differences and difficulties in combining different objectives in public-private innovation partnerships.

3. INNOVATION PERFORMANCE IN THE EU MEMBER STATES

The European Innovation Scoreboard 2016 provides the evaluation of the innovation performance in the EU Member States, based on 25 indicators. It reveals the strengths and weaknesses of each country taking into consideration important innovation drivers, such as research systems, public and private investment, the economic effects of innovation.

Based on the statistic data of the Innovation Union Scoreboard 2016, figure 1 reveals the innovation performance in the European Union Member States.

Four categories of states have been identified:

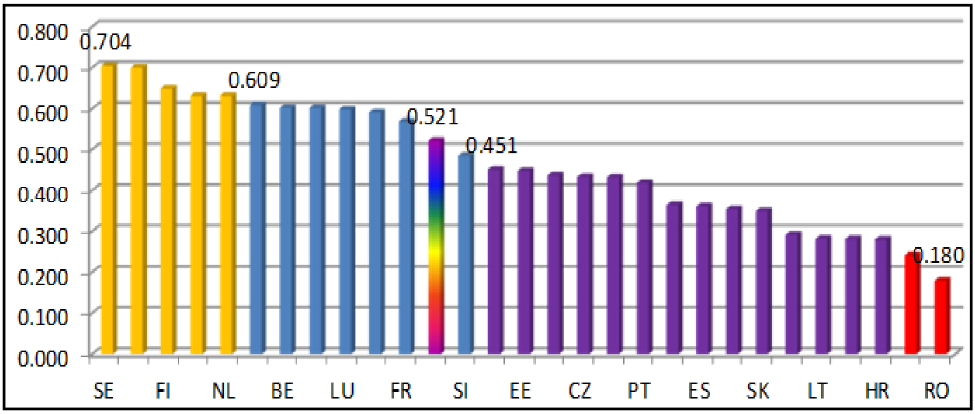
- "Innovation leaders – innovation performance is above that the average of the EU by 20%. Sweden, Denmark, Finland, Germany, Netherlands;
- Strong innovators – innovation performance is between 90% and 120% of the EU average. Austria, Belgium, France, Ireland, Luxembourg, Slovenia, and the UK.;
- Moderate Innovators – innovation performance is between 50% and 90% of the EU average. Croatia, Cyprus, Czech Republic, Estonia, Greece, Hungary, Italy, Latvia, Lithuania, Malta, Poland, Portugal, Slovakia, and Spain;
- Modest innovators – innovation performance is below the average of the EU by 50%. Bulgaria, Romania" (European Commission, Innovation Union Scoreboard 2016).

Table 1. Innovation performance in the EU in 2015

Country	IP	Country	IP	Country	IP
Romania	0.180	Portugal	0.419	Belgium	0.602
Bulgaria	0.242	Italy	0.432	United Kingdom	0.602
Croatia	0.280	Czech Republic	0.434	Ireland	0.609
Latvia	0.281	Malta	0.437	Netherlands	0.631
Lithuania	0.282	Estonia	0.448	Germany	0.632
Poland	0.292	Cyprus	0.451	Finland	0.649
Slovakia	0.350	Slovenia	0.485	Denmark	0.700
Hungary	0.355	France	0.568	Sweden	0.704
Spain	0.361	Austria	0.591		
Greece	0.364	Luxembourg	0.598	EU28	0.521

Source: Authors - based on the data of Innovation Union Scoreboard 2016, European Commission

Figure 1. Innovation performance in the EU in 2015



Source: Authors - based on the data of Innovation Union Scoreboard 2016, European Commission

We are going to analyse the innovation performance in the EU Member States from the view point of the following dimensions: human resources, research systems, funding resources.

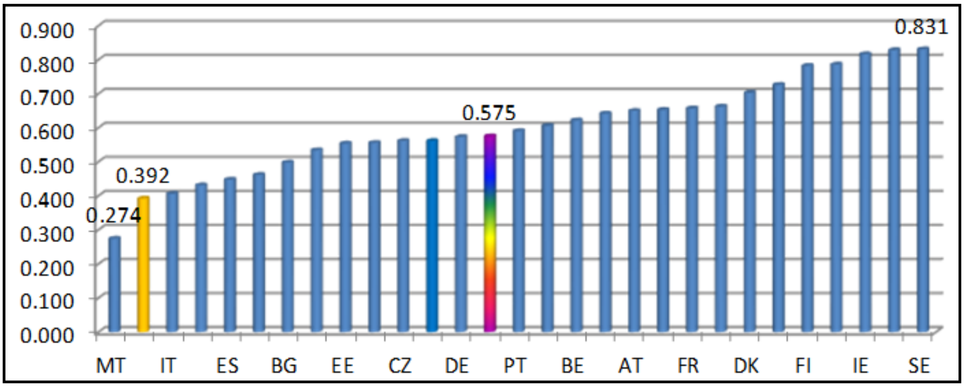
Considering the dimension related to Human Resources, figure 2 presents a relevant situation. Sweden (0.831) is the leader of this ranking, being closely followed by Slovenia (0.829), Ireland (0.816), UK (0.786) and Finland (0.783), thus acknowledging that a high share of the labour force has the skills for developing a knowledge-based society.

Table 2. Innovation performance in the EU – Human Resources

Country	Human resources	Country	Human resources	Country	Human resources
Malta	0.274	Czech Republic	0.561	Cyprus	0.662
Romania	0.392	Greece	0.562	Denmark	0.703
Italy	0.407	Germany	0.573	Lithuania	0.726
Luxembourg	0.431	Portugal	0.591	Finland	0.783
Spain	0.448	Croatia	0.606	United Kingdom	0.786
Hungary	0.462	Belgium	0.622	Ireland	0.816
Bulgaria	0.498	Slovakia	0.642	Slovenia	0.829
Latvia	0.534	Austria	0.650	Sweden	0.831
Estonia	0.554	Netherlands	0.653		
Poland	0.556	France	0.657	EU28	0.575

Source: Authors - based on the data of Innovation Union Scoreboard 2016, European Commission

Figure 2. Innovation performance in the EU – Human Resources



Source: Authors - based on the data of Innovation Union Scoreboard 2016, European Commission

At the other extreme we find Malta (0.274), Romania (0.392) and Italy (0.407), countries that should do efforts in view to improve the human resource skills, vital for a competitive economy.

The differences in human resource performance have become smaller over time, thus we witness the convergence in innovation performance for this dimension.

From the viewpoint of the dimension related to Research Systems, Sweden (0.814), UK (0.795), Netherlands (0.774), Luxembourg (0.771), Belgium (0.768) and Denmark (0.765) are top performers. It is acknowledged that the research systems in the above countries are open to cooperation with partners at international and European level, the researchers and specialists are disseminating information and knowledge by networking and the quality of research is very high.

At the same time, we remark that the differences between countries are quite large for this indicator (see fig. 3).

Table 3. Innovation performance in the EU – Research Systems

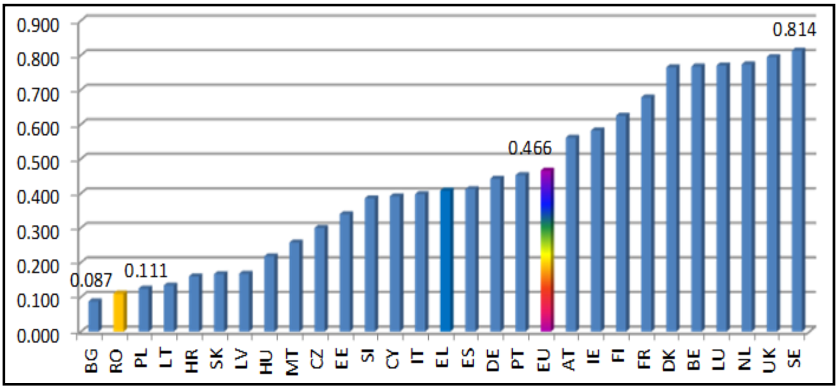
Country	Research systems	Country	Research systems	Country	Research systems
Bulgaria	0.087	Estonia	0.340	Finland	0.625
Romania	0.111	Slovenia	0.386	France	0.678
Poland	0.125	Cyprus	0.392	Denmark	0.765
Lithuania	0.134	Italy	0.398	Belgium	0.768
Croatia	0.160	Greece	0.408	Luxembourg	0.771
Slovakia	0.166	Spain	0.413	Netherlands	0.774
Latvia	0.168	Germany	0.443	United Kingdom	0.795
Hungary	0.218	Portugal	0.453	Sweden	0.814
Malta	0.258	Austria	0.561		
Czech Republic	0.300	Ireland	0.582	EU28	0.466

Source: Authors - based on the data of Innovation Union Scoreboard 2016, European Commission

Concerning the dimension related to Funding, Finland (0.765) is the incontestable leader, being followed by Estonia (0,727), Sweden (0.710), Netherlands(0.663) and Denmark (0.654). In these countries, the public sector is developing powerful activities of research, development and innovation.

This indicator is based on a large extent on the expenditures in the field of research, development and innovation in the public sector.

Figure 3. Innovation performance in the EU – Research Systems



Source: Authors - based on the data of Innovation Union Scoreboard 2016, European Commission

The differences concerning innovation performance from the viewpoint of this dimension are relative high, thus demonstrating the fact that the EU Member States are not developed in a similar way, and for some countries, the global innovation performance could be improved by developing this dimension (see fig. 4).

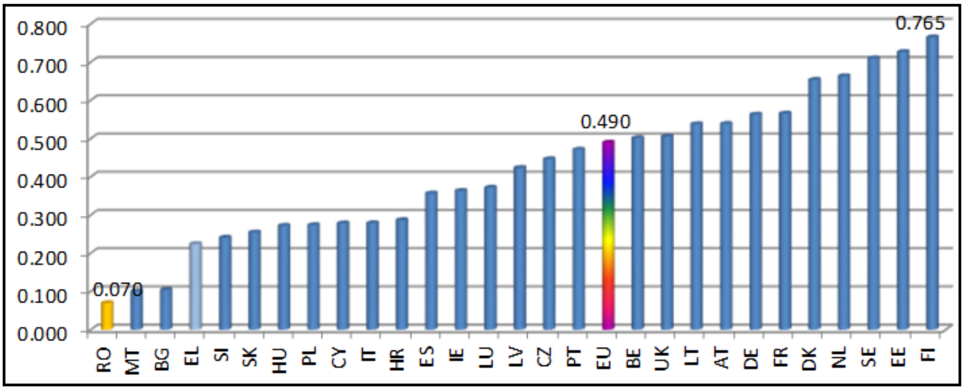
Table 4. Innovation performance in the EU –Funding

Country	Funding	Country	Funding	Country	Funding
Romania	0.070	Croatia	0.287	Austria	0.538
Malta	0.100	Spain	0.357	Germany	0.563
Bulgaria	0.104	Ireland	0.363	France	0.566
Greece	0.224	Luxembourg	0.372	Denmark	0.654
Slovenia	0.241	Latvia	0.424	Netherlands	0.663
Slovakia	0.255	Czech Republic	0.446	Sweden	0.710
Hungary	0.272	Portugal	0.471	Estonia	0.727
Poland	0.274	Belgium	0.502	Finland	0.765
Cyprus	0.278	United Kingdom	0.506		
Italy	0.279	Lithuania	0.538	EU28	0.490

Source: Authors - based on the data of Innovation Union Scoreboard 2016, European Commission

According to the Innovation Union Scoreboard 2016, Romania is a modest innovator. Innovation performance increased until 2010, after which it has been declining. Innovation performance in 2015 was at a significantly lower level than in 2008. The development of Romania's relative performance to the EU has closely followed the development of the innovation index. Over time, the relative performance has worsened from almost 50% in 2008 to 34.4% in 2015.

Figure 4. Innovation performance in the EU –Funding



Source: Authors - based on the data of Innovation Union Scoreboard 2016, European Commission

Concluding, the Nordic countries have remarkable innovation performance. Concerning the dimension related to human resources, Sweden, Slovenia, Ireland and UK are recording the best performance. Sweden, UK, Netherlands are incontestable leaders taking into consideration their efficient research systems, while Finland, Estonia, Sweden, Netherlands and Denmark are recording best performance in funding their activities of research, development and innovation.

4. CONCLUSIONS

This paper attempts to reveal that there is a powerful trend among the EU Member States which shows the correlation between high quality public services and innovation performance. Really, on the one hand, innovation represents an important enabler for public sector modernisation and on the other hand, smart public administrations represent a key asset to trigger Europe’s innovation potential.

The EU innovation performance has been increasing at an average annual rate of 0.7% between 2008 and 2015, but growth has not been equally strong across all dimensions and indicators.

Growth has been strong in Open, excellent and attractive research systems (2.9%), triggered by high growth in International scientific co-publications (6.5%).

The EU innovation system is becoming more networked both between Member States and at the global scale.

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Section IV

EU PUBLIC SPENDING AND CONTROL

AN ANALYSIS OF THE 2014 EU PUBLIC PROCUREMENT DIRECTIVES: NEW DIRECTIONS FOR EFFICIENCY AND CONTROL

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Abstract
As the result of EU public procurement legislation reform, three new directives were adopted in 2014. The EU member states had two years to implement and enforce these directives at the national level. The directives' aim was to improve the efficiency of public spending for public procurement, to make the negotiation process more flexible and to eradicate corruption by enhancing control over procurement procedures. This paper considers how the new directives have improved public procurement in the EU and their prospects for continuing to do so.
Keywords: *public expenditures, public procurement, corruption.*
JEL Classification: H570

1. INTRODUCTION

Central and local officials are responsible for spending public money wisely and thereby improve their constituents' lives. The returns from public spending are the ultimate measure of public administrators' management efficiency. Accordingly, citizens are interested in how and where their money is spent by public officials.

Public procurement has always been vulnerable to corruption. Numerous corruption cases involving the mismanagement of public funds, including in the EU, have revealed the extent and seriousness of public procurement corruption.

Four years ago, for the first time, EU officials reported the European Union loses 120 billion euro to corruption annually, mainly from public procurement contracts worth around one percent of the EU's GDP. Indeed, 20 to 25 percent of the value of public contracts may be lost to corruption annually (Nielsen, 2013). More recently, these estimates were proven to be wrong. Instead of 120 billion in annual losses, the EU loses 990 billion euro a year to corruption, including 5 billion euro from public procurement corruption (Collins, 2016).

Obviously, government efficiency is substantially affected by public procurement corruption. After all, procurement corruption results in inflated public expenditures, harming everyone but the corrupt actors who wrongly enrich themselves.

Government procurement legislation has existed for more than 40 years in the EU. However, adding anti-corruption provisions only started in 2012.The EU legislative package on public procurement was reformed in 2014, inspired by the encouragement and model legislative standards offered by the United Nations, the Organization for Economic Co-operation and Development, the World Trade Organization, and the World Bank.

Several directives specifically addressed the public procurement process in the EU. Two directives were modified: Directive 2004/18/EC of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts and Directive 2004/17/EC of 31 March 2004 coordinating the procurement procedures of entities in the water, energy, transport and postal services sectors. Their new, improved provisions addressed several key issues. These included the prevention of conflict of interests, e-procurement, and the simplification of documentation, and better access to the market for small companies, monitoring and reporting on public procurement activity by member states to ensure the rigorous and uniform enforcement of EU law. Their replacements, Directives 2014/24/EU and Directive 2014/25/EU, were essentially intended to more tightly filter out public procurement corruption by using more flexible rules without sacrificing strictness.

Also, until 2014, transnational works concessions had not been addressed by specific legislation; instead, they were dealt with under limited and general provisions (Directive 2004/18/EC). Transnational service concessions were only governed by EU Treaty principles. As a result, a new directive was created to cover concession contracts, Directive 2014/23/EU.

Initially, EU member states opposed the additional costs for their national administrations the revisions would impose. Nonetheless, the directives were approved by the EU Counsel in February 2014. Member states had until April 2016 to transpose the new provisions but for the e-procurement rules, which can be implemented as late as April 2018.

The main modifications covered procurement in the water, energy, transport, postal services sectors, and in public works, supply and service contracts and concessions regulated at EU level. A new provision defines and targets conflicts of interest. Other provisions better address centralized data on corruption, fraud, modification of contracts, exclusion criteria and monitoring of concluded contracts. The legislation ensures the implementation of public procurement rules will be monitored and red flagging and alert systems will be used to detect fraud and corruption (Popescu, 2014).

The EU member states have similar public procurement laws. However, the new and improved EU public procurement legal framework seeks to ensure integrity, transparency, accountability, fair competition and professionalism in all EU member states and to enhance the functioning of the EU Single Market.

The EU's extensive reform reflects initiatives in other markets. Directive 2014/24/EU's provisions compare favorably to those in United States (US) public procurement law, which is likely to help US businesses gain access to the EU public procurement market. At the same time, however, wide gaps between the two public procurement laws are preventing fair competition for businesses outside of the EU Single Market. Yet these gaps offer promising opportunity to understand these barriers and move towards harmonization in future US trade negotiations with the EU (Yukins, 2015).

2. EFFICIENCY AND CONTROL USING ELECTRONIC INFRASTRUCTURE

The new provisions seek to simplify public procurement procedures by requiring e-procurement within the EU Single Market by 2018 when it will become mandatory. The expected outcomes are less bureaucracy, more transparency and more savings.

The use of electronic infrastructure will facilitate aligning supply with demand. The European Single Procurement Document will expedite the verification phase of bidders' financial standing and their selection credentials. The new legislation requires that only contract winners will be obligated to provide this information, and, gradually, this information will be accessible through electronic links to national databases. The use of the standard European Single Procurement Document during the bidding phase could reduce the bidding companies' administrative costs by around 80% and public authorities' expenses by 5 to 20 percent (European Commission, 2016).

E-Certs will provide information about different types of EU certificates required in the public procurement process. Simultaneously, the Tenders Electronic Daily (TED) database offers a detailed list of tenders around Europe, providing for more transparency and publicity. The number of contract notices and contract award notices made public using this database has been growing during the past few years.

The use of e-procurement has proved its value in countries that have transitioned to this system. For example, Lithuania and Estonia have succeeded in implementing an e-procurement practice. More than 50 percent of the total value of public bids is done electronically, in total transparency, in Lithuania. The Estonian State Public Procurement Register is an electronic system providing for e-procurement and for other e-services. Its use tripled in just one year (European Commission, 2014).

BASE is Portugal's example of a unique national web portal used to centralize public procurement contracts, a way of keeping extended records on public procurement transactions, especially those in construction and real estate

(Popescu, 2014). Also, Portugal has an e-procurement platform that offers the possibility of downloading documentation free of charge, announces public calls for tenders, allows e-invoicing, receives queries from suppliers, and uploads and monitors public procurement contracts (European Commission, 2014).

3. ENCOURAGING SME's PUBLIC PROCUREMENT PARTICIPATION AND BUSINESS COMPETITION

The new rules recognize standard business practices and, as a result, are more flexible than previous laws. Still, they are designed to ensure transparency, competition, fair and equal treatment for all business participating in public procurement.

Major improvements of public procurement legislation also refer to small and medium-size enterprises (SMEs) as bidders. The changes were needed since SMEs are the EU economy's engine. Almost 20,8 million SMEs are registered in the EU, representing 99,8 percent of all enterprises and producing more than a half of Europe's GDP. More than half of the public procurement contracts in the EU are awarded to SMEs. However, compared to their importance for the EU economy, these enterprises were to some extent unrepresented in public procurement, especially in procedures above the EU thresholds (PwC, 2014). Thus, the new rules were designed to facilitate their access to public procurement market in several ways.

First, the new rules permit contracts to be divided into lots. However, this might make the monitoring of the execution of the entire public work more difficult.

Second, the rules no longer require SMEs to have a high annual turnover to be eligible for participating in public tender procedures. The threshold for the annual turnover will not be higher than the double value of the contract.

Third, the new provisions create possibilities for SMEs and other businesses to establish the rules for innovative partnerships that allow contracting parties to advance new, modern, and better solutions for improving communities' lives by combining research and development and the purchase of goods. The directive creates an exemption from pre-commercial public procurement procedures for research and development services so long as the contracting authority will share the risks and benefits with the service provider (European Commission, 2016).

Another new procurement procedure that is an exception targets social, health and education services. A simplified procedure for the public purchase of this type of services was established on the condition that their contract value exceeds 750.000 euro.

Simpler rules, adapted to commercial activity have been created for companies that provide utilities such as water, energy, transportation and postal services. Some of the rules from Directive 2004/17/EC were maintained by Directive 2014/25/EU, but they were revised and improved to bring more flexibility to the public procurement procedures in this field. Thus, a Member State can ask for an exemption from the EU public procurement rules for a utilities sector where companies have access and where competition among them exists. This rule favors utilities companies that operate under an exclusive or special right and therefore can be exempted from the EU rules. For them, contracts can be awarded directly.

Overall, the new provisions are facilitating business access to public procurement contracts and thus are encouraging businesses to get involve in communities' life by building solid, long lasting partnerships with public authorities based on trust, professionalism and social responsibility.

4. MODERN PUBLIC ADMINISTRATION

Other changes have sought to help contracting authorities to adapt procurement procedures to specific situations determined by communities' needs, timeframes and the amount of money they have for purchasing goods or services. These simpler and more flexible selection procedures seek to encourage public authorities to buy internationally, relying on the "most economically advantageous tender" principle and not on the "lowest price" one. Thus, enduring quality, market competition, social welfare, innovation and environmental protection are favored.

The classic negotiation procedure with its prior publication of a contract notice has been replaced with competitive procedures coupled with negotiation. This is particularly useful if public authorities need products, services or works that are complex or require design and innovation specifications that need to be negotiated or when the tenders received were all unacceptable. Thus, the contracting authorities will be able to purchase the desired product or service and also to continue the already started procurement procedures, even if the initial offers were all rejected. They will not to be forced to retrace their steps and repeat the entire procedure all over again.

The desired outcome could also be obtained by public authorities using the new, simplified version of the old competitive dialogue procedure or the innovation partnership if necessary. These solutions save time and money for public authorities and, in the long run, help them modernize public administration. For example, through innovation promoted by public needs, health services costs were reduced in some EU member states, taking some of the pressure off healthcare budgets, preventing the increase of health insurance contribution and succeeding in providing value for money medical products.

This can lead to good results. In Poland, for example, a hospital unit achieved its patients' thermal comfort and energy self-sufficiency after developing an innovative partnership with the firm Ecoquip and accepting its idea to install fixed outward stores covered with solar panels on the walls of the building. (European Commission, 2016).

Also, under the new rules, EU contracting authorities have more freedom to impose shorter deadlines for the submissions of tenders and to negotiate contracts for complex projects. And public authorities can save money by being able to use on-line advertising for their contracts and to verify documentation and information about EU companies using the Internal Market Information System (IMI) (European Commission, 2016).

At the same time, bidders can be excluded from procedures by contracting authorities on the grounds of “bad reputation”; specifically, on previous contractual conflicts because of their inadequate performance. This is one of the modifications that target the elimination of fraud and corruption from public procurement. The World Bank and OECD are encouraging debarment, including permanently. Although the new directive has widened the range of criminal offences that would result mandatory debarment, it imposes less severe sanctions for companies convicted of economic or corruption crimes. Basically, the directive has put an end to permanent debarment; a measure which we believe could lessen the fight against corruption in EU member states where corruption is still virulent, such as Eastern European countries.

The new directive encourages local and regional public authorities to cooperate to solve different problems and to use the full potential of the EU’s Single Market by engaging in cross-border joint procurement procedures. The partnership could be between independent public authorities or between them and controlled entities. In both cases, among other conditions, 80 percent of the products, services or works resulted from the contract must be provided to the contracting authorities. Joint procurement minimizes the risk of investments for public authorities in complex, innovative projects. And this helps to act faster and to overcome a crisis. For example, the majority of EU member states have agreed to use the EC Joint Procurement Instrument to purchase vaccines in case of a health thread across Europe (European Commission, 2016).

At the same time, joint procurement can be used at national level in different sectors. For example, central purchasing bodies had been particularly successful in the health care field in many EU member states. These bodies have more leverage power to negotiate with companies that provide medical services and goods. In Germany, France, Slovenia public hospitals have organized themselves as central purchasing bodies that facilitate the negotiation of contracts with pharmaceutical companies, medical devices and service providers. France has taken the lead in purchasing modern medical equipment using a central representative body (Resah) for 150 public hospitals and nursing homes.

5. FIGHTING CORRUPTION

The fight against corruption has intensified during the last decade. The EU has joined the anti-corruption efforts of governments, international organisations and NGOs since the phenomena is common in all Member States.

Public procurement corruption extends throughout the EU. Member States are fighting it unevenly sometimes. In the main, a legislative solution is in place. Now it must be enforced.

The new public procurement directives strengthen transparency and ethical standards. Among the most important improvements in this respect are the introduction of mandatory e-procurement system starting in 2018; the EU-wide use of the European Single Procurement Document; the first definition of conflict of interest in the EU legislation; the possibility of debarring companies convicted for fraud and corruption crimes; clearer rules for the modification of contracts during their term; and the preliminary market consultation required of public purchasers respecting the rules of transparency and fair competition among tenders. The new concession contract rules require public purchasers to maintain detailed, public records on every contract award. And member states must closely monitor their respective enforcement of public procurement rules at national level and to report to the European Commission every three years on frequently occurring illegalities that foster corruption.

Often, during the last ten years or more, in some EU member states, national authorities lacked the financial means, the human resources, the logistics or the political will to closely control the legality of public procurement. This is particularly true for the EU's Eastern European members. All EU members, including these, are now forced to develop new anti-corruption electronic tools, including databases that must reflect the real monetary value of public procurement contracts.

Moreover, anti-corruption good practices in public procurement are shared among EU member states. Some of these practices include establishing codes of conduct and central authorities for tender and awarding, rotation of staff, clear regulations on sponsoring and the prohibition on accepting gifts, organization of tender procedures, increased use of e-procurement, black lists or corruption registers, and other similar measures (European Commission, 2014). Also, the use of integrity pacts mostly used in large construction projects has produced positive result in Germany and Austria.

Finally, whistleblower protection in the public sector has favoured the fight against public procurement corruption in Europe. According to Transparency International, United Kingdom, Luxembourg, Slovenia and Romania have developed a comprehensive legal framework in this respect (Worth, 2013).

6. CONCLUSIONS

The new EU public procurement rules have brought much needed improvements, and they have been absorbed and implemented by EU Member States. However, despite the existing good practices standards, the enforcement of the new public procurement provisions remains a challenge for the EU. The full extent of the effects of these new rules is yet to be shown. But this may happen starting with the 2018 when public procurement will be done exclusively through electronic infrastructures. Even then, vigilance will not be enough; when corruption is uncovered, the law's enforcement must follow. Efficiency and control could not be achieved without it.

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PUBLIC SPENDING EFFICIENCY IN EAST EUROPEAN COUNTRIES

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Abstract
After calculating the indicator of the Public Sector Performance (PSP), this article analyses the public sector efficiency in 5 countries from South and Central Europe, during 2000-2008 and 2009-2015. Using data envelopment analysis (DEA), we found that among these five, the performer is Bulgaria, followed by Romania and Turkey. Added to this, we found significant pre and post crisis differences, as the efficiency of governments improved post crisis.
Keywords: *government expenditure, efficiency, DEA method.*
JEL Classification: C14, H40, H50

1. INTRODUCTION

The importance of an efficient use of resources for citizens' economic growth and stability has been brought to public attention over the past decades, following macroeconomic constraints in public expenditure. EU states have an additional financial obligation, namely to ensure sound public finances and budget through the Growth and Stability Pact. Social networking and growing citizen involvement have increased tensions over transparency in public expenditure (Tanzi & Schuknecht, 2000).

However, it is extremely difficult to accurately measure public sector efficiency, particularly when it comes to quantifying costs and the results of public activities. International organizations and theoreticians have attempted timid analyses, based on the structure and marginal efficiency of public expenses, but recent studies lean towards focusing on allocated resources and results (OECD, 2003; Afonso *et al.,* 2005).

In this study, the author' contribution takes two directions: first, to design the Public Sector performance indicator (PSP) and to calculate it over a long period of time, 2000-2015 and second, to use Data Envelopment Analysis and calculate the four types of efficiency: constant and variable, depending on input, and depending on output.

To our knowledge, so far, such an analysis, spanning over a 15-year period, which includes the pre- and post- crisis periods, has not been carried out for Eastern European countries.

The study is structured as follows: the second section provides a literature review; the third discusses our methodology; the fourth deals with PSP and DEA calculus, and the last session presents our conclusions.

2. LITERATURE REVIEW

In specialized literature increasing importance is given to the measurement of public spending efficiency and the factors which influence it (De Borger & Kerstens, 1996; Afonso *et al*., 2005; Afonso & Fernandes, 2006; Bose *et al.,* 2007; Rayp & Van De Sijpe, 2007; Feeny & Rogers, 2008; Angelopoulos *et al.,* 2008). Most studies are focused on particular branches of public spending, such as: education, investments, justice, healthcare, and infrastructure, and most conclude that there are extreme variations between the analysed countries. A number of authors (Afonso *et al*., 2006; Afonso & Fernandes, 2008) argue that a series of exogenous factors, such as education levels and per capita income have a significant effecting the efficiency of public spending (De Borger & Kerstens, 1996; Rayp & Van De Sijpe, 2007).

Other studies found that the size of the public sector influences its efficiency, namely that smaller governments are more efficient (Afonso *et al*., 2005), and are even more efficient when combined with a legal environment close to citizens. Also, Feeny & Rogers (2008) reached similar conclusions after they analysed African countries. In addition, they discovered that, beside current indicators, governance and literacy also influence efficiency significantly. Rayp & Van De Sijpe (2007) analysed countries with medium and low living conditions and concluded that the efficiency of public expenses increases under the influence of civil liberty and good governance.

In an analysis carried out for 1980-2000 on OECD countries, Adam *et al.* (2011) demonstrate that for mastery in government efficiency, the quality of governance is more important than economic and social conditions. Angelopoulos *et al.* (2008) introduce two new categories of indicators with an impact on the efficiency of developing and developed countries, namely investment and openness of the economy.

Afonso *et al.* (2006) analyse the efficiency of the East European public system compared to Western European and developed Asian countries. They discovered that, in Eastern European countries, spending efficiency is extremely diverse compared to Western and Asian countries; in this case, strong reasons are income, civil service competence and education levels.

Despite the importance of public spending efficiency, there are few articles which analyse East European countries. Most studies deal with Western developed countries. This is why our study focuses exclusively on Eastern

European countries over an extended period of time and it aims to take note of changes incurred due to the 2008 financial crisis.

3. METHODOLOGY

In later years there have been several attempts at measuring public sector efficiency with the help of composite indicators, either macro - when they estimate the general public spending efficiency (a certain country spends differently from another, is general efficiency different?), or micro - when they estimate only a certain category of public spending (the efficiency of certain hospitals or immunization programmes for health expenditure).

Tackling 18 developed countries, Tanzi & Schuknecht (1997, 2000) are the first authors who analyse macro efficiency, namely whether an increase in public spending resulted in a corresponding increase in benefits. Their analysis compared certain social and economic indicators, in countries grouped according to the level of general public spending. They noted that countries with lower public expenses fared better than countries which allocated more resources.

In this article, we use the method developed by Afonso *et al.* (2005) which develops indicators for public sector performance (PSP), defined as a global indicator for public sector results. The authors develop this indicator by taking into account a series of variables and social indicators, as follows:

$$PSP_i = \sum PSP_{ij} \qquad (1)$$

The PSP function, which measures public performance, contains seven sub-indicators, similar to those used by Afonso *et al.* (2005). Thus, the indicators are divided in two categories: administrative (Administration, Education, Health, Infrastructure) and "Musgravian" (distribution, stability, economic). In their turn, each of these sub-indicators contains several elements. The administration indicator contains four elements: Corruption (we have used the Corruption Perception Index computed by the International Transparency Agency); Burden of government regulation (we have used the following indexes from the annual report Doing Business); Efficiency of legal framework in settling disputes (we have used the following indexes from the annual report Doing Business); Shadow economy index (Schneider & Enste, 2000). It can be assumed that the rule of law, a functional judiciary system, and low corruption and shadow economy levels result in greater government efficiency, because each of the indicators influences it directly.

Education is measured by only one indicator, Quality of education (used in the World Economic Forum annual reports). It is assumed that this indicator directly influences governmental efficiency, that is, educated people will be reluctant to tolerate negative acts such as corruption and shadow economy. In order to calculate the health sub-indicator we have used two elements: life expectancy at birth, age and infant mortality rate (published by the World Health Organization). This indicator also directly influences efficiency, namely a healthy population supposes improved public sector efficiency. Infrastructure is measured by the indicator known as Quality of overall infrastructure, taken from the World Economic Forum. It is assumed that, as with the previously mentioned indicator, its high values result unimproved public sector efficiency.

The second type of performance indicators refer to governmental acts related to resource management; these are defined according to Musgrave's theories. The distribution indicator uses the values of Gini coefficients, taken from the World Bank (it can be assumed that this indicator influences efficiency indirectly: the higher its value the more inefficient the administration). Stability uses two values: coefficient of variation of GDP growth and inflation (calculated as a ten year average) (similar to the previous indicator, this too indirectly influences efficiency: a high stability rate of the nation results in improved government efficiency); economy uses three values: GDP per capita expressed as PPP, GDP growth and unemployment (calculated as mean value for the past ten year).

Each indicator is granted equal weight in the resulting PSP indicator; the used values were standardised by referring the indicators to the calculated mean values.

Data enveloping analysis (DEA), developed by Charnes, Cooper and Rhodes in a study from 1978, the method applied in this study for the analysis of CDI efficiency, requires that we apply linear programming techniques to calculate the efficient frontier, using two modalities which refer to constant returns to scale (CRS) and variable returns to scale (VRS), respectively. Mathematical formulas for solving the system of equations involve finding the decision making unit (DMU), i.e. those points that are on the efficiency boundary, based on consumed inputs and outputs produced. The method can be used considering inputs (input orientation in which inputs change and outputs are kept constant) or outputs (output orientation in which inputs are constant and outputs change). Mathematical programming starts from input data Xi and output yi, for which a vector N is constructed, which implies a limitary series, θ represents the efficiency of each DMU relative to the effective boundary, CRS (left) and VRS (Right) are shown below (Charnes *et al.,* 1978):

CRS	VRS
$\min \theta_{\theta, \lambda}$	$\min \theta_{\theta, \lambda}$
$-yi + Y\lambda \geq 0$	$-yi + Y\lambda \geq 0$
$\theta x_i - X\lambda \geq 0$	$\theta x_i - X\lambda \geq 0$
$\lambda \geq 0$	$N_i\lambda = 1$
	$\lambda \geq 0$

With reference to public sector efficiency, for each country i, the general equation that is tested have the following function:

$$Yi\, f\,(Xi\,),\ i=1,\ldots,n \qquad (2)$$

Where: Yi is a composite indicator which measures performance (previously computed PSP), Xi - public spending, which measures the entries for a particular country.

Using DEA, we measure efficiency for each country. If the score is 1, that particular country is on the efficient frontier; with scores under 1, in fact, we calculate inefficiency, by calculating the distance from the required value.

The analysis of the efficiency of the research developed using DEA (dictated) by economic or other suppositions made on the set of data will be analysed in the following section.

4. RESULTS. COMPARATIVE ANALYSIS

Our analysis opens with a discussion of the public expenditure levels in the five Eastern European countries (Bulgaria, Greece, Hungary, Romania and Turkey). We have chosen these countries based on the numerous similarities between them; for each there is enough data to give meaning to public spending efficiency.

Table 1 illustrates their public expenses for 2000-2015. As one can see, in order to be able to estimate the effects of the financial crisis, the period was divided in two sub-periods: pre-crisis (2000-2008) and post-crisis (2009-2015). It can be noted that there are significant differences between these five countries: Hungary has the highest indicator rate, close to 50%: the financial crisis hardly changed this level; Greece comes second, indicating over 40%: one can notice a slight decrease in public expense, of about 1%; Bulgaria (34.74%), Romania (33.38%), Turkey (36.94%) had percentage of public spending around 35%; after the 2008, the leader becomes the Greece (51.72%), second, Hungary (49.74%), and the group of the other three countries, with the same percentage or even lower (table 1).

Table 1. Public expenditure for 5 East European countries in 2000-2015

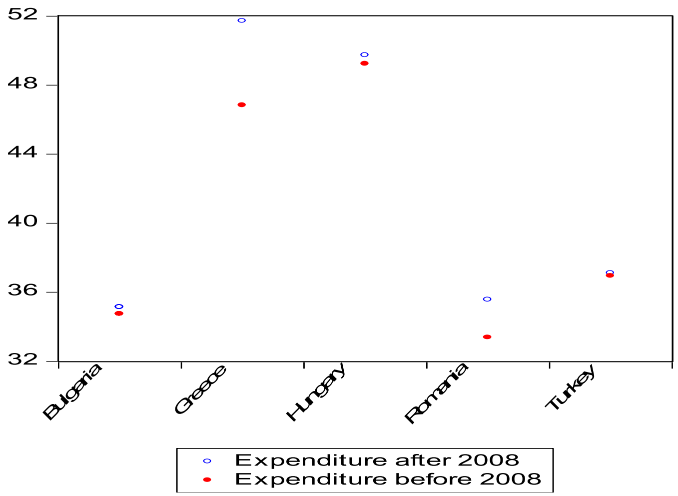
	Bulgaria	Greece	Hungary	Romania	Turkey
2000	37.41	46.99	47.21	34.86	36.57
2001	36.60	45.99	47.25	32.90	41.03
2002	35.17	45.80	50.95	32.01	43.15
2003	35.88	46.59	49.13	30.72	41.39
2004	34.70	47.62	48.63	33.11	35.52

	Bulgaria	Greece	Hungary	Romania	Turkey
2005	34.09	45.56	49.56	31.90	33.17
2006	32.57	45.12	51.66	33.44	33.49
2007	32.87	47.07	50.07	35.18	33.63
2008	33.34	50.81	48.75	36.31	34.51
Average 2000-2008	34.74	46.84	49.24	33.38	36.94
2009	33.93	54.06	50.64	37.76	38.56
2010	35.07	52.46	49.55	37.88	36.69
2011	32.36	54.24	49.75	36.33	35.21
2012	32.96	52.19	48.61	34.92	36.63
2013	35.59	49.20	49.53	33.86	38.41
2014	37.31	49.94	49.89	33.90	37.29
2015	38.78	49.99	50.23	34.34	36.96
Average 2009-2015	35.14	51.72	49.74	35.57	37.11

Source: Eurostat database

The greatest differences between the values of public spending between the 5 analyzed countries are for Greece (5%) and Romania (2%); the small differences, almost insensible are for the three remaining countries: Bulgaria, Hungary and Turkey (fig.1).

Figure 1. The evolution of public expenditure for 5 East European countries in 2000-2015



Source: Eurostat database

Table 2. Public Sector Performance (PSP) indicators (2000-2015)

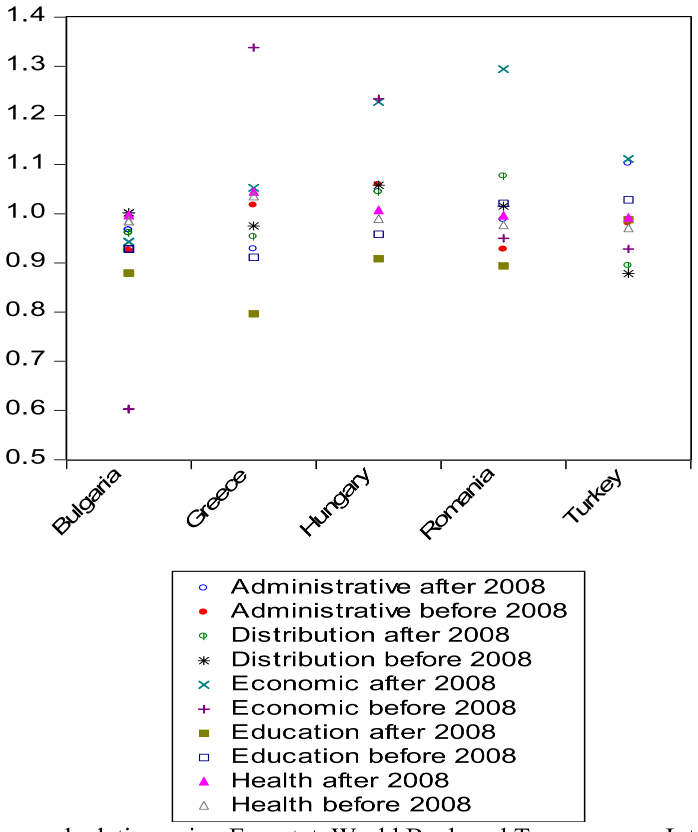
	Bulgaria		Greece		Hungary		Romania		Turkey	
	2000-2008	2009-2015	2000-2008	2009-2015	2000-2008	2009-2015	2000-2008	2009-2015	2000-2008	2009-2015
Corruption index	3.90	3.90	4.43	3.89	5.07	5.11	3.07	4.10	3.68	4.51
Burden of government regulation, 1-7 (best)	2.75	3.08	2.69	2.35	2.77	2.38	3.14	2.95	2.89	3.25
Efficiency of legal framework in settling disputes, 1-7 (best)	2.78	2.80	3.24	2.80	3.05	3.19	2.94	2.94	3.34	3.67
Shadow economy index	35.02	31.73	27.14	24.27	24.21	22.53	32.60	29.10	31.27	27.66
ADMINISTRATIVE	0.93	0.97	1.02	0.93	1.06	1.04	0.93	0.99	0.98	1.10
Quality of education, 1-7 (best)	3.50	3.32	3.44	3.00	3.61	3.43	3.85	3.37	3.88	3.73
EDUCATION	0.93	0.88	0.91	0.80	0.96	0.91	1.02	0.89	1.03	0.99
Life expectancy at birth, years	72.11	73.74	79.11	80.36	72.56	75.00	71.56	73.86	71.22	73.52
Infant mortality rate	12.00	9.86	4.00	3.54	7.89	5.43	20.11	11.86	27.78	16.62
HEALTH	0.98	1.00	1.04	1.04	0.99	1.01	0.98	1.00	0.97	0.99
Quality of overall infrastructure, 1-7 (best)	2.73	3.28	4.43	4.48	4.11	4.76	2.51	2.97	3.52	4.99
INFRASTRUCTURE	0.74	0.89	1.21	1.22	1.12	1.30	0.68	0.81	0.96	1.36
Gini coefficient	32.56	35.27	34.35	35.82	28.78	29.67	31.64	27.54	40.86	39.78
DISTRIBUTION	1.00	0.96	0.98	0.95	1.06	1.04	1.02	1.08	0.88	0.89
Average inflation	123.48	4.93	4.91	2.66	15.07	5.68	72.40	11.54	57.14	12.93
Average GDP real growth rate	1.60	3.69	3.41	-0.15	3.00	1.48	2.26	3.66	3.80	4.48
STABILITY	0.35	1.11	1.10	1.01	0.66	0.69	0.40	0.84	0.64	0.93
Average GDP real growth rate	1.60	3.69	3.41	-0.15	3.00	1.48	2.26	3.66	3.80	4.48
Average unemployment	13.75	10.31	10.44	12.61	7.51	8.13	7.92	6.99	7.59	9.68
Per capita GDP, PPP USD	3658.84	7288.87	20906.26	23756.00	18553.31	23458.60	11939.08	18266.78	6134.33	10013.98
ECONOMIC	0.60	0.94	1.34	1.05	1.23	1.23	0.95	1.29	0.93	1.11
PSP	0.89	1.08	1.21	1.12	1.13	1.15	0.96	1.10	1.02	1.18

Source: own calculation using Eurostat, World Bank and Transparency International databases

To measure public expense efficiency, we have used the described methodology, as suggested by Afonso *et al.* (2005). Thus; we have calculated the sub-indicators for the seven categories, the opportunity indicators and "Musgravian" indicators. Table 2 presents the separate values for sub-indicators and the final value for PSP, the composite indicator.

As can be noted, all countries have improved the PSP indicator in second period towards the first one. The only exception is Greece, but this country had suffered very difficult economic times, but only is superior for the four other countries.

Figure 2. The evolution of Public Sector Performance (PSP) indicators (2000-2015)



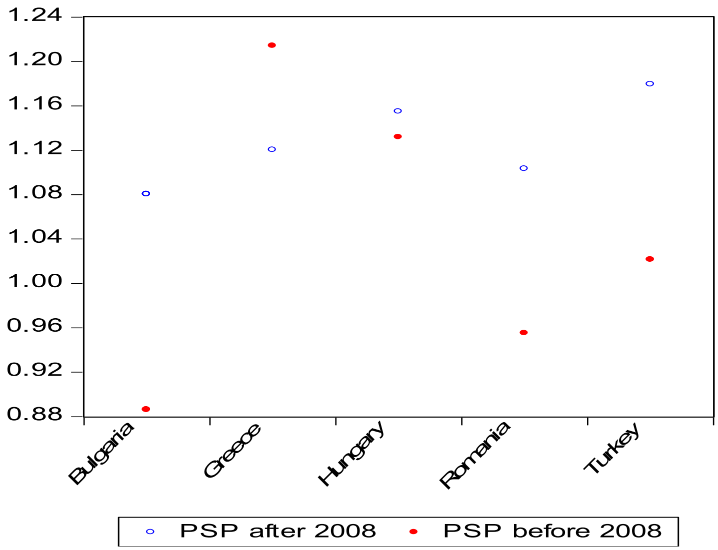
Source: own calculation using Eurostat, World Bank and Transparency International databases

Bulgaria ranks last among the five countries. Before the crisis, for each indicator, Bulgaria registered smaller values than the other two (fig. 2). Turkey and Romania are the most efficient, each with high values in particular fields

(Turkey in Administration and Infrastructure; Romania in Education, Health, Distribution, Stability, Economic). The final PSP values reveal the same characteristics (Bulgaria 1.08; Greece 1.12; Hungary 1.15; Romania 1.10; Turkey 1.17). Romania's and Hungary's high values, compared to Bulgaria's, can be accounted for by their earlier start in the democratization process, and by an earlier adherence to EU (2004). There is a slight but insignificant difference between Hungary and Romania caused by a pre-crisis period which was fruitful for Hungary: a more friendly business environment, massive investment in infrastructure.

Post-crisis, we note as a general rule that all three countries have improved the analysed indicators: Hungary, to the least extent (3%); Romania (17%) and Poland (19%), to a greater extent. This is a good sign, showing that these countries have become more efficient. Possible explanations for the differences in their evolution are the following: Hungary did not pursue reforms as expected, entered the grey zone and became the "black sheep" of the EU; Poland ranked first in terms of absorbing European funds, improved its infrastructure enormously (they also organized the Euro 2012); Romania began a titanic work to cleanse endemic corruption, with spectacular results, and thus it has become the EU performer in this field (fig. 3).

Figure 3. The evolution of Public Sector Performance (PSP) indicators (2000-2015)



Source: own calculation using Eurostat, World Bank and Transparency International databases

Table 3. DEA indicators (2000-2015) Constant (CRS) and Variable (VRS)

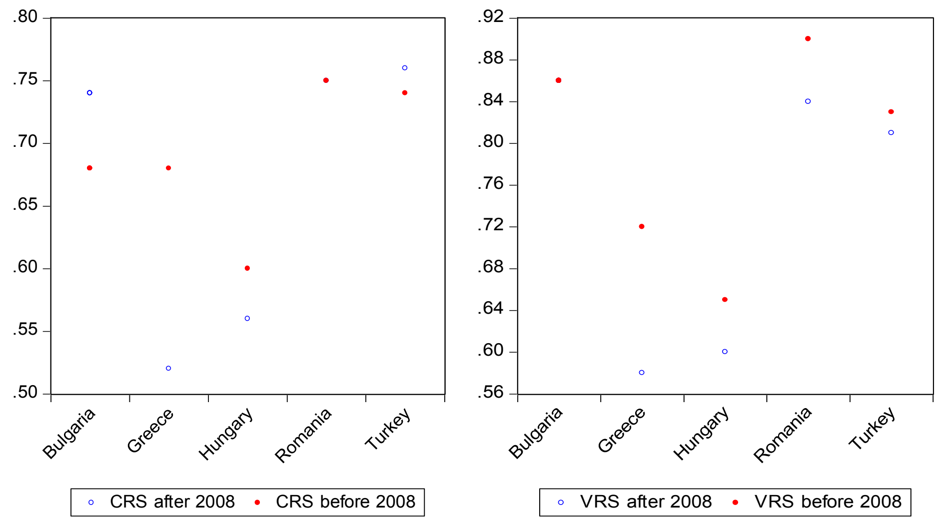
CRS INPUT	2000	2001	2002	2003	2004	2005	2006	2007	2008	Average 2000-2008	2009	2010	2011	2012	2013	2014	2015	Average 2009-2015
Bulgaria	0.43	0.48	0.58	0.67	0.69	0.76	0.82	0.85	0.81	0.68	0.85	0.72	0.75	0.72	0.73	0.75	0.67	0.74
Greece	0.59	0.61	0.66	0.72	0.70	0.76	0.77	0.70	0.63	0.68	0.61	0.52	0.46	0.45	0.51	0.57	0.53	0.52
Hungary	0.53	0.57	0.58	0.64	0.63	0.65	0.63	0.61	0.59	0.60	0.60	0.54	0.54	0.52	0.55	0.60	0.55	0.56
Romania	0.57	0.66	0.76	0.86	0.79	0.84	0.79	0.74	0.76	0.75	0.77	0.66	0.66	0.68	0.78	0.88	0.81	0.75
Turkey	0.69	0.60	0.60	0.65	0.78	0.88	0.85	0.81	0.76	0.74	0.74	0.72	0.78	0.75	0.77	0.83	0.75	0.76
VRS INPUT MODEL	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**Average 2000-2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**Average 2009-2015**
Bulgaria	0.84	0.82	0.87	0.81	0.85	0.84	0.89	0.89	0.95	0.86	0.96	0.84	0.89	0.86	0.82	0.85	0.77	0.86
Greece	0.71	0.71	0.72	0.72	0.72	0.77	0.78	0.70	0.65	0.72	0.62	0.56	0.53	0.54	0.59	0.63	0.60	0.58
Hungary	0.70	0.69	0.63	0.64	0.66	0.66	0.65	0.62	0.65	0.65	0.65	0.59	0.58	0.58	0.59	0.63	0.60	0.60
Romania	0.91	0.94	0.96	0.94	0.89	0.89	0.86	0.83	0.87	0.90	0.87	0.78	0.80	0.81	0.86	0.93	0.87	0.84
Turkey	0.90	0.77	0.71	0.70	0.84	0.88	0.90	0.87	0.92	0.83	0.85	0.80	0.82	0.77	0.78	0.85	0.81	0.81

Source: own calculation using Eurostat, World Bank and Transparency International databases

In what follows we shall use Data Envelopment Analysis (DEA), as described above, by resorting to one input (public expense as PIB report) and one output (PSP calculated and presented in table 2). Table 3 shows the four efficiency coefficients, both those relative to constant and variable returns to scale, and those which are input and output oriented. In this case the ranks are slightly reversed: Romania replaces Hungary, Turkey remains first.

This can easily be explained: with large public spending (almost 50%) Hungary obtains results only slightly better than another country, Romania, which uses only 35% of public funds (fig. 4).

Figure 4. The evolution of DEA indicators (2000-2015)



Source: own calculation using Eurostat, World Bank and Transparency International databases

5. CONCLUSIONS

In this study, we analysed the public sector efficiency of five eastern European countries (Bulgaria, Greece, Hungary, Romania and Turkey). We began with a presentation of DEA, and a correct definition of input and output. Then, we calculated a composite indicator, PSP public sector performance, based on 7 sub-indicators (Education, Health, Administration, Economic stability, Economic activity and Distribution), for two periods, 2000-2008 and 2009-2015.

Our analysis shows that there are differences between the three countries: PSP shows the leading countries to be Turkey and Romania, Hungary lagging behind. There are also differences between the two (pre and post crisis) periods: after 2008, all countries have improved their efficiency indicators.

In what DEA is concerned, the efficient countries are Turkey and Romania, and the least efficient is Greece. Greece's inefficiency is between 12-15% of its public spending.

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THE GAME OF PRINCIPLES: COMPETITION AND FUNDS' EFFICIENCY IN THE AWARD OF CONTRACTS BELOW THE PROCUREMENT THRESHOLD

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Abstract
An important amount of the non-reimbursable funds granted to Romanian beneficiaries under EU and EEA states financial regulations are usually spent under contracts whose value is below the thresholds provided by the public procurement directives. Nevertheless, applicable financial regulations, national regulations and financing agreements imperatively require that certain, usually simplified, procurement procedures are to be followed for the award of such relatively small value contracts. In these cases, the requirement to follow a specific procurement procedure may be deemed to equally serve the competition (as a general objective of the application of the non-discrimination, transparency and equal treatment principles) and the funds' efficiency principle. However, in specific cases, where these two principles cannot be equally applied, this contribution argues that the efficiency principle will have to be primarily considered.
Keywords: *public procurement, EU funds, contract award, contracts below thresholds.*
JEL Classification: K10, K23, K29

1. PRELIMINARY CONSIDERATIONS

A rather significant practical issue raised during the implementation of various programs financed from structural instruments, as well from the EEA states and Norwegian financing programs, is related to the award procedures applicable for contracts having a value below the thresholds as well as to those procedures that are to be conducted by the private beneficiaries of such funds.

Prior to the implementation of the 2014 procurement directives by the Law no. 98/2016 on public procurement contracts, Law no. 99/2016 on sectoral procurement contracts and Law no. 100/2016 on concession contracts, the national public procurement regulation, namely E.G.O. no. 34/2006, which transposed into Romanian law both Directive 2004/17 on public procurement contracts and Directive 2004/17 on utilities procurement, was referring solely to the procurement procedures applicable for public contracts whose value was above the thresholds, awarded by contracting authorities. A specific lower threshold was included in E.G.O. no. 34/2006 as concerns direct awards. The new rules on public procurement in Law no. 98/2016 are following a similar pattern, with a cap for direct awards, a simplified procedure for contracts whose value is above such cap and below the thresholds, and full application of procurement rules for contracts having a value above thresholds (Rațiu, 2017, pp. 94-98).

Private beneficiaries of EU and EEA states non-reimbursable funds may be subjected to the procurement regulations and thus be assimilated to contracting authorities in case they are awarding specific works contracts as well as ancillary services contracts related to such works, whose value is above thresholds and are also financed by more than 50% by a contracting authority.

However, in respect of non-reimbursable funds allocated under EU and EEA regulations, specific tertiary regulations were adopted, explicitly providing a special simplified procurement procedure. It is true that the procedures thus imposed were much simplified compared to those provided for contracts above thresholds, yet any failure to observe them could trigger serious effects, as corrections applied against the contract/financing value in accordance with the Emergency Government Ordinance (EGO) no. 66/2011. Thus, the Ministry for European Funds has issued two consecutive orders, no. 1050/2012, replaced in 2013 by Order 1120 (in force starting from October 22, 2013), both approving a simplified procedure for the award of contracts by private beneficiaries of projects financed by structural instruments or by EEA or Norwegian financial mechanisms. Whilst the award procedure initially adopted by Order no. 1050/2012 was much alike the „regular" procedures provided by the EGO no. 34/2006 for the award of contracts above thresholds, the replacing Order no. 1120/2013 was the result of a simplification effort. Nonetheless, this simplification was prompted not only by the below threshold value of the contracts subjected to this procedure but also by the fact that it was applicable by private beneficiaries of non-reimbursable funding, which also contributed to the co-financing of the project. Starting August 12, 2016 the Order no. 1120/2013 was replaced by Order no. 1284/2016, adopting a similarly simplified procedure applicable for the 2014-2020 exercise of EU and EEA funds.

The common element for all these successive award procedures is the explicit statement that the contracting entities will have to abide by four principles in contract awards, namely transparency, economy, efficiency and effectiveness. This repeated reference to the four principles as a basis for award procedures organised under these tertiary regulations further opens a discussion on two legal issues, at least.

First, an assessment is required as concerns the relation between the principles stated by the above mentioned ministry orders and the more general competition-derived principles applicable to procurement contracts, and, *second*, where the principles governing the procurement procedure are deriving from several sources, an hierarchy of such principles, or rather of their sources, has to be defined.

As concerns the first issue, considering the ECJ case law relating to the contracts below thresholds as well as the 2006 Commission Communication on such contracts, we argue that the economy, effectiveness and efficiency principles applicable to award procedures for contracts not covered by the procurement regulations will have to be interpreted in relation to such established case law. This may result in an extension of the number of principles applicable to those award procedures organised for contracts of cross-border interest, the economy, effectiveness and efficiency principles being supplemented with the other principles derived by the ECJ case law, as restated by the 2006 Commission Communication on contracts excluded or below thresholds, from the Treaty: non-discrimination, equal treatment, proportionality, mutual recognition.

As for the *second* issue, where all the principles are reunited, is there any hierarchy between the competition-derived principles in the Treaty (transparency, non-discrimination, equal treatment, proportionality, mutual recognition), on one hand, and the efficient use of funds-derived principles (economy, efficiency, effectiveness), in those cases when a tension between these two categories of principles may be identified?

2. CONTRACTS NOT COVERED BY PROCUREMENT REGULATIONS

The issue of award procedures to be used for contracts below thresholds has been extensively debated (Risvig Hansen, 2012, pp. 121-144). In its *Telaustria* judgement as of 2000 (case C-324/98 *Telaustria and Telefonadress* [2000] ECR I-10745), the ECJ has stated that for service concessions, although excluded from the scope of the 2004 directives, the contracting authority has to ensure a certain degree of advertising and transparency „sufficient to enable the market to be opened up to competition”.

Building on its rationale expressed in *Telaustria*, by its further case law (e.g. case C-231/03 *Coname* [2005] ECR I-7287, case C-458/03 *Parking Brixen* [2005] ECR I-8585, case C-324/07 *Coditel Brabant* [2008] ECR I-8457), the Court established that contracts below the thresholds are to be awarded further to a procedure subjected to the principles derived from the fundamental freedoms stated in the Treaty on the Functioning of the European Union, provided that such contracts are of cross-border interest.

An important criterion for the requirement to conduct an award procedure that complies with the general principles of equality of treatment, transparency, non-discrimination in case of contracts below threshold, the concept of „cross-border interest” was first referred to in case C-507/03, *Commission v. Ireland* („*An Post*”) [2007], where the Court held that the award of a non-priority service contract without any advertising is a breach of the transparency obligation and thus of articles 49 and 56 TFEU. Should the ECJ continue this line of reasoning under the 2014 procurement directives, these principles will apply also to contracts that are excluded or below the thresholds. In the absence of a manifest cross-border interest, the Treaty-derived principles shall not be applicable, as no direct connection with the application domain of the Treaty exists (Arrowsmith, 2014, p. 245).

Whilst the solution that may be adopted by the ECJ in this respect could not be entirely derived from its previous jurisprudence, it was pointed out that the Court may consider that a cross-border interest exists especially in case of services concessions with a value at least equal to the much lower threshold provided by the 2014 Public Sector Directive and the 2014 Utilities Directive for service contracts (Bogdanowicz, 2015b). It is to be mentioned that the threshold for works contracts and works concessions is the same in all 2014 directives.

In other opinions (Telles, 2013), the existence of cross-border interest should be presumed for contracts with a value above the threshold, without any further assessment. However, for contracts below threshold, in the absence of a clear definition of cross-border interest provided in the directives as well as of rules for its accurate determination by contracting authorities, the assessment of the existence of cross-border interest has to be made on a case-by-case basis (Bogdanowicz, 2015a). In cases where cross-border interest is deemed to exist for contracts below threshold, the Treaty principles shall be applicable, whilst in those cases where no such interest is in place, the contract shall be awarded according to national rules applicable below thresholds, if any. This latter case will also extend to certain contracts awarded by beneficiaries of EU structural and/or EEA states funding, where the conditions in article 13 of Directive 2014/24 on public procurement contracts.

In this context, the burden of assessing the existence of cross-border interest and thus of the applicability of the EU or national law is placed on contracting authorities. Yet, no clear rules or guidance are available, as this issue is addressed by the Commission's Communication of 2006 as well as by a variable ECJ jurisprudence, which is not always of much help in the process of identification of clear criteria for the existence of cross-border interest and was criticised as further increasing legal uncertainty (McGowen, 2007).

The Commission interpretative communication on concessions under Community law (2000) reiterates the findings of the ECJ in *Telaustria*, without any explicit reference to the cross-border interest test (Braun, 2000). Following requests for guidance regarding the application of the principles derived from the Court's case law, the European Commission issued in 2006 the Interpretative Communication on the Community law applicable to contract awards not or not fully subject to the provisions of the Public Procurement Directives.

The 2006 Commission Communication stipulates three general rules (referred to as „basic standards”) that are to be followed in the award of contracts not covered by the 2004 procurement directives: (i) adequate advertising of the intention to award the contract, (ii) impartiality of the award procedures and (iii) the availability of an adequate review mechanism in respect of the award procedure. These standards, as detailed by the 2006 Commission Communication, are applicable to contracts „having a sufficient connection with the functioning of the Internal Market”. The Communication makes reference to the ECJ case law, stating that in certain cases, „because of special circumstances, such as a very modest economic interest at stake”, a contract award would be of no interest to economic operators located in other Member States. Accordingly, as stated by the Court in *Coname* (C-231/03, 2005, para. 20), „the effects on the fundamental freedoms are […] to be regarded as too uncertain and indirect”.

Article 1.3 of the 2006 Commission Communication further stipulates „It is the responsibility of individual contracting entities to decide whether an intended contract award might be of interest to economic operators located in other Member States. In the view of the Commission, this decision has to be based on an evaluation of the individual circumstances of the case, such as the subject-matter of the contract, its estimated value, the specifics of the sector concerned (size and structure of the market, commercial practices, etc.) and the geographical location of the place of performance. If the contracting entity comes to the conclusion that the contract in question is relevant to the Internal Market, the contract has to be awarded in conformity with the basic standards derived from Community law.”

Further to the annulment request submitted to ECJ by Germany in respect of the 2006 Commission Communication, the Court declared this request to be inadmissible by its decision in case T-258/06 *Republic of Germany v. Commission* [2010]. The ECJ upheld the position of the Commission in this respect and further extended the cases where cross-border interest was identified, yet without crystallising a general rule or criterion for such determination. Currently, the ECJ case law provides a list of specific situations where the relevance of a contract to the internal market was determined and includes: the value of the contract, the location of the activities related to the concession (Case C-347/06 *ASM Brescia* [2008] ECR I-5641, para. 60), the technical features of the concession (Joined cases C-147/06 and C-148/06 *SECAP and Santorso* [2008] ECR I-3565, para. 24, case C-221/12 *Belgacom* [2013]), complaints made by operators established in other Member States, provided that such complaints are not fictitious (Case C-113/13 *Spezzino* [2014] EU:C:2014:2440), or the reference to the supply of products under an international brand (Case C-278/14 *SC Enterprise Focused Solutions SRL* [2015], para 21). The reasoning of the Court and its analysis of the cross-border interest are not consistent throughout this jurisprudence (Telles, 2013) and therefore contracting authorities are not provided with a clear test.

Once the existence of a cross-border interest is determined, further to the application of the qualitative criteria used by ECJ case law, as uncertain as they may be, the contracting authority or the contracting entity has to establish an award procedure that is consistent with the basic standards provided by the 2006 Commission Communication. This will mean that contracting authority must have to advertise the contract in advance, in a manner deemed as sufficient in terms of content and form, so as to observe the principles of transparency, equal treatment and non-discrimination.

Given the uncertainty derived from such general indications and standards provided by the ECJ case law and the 2006 Commission Communication (Brown, 2007, pp. 2-21), several solutions were proposed, such as the determination at the national level of specific advertising rules for contracts below the thresholds (Bovis, 2012), the adoption by the Member States of alternative approaches to transparency rules, such as systems of attestation (Arrowsmith, 2014), or even the lowering of thresholds, resulting in a much extended application of the rules in the directives (Telles, 2013).This latter solution was considered by the Romanian legislator, which extended the application of principles to all procurement (not excluded) contracts awarded by contracting authorities whose value is above the threshold limiting direct awards.

The new Law no. 98/2016 on public procurement (hereinafter „the Public Procurement Law"), transposing into Romanian law Directive 2014/24, together with its Methodological Norms adopted by Government Decision no. 395/2016, are providing for a simplified procedure for the award of contracts whose value is above the thresholds provided by article 7 paragraph 5 of the Public Procurement Law for direct procurement and below the thresholds provided by article 7 paragraph 1 of the same law for its full application. Article 7 paragraph 2 of Public Procurement Law states that any simplified procedure to be regulated by the Methodological Norms for such contracts shall observe the Directive-derived principles provided by article 2 paragraph 2 of the same law, namely the principles of non-discrimination, equal treatment, mutual recognition, transparency, proportionality and accountability.

It is to be emphasised that this extension by law of the application domain of such principles, beyond the application domain of the public procurement law and of the Directive 2014/24 (i.e. contracts above thresholds), is provided irrespective of the identification of any cross-border interest. This may prove to be a national solution that overpasses the difficulties of identifying the presence of a cross-border interest on a case-by-case basis. Yet, the relevance of the cross-border interest remains for contracts below the threshold for direct award.

Further, the simplified procedure for contracts awarded by entities qualified as contracting authorities pursuant to article 4 of the Public Procurement Law is regulated by articles 101 to 105 of the Methodological Norms (GD no. 395/2016).

Certain distinctions are to be drawn starting from these regulations: in case of contracts that may awarded directly, namely contracts having a value lower than approx. EUR 30.000 (RON 132.519) for supply and services contracts and approx. EUR 100.000 (RON 441.730) for works contracts – the Treaty-derived principles, related to the overarching principle of competition, shall be applicable only if a cross-border interest is in place in respect of such contract. In case no cross-border interest is identified, the contract may be awarded without any explicit effort of the contracting authority to ensure observance of said principles. However, this is true only as concerns contracts awarded by the contracting authorities listed by the Directive and the Public Procurement Law.

In case of contracts awarded by the private beneficiaries of EU or EEA states non-reimbursable funds, if such beneficiaries of funds are not contracting authorities in the sense of the Public Procurement Law, neither the principles in the Public Procurement Law nor those derived from the Treaty according to the ECJ case law and the 2006 Commission Communication shall not be applicable.

However, according to article 6 of the Public Procurement Law, transposing article 13 of Directive 2014/24, private entities which do not qualify as contracting authorities under the provisions of article 4 of the same law will have to abide by its provisions when awarding certain works and/or related services contracts having a value above thresholds, if more than 50% of the value of such contract is directly financed by a contracting authority. The reason for extending the quality of contracting authority to private entities, the latter thus being fully subjected to the Public Procurement Law, resides in both the public source of the financing for the contract and the public character of the works and related services financed from public funds.

Consequently, from the standpoint of the applicable procedures for the award of procurement contracts, private beneficiaries of EU or EEA states non-reimbursable funds may fall within one of the two above-mentioned categories: (i) those awarding contracts in accordance with the public procurement rules, and (ii) those awarding contracts in accordance with special procedures applicable to contracts falling outside the public procurement regulations.

Our analysis concerns this second category, in particular the role of the principles in organising and conducting award procedures. Given the simplified procedures instituted by the successive ministry orders issued for this purpose and scarcity of rules thus provided, any situation not explicitly regulated could be solved by direct reliance on the principles governing the award procedure. Moreover, the successive ministry orders adopting such simplified procedures are expressly referring to four principles that have to be observed when organising and conducting such award procedures: transparency, economy, effectiveness, efficiency.

3. PRINCIPLES APPLICABLE TO CONTRACT AWARD PROCEDURES

Based on the ECJ case-law concerning the award procedures applicable for contracts not subjected to the procurement directive, the presence of a cross-border interest in such contracts shall always trigger an obligation to abide by the principles derived from the Treaty: transparency, non-discrimination, equal treatment, reciprocity. This will be true in all cases when the contracts below thresholds are awarded by contracting authorities, as defined by the procurement directives and by the national procurement regulations.

As concerns contract award procedures conducted by private beneficiaries of EU or EEA states non-reimbursable funds, the cross-border interest test shall play no role. Private beneficiaries shall conduct their award procedures in accordance with either (i) the simplified procedure established currently by the Order of the Ministry of European Funds no. 1284/2016 or (ii) the procurement regulations in case of specific works and related services contracts, having a value above thresholds and financed at least 50% by a contracting authority.

This leaves an important portion of the contracts that may be awarded by private beneficiaries of non-reimbursable funds within the domain of the simplified award procedure subjected to the principles of transparency, economy, efficiency and effectiveness.

From the perspective of the typology of contracts below thresholds, several situations may be identified:

(i) contracts below the direct award threshold awarded by contracting authorities (further referred to as „direct contracts");

(ii) contracts above the direct award threshold and below the main threshold awarded by contracting authorities (further referred to as „intermediate contracts");

(iii) contracts awarded by private beneficiaries of EU and EEA states funds, excluding specific works and ancillary services contracts above the main threshold awarded by private beneficiaries of EU and EEA states funds, whereby more than 50% of the contract value is financed a contracting authority (further referred to as „private beneficiaries contracts").

For all three above listed categories of contracts below thresholds, the procurement rules in the Public Procurement Law are not fully applicable. More specifically, only in respect of „intermediate contracts" the Public Procurement Law provides a simplified procurement procedure, whilst for „direct contracts" certain simplified rules are provided in the GD no. 395/2016 approving the methodological norms. „Private beneficiaries contracts" are totally excluded from the domain of the Public Procurement Law in all cases, being entirely subjected to the simplified procurement procedure approved by the Order of the Ministry of European Funds no. 1284/2016. In practice, it was attempted to supplement the relative absence of rules in the simplified procedure with the more abundant rules in the procurement regulations.

For example, if the private beneficiary chose to award a framework agreement, certain interpretations by practitioners followed a formal line that ended in the conclusion that all rules on framework agreements provided in the public procurement law and methodological norms became fully applicable, since the private beneficiary decided to depart from the simplified procedure and award a framework agreement (not regulated by the ministry order approving the simplified procedure for private beneficiaries).

The only visible argument for such extension of the domain of the public procurement regulations is a formal one. If a framework agreement is awarded, and such award is regulated by the public procurement regulations, the latter will apply irrespective of the fact that the contract is awarded by a private entity, not qualified as contracting authority, further to its choice to use a contractual form regulated by the public procurement regulations.

Such voluntary yet implicit extension of the domain of the public procurement regulations is not valid, as its rationale is seriously flawed. The norms in the public procurement regulations are applicable only to those situations explicitly provided therein or in all cases when an entity that is not a contracting authority explicitly chooses to abide by such regulations when awarding its private contracts. Yet the public procurement regulations cannot be invoked against such a private entity unless it did not explicitly assumed compliance thereto. The decision of a private entity not qualifying as a contracting authority to award a framework agreement cannot by itself deemed to be an explicit choice to abide by all relevant rules in the public procurement regulations. Such award procedure, although not provided by the simplified procedure approved by the Order of the Ministry of European Funds no. 1284/2016, shall be submitted to the principles governing all procedures completed by private beneficiaries: transparency, economy, efficiency, effectiveness.

The principles applicable to each of the three categories of contracts below thresholds shall also be different in each case.

In case of „direct contracts", if a cross-border interest may be identified, the Treaty-derived principles shall become applicable, based on the ECJ case law and the 2006 Commission Communication. If no cross-border interest exists, no such principles shall have to be observed by the contracting authority. However, national regulations concerning the use of public funds, such as the Law no. 500/2002 on public finances and Law no. 273/2006 on local public finances, both as further amended, provide the obligation of those managing public funds to ensure economy, efficiency and effectiveness of operations related thereto. Consequently, these three objectives are to be complied with when awarding contracts financed from public funds.

Yet, if the contracting authority is not using public funds (e.g. is a public company not included in the general government according to Regulation

549/2013 on the European System of Accounts), such obligations related to the efficient use of funds shall not derive from the laws concerning public finances but from corporate, statutory, documents.

In case of „intermediate contracts”, the Treaty-derived principles stated by article 2 of the Public Procurement Law shall be applicable in all cases, without any need for a cross-border interest test. The above considerations concerning the obligations to ensure economy, efficiency and effectiveness of funds are also valid in this case.

Finally, in case of „private beneficiaries contracts” the cross-border test is again irrelevant. There is also no application of the public procurement regulations, except for the case of contracts expressly submitted thereto (specific works and ancillary services contracts above thresholds, financed by more than 50% by contracting authorities). The only explicit principles applicable to the award of such contracts, according to the Order of the Ministry of European Funds no. 1284/2016, shall be: transparency, economy, efficiency, effectiveness.

Given the various sources of principles applicable to the award procedures organised for contracts below thresholds, the identification of their hierarchy may prove relevant in practice, especially in those cases when not all applicable principles may be equally served. In fact, the main collision may occur between the Treaty-derived principles, which are meant to ensure competition, and the efficient use of funds-principles, responding to another type of concern, related to the sound management of public and private funds.

In those cases when both Treaty-derived principles and the efficient use of funds-principles provided by the national regulations are applicable, the competition-aimed principles provided by the Treaty and the procurement directives shall prevail. This will happen in case of „direct contracts” which are of cross-border interest as well as in case of all „intermediate contracts”.

In case of „direct contracts” which are not of cross-border interest as well as in case of „private beneficiaries contracts” the Treaty-derived principles shall not be applicable. For the „private beneficiaries contracts”, the transparency principle is expressly indicated by the Order of the Ministry of European Funds no. 1284/2016. The transparency principle may be placed at the intersection of competition-aimed principles and of efficiency of funds-aimed principles, as it is common for both.

However, for both types of contracts the competition is not longer the primary aim of the procedure, as the efficient use of the funds becomes prevalent. As such contracts are either small enough to not have an impact on competition (the case of „direct contracts” without a cross-border interest) or are awarded by private entities which presumably are concerned with ensuring the most efficient management for both the non-reimbursable funds entrusted to them and their own co-financing contribution (the case of „private beneficiaries contracts”), the competition principles are subsequent to those related to the efficient use of funds.

4. CONCLUSIONS

The interplay between the various regulations applicable to contracts below the thresholds in the procurement directives (as transposed into national regulations), including here those concerning contracts awarded by private beneficiaries financed from EU and EEA states non-reimbursable funds, may lead to certain errors in interpretation in practice, thus generating a „gray zone" that shelters such contracts. Any clarification effort should begin with the identification of the underlying principles governing the award procedures.

From the standpoint of principles governing the award procedures for contracts below the thresholds and contracts awarded by private beneficiaries financed from EU and EEA states non-reimbursable funds, several types of contracts may be identified and their legal regime may be further defined based on such principles. Moreover, it appears that for an important part of such contracts the competition-derived principles are superseded by the principles aimed at ensuring the efficient use of funds.

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THE IMPACT OF THE EUROPEAN DIRECTIVES ON THE ROMANIAN REPORTING CREDIT INSTITUTIONS

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Abstract
Broadly speaking, the financial viability and the institutional defaults of a bank are detected using financial assessments and extended analysis with the purpose of reclaiming the economic information delivered by the financial and non-financial reports. This paper aims at analyzing and presenting both the legal and the regulation frames for the Romanian credit institutions that are setting up the request for the disclosure of the financial and non-financial information. The paper will finally discuss the issuing options for the credit institutions.
Keywords: *accounting, standards, regulation, bank.*
JEL Classification: M41, M42, G21

1. INTRODUCTION

The development and modernization requirements of the domestic banking system mean aligning it with the existing requirements and standards in the European and international space. And we are referring here not only to the alignment of regulations, practices, techniques or working procedures, but also to the special discipline and the high professionalism that must characterize banking activity. Given the importance of the information provided by a credit institution's financial statements and, above all, the importance of its quality, the usefulness of accounting standards is indisputable.

A country's legal/judicial institutions can influence incentives to produce conservative accounting numbers through several channels (Bushman & Piotroski, 2004).

The annual financial statements pursue different objectives and provide not only information to investors on the capital markets but also present previous transactions and improve corporate governance. It is necessary for Union legislation in the field of accounting to strike an appropriate balance between the interests of the recipients of financial statements and the interest of companies not to overburden themselves with the reporting requirements.

To allow users of financial statements to better compare the financial position of enterprises within the Union, a limited number of formats are needed for the presentation of the balance sheet.

Although financial reports may seem similar from one country to another, differentiations may arise from the diversity of legal, economic and social environments, as well as from the dissimilar needs of users due to the specificities of national requirements. For users of information not to have difficulty understanding and interpreting them, it has become necessary to have the same rules and accounting norms at the basis of financial reporting (Ball, 2006). A first step in this direction was the accounting normalization process.

The normalization process results in defining concepts, principles and accounting rules based on precise and identical terminology for all accounting information producers and users and applying them in practice to achieve comparability in accounting information in time and space (Ogien, 2008). But following the same rules and regulations involves a normalized body able to impose all the rules and regulations once agreed. They may have as their source the public sphere or the private sphere. On the other hand, the vocation of these bodies can cover the sphere of one country, several countries, or have a global vocation. There are several references in the field of accounting: the national referential, the regional referential and the international referential. Between the three references there are certain ratios that have evolved over time from alignment to convergence. The social pressure on the transition from harmonization to convergence has been particularly displayed the international reference level, when it was concluded that harmonization has exhausted all the resources for improvement.

The IASB is therefore the world reference for accounting standardization, the main objective of which is to improve the transparency of financial reporting.

The new standards that the IASB has begun to issue are called International Financial Reporting Standards (IFRS) and aim at creating a universal body of accounting rules on the assessment and presentation of financial information by the enterprise and a conceptual accounting framework. These have been supplemented by Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC).

In addition to the flexible package of standards and interpretations, the International Accounting Report also includes a conceptual accounting framework known as the "General Framework for the Preparation and Presentation of Financial Statements". These standards are used by all listed companies within the European Union but also in other regions.

The establishment of the European Union (EU) and its continued development over the past decade have amplified the process of harmonization, especially in the field of law. Since 2005, IFRSs have been imposed in Europe for all listed companies.

While in Europe there have been such changes in accounting normalization, in the United States of America, the Financial Accounting Standards Board (FASB) was established in 1973.

Beginning with this date, the FASB becomes the body responsible for promulgating US accounting rules known as US GAAP (United States General Accounting Principles).

At present, the Financial Accounting Standards Board (FASB) requires financial reporting objectives to be met, namely to provide information (Financial Accounting Standards Board, 2010): useful for future investors and creditors to make rational decisions ; understandable for those users who have minimal economic training; information illustrating the economic resources of companies and events that cause changes in company resources or sources of funding; information on financial performance over a period; information to help users evaluate the amounts, periods and uncertainties associated with investors' future cash flows.

2. THE GENERAL FRAMEWORK CONCERNING THE ACQUIS IN THE ACCOUNTING FIELD

In accounting there are two Directives, Directive IV of EU (1978) and the Seventh EU Directive (1983), which apply to companies and which can be considered as the basis for the acquis. However, these Directives do not cover banking and insurance companies. Therefore, two Directives were adopted to cover the annual financial statements of these two sectors: the Banking Accounts Directive of 1986 and the Insurance Companies' Accounts Directive of 1991.

Taken together, these four Directives became the fundamental pillars of the acquis, relevant for the corporate sector accounting. The following will present a summary of these four fundamental Directives, replacement and subsequent amendments to those directives.

The Council's Fourth Council Directive (78/660/EEC) on the annual financial statements of limited liability companies coordinates the provisions of the Member States on the presentation and content of annual financial statements and annual reports, the general principles for the assessment of positions in annual financial statements (prudence), specific valuation rules (valuation rules for fixed assets) and publication of annual financial statements. In addition, the Directive provides a system of auditing the companies; companies must have annual accounts audited by one or more persons authorized by national legislation. This Directive applies to all companies with limited liability but may exempt banks, other financial institutions and insurance companies.

Council Directive VII (83/349/EEC) on consolidated financial statements of limited liability companies coordinates national legislation on consolidated financial statements (this means at group level) and defines the circumstances in which consolidated financial statements are to be prepared. A parent company that legally controls another (subsidiary) company is required to prepare consolidated financial statements. In most cases, legal control takes the form of holding the majority of the voting rights. Member states may also require that consolidated financial statements should be prepared in cases where a company has only a minority of votes, but exercises control.

In order to simplify the reporting requirements for SMEs, the European Commission has revised the European Accounting Directives (IVth Directive and VII th Directive) which have been replaced by a new Accounting Directive - Directive 34/2013/EU – annual accounts, consolidated financial statements and related reports of certain types of enterprises.

This directive aimed at reducing the administrative costs of reporting - especially for SMEs: increasing the comparability of the financial statements of internationally performing entities that have a larger number of external users, protecting investors' interests by retaining essential information for them and increasing transparency on payments made to governments by entities operating in the extractive industry or in the primary forestry sector and has been transposed into national law from July 2015.

Directive 33/2013/EU was amended by Directive 95/2014/EU which introduced the obligation to include in the Administrator's report a non-financial statement in order to increase the level of transparency in the annual reports.

Council Directive (86/635/EEC) on the annual financial statements of banks or other financial institutions: provides for specific rules on disclosure and the extent to which such rules are needed in those areas due to the specific nature of the banking sector and credit institutions. The Directive applies to most credit institutions and other financial institutions, with a few exceptions: Greece (Eteba - the National Investment Bank for Industrial Development) and Ireland (industrial companies).

Directive 51/2003/EU amends Directive 86/635/EEC and requires all listed companies to be required to prepare consolidated financial statements by 2005 on the basis of a single set of accounting standards, namely international accounting standards (hereinafter referred to as "IAS").

Council Directive 91/674/EEC on the annual financial statements and consolidated financial statements of insurance companies aims to provide for specific rules on disclosure and the extent to which these rules are deemed necessary in these areas because of the specific nature of the insurance. The directive applies to all insurance companies or firms, except for small mutual associations.

3. GENERAL FRAMEWORK FOR THE PRESENTATION OF THE BANKING INFORMATION IN ROMANIA

The reporting requirements set out in these Directives cannot ensure a high level of transparency and comparability of the financial reports of all Community companies, so it is necessary to complete the legislative framework at national level. Since 2007, Romania has become a member of the European Union, and the convergence process between US GAAP and IFRS also influences national reference. This influence will, however, be mediated by compliance with Community reference.

For Romanian credit institutions, the alignment of the regulatory framework in the field of accounting to similar provisions existing in the field at EU level, as well as to International Financial Reporting Standards, is one of the central bank's (BNR) regulatory preoccupations.

Banks in Romania prepare annual financial statements that contain the same structures as those set out in the Directives: the balance sheet and the income statement in credit institution specific structures, the statement of changes in equity, the cash flow statement and explanatory notes. Since 2006, the national framework has complied with the requirements of Directive 51/2003/EU, and banks are required to prepare consolidated financial statements under IFRS.

2012 is an important year for reporting by banks, as individual financial statements also must comply with International Financial Reporting Standards (IFRS). In addition to these individual and consolidated financial statements, banks whose shares are admitted to trading on a regulated market must prepare, transmit and report to the public quarterly, half-yearly and yearly partial, preliminary and total information on risks assumed in their financial position, performance and changes, reports known as transparency and disclosure information report. However, in addition to reporting, banks are also reporting for surveillance and prudential purposes. Unlike financial reports, prudential reports include prudential conditions or criteria that counteract excessive indebtedness, irregular intra-group transactions, liquidity crises. EU requests for the publication of information on environmental and societal impacts have been assimilated within the national framework by the NBR Order no. 7/2016 amending the NBR Order no. 27/2010 for the approval of the Accounting Regulations in compliance with the International Financial Reporting Standards Applicable to credit institutions and that are obliging banks to issue a non-financial statement containing information on at least environmental, social and personnel aspects, respect for human rights, combating corruption and bribery starting with 2017.

4. CONCLUSIONS

In the context of accelerating the global integration process, in the context of the development of information structures, banks must be at the forefront of promoting change in the financial sector in a country. The offer of products and services of a bank must, on the one hand, satisfy the requirements of the clients and, on the other hand, create new business opportunities for them, provided that the bilateral advantage is preserved. An analysis of a bank's financial position is a picture of the bank's position at a given moment in the financial-banking environment being reported, as well as the quality and credibility of the bank in order to establish / continue business relationships on different terms. This picture is completed with other financial states determined at other time intervals, which confirm the evolution of the bank in a certain direction. The financial statements on the basis of which the financial standing analysis is carried out are the balance sheet and income statement, which are related to the degree of efficiency and the risks in which the banking activity takes place.

Although some companies issue financial statements, they partially meet international accounting standards. So, regulators in accounting have faced the issue of harmonizing accounting information and transparency standards. Under these circumstances, it is noted that in a market economy, accounting becomes an indispensable and reliable means of disclosing information to users.

When International Financial Reporting Standards (IFRS) were created by the International Accounting Standards Board (IASB), they have had a major impact on the substance and quality of financial reporting across the world. For the first time, there is a true financial reporting system whereby companies can be judged by the same high standard regardless of their geographic area, thereby facilitating the work of investors, regulators and other stakeholders interested in the financial situation of companies from different countries. However, reporting under IFRS has become a legal requirement for certain companies in many countries around the world, including all listed companies within the European Union since 2005.

Because credit institutions are considered different from other companies in the production or trade sector, this has imposed specific reporting requirements.

We believe that fair reporting means compliance with standards, meaning compliance with all international accounting standards (IAS), International Financial Reporting Standards (IFRS) standards and the general framework.

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MODERN TENDENCIES IN EDUCATIONAL BUDGETING - CASE STUDY IN VARIOUS EU COUNTRIES

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Abstract
In the last years European education systems have been facing several changes to be increasingly competitive and offer knowledge and competences for participants on the labor market. The budgeting process appears to be the fundamental instrument in economic and financial support processes of high quality education.
This paper examines the budgeting process in the education system by analyzing budgets of different universities from several European countries. The comparative analysis is carried out by determining various budgetary indicators which are relevant in the financial management and practice of academic education. The findings of the study can be used by decision makers to establish benchmarks for the financial strategic planning process and also to adopt and implement good practices in the financial management of education institutions.
Keywords: *public educational system, budgeting process, efficiency, European good practices.*
JEL Classification: H5, H6, I2

1. INTRODUCTION

The increase in the competitiveness of the academic process, regarding the insertion of graduates on the labour market and relevant research in universities has created a series of structural modifications at European level. Consequently, adequate financing has become one of the main preoccupations of higher education institutions. In these circumstances, there is increased focus on budgetary processes and the financial performance of these institutions, modern budgeting techniques and the development of relevant performance indicators becoming core preoccupations of financial management. In this respect, budget is essential for grounding decisions and this is the reason why two questions are being raised (Lalli, 2012):

- What means a good budget?
- How do we differentiate between a good budget and a less than perfect one?

The current paper focuses on the synthesis of recent literature, studies and analyses that are relevant to the field of study. This stage in documentation is extremely valuable because it allows the enlargement and deepening of knowledge that is necessary to conducting the research, comparative analyses that can identify the research tracks of other authors, as well as an awareness of their conclusions or results, the identification of the correlations between theory and practice, as well as the prevention of overlaps, as Onwuegbuzie *et al.* (2012) remark.

The aim of research is to identify by literature review the modern budgeting techniques that are adequate to higher education, used at European level, and the impact of the analysis of financial performance indicators at decisional level.

2. LITERATURE RIEVIEW

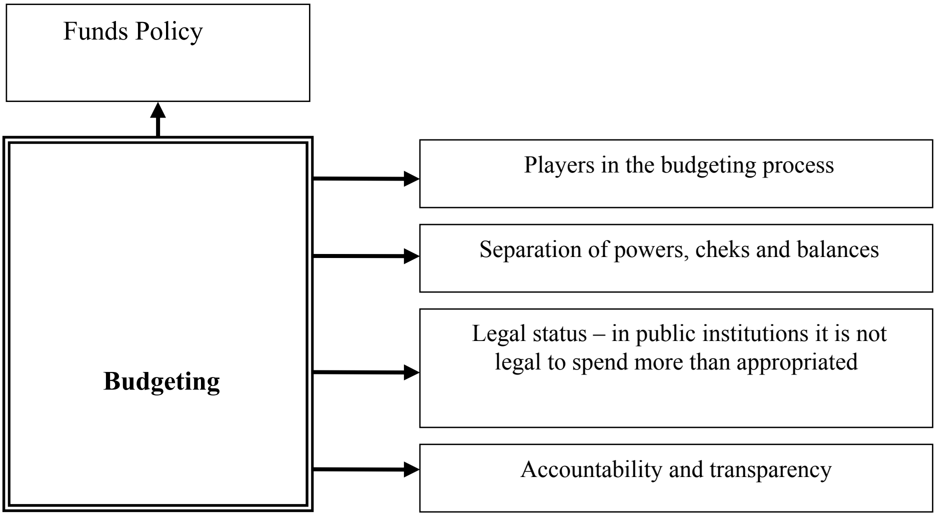
Lewis & Hildreth (2011) identifie certain directions that a budget must take, among which: the balance between revenue and expenditures, offering information for policy-making within the entity, ensuring high degree of credibility to stakeholders by presenting clear, precise, comparable information, which can be analysed. Public budgeting was studied, in general, from at least three divergent perspectives: the economic, managerial and political sciences perspectives (Caiden, 1990). The approach of the actor as a rational actor defined by its own interest and by its intention to maximize its own budget is specific to economic studies. In this context, economic studies mostly focus on the nature of the public assets and on the efficient allocation of assets for the optimum or satisficing supply of assets and services.

The decisional elements grounding a good budget can be divided into: formal elements (such as legislative framework and country-level policies) and informal elements (Lewis & Hildreth, 2011), such as specific habits or preferences at institutional level. Two levels are encountered in the budget structure (Dumitrescu – Peculea *et al.,* 2014), respectively:

1) a level concerning incomes and expenses,
2) and a second level concerning the amounts received from the central level.

The way revenue budget is designed and grounded differs from one country to the other, being directly influenced by a series of specific factors presented in fig. 1.

Figure 1 The role of budget in formal and informal elements



Source: based on Lewis & Hildreth (2011, p.83)

The literature review and the reports of various authorities show that the continuous decrease in the number of students in tax-funded programs and the shortage of funds from the state budget, resulting from major budget cuts in education throughout Europe in the last years, have put additional pressure to the way public funds are used and the way management seeks to diversify the financing sources in public higher education (see the studies conducted at international level by Estermann *et al.* (2015), and the national reports of CNFIS - Annual Public Report 2015 made by CNFIS for 2015).

In the context of the university becoming an entrepreneurial environment (Hannon, 2013; European Commission & OECD, 2012), we need to conduct an in-depth analysis on financial aspects, and financial performance indicators respectively, which will lead to an identification of high-performing programs, of those internal activities which can generate financial resources, without transforming the university into an economic, profit-oriented organisation. As a generator and promoter of culture and science, the university needs to adapt to current demands of the labour market on the one hand, and opportunities to transfer knowledge from research (European Commission & OECD, 2012). This way, initiative and competition in universities would be encouraged, these aspects involving adequate financial support, the promotion of entrepreneurial attitudes in universities representing a sure way for institutional development, in the context of adequate financing (Stancu *et al.*, 2011).

Morariu *et al.* (2008) assert that the important recent changes in organisations (that have changed the way they operate) and governments, towards an increase in competitiveness and providing knowledge and competences to participants on the labour market, have been facilitated because globalisation has lately thickened.

Henard & Roseveare (2012) mentions that sustainable development of higher education institutions depends on ensuring a balance between strategic objectives, responsibly correlated with ensuring the necessary financial sources, and establishing criteria for academic, financial and managerial performance which would allow these objectives to be attained in the best conditions of efficiency, efficacy and economy. It is thus necessary to identify those elements that work and can be implemented and improved. Still, V.L. Meek and J.J. van der Lee (2005), quoted by Andreescu *et al.* (2009), consider that benchmarking involves the agreement of institutional leaders on finances, but also the collaboration among stakeholders.

In Lebas' vision (1995), performance is an aspect that has an impact on the future, and results from the capacity of attaining objectives.

Benchmarking has been developed in the private sector and its application is not easy at the level of public institutions, because the drivers of the two systems are different. The strategic objectives from the private sector are defined by market competition and are focused on meeting consumers' demands and profit-making, as shown in a study conducted by OECD (1997), while public organisations in general and education institutions especially focus on offering public educational services, and are not profit-oriented.

However, Willoughby (2014) underlines the major difference in flexibility in what regards the adaptability of budgets in the public versus private sector. In the private environment, adapting budgets to the moment's financial needs is a simple process, oriented towards and motivated by maximizing profit, while budgeting processes in the public sector are characterised by high austerity and rigidity, the motivation to generate profit being replaced by the necessity to attain high efficiency and financial performance levels. A result-oriented activity involves the identification of measurable performances, which would provide the necessary feedback for attaining strategic objectives (Willoughby, 2014).

Contrary to the profit-oriented private sector, the public sector is oblivious to the problem of distributing profit, while the necessity to identify and ensure necessary resources for continuing activities in the long term still stands, which makes the use of financial performance indicators possible for both sectors (Dumitrescu-Peculea & Sopu, 2016).

3. BUDGETING AND FINANCIAL PERFORMNACE IN HIGHER EDUCATION INSTITUTIONS

Budgeting and financial performance in higher education institutions involves two main aspects: the quality of budgeting – affected by the rigidity of public budgets – and the budget execution.

The problem of the rigidity of public budgets and implicitly, of state universities, cannot be solved through classical budgeting tools, such as automated method, increase/decrease method or direct evaluation method. In fact, these methods do not pertain to modern budgetary practices, because they are characterised by automatism and suppose the existence of a stable or rising economy, being uncertain and prone to leading to inadequate quality of budgeting and execution. The quality of budgeting in public institutions in general and higher education institutions in particular becomes essential for their adequate financing, being defined by the following fundamental dimensions:

- The accuracy of budgeting;
- The readiness of budgeting;
- The detailing of budgeting.

Moșteanu *et al.* (2005) asserts that their use is based on the execution from the previous year with a correction factor, because budget indicators cannot be rigorously predicted. Periodical rectification is needed during public revenue and expenditure execution. Taking this factor into consideration, a series of countries have appealed to direct evaluation of revenue and expenditure, which method involves the identification of each source of revenue and expense depending on actual performance or budgeting for the current year and the perspectives of economic development in the following year, depending on GDP evolution. International practice has highlighted two main categories of modern methods for calibrating expenditure and for taking decisions which are mainly based on cost-advantages or cost-efficiency analysis (Moșteanu *et al.*, 2005; Lalli, 2012):

- **Planned Programmed Budgeting System (P.P.B.S.)** – involves the definition of "administrative strategy" and establishing long-term objectives (planning), the identification of direct and indirect costs supposed by each program (programming) and translating the costs of the program in budgetary terms (budgeting);
- **Zero Base Budgeting (Z.B.B.)** – consists in identifying those programs which minimize the costs determined by the accomplishment of a certain objective, by periodically analysing the utility and opportunity of expenditure approved through the budget and based on the criterion on net benefit and advantage-cost relationship
- **Rationalization of budgetary options (R.C.B.)** – based on the evaluation and re-evaluation throughout budget execution of events which can cause increase/decrease of budget credits. The original trait is that this method allows the adaptability and reformulation of objectives, ensuring a self-

regulating system, which could ensure a realistic design of budgetary revenue and expenditure, closer to the real necessities of each period, but without identifying the influences of all factors on economic phenomena.

We need to underline that the applicability area of these modern budgeting methods is conditioned by the existence of proposed objectives as L. Mladen & G. Manolescu (2012) mention, and the use of cost-advantages methods represents a practical way of choosing the project that maximizes the results with low costs levels, being most frequently applied to select investment projects in the public sector.

There is a direct connection between the academic performance of a higher education institution and the degree of trust from society, reflected in a higher position in formal rankings, which implicitly leads to better financing (European Commission & OECD, 2012). The performance at the level of higher education public institutions is measured through two aspects: academic and research performance and financial performance. To measure them, a series of indicators are used, selected so that the information they provide be highly relevant for managerial and strategic decisions they condition.

The system of performance indicators established in an organisation is an integral part of its governance system. We define governance as the totality of actions, habits, policies, procedures, internal regulations and values by means of which organisations are ruled (Dumitrescu-Peculea, 2015). Ungureanu (2010) also remarks that the way entities are managed, decisions taken and values they have and reflect in society constitute the governance of an entity. Good governance leads to efficient risk management, to an increase in performance and competitiveness by improving managerial processes, ensuring at the same time transparency and social responsibility (Crețu & Crețu, 2011).

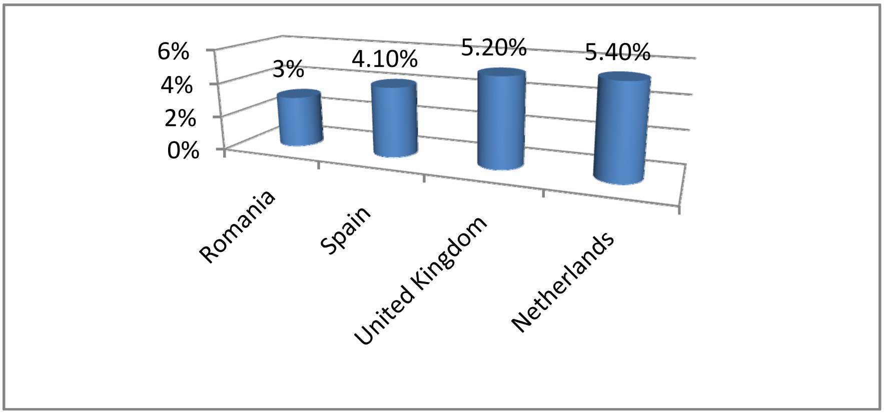
CNFIS Report, 2014 shows that "Romanian universities are experiencing one of the most difficult periods in the last years". This comes to highlight the problems of financing and budgeting Romanian public universities from the period of economic and financial crisis. There are multiple causes for the problems in the Romanian higher education: the tendency to contract quantitatively the higher education system, the decrease of Baccalaureate graduates, the decrease in the number of tax-paying students (including the contraction of distance learning), the mobility of young people willing to attend course in foreign universities etc. In these circumstances, there is "increased dependency on the revenue obtained from state budget allocation". As a consequence, 472.739 of students in Bologna programs in public universities, as well as 23.045 academic staff (CNFIS data, based on university reports, as of 1 January 2013) depend on state budget financing.

The largest Romanian universities host most tax paying students: "Babeș-Bolyai" University of Cluj-Napoca (37% of students), University of București (30%), University "Alexandru Ioan Cuza" from Iași (35%), University

“Politehnica“ from București (11%), ASE București (48%), University of Craiova (35%) etc. (CNFIS Report 2014). This encouraging situation, however, is not met with elsewhere.

The same report mentions that in the period 2002-2011 public expenditure for education was never higher than 4.24% of GDP (CNFIS, 2015 based on Eurostat Databases, 2014). We need to mention, at the same time, that the budget allotted to education in Romania in GDP terms is the lowest in the EU at 3%, compared to EU average, 4.9% (see the country report in 2015). In the same period, the GDP percentage for education in Spain was 4.1%, in UK, 5.2%, in the Netherlands, 5.4%, and Sweden 6.6%. Among European countries, Sweden has the strongest support for higher education (European Commission, EU Report, 2016), as seen in fig. 2.

Figure 2. Public expenditure on education – As a share of GDP



Source: based on EU Report 2016 (European Commission, 2016)

In an interview for the Research and Higher Education Journal, G. Jitaru (CNFIS, 2015 and 2016) mentions that quality indicators for performance-based financing were introduced in higher education in 2003-2011, when quality indicators increased from 4 in 2002 to 17 in 2011 (Batali, 2015). In the period 2012-2014 the financing methodology was improved and the following dimensions were introduced:

- Financing doctoral studies based on multiannual study grants;
- Supplementary financing for stimulating excellence of institutions and programs, based on quality criteria and standards;
- The institutional development fund, aimed at the best performing higher education institutions.

At present, CNFIS’s suggestion for distributing supplementary financing in 2017 takes into consideration 15 quality indicators grouped in four general classes of indicators: C1. Teaching/learning, C2. Research/artistic creation, C3. International focus, C4. Regional focus and social equity (CNFIS, 2017).

The following elements have been considered in introducing supplementary quality indicators (Robu & Sandu, 2006):

- The possibility to compare performance and the quality of fields in the educational offer of public universities, which could ensure intra and inter-institutional comparisons;
- The design of indicators have in view measurement and evaluation over four years, so as to minimise potential negative consequences of performance variations from one year to another;
- Making the evaluation process more efficient, by reducing reporting tools efforts and by aligning with the reference frameworks used by other national public bodies with specific duties in higher education.

From the financial performance perspective, it focuses on aspects related to organisational efficiency and address the management as support in the decisional process, as well as potential investors or donors, as Montanaro (2013) remarks.

Financial indicators are used to provide information on the efficiency of an entity's administration to stakeholders (authorising bodies, donors, credit institutions etc.). At the same time, they serve as tools to evaluate performance. An analysis of the same information from the perspective of several indicators or following the evolution of the same indicator over a longer period of time can offer a clearer vision on the trend of organisational development and can ground decisions about its future, as Montanaro (2013, p.14) remarks.

Consequently, in higher education, a careful analysis of performance indicators can offer the necessary information to provide management with the necessary support in what regards the university's capacity to support the educational, research and management processes, and possible investors, sponsors, donors or partners in research projects with information on the entity's credibility and sustainability. Rigorous financial management, supported by financial analysis and adequate financial decisions will allow public universities to maximize their value, maintain and even develop performance and control risks.

The fundamental qualities of financial analysis indicators are, according to Vasilescu (2003):

- Synthetically and dynamically reflecting the organisation's economic and financial situation;
- Ensuring the interdependence between economic, social and natural interdependence, so as to prevent and slow down the degradation of natural environment;
- Reflecting the correlation among the organisation's functions;

- Offering the possibility to make comparisons in time and space and mixed comparisons on the basis of using standardised financial quotas nationally and internationally.

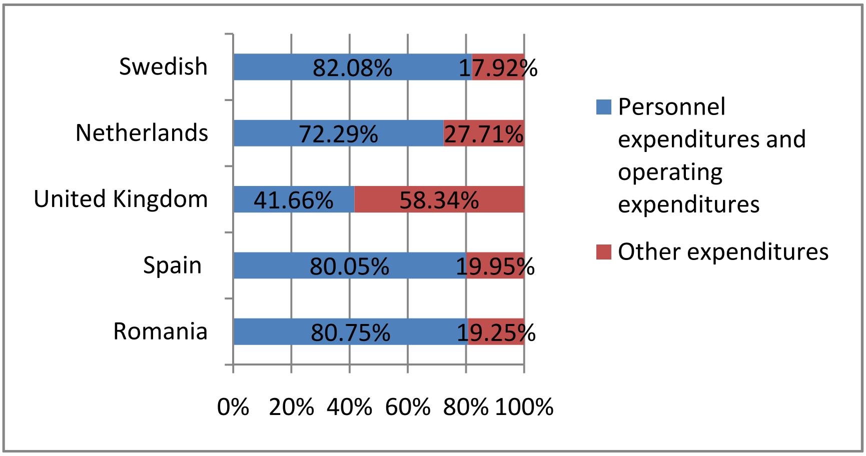
4. DATA AND RESULTS

For the case study we have chosen the budgets of five European universities, which were compared based on the structure of revenue and expenditure. The selected institutions – Valencia, Amsterdam, Oxford, Sveriges lantbruksuniversitet (Sweden) and Carol Davila Bucharest – are public higher education institutions, and are prestigious universities, representing true benchmarks of their country's values. The Northern higher education system is characterised by elements such as the adjustment of curriculum to the demands on the labour market and joint research projects on the development of social welfare systems and new educational standards.

The public higher education system in the Netherlands, the first non-Anglo-Saxon country to offer university courses in English, has the reputation of high quality, student-centred educational system, focusing on practicalities and career-oriented.

Great Britain traditionally offers elite education, and is ranked second in Europe and sixth in the world in international rankings. The Spanish educational system is similar to the Romanian one.

Figure 3. Percentage of expenditures for core activity in total expenditure

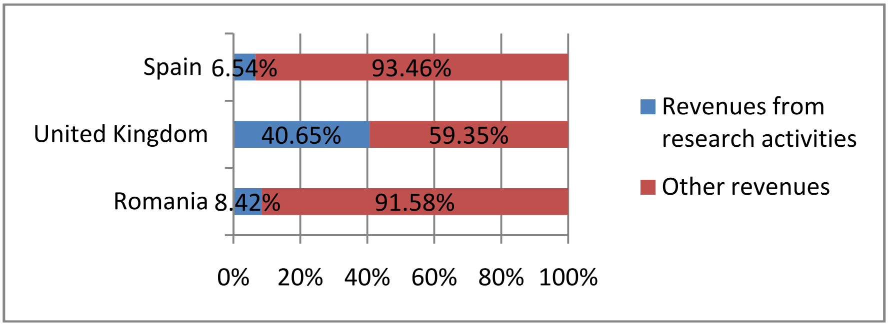


Source: authors' interpretation based on data from 4 universities (Universitat de València; University of Amsterdam; University of Oxford; Swedish University of Agricultural Sciences; Universitatea de Medicină şi Farmacie „Carol Davila“, Bucharest)

The analysis of the budget structure of the five entities allows several comparisons. For core activities such as wages expense and administration costs, the lowest percentage, 41,66%, is to be found in the British university, compared to the Netherlands, 72,29%, Spain, Romania, approx. 80%, and Sweden, 82,08%, as seen in fig. 3.

We can notice that in the UK universities the revenue from research activities is a significant percentage of the total revenue, as opposed to Spain and Romania, where this category of revenue barely reaches 7%, respectively 9%, as seen in fig. 4.

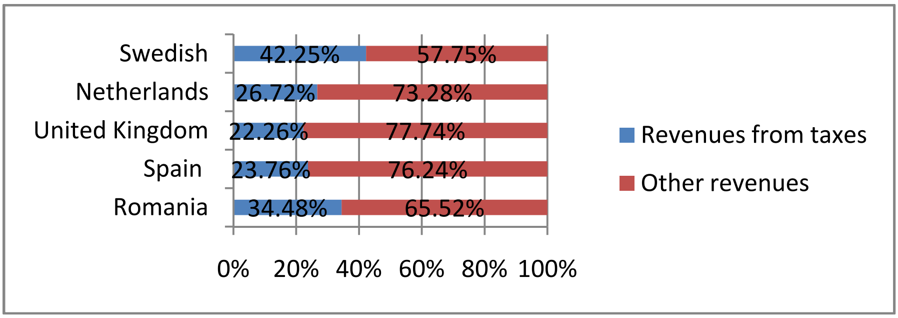
Figure 4. Percentage of research revenue in total revenue



Source: authors' interpretation based on data from 4 universities (Universitat de València; University of Amsterdam; University of Oxford; Swedish University of Agricultural Sciences; Universitatea de Medicină şi Farmacie „Carol Davila", Bucharest)

The comparison of revenue budgeted for 2017 in the above-mentioned universities shows higher percentage of revenue from tax and other revenue in Spain, as seen in fig. 5.

Figure 5. Percentage of revenue from taxes and other revenue in total revenue



Source: authors' interpretation based on data from 4 universities (Universitat de València; University of Amsterdam; University of Oxford; Swedish University of Agricultural Sciences; Universitatea de Medicină şi Farmacie „Carol Davila", Bucharest)

It is important to mention that the financial information has been presented in percentages, because of different dimensions of universities.

5. CONCLUSIONS

Although not all performance criteria are applicable at the level of higher education institutions, in my view a correlation of financial and non-financial aspects is the only variant that can provide adequate support to university management. The identification of a model of comparative indicators at university level can provide correct information that reflects reality and offers applicable recommendations.

The identification of each structure/program within a university with a cost centre, the budget design and execution, as well as the analysis of performance indicators at the level of cost centres can offer a different perspective on their management not only from short-term financial perspectives, but also from long-term development perspectives.

At the same time, involving and motivating all participants to the educational system from the teaching and academic areas through adequate policies can lead to an increase in their involvement in developing strategic objectives.

As to the limits of research, they consist in the lack of public information on the transparency of budgets at European universities level, considering the public information principle defined at national level in the Law of public finances and accomplished through information means (Law no. 500/2002 on public finances), and the transparency principle, mentioned at OECD level (OECD, 2002).

The current paper is a starting point for future research on the identification of adequate financial indicators for analysing performance in higher education.

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DYNAMICS OF BUDGET DECENTRALIZATION REFORM IN UKRAINE

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Abstract
The reform of the decentralization budget in Ukraine is the basis of system changes in the decentralization of the power, in the cloth of which resources are transferred to territorial communities - cities and villages. The decentralization is the only way to create a strong, unitary, democratic, European Ukraine. In Ukraine the view on budgetary funds changes. Earlier people considered them a target, today such paternalistic look is changed to understanding the budget as private means of taxpayers. These means are replaced by the state in the form of public income and have to be returned to them in the form of qualitative budgetary funds.
During the state decentralization, there were used such progressive techniques as: programmer and target method; strategic and medium-term planning; horizontal transfers; dissertation method; key performance indicators.
Keywords: *decentralization, Ukraine, budgetary system.*
JEL Classification: H790

1. INTRODUCTION

The strategy of decentralization of the public power, mutual responsibility of both representative local authorities and the government, and territorial communities is one of the important conditions of its realization.

By means of decentralization, Ukraine can find recovery from the crisis, achieve highest rates of economic growth and stabilization, successful development and economic growth of the country.

Decentralization leads not only to changes in the system of government of the country. The changes affect all aspects of our daily lives. All kinds of permissions and registration certificates - for business, for example, you can get immediately. You will be able to attract investment, without waiting for permission from Kyiv. You can decide whether to repair schools, insulate kindergartens, repair roads or buy a few rural fire trucks - be yourself. The reform will enable us to improve life in our community and the country as a whole.

2. DECENTRALIZATION REFORM AND ITS IMPLEMENTATION

The decentralization first of all concerns elections of local governments, participation of citizens in local governments that will strengthen democracy.

The budgetary system is implemented by the principle of subsidiarity – that is the key principle of the European democracy; it is stipulated in the budgetary code of Ukraine. During the existence of Ukraine, such phenomenon is found for the first time in the history of the state. Subjects of state decentralization are 407 integrated territorial communities, which were formed in 2015-2017.

The change of system of local government in Ukraine was provided in the Law of Ukraine "On voluntary association of territorial communities" adopted by the Verkhovna Rada on February 2, 2015 (No. 157 - VIII). The association of territorial communities is since then carried out according to this Law, in which all actions and limits of association are stated.

After the introduction of the Law "On voluntary association of territorial communities" a new aspect of the budget appeared, namely the budget of the joint society.

Further, according to the Law "On voluntary association of territorial communities", the ***results to united community*** take the form of:

- Improving education and development of villages;
- Increased community development;
- Increased accountability of local governments;
- Increased local budget;
- Establishing a closer connection between people and government decision-making.

In 2015, according to the Law of Ukraine "On voluntary association of territorial communities" were held the first elections and as a result of the relationship, 159 local communities were united.

In table 1, we can see the number of local communities for 2014-2016.

Table 1. Number of local communities established for 2014-2016

Region	**City**	**Small town**	**Village**	**All**
Zaporizhia	1	3	12	16
Lviv	4	4	14	22
Vinnytsia	5	7	9	21

Region	**City**	**Small town**	**Village**	**All**
Sums	1	6	7	14
Odessa	2	3	6	11
Zakarpattya	1	0	2	3
Chernihiv	5	6	5	16
Mykolaiv	1	5	13	19
Kirovohrad	3	0	2	5
Kiev	0	2	0	2
Chernivtsi	4	2	10	16
Herson	0	4	8	12
Cherkassy	1	2	3	6
Volyn	1	4	10	15
Zhytomyr	3	13	16	32
Ivano-Frankivsk	1	2	8	11
Rivne	1	3	14	18
Poltava	2	4	12	18
Ternopil	5	12	12	18
Donetsk	3	1	2	6
Kharkov	1	3	0	4
Lugansk	0	2	0	2
Dnipropetrovsk	2	14	18	34
Total	**50**	**113**	**203**	**366**

Source: Vernyhora (2016, p. 4)

According to the Ministry of Finance of Ukraine, for 11 months of 2016 the general fund of local budgets received UAH 131.9 billion, representing 104.6% of the annual revenues approved by local councils.

In table 2, we can see the growth rate of actual fund revenues by region. We can observe the increased revenues, but also increased cost of the state budget for regional development, namely local development associations and local communities.

The subjects of decentralization are 407 local communities, which were formed in the years from 2015 to 2017.

Table 2. The growth of actual general fund revenue by region

	Growth rate %	*Nominal amount*
Zaporizhia	157,3	+3541,0
Lviv	155,7	+2607,1
Vinnytsia	155,5	+1518,8
Sums	154,7	+1139,1
Odessa	154,2	+2918,3
Zakarpattya	154,2	+871,7

Chernihiv	154,1	+1016,5
Mykolaiv	153,1	+1209,2
Kirovohrad	153,1	+992,8
Kiev	152,2	+2444,4
m. Kyiv	152,1	+7609,5
Khmelnytsky	151,9	+1100,1
Chernivtsi	151,3	+575
Herson	150,8	+861,3
Cherkassy	150,8	+1242,3
Volyn	150,7	+770,4
Zhytomyr	150,4	+1084,4
Ivano-Frankivsk	149,9	+909,6
Rivne	149,6	+827,2
Poltava	149,3	+1821,1
Ternopil	147,3	+643,2
Donetsk	145,3	+1904,8
Kharkov	145,0	+2807,4
Lugansk	138,2	+487,4
Dnipropetrovsk	135,9	+3816,4

Source: Vernyhora (2016, p. 23)

Analyzing the implementation of decentralization strategy, we can conclude that decentralization has given impetus to improve services to the community, namely to: increase spending to upgrade municipal infrastructure; implement significant amounts of construction and repair roads; improve and develop public transportation and repair buildings; implement energy efficiency measures, street lighting, housing.

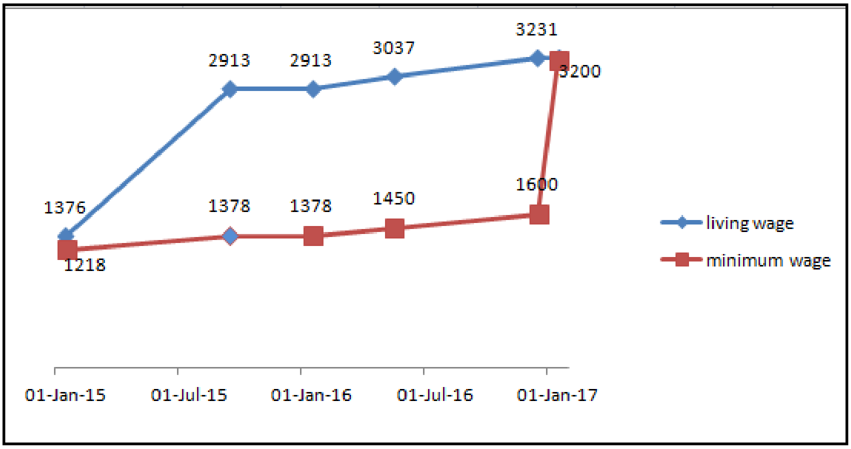
Development of local communities is precisely the territorial unity of the people of the community and interests: community property, financial resources budgets that unite them. In art. 13 of the Constitution of Ukraine it is stated that "land, its minerals, air, water and other natural resources within the territory of Ukraine, natural resources of its continental shelf and exclusive (maritime) economic zone, are the property of the Ukrainian people. On the Ukrainian people's exercise of ownership of public authorities and local governments."

Based on this association, municipalities own resources indicated in the Constitution of Ukraine. "Certainly, the local community can not operate successfully without overcoming fragmentation amorphous entities. On the contrary - it is necessary to step up economic activities through the consolidation efforts of the community and businesses, and the administrative center of local community has become a center of business activity. In a market economy functions consolidate efforts for development are in authority powers of public authorities" (Beet, 2014, p.58).

A sociological study of the Council and the Kiev International Institute of Sociology showed that 67% of Ukraine's population experienced an improvement in the process of decentralization in Ukraine and the reform of local self-government. It is good that more than half of the population has already experienced the desired result.

During 2016, data in fig.1 show growing living wage and minimum wage.

Figure 1. Growth of incomes of citizens (UAH)



Source: Vernyhora (2016, p. 56)

On fig. 1, we can see an increase in the minimum wage in January 2017 from 1600 UAH to 3200 UAH, which is almost 100% of the actual living wage and the salary and the rate make up 100% of the living wage.

3. CONCLUSIONS

During the decentralization reform successfully continued voluntary associations of societies.

The reform of decentralization in Ukraine is already at a high stage of its success, as a result of which Ukraine has already achieved:

- Increased local budgets;
- Open modern centers of administrative services;
- Increased state support for regions and communities.

The example of successful countries, such as Italy, Poland, Great Britain and France, shows that these countries experienced a lot of difficulties in decentralization of the power. This gives us inspiration not to stop, on our way to decentralization, but to undertake maximum efforts to achieve the goal.

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EUROPEAN OPPORTUNITIES TO IMPLEMENT BUSINESS INTELLIGENCE BENEFITS IN THE FINANCIAL AUDIT

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Abstract
Business Intelligence tools are recognized and implemented in organizations that are determinant in shaping new current information systems. The large data volumes that economic entities face can be managed by these computer applications capable of supporting managerial processes, and not only through detailed, instantly-generated reports that provide a complete picture of business-specific flows. Financial audit, in the current European context and through the Digital Agenda 2020 action directives, can benefit from Business Intelligence solutions capable of boosting or even replacing traditional methods or techniques. The analysis of financial-accounting data or KPI's can be achieved more accurately, at an increased speed and with a higher degree of accuracy, the barriers to implementing Business Intelligence leverage in the financial audit are rather of the nature of specific standardization or the reluctance of professionals in the field.
Keywords: *Business Intelligence (BI), financial audit, Big Data, Cloud Computing.*
JEL Classification: D81, D83, M42

1. INTRODUCTION

Technological changes in recent years have led to a reconsideration of how to approach the enterprise as a whole, with specific mechanisms, processes and management. The development and use of intelligent systems within an organization allows managers to use stored knowledge to solve complex problems and to make strategic decisions (Oprea *et al*., 2005). Current information systems come with solutions dedicated to organizations that face large volumes of data, high transaction speeds, and need to apply multiple scenarios to get predictive analytics. The urgent need for predictability is given by the increasingly complicated economic environment, with today's reality being marked by opportunities and multiple challenges (Turban & Sharda, 2011).

Depending on the profile, the size of the activity and the objectives pursued, management has at its disposal a wealth of information and data, more or less structured, accessible/intelligible or not, coming directly from an external source or have undergone internal processing through different methods / means. The decision-making process is mainly based on such data and often involves an increased response speed that is found to be essential in most cases. Facing this goal of addressing the new challenges in the data processing area, Business Intelligence systems have been designed, developed and continuously improved.

In the form of a simplistic definition, Business Intelligence tools cover a wide range of IT solutions to support managerial action in decision-making by analyzing large volumes of data. Essentially, the end product is intelligible, clean, secure, and accessible information at the right time (on time or on line), an essential condition for conducting a fair and effective management act.

2. METHODOLOGY

The present study proposes a conceptual approach to the evolution and transformations within the scope of the audit notion through the analysis of the specialized literature as well as of the legal framework represented by norms, standards, European directives or national laws. This is driven by the unprecedented development of information systems through Business Intelligence.

The article seeks to point out the immediate reactions at the theoretical level and practically as well from the scope of the specific audit processes both from the point of view of normative framework and of proposals for enrichment of the working tools at the disposal of practitioners through the implementation of the new IT solutions.

3. BUSINESS INTELLIGENCE CONTEXT AND EVOLUTION

In March 2010, the European Commission launched the European Strategy to prepare for exit from the crisis and the economy as a whole for the next period. This strategy also includes the "Digital Agenda for Europe" initiative which sets out the role of IT & C in achieving the overall 2020 targets - securing 5% of Europe's gross output with a market of 660 billion euros annually. The European Commission aims to help EU citizens and businesses gain value from digital technologies. This document is built and launched on the basis of the notion of a digital economy that is seen as effective, inclusive and innovative if it transforms businesses and society and can deliver better products and services using new and more efficient processes. The digital economy has a seven times higher growth rate than the rest of the economy and predicts an increase in European GDP by 5%, equivalent to € 1,500 per person over the next eight years, by increasing investment in information and communication technologies. This will be achieved by improving digital and information technology skills in the labor market, thus enabling innovation in the public sector, as well as reforming framework conditions for the internet economy.

Under these circumstances, the evolution of Business Intelligence solutions is encouraging from the perspective of financial information users in all areas or positions held in relation to economic entities (management level, IT department, auditors, etc.). Academic or non-academic studies devoted to these intelligent tools converge to the idea of practical applicability and quantification of benefits to be gained from the rapid, on-line reporting of BI-specific analytical capabilities.

The term Business Intelligence covers architectures, tools, databases, applications and methodologies geared to transforming data into information, then into decisions, and ultimately into action. Thus BI solutions are seen as dedicated to the management level, precisely in terms of advanced analytical capabilities. The role of decision support is ubiquitous in the literature dedicated to Business Intelligence facilities. Thus, Leonard Fuld in his New Competitor Intelligence (1995) defines the notion of competitor intelligence as information about competition that has implications for decision-making within a company. The dynamics of the business environment, the globalization of the economy, the legislative changes and the intensification of competition have led to the need for adaptability and adequate response of the organization. In this respect, business researchers see in Business Intelligence an appropriate model to support a responsible and flexible management act, as shown in fig. 1.

Figure 1. Pressure from business – Response – Support Model

Source: Turban & Sharda (2008)

Therefore, the complexity of the business environment creates problems but also opportunities, which causes organizations to have a reactive, anticipative, adaptive and proactive attitude. Business Intelligence tools can help shorten the gap between current and desired performance and expressed through mission, goals, and strategies. In practice, the real benefit of BI systems should translate into revenue growth and / or cost reductions, namely improving performance and increasing profits, by improving management and operational processes (Williams & Williams, 2007). The approach of the authors is quite pragmatic in this case, as investments in Business Intelligence applications can be quite consistent and, also because of this fact, the expectations within the organization are adequate. This is why the technologies required to implement such systems are not sufficient if they are not accompanied by business process optimization, especially management (planning, budgeting, forecasting, etc.).

There are authors who present Business Intelligence as a term strictly related to business management in the sense that it incorporates applications and technologies that gather, analyze and provide access to data and information. These analytical technologies produce predictions and identify cause-to-effect relationships specific to a particular business scenario. Thus, Business Intelligence involves the use of data-mining. This term is seen in the literature as the technology incorporating the application of statistical methods correlated with mathematical formulas that determine the significant relationships between the variables in the historical data that can then be used in the forecasting. In other words, these tools are specialized in assisting decisions and convert information into the form required by decision makers (graphs, diagrams, organizational charts) or offer the possibility of analyzing trends, correlations and interpretations (Airinei, 2002). In the same category, OLAP facilities are based on multidimensional data representation (data cube) and allow interactive and rapid data analysis through roll-up, drill-down, slice, dice, etc.

Beyond the conceptualization or argumentation efforts in the area of the benefits derived from the implementation of BI applications or philosophy in organizational culture, theoreticians and practitioners alike bring analyzes to the gray area and, in particular, to the dilemmas or even to the failures observed in these projects. For example, David Loshin in The Savvy Manager's Guide to Business Intelligence suggests the hypothesis of a conflict between increasing data volumes and recognizing the value of BI tools. But the same author offers the solution, presenting the idea of an organization focused on clearly defined objectives, decision-makers acting to succeed, using the data as strategic resources. In this respect, the correct application of the new technologies to the data to be processed is essential, as well as the need for the management to be supported and involved in this process.

Implementing BI methodologies involves identifying key organizational representatives both in business and technical terms, according to a study by Shaku Atre, president of Atre Group Inc., entitled *The Top 10 Critical Challenges for Business Intelligence Success*. In this paper, it is emphasized that the main objective of BI is a rather technical rather than business oriented, as most BI projects are coordinated by IT managers with a minimum level of entrepreneurial knowledge. So, the 10 main reasons identified by the author as the basis for the failure of many BI projects can be summarized as follows:

1. Treating BI projects as stand-alone solutions without taking into account the functionality of the organization as a whole;

2. Non-involvement or insufficient involvement of financiers in business;
3. Disinterest from management;
4. Lack of qualified staff or insufficient use of existing staff;
5. The absence of a plan with precise methodologies and objectives;
6. The lack of a precise plan of activities into the smallest details in the design phase of a BI system;
7. Lack of business analysis and data standardization to make them accessible to internal processing and reporting processes;
8. Not aware of the effect of inaccurate, inconsistent or false data on the profitability of a business;
9. Lack of a view on the importance of metadata (data about data, transformation of data into information);
10. Exaggerated confidence in single technologies or tools that would meet the intended purpose of a BI application. In general, BI projects need to be based on multiple tools and techniques (data extraction, transformation, data warehousing, front-end reporting applications, etc.).

The causes of the failures recorded in the practice of BI project implementations in various organizations have been extensively addressed in articles, case studies, or market research undertaken by prestigious Gartner. This American IT consultancy and research company was founded in 1979 and is considered to be a source of trust in the field, given numerous quotes and systematic reports by established analysts and authors. The company has launched a 2016 study showing that 70% of Business Intelligence projects fail on their mission for two main reasons:

- The real needs of the business are not correctly perceived;
- Business users (IT, management, financiers, etc.) do not use a common language.

Configuring a Business Intelligence architecture in line with business realities to involve all factors in operational flows, whether they will be all or not beneficiaries of future BI reports, is essential and requires an open approach and beneficial results in the future. Correct communication between departments can be the basis for establishing a set of common objectives and actions to generate the implementation of computerized applications that are justified in terms of both the costs involved and the information needs at all organizational levels. Moreover, internal audit is one of the main beneficiaries of information produced through BI, the practice being eloquent in this respect, exemplified by large companies with experience in implementing such systems. IT tools can thus become essential in conducting external audit steps based on know-how gained through internal audits.

4. FINANCIAL AUDIT THROUGH BUSINESS INTELLIGENCE

The implementation of IT tools in audit missions can generate measurable benefits and a combination of manual and computer-assisted techniques brings optimization of operations and cost savings. It should be noted, however, that the recent evolution of information technologies, along with the spread of mobile terminals (smart phones, tablets etc.), the development of business in the Internet area brings with it unprecedented opportunities and threats. According to the Institute of Internal Auditors (IIA), risk assessment in the implementation of new information technologies is related to issues such as (www.theiia.org/itaudit/):

- Vulnerability (physical access, network access);
- Complexity (organizational, system functions, human resources, management, documentation, life cycle);
- Financial implications.

The financial auditor evaluates its activity and prioritizes its objectives according to the complexity of the operations carried out, the size of the contracts in force or in the process of negotiation, the resources available to it (human, financial, material, etc.) and the prospects for the development of their own business. The option of deploying computer applications to support the professional in conducting specific audit tasks directly depends on all of these listed factors and should take into account the general risks mentioned above as well as the risks strictly related to the financial audit activity itself. The degree of complexity of such applications must be directly proportional to the needs of the organization and the solutions can range from simple spreadsheet to elaborated applications that support the auditor's work through rapid data processing, providing detailed reports, in agreement with Standards and legislation in force, and ultimately to provide an opinion in line with reality and with a high degree of timeliness. The major audit firms have the resources to ensure the implementation of web-based or cloud computing systems with collaborative capabilities or modules that are compatible with intelligent systems in Business Intelligence, ERP, CRM, etc. In such situations, the processing of large volumes of data, access to the information “sensitive area” of the entity under consideration and the confrontation of audited financial statements with reports obtained through the auditor's advanced processing applications and systems may give rise to controversy over legality of the operations or compliance with rules or standards.

Taking into account the academic research efforts undertaken to involve Business Intelligence IT tools in financial audit, the offers of software providers specialized in financial-accounting analyzes as well as the concerns of the large audit firms in the sphere studied through this doctoral thesis, there are some certain observations such as:

- The audit engagement practice shows a widespread use of CAATs (Computer Assisted Audit Techniques) tools to support and automate financial analysis processes;
- The internal market does not come with Business Intelligence offers for financial audit;
- There is no clear distinction that distinguishes between the opportunity to promote Business Intelligence applications strictly dedicated to the external financial audit that is the property of the auditor and the opportunity to create audit working modules (at least internally) within the client's implemented BI solutions.

There is a slight confusion or ambiguity regarding the role of Business Intelligence applications from the perspective of the auditor who may be a simple user of the information or knowledge generated by such systems (to the extent that they are accepted or recognized as evidence) or as an owner of BI systems dedicated to the audit. In the latter version, the studied literature does not make clear references and does not promote this idea; there are products dedicated to financial analyzes, but they are addressed to interested companies to manage data as efficiently as possible and to provide an adequate and competitive information system in relation to the new requirements of the economic environment. The financial auditor may be in the position of a beneficiary of dynamic dashboards, scorecards, etc. and can implement within its own information system BI-based solutions to process data and gain the knowledge needed to substantiate views from the final reports. In this case, however, there is the dilemma of accessibility to the sensitive data of the audited customer, compatibility with its computer systems.

The existence of own business modules within a Business Intelligence application built in an audit firm implies an adaptation to the mission-specific needs in accordance with professional standards. This is why international software vendors outline the difference between their own products and BI tools that they consider to be complementary.

The examples of software having analytics and complex reports viewed through dashboards are mainly from the category of applications dedicated to complex audit missions that face large volumes of data with a particular dynamics specific to large companies. From the analysis of the specialized literature, especially the articles published in national or international journals, the new informational context determined by the progress of IT & C and the digitization of the economy (with the huge contribution of the Internet) faced by the financial audit processes is clearly highlighted. The IT factor is the key element of progress, an engine of the economy, a confirmed reality and the value of investments in this sector (Ţugui & Gheorghe, 2016). The interaction between digital technologies and the profession of accountant or auditor is a subject of debate and launches certain dilemmas related to the harmonization with professional standards or information security (Bendoveschi & Ionescu, 2015). At the same time, the involvement of Big Data in the audit area raises issues precisely through the particularities of each field and requires concrete answers to the following punctual questions (Alles *et al*., 2015):

- Which of the Big Data specific features have the greatest potential to increase the efficiency and effectiveness of financial statement audit?;
- What are the tangible and intangible benefits of Big Data's involvement in the financial audit in terms of the quality and effectiveness of the audit, as well as the discouraging effects?;
- What are the costs (of software, personnel, etc.) of entering Big Data in the financial audit and what are the necessary technical and cognitive skills of auditors in such an environment?;
- What can be the optimal approach to Big Data involvement in financial audit, especially some Big Data components in certain phases of audit processes?.

The same author notes the rather incipient phase of Big Data's implementation in the spectrum of professional accountants 'working tools, and, as noted by the profile providers' offerings, internal auditors are more familiar with these information technologies than external auditors. The reason is simple: big companies that have implemented intelligent information systems have trained and qualified personnel on all the organizational levels involved. Moreover, the experience of internal audit work with non-financial data may be useful in targeting external audit on this information area.

5. CONCLUSIONS

Romania's accession to the European Union has restored the audit work itself, the standards to be followed for its optimal deployment, as well as the professional training and the knowledge required for professionals in the field. National audit standards are eminent for the reform of the Romanian accounting profession, in line with international standards and European Financial Audit Directives. Thus, the financial audit activity is regulated by precise laws and regulations and follows predefined templates. The information analyzed is predominantly of accounting nature and the accounting techniques and methods govern practically the auditor's work. The objective of faithful image is primordial and it is more necessary than ever for this goal to be achieved through correct professional conduct and a substantiated documentation process. This is desirable in today's economy where information is omnipresent, and also in excess, and the sources from which it comes are more and more varied.

This requires a correct data processing, adapted to minimum costs; traditional methods, whether automated or not, no longer meet this desiderate due to the acute need to update and visibility of key information for the management or other users. Business Intelligence solutions have no claim to definitively solve this challenge, but by integrating specific automation solutions (accounting software, cloud accounting, management systems, personal records, etc.), these instruments can create an intelligent way of managing the information system of an organization.

The auditor is interested in the existing information system, how the audited departments process data and have access to information, and how management engages in accurately outlining realities within the organization. The dedicated functionalities of BI tools in the financial and accounting field, in particular, meet the need for information of the management that benefits from such accurate information that can be also available to those interested, including external professionals. The auditor has the opportunity to transform the BI-specific utilities of the studied organization into useful work tools through their precision, accuracy of the information provided, the advanced possibilities of verification of the results by correlating with other sources according to the audit procedures. The reports generated by the solutions presented can be added as additional information in support of the final opinions provided and can be useful in front of the contracting entities of the audit.

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Section V

EU TAX LAW

SPEEDING DIFFERENTLY.
OUTCOME OF THE EUROPEAN CCCTB PROJECT

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Abstract
In late 2005, the European Court of Justice ruled in the much-debated Marks & Spencer (no. 2) case. It then became obvious that what the economists had been saying – European Union was (and still is) running slow in comparison to Japan, United States of America or Canada in terms of companies – was true to an even greater extent, since European companies' life and finance had been seriously disturbed by aggressive national tax rules, within an alleged single market. For a decade or so, experts have tried to put forward an adequate response, in the form of a proposal for a Common Consolidated Corporate Tax Base (CCCTB). They did come up with a proposal, but Member States failed to react and actually set up a common system of taxation for companies within the European Union. As the Union itself seems to be falling apart due to exit(s), there is a question on whether there is still hope for this project. The author looks into the possibility that - while speeding differently – finally (all or some) Member States agree on a scheme for making bearable and competitive the system of European corporate taxation.
Keywords: *CCCTB, direct taxation, corporate tax, consolidated tax base, common tax base.*
JEL Classification: K34

1. HISTORICAL BACKGROUND OF CCCTB

More than a decade ago, while taking part in professor's Adriano Di Pietro tax conference in Ravenna (Italy), I came across an analysis of the American professor Charles E. McLure, Jr., as far as the European corporate taxation was concerned: „*However, more than 50 years after the signing of the Rome Treaty (...), corporate taxes collected by the Member States of the European Community, reflecting their historical origin, remain inappropiate for an internal market under many essential issues. (...) By comparison, the structure of the state corporate tax in the United States, reflecting a history that is significantly different from that of the European Community, is much more appropiate for an internal market*" (McLure, 2006). It seems that this brief analysis is as true as it gets in early 2017.

In fact, the European tax doctrine has long pointed out that uncoordinated national company taxation is an obstacle to an EU single market. It leads to double taxation, double non-taxation, tax avoidance and difficult administration and it is heavily challenging the idea of an European single market (Terra & Wattel, 2005, pp. 293-294). Therefore, ideas such as Home State Taxation, Common Base Taxation or European Company Tax have been put forward as possible solutions for European common problems in the field of corporate taxation.

For ten years, the Commission struggled to develop early policy work (communications referring to CCCTB were issued in 2001 and 2003 and a public consultation was held in 2003, concerning the use of International Accounting Standards as a possible starting point for a common EU tax base) and set up a CCCTB Working Group that provided technical assistance to the Commission from 2004 to 2008. In the process, both the CCCTB Working Group and the Commission itself had to overcome the specifics of EU harmonisation policy. Using McLure's terms, the EU Council is entitled to proceed to both prescriptive or positive harmonisation (adoption of sub-national laws that are similar, if not identical) and prescriptive or negative harmonisation (interdiction of sub-national policies that would interfere with the creation of an internal market), while keeping in mind that only prescriptive harmonisation can entirely satisfy the demands of a an internal market. The Court of Justice of the European Union issues judgements qualified as proscriptive harmonisation, since it is obvious that Member States cannot be forced to provide an uniform and consistent reply following a specific ruling of the Court. Finally, the EU Commission can put forward both legislation (hard law) and mere instruments of soft law. Failing to convince the EU Council to act in the field of corporate taxation, the Commission considered from these early stages a proposal to use the intensified cooperation mechanism in order to start the process of creating a harmonised corporate tax system that would be more appropriate for the internal market.

As the CCCTB Working Group was making progresses, a few ideas about how a European corporate tax should look like were discussed. It seemed that, in an internal market, taxation should not significantly distort the localisation of economic activities. It was high time to set up a common definition of the taxable base and a common methodology for the partition of the taxable base between different Member States and these seemed to constitute acceptable constraints, as Member States shall remain free to apply the level of corporate tax they consider appropriate. Participants suggested that a common method of source taxation was needed, with all the Member States being encouraged to use the same method for determining the source of taxable income. The exemption of internal dividends from taxation was also on the table. Most significantly, CCCTB should imply accounting consolidation and formulary apportionment of profit, as an alternative to separate accounting and the arm's length standard for transfer prices. Last but not least, administrative cooperation between tax administrations of the Member States, the so-called *one stop shop*, was also encouraged.

2. 2011: THE LOST MOMENTUM

A decade's work on the CCCTB project amounted to the Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) (European Commission, 2011). As the first paragraph of the Explanatory Memorandum mentioned, in the absence of common corporate tax rules, the interaction of national tax systems led to over-taxation and double taxation, building-up heavy administrative burdens and high tax compliance costs for the European businesses. This was directly opposite to the priorities set in EU's Europe 2020 Strategy for Smart, Sustainable and Inclusive Growth (European Commission, 2010).

The European Commission explained in an 85 pages document the whole network that supported the proposal, including the results of consultations with the interested parties and impact assessments. As to the legal elements of the proposal, it relied on art. 115 TFEU and paid respect to subsidiarity and proportionality principles.

CCCTB was meant to apply to European companies or cooperatives and to other companies either mentioned in Annex I (e.g. for Romania "*societăţi pe acţiuni*", "*societăţi în comandită pe acţiuni*" and "*societăţi cu răspundere limită*") or in Annex II (generally companies that paid corporate tax or a similar tax – e.g. Romania "*impozit pe profit*") of the 2011 Proposal. Under art. 6, a right of option for the application of this system was recognized to eligible companies. With a tremendous effort put in, the working group and the Commission tried to regulate a great deal of what it would have been a European corporate tax base. Art. 86 set up the general principles as to the consolidated tax base, taking into account sales, payroll, number of employees and assets for the apportionment of the consolidated tax base.

As the European Commission showed in June 2015, four years after the Proposal, no significant progress had been made. The project seems too ambitious, on one hand, and a bit behind the tax developments of the European level, on the other hand. Therefore, the Commission admitted that the 2011 Momentum had been lost and it was high time for a re-launch of the CCCTB.

It strikes us as obvious that any question of this type left at the hands of the Member States had slim changes of ever getting through an effectively applying within the European Union. It also needed to be improved in order to tackle tax avoidance, a newer threat for both Member States and companies. Therefore, new proposals regarding CCCTB were considered as part of an Action Plan on Corporate Taxation (along with ensuring fair taxation where profits are generated, creating a better business environment, increasing transparency and improving EU coordination).

3. THE 2016 RE-LAUNCH OF CCCTB

On 25 October 2016, in Strasbourg, the Commission proposed a major corporate reform for the European Union. The Package comprised the following:

A. The Common Consolidated Corporate Tax Base (CCCTB). With the CCCTB, companies will for the first time have a single rulebook for calculating their taxable profits throughout the EU. Compared to the previous proposal in 2011, the new corporate taxation system will:

- Be mandatory for large multinational groups which have the greatest capacity for aggressive tax planning, making certain that companies with global revenues exceeding EUR 750 million a year will be taxed where they really make their profits.
- Tackle loopholes currently associated with profit-shifting for tax purposes.
- Encourage companies to finance their activities through equity and by tapping into markets rather than turning to debt.
- Support innovation through tax incentives for Research and Development (R&D) activities which are linked to real economic activity.

Corporate tax rates are not covered by the CCCTB, as these remain an area of national sovereignty. However, the CCCTB will create a more transparent, efficient and fair system for calculating the tax base of cross-border companies, which will substantially reform corporate taxation throughout the EU.

A.1. The CCCTB will improve the Single Market for businesses. Companies will now be able to use a single set of rules and work with their domestic tax administration to file one tax return for all of their EU activities. With the CCCTB, time spent on annual compliance activities should decrease by 8% while the time spent setting up a subsidiary would decrease by up to 67%, making it easier for companies, including SMEs, to set up abroad. Growth-friendly activities such as R&D investment and equity financing will be incentivised, supporting the wider objectives of reviving growth, jobs and investment. Once fully operational, the CCCTB could raise total investment in the EU by up to 3.4%. Companies will be able to offset profits in one Member State against losses in another. Tax obstacles such as double taxation will be removed and the CCCTB will increase tax certainty by providing a stable, transparent EU-wide system for corporate taxation.

A.2. The CCCTB will help to combat tax avoidance. The CCCTB will eliminate mismatches between national systems which aggressive tax planners currently exploit. It will also remove transfer pricing and preferential regimes, which are primary vehicles for tax avoidance today. It also contains robust antiabuse measures, to stop companies shifting profits to non-EU countries. Since the CCCTB will be mandatory for the biggest multinational groups operating in the EU, those companies most at risk of aggressive tax planning will be unable to attempt large-scale tax avoidance.

A.3. The CCCTB will support growth, jobs and investment in the EU. The CCCTB will offer companies solid and predictable rules, a fair and level-playing field and reduced costs and administration. This will make the EU a more attractive market in which to invest and do business. The re-launched CCCTB will also support R&D, a key driver of growth. Companies will be allowed a super-deduction on their R&D costs, which will particularly benefit young and innovative companies which choose to opt-in to the new system. Finally, the CCCTB will take steps to address the bias in the tax system towards debt over equity, by providing an allowance for equity issuance. A set rate, composed of a risk-free interest rate and a risk premium, of new company equity will become tax deductible each year. Under current market conditions, the rate would be 2.7%. This will encourage companies to seek more stable sources of financing and to tap capital markets, in line with the goals of the Capital Market Union. It would also provide benefits in terms of financial stability, as companies with a stronger capital base would be less vulnerable to shocks.

B. Resolving Double Taxation Disputes. The Commission has also proposed an improved system to resolve double taxation disputes in the EU. Double taxation is a major obstacle for businesses, creating uncertainty, unnecessary costs and cash-flow problems. There are currently around 900 double taxation disputes in the EU, estimated to be worth €10.5 billion. The Commission has proposed that current dispute resolution mechanisms should be adjusted to better meet the needs of businesses. In particular, a wider range of cases will be covered and Member States will have clear deadlines to agree on a binding solution to double taxation.

C. Addressing Mismatches with non-EU Countries. The third proposal in the Package contains new measures to stop companies from exploiting loopholes, known as hybrid mismatches, between Member States' and non-EU countries' tax systems to escape taxation. Hybrid mismatches occur when countries have different rules for taxing certain income or entities. Companies can abuse this to avoid being taxed in either country. The Anti-Tax Avoidance Directive, agreed in July 2016, already addressed mismatches within the EU. This proposal completes the picture by tackling mismatches with non-EU countries and is being made at the request of the Member States themselves.

4. WOULD SPEEDING DIFFERENTLY WORK?

Although the Commission’s 2016 Proposals are filled with enthusiasm, the outcome of the CCCTB project remains uncertain, since the unanimous vote of the 27 Member States is still needed to turn the Proposals into working directives. Therefore, looking back to the *enhanced cooperation* mechanism made available by the Nice Treaty, the Commission seriously considered a two-steps approach. In this respect, different proposals regarding first the Common Tax Base and second the Consolidation were put through.

In our opinion, in a complicated European Union, particularly in the tax field, different speeding and the use of the enhanced cooperation mechanism seem to be the wisest and the only way to accomplish the objectives of the Single Market. The 2011 lost momentum showed that Member States are incapable of reaching agreement in this field, even if the *Marks & Spencer* experience and other similar case courts have proved to be painfully complicated. If Europe wants a better chance in the world's economic environment, it has to speak in terms of competitiveness. As clearly showed by professor McLure some ten years ago, economic and legal models available prove that a CCCTB is the best chance to work on this matter.

At the time being, it remains unclear whether Romania would support any type of CCCTB. The 2015 Fiscal Code and the early 2017 changes of the fiscal legislation, placing businesses with turnover of less than 500,000 euros in good use of a 1% tax rate (applied as "*impozitul pe veniturile microîntreprinderilor"*) are tempting tax incentives. A recent campaign of tax inspections concerning transfer prices and the yet unknown proposal for a corporate tax based on the companies' turnover seem to go in the opposite direction.

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ROMANIAN TAX RULES IN NON TAX AGREEMENTS

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Abstract
The following article presents a key issue in international relations, the taxation of personal involved in such activities. The article makes an overview of the taxation policy that applies for Romania in the case of specific agreements that were signed by the Romanian government. Although it is specific to Romania the article presents the theoretic background that applies to every member state that has signed the agreements in question.
The agreements that are part of the presented article are: the Vienna Convention on Diplomatic Relations, the Vienna Convention on Consular Relations, the North Atlantic Treaty Organization agreement and other European treaties and agreements.
All the previous mentioned agreements are not linked to a specific tax issue were tax issues are specific mentioned and thus might raise some issues at first sight.
Keywords: *taxation, exemption, tax provisions, diplomatic relations.*
JEL Classification: K34, K42

1. INTRODUCTION

Although the present article might seem specific to a certain country, in this case Romania, most of the provisions that are applied by the Romanian tax system are similar to the ones in other countries. Most of the treaties that are discussed in this article are treaties that are at their core politically and thus at first look would not have any influence in tax provisions of the countries engaging in them.

At a closer look, all the treaties have a certain effect on the tax system of the signing countries. The most frequent case is the taxation of individuals that are taking part in the implementation of the treaty but there are also other issues that have to be treated with precision. In the article we have decided to study each type of treaty separately and study its effect on the Romanian tax system.

2. TAX PROVISIONS OF THE VIENNA CONVENTION ON DIPLOMATIC RELATIONS AND THE VIENNA CONVENTION ON CONSULAR RELATIONS

The premises of consular offices enjoy, from a tax point of view, the same privileged status as the premises of the foreign missions (United Nations, 2005a, pp. 13-14). The Vienna Convention on Consular Relations (further noted as VCCR) comprise provisions concerning tax and levies exempt for consular premises, and, for lack of treaty rules the tax exemption for the premise of consular offices used in the public interest of a foreign sovereign state has been acknowledged by the courts in certain states.

The taxes consulates levy for specific private services (for the performance of notarization, succession assignments for visa granting and passport issuing, etc.), are tax exempt in compliance with consular regulations, the respective taxes belonging to the sender sovereign state. That is why, in compliance with the general principles of international law, these funds cannot be burdened with taxes or levies with national or local character; this rule is laid down in the VCCR as well (United Nations, 2005, Art. 39).

The VCCR usually establish personal tax exemption in the benefit of consular officers; for lack of conventional provisions, the residence state's laws and regulations often regulate the matter, by granting the personal tax exemption based on reciprocity. The VCCR provides for the direct tax exemption from which consular officers, employees and their families benefit (United Nations, 2005, Art. 49). Tax exemption does not apply to the following: excises that are normally incorporated in the price of merchandise and services, taxes paid for public services (water, electricity, gas, etc.), taxes related to private real estate, as well as taxes on the revenue from commercial or industrial activities or the liberal professions, as well as activities performed by consular officers on their own behalf, and not within their consular duties.

Where customs duties are concerned, it is expressly permitted in state practice, as it is substantiated in the national legislation and bilateral conventions that consular positions are exempt from customs duties for all imported items meant for official use.

The legal foundation for this exemption lies in the idea that the assets belonging to the sending state, meant for the public use of this state, are covered by jurisdictional immunity with respect to the residence state.

If the consular office enjoys customs duties exemption for all assets meant for official use, the office staff (consular officers and employees) has a different status. International practice acknowledges two concepts: the first ascertains that consular officers are entitled to tax exemption solely for the assets they bring to the residence state in due time since they are instated in the second permits the customs duties exemption for all items destined to the officer's personal use and those of the members in his family that he lives with, regardless of their import date.

The personal luggage of the consular officers and the members of their families that they live with are free of customs control, under the same conditions applicable to diplomats. The principle of reciprocity is the guideline for tax exemption status through internal laws and regulations, by lack of certain treaty rules.

Other privileges and immunities, such as exemption from alien registration and residence permits, exemption from work permits, exemption from social security liabilities, are granted to consular officers under certain conditions set out in the VCCR.

After having described the essential features of the privileged status of consuls, their duties to the residence state should be specified, duties that make possible all consular activities.

With no prejudice to their privileges and immunities, the consular officers and employees and the other persons enjoying the same, have – as do diplomats – the duty to abide by the laws and regulations of the residence state: at the same time they are not allowed to interfere in the internal affairs of that state.

The consular premises must be used for consular activities; their use in a manner that is incompatible to these activities is forbidden (United Nations, 2005b). Art. 35 VCDR that was ratified by Romania through the Decree no. 566 of 8 July 1968.

It is specified that the legal institutions that have their origin in unwritten law, as revealed in the way the majority of the articles are applied in practice in Romania.

Where the innovations put in place by the convention are concerned with respect to diplomatic law, most of them were either suggested by the socialist countries or embraced by the same.

The diplomatic privileges constitute a special treatment owed to diplomatic agents; their contents refer to the benefit from certain facilities determined by special services and it is expressed in the granting by the residence state of certain exceptional facilities that have a mainly positive content, not necessarily involving a special activity on behalf of the beneficiaries.

Article 34 VCDR provides that "The diplomatic agent is exempt of any personal or actual taxes and levies, may they be national, regional and communal, except for:"

- excises that by their nature are normally incorporated in the price of merchandise and services;

- levies and taxes on private real estate located in the receiving state, except for the situation when the diplomat is the holder of the assets on behalf of the sending state, for the purposes of the mission;

- the succession rights granted by the receiving state, subject to the provisions of paragraph 4, Article 39 [1];

- levies and taxes on private income that originated in the receiving state and the capital taxes on investments made in commercial ventures located in the receiving state;

- levies and taxes on remuneration for actually provided services;

- registration rights, record office, mortgage and stamp regarding real estate assets, subject to the provisions of Article 23 [2].

According to the Romanian Law, diplomatic agents, administrative and technical staff, consular officers, consular employees and service staff, together with members of their families forming part of their household (spouses and dependent minor children not gainfully employed in Romania) should be exempt from all dues and taxes, personal or real, national, regional or municipal, except:

➢ indirect taxes of a kind which are normally incorporated into the price of goods or services;

➢ dues and taxes on private immovable property situated in the territory of the receiving state, ...;

➢ estate, succession or inheritance duties levied by the receiving state, ...;

➢ dues and taxes on private income having its source in the receiving state and capital taxes on investments made in commercial [or financial] undertakings in the receiving state.

VAT is an indirect tax incorporated in the price of goods and services. Therefore, VAT on the purchase of property and services intended to meet the requirements of foreign agents posted to Romania could not be refunded in Romania.

However, as a courtesy, certain purchases of property or products on the domestic market may be exempted from duty and taxation under certain conditions:

- personal vehicles of agents holding a residence permit;

- products subject to quotas such as liquor, tobacco and fuels are the subject of annual quotas allocated to Missions within the limits set by the Ministry of Foreign Affairs and the Ministry of Economy, and Ministry of Finance.

Save as otherwise provided in international tax agreements that may impose compliance with certain conditions or rule differently, members of diplomatic or consular missions who are not Romanian nationals or permanent residents are deemed to be resident in the sending state. Their official remuneration is not taxable in Romania.

Honorary consular officers are relieved from income tax only for the allowances they receive to cover expenses incurred in the exercise of their functions.

Property tax is payable by the owner of the premises. Only the official residence of heads of diplomatic and consular missions, which is part of the official premises, is relieved from the payment of property tax. Other properties are not exempt from property tax.

Dues and taxes levied for specific services rendered such as road sweeping, connection to the sewer network, refuse collection, and airport tax (included in the price of the plane ticket), must always be paid.

Fiscal Exemptions Relating to Premises and Residences

1. Lands and buildings situated in the territory of the receiving state which are owned by the sending state or are leased by it for the requirements of a consular establishment, or as residences for the consular officers or consular employees, shall be exempt from all taxes and charges in the receiving state, with the exception of charges for special services rendered.

2. The exemptions referred to in the above paragraph of this Article shall not apply if, under the law of the receiving state, such taxes and charges are payable by the person who contracted with the sending state or with the person acting on its behalf.

3. TAX PROVISIONS OF THE CONVENTION ON THE PRIVILEGES AND IMMUNITIES OF THE UNITED NATIONS AND OF OTHER INTERNATIONAL (BILATERAL AND MULTILATERAL) AGREEMENTS CONCLUDED BY YOUR COUNTRY AND (MORE OR LESS) COPIED FROM THIS CONVENTION

Romania has entered into a series of multilateral conventions. The agreement of 14 October 2005 (hereinafter: the 2005 Agreement) between the Romanian Government and the Latin Union concerning the set-up of a Latin Union office in Bucharest and the privileges and immunities of the Latin Union Office on the Romanian territory, published in the Official Gazette of 23 May 2006 (Official Gazette 444/2006) based on the Convention of the Latin Union creation, adopted in Madrid on 15 May 1954, that Romania adhered to by the State Council Decree no. 421 of December 5, 1979, considering that the parties agreed, by the VIII Congress of the Latin Union that took place in Paris in 1986, to set up a Latin Union office in Romania, the following were agreed upon: "the assets provided to the office for its official mission shall be free of direct taxes in compliance with the Romanian legislation in force; nevertheless, the exempt does not address to the taxes perceived for the payment of provisioned services. The purchase or rent by the Latin Union of the building spaces necessary for the official mission of the office is exempt of registration taxes, the real estate advertising tax, rent tax and any other similar taxes. The Latin Union benefits from the exemption with deduction right of the value added tax for the assets deliveries and service performance in its favour. The return of the value added tax shall be made in compliance with the procedure provisioned by the Romanian legislation for accredited international intergovernmental organizations in Romania" (Paun, 2009, p. 34).

This type of immunity is not found in any other treaty concluded by Romania.

Taxation of individuals, setting up Romanian law after an international treaty

International treaties become part of Romanian legislation upon the consent of the Romanian State to become party to the treaty. The consent may be expressed under the following procedures: ratification, approval, adhesion, or acceptance. According to the Law No. 590/2003 on treaties, the provisions of the treaty ratified by Romania prevail over the domestic law and are binding for all Romanian authorities as well as for all Romanian legal entities and individuals. Furthermore, the domestic provisions cannot be invoked for justifying failure to apply the provisions of a treaty, which is in force in Romania. The provisions of an international treaty cannot be modified or revoked by internal regulations subsequent to the date of the treaty's entry into force but only according to its provisions or the approval of the parties involved. According to the Constitution of Romania, when the provisions of an international treaty are contrary to the Constitution, the mentioned treaty will not be ratified by the Romanian authorities until the appropriate amendments of the Constitution's provisions have been made. The Romanian Fiscal Code provides that, in the cases in which the withholding tax rate applicable under domestic law for income derived by a non-resident/foreign legal entity in/from Romania is different than the tax rate set out under the double tax treaty, the most favourable rate between the two tax rates will apply.

According to the Romanian Fiscal Code, the definition of resident contains an exception: a resident natural person does not include a foreign citizen with diplomatic or consular status in Romania, a foreign citizen who is an official or employee of an international and intergovernmental organization that is accredited in Romania, a foreign citizen who is an official or employee of a foreign state in Romania and members of the family of such foreign citizens. According to Art. 42 of the Romanian Fiscal Code "For purposes of the income tax, the following income is not taxable: income received by members of diplomatic missions or consular offices for and incomes received by officials of international bodies and organizations from activities carried out in Romania in their official capacity, on the condition that the position of the official is confirmed by the Ministry of Foreign Affairs; income received by foreign citizens for consulting activities carried out in Romania in accordance with agreements of non-reimbursable financing entered into by Romania with other states, with international bodies and nongovernmental organizations. Income received by foreign citizens from activities carried out in Romania in the capacity of press correspondents, on the condition that reciprocal treatment is granted to Romanian citizens for incomes from such activities and on the condition that the position of such persons is confirmed by the Ministry of Foreign.

Tax provisions of status of forces agreements

The NATO SOFA is a multilateral agreement that has applicability among all the member countries of NATO. As of June 2007, 26 countries, including the United States, have either ratified the agreement or acceded to it by their accession into NATO. Additionally, another 24 countries are subject to the NATO SOFA through their participation in the NATO Partnership for Peace (PfP) program. The program consists of bilateral cooperation between individual countries and NATO in order to increase stability, diminish threats to peace and build strengthened security relationships. The individual countries that participate in the PfP agree to adhere to the terms of the NATO SOFA. On 30 October 2001 Romania signed the Agreement between Romania and USA regarding the Status of US Armed Forces in Romania.

According to Article X, the United States forces and its contractors, identified in Article XXI, are not subject to direct or indirect taxation in respect of matters falling exclusively within the scope of their official or contract activities or in respect of property devoted to such activities. Deliveries made and services rendered by the force or such contractors to members of the force or civilian component and dependents must also be regarded as such activities. With respect to the value added tax (VAT), exemptions apply to articles and services acquired by the United States contractors in Romania solely for the purpose of supporting the United States forces may not be subject to any form of income or profits tax by the Government of Romania or its political subdivision.

Vehicles, vessels and aircraft owned or operated by or for the United States forces may not be subject to the payment of landing or port fees, pilotage changes, navigation, overflight, or parking changes or light or harbour dues, or any other changes in connection with carrying out missions related to its operations or with the use of state owned or operated facilities in Romania; however, the United States must pay reasonable changes for services requested and received. The provisions of Romanian laws and regulations pertaining to the withholding of payment of income taxes and social security contribution are not applicable to United State citizens and non-Romanian employees of the United States forces or United States contractors exclusively serving the force in Romania.

The personal tax exemptions are defined in Article XI. With respect to Articles X and XI of the NATO SOFA, and in accordance with Article X of this agreement, members of the force, or of the civilian component are not liable to pay any tax or similar changes, including the value added tax, in Romania on the ownership, possessions, use, transfer amongst themselves, or transfer, in connection with death, of their tangible movable property imported into Romania or acquired there for their own personal use. Motor vehicles owned by a member of the force, or civilian component or a dependent are exempt from Romanian circulation taxes, registration or license fees, and similar charges. The exemption from taxes or income provided by Article X NATO SOFA also applies to income received by members of the force or civilian component or dependents from employment with the organizations referred to Article I, paragraph 1, and Article XVII of this agreement, and to income derived from sources outside Romania.

According to the agreement, with reference to Article XI NATO SOFA, the importation of equipment supplies, provisions, and other goods into Romania by the United States forces or by United States contractors for or on behalf of US forces is exempt from duties. The United States forces are liable for the payment of changes for services performed by the Romanian Government or any political subdivision thereof only when such services have been requested and received. Equipment, supplies, provisions and other goods are exempt from any tax or other charges, which would otherwise be assessed upon such property after its importation or acquisition by the United States forces. The exportation from Romania by the United States forces of the equipment, supplies provisions, and other goods referred to above are exempt from all types of Romanian tax under terms and conditions, including payment of taxes, imposed by authorities of Romania. The exemptions provided above also apply to services, equipment, supplies, provisions, and other property imported or acquired in the Romanian domestic market by or on behalf of the United States forces for use by a contractor executing a contract for such forces. The United States forces must cooperate fully with the appropriate Romanian authorities to prevent abuse of these privileges. Deposit of the certificate provided for in Article XI, paragraph 4 NATO SOFA will be accepted in lieu of the customs inspections by Romanian authorities of the items imported or exported by or for the United State forces under the provisions of the agreement.

The members of the US force or civilian component and their dependents may import their personal effects, furniture, private motor vehicles and other good intended for their personal or domestic use or consumption free of duty during their assignment in Romania. The property referred to above and other goods acquired free of taxes and duties may not be sold or otherwise transferred to persons in Romania not entitled to import such property duty free, unless such transfer is agreed upon by the appropriate Romanian authorities. This provision does not apply to gifts to charity. Members of the force, or civilian component and their dependents may freely transfer such property amongst themselves and to or from the force, and such transfers are free of tax or duty. The US forces are responsible for maintaining records, which will be accepted as proof by Romanian authorities of these transfers of tax of duty-free merchandise. The Romanian authorities must accept copies of duly filed police reports as proof that duty-free property of members of the force or civilian component or dependents has been stolen, which shall relieve the individuals of any liability for payment of the tax or duty.

Members of the force or civilian component and their dependents may re-export, free of exit duties or charges, any goods imported by them into Romania or acquired by them during their period of duty in Romania.

The Romanian authorities will honour the registration and licensing by United States military and civilian authorities of motor vehicles and trailers of the force, or members of the force, or the civilian component or dependents. Upon the request of United States military authorities, the Romanian authorities will issue license plates, without charge, which are indistinguishable from those issued to the Romanian population at large. The United States military authorities must provide for the safety of motor vehicles and trailers registered and licensed by them or used by the force in Romania, and must cooperate with the Romanian authorities to safeguard the environment.

According to the agreement, Romania must take all appropriate measures to ensure the smooth and rapid clearing of imports and exports of forces, members of the force, the civilian component and dependents by Romanian customs authorities. Customs inspections under the agreement will be carried out in the facilities in accordance with procedure mutually agreed between the appropriate Romanian authorities and the United States forces. Any inspection by Romanian customs authorities of incoming or outgoing personal property of members of the force or civilian component or dependents must be conducted when the property is delivered to or picked up from the individual s residence. United States military authorities must establish the necessary customs controls at facilities where United States forces are located to prevent abuses of the rights granted under the NATO SOFA and the agreement. United States military authorities and Romanian authorities will cooperate in the investigation of any alleged offenses involving customs violations.

According to the Agreement between Romania and NATO, the Organization shall have the same exemption or relief from taxes and rates, other than taxes on the importation of goods, as is accorded to a foreign sovereign power. The Organization is granted exemption from taxes on the importation of goods directly imported by the Organization for its official use in Romania or for exportation, or on the importation of any publication of the Organization directly imported by it, such exemption to be subject to compliance with such conditions as the Minister responsible for finance may prescribe for the protection of the revenue. Except in so far as in any particular case any privilege or immunity is waived by the Government of the member which they represent, every person designated by a member of the Organization to be its principal permanent representative to the Organization in Romania and such members of his official staff resident in Romania as may be agreed between the parties.

The representatives of the Organization enjoy the like immunity from suit and legal process, the same inviolability of residence and the same exemption or relief from taxes as is accorded to a diplomatic representative accredited to Romania. Where the incidence of any form of taxation depends upon residence, any representative to whom this paragraph applies must not be deemed to be resident in Romania during any period when he is present in Romania for the discharge of his duties. Where the incidence of any form of taxation depends upon residence, official clerical staff to which this paragraph applies, if accompanying such a representative as aforesaid, must not be deemed to be resident in Romania during any period when they are present in Romania for the discharge of their duties.

Tax provisions of cultural exchange agreements

The OECD Model Tax Convention does not include an article dealing specifically with visiting teachers and researchers. The reason why some tax treaties have a separate article that provides a tax exemption in the state of source ("state of visit") for such individuals is to stimulate the cross-flow of academics, not so much to allocate taxing rights between the contracting states (Baker, 1994, p. 344).

In Articles 20 and 21 of the agreements regarding the avoidance of double taxation concluded by Romania, this income class is a stand-alone class with regard to taxation. Accordingly, a person who is a resident of a contracting state, temporarily visiting the other contracting state, at the invitation of the authorities of that state, or of a university or another educational institution acknowledged by the contracting state, for the purpose of teaching or carrying out research at a university or other educational institution in that state, is exempt from tax in the first-mentioned state on any remuneration for such teaching or research for a period not exceeding two years from the date of his visit to that state for that purpose. These provisions do not apply to income resulting from research, if such research is not carried out for the public interest, but mainly for the benefit of private individuals. Consequently, income drawn by a teacher or researcher of a contracting state who carries out such activities over a limited period of time in the other contracting state may only be taxed in the state of residence (Miff & Păun, 2005, p. 223). In this sense, most tax treaties concluded by Romania stipulate the tax exemption of income obtained from teaching or research in the state in which such activity is carried out (the host state), the exemption being granted for a period not exceeding two years.

To qualify for the exemption in the state of visit, the individual must be resident in the other contracting state immediately before making the visit. One issue is whether the exemption applies only to an individual who remains resident in his home state or becomes a resident of the state of visit during the period of the visit or whether the exemption also applies to an individual resident in neither of the two states. The latter view implies that the article is not subject to the restriction in Art. 1 (Persons covered) of the OECD Model in the absence of express wording to the contrary and is supported by the fact that the OECD Model itself contains provisions, such as Art. 24(1), that extend treaty benefits to a third-state resident (Hattingh, 2003, p. 215).

The visit must be at the invitation of a university, college, school or other similar educational institution that is recognized by the competent authority in the state of visit. In the absence of a treaty definition, the word “invitation” takes its ordinary meaning in the state applying the treaty. The visit must be solely for purposes of teaching or research or both at an educational institution. Because of the word “solely”, it is not clear whether an academic who concurrently takes up an advisory or consultancy engagement for a government or private organization or statutory board would lose the exemption altogether. Such work is likely to complement and relate closely to his teaching or research, and this is particularly so if taking up such work is an expectation of the educational institution that engaged him. The individual’s remuneration for teaching or research is considered to remain eligible for the exemption, but the income derived separately from the advisory or consultancy work is not exempt under the teachers and researchers article because the work is not performed at an educational institution. As a practical matter, although this is not strictly necessary from the wording, the educational institution would be the payer of the remuneration, and the teaching or research or both would be conducted for (and not only at) the institution as well. A separate paragraph is usually included in the teachers and researchers article which provides that income from research will not be exempt in the state of visit if the research is undertaken, not for the public interest, but primarily for the private benefit of a specified person. The public or public interest will be analysed from case to case. Generally, the teachers and researchers article does not require that the source of the payment be outside the state in which the teaching or research is done.

4. PROTOCOL OF THE PRIVILEGES AND IMMUNITIES OF THE EUROPEAN UNION

The structures of the institutions of the European Union as a supranational organization created on the basis of the Treaty establishing the European Union enjoys privileges and immunities vis-à-vis the EU Member States. In this context the term ‘privileges’ means that national legislation is either not applicable to the European Union or is differently applicable. Thus, the European Union is partially exempt from national laws. In contrast to this, ‘immunities’ (immunity from jurisdiction and enforcement) do not affect the applicability of national law but its enforcement (Gruber & Benisch, 2007).

National authorities and national courts are prevented from enforcing it by means of constraint. Such privileges and immunities are not unusual in public international and Community law. All international and supranational organizations enjoy privileges and immunities vis-à-vis their member states in order to enable them to perform their tasks independently and impartially. If an international organization were subject to national law, a member state.(in particular the host state) could exert undue influence on the organisation's activities. Privileges and immunities are granted on the basis of public international or Community law. They are usually laid down in the organization's statute and/or in the headquarters agreement between the international organization and its host state.

The legal basis of the privileges and immunities granted to the European Union is Article 291 EC. The provision reads as follows: "The Community shall enjoy in the territories of the Member States such privileges and immunities as are necessary for the performance of its tasks, under the conditions laid down in the Protocol of 8 April 1965 on the privileges and immunities of the European Communities. The same shall apply to the European Central Bank, the European Monetary Institute, and the European Investment Bank. That provision is reiterated by Article 40 of the Statute of the European System of Central Banks and of the European Central Bank (hereinafter: "ESCB Statute") which provides that "The ECB shall enjoy in the territories of the Member States such privileges and immunities as are necessary for the performance of its tasks …".

These general provisions are implemented by the Protocol on the privileges and immunities of the European Communities of 8 April 1965 (hereinafter: "Protocol"). The Protocol is an integral part of the EC Treaty and is binding on all Member States of the European Union; it takes precedence over national law. Since privileges and immunities primarily concern the relationships with the host state of the territory where the organization is established, the EU institutions concluded a number of treaties with the host states concluded that took the form of a headquarters agreement implementing the Protocol (hereinafter: "Headquarters Agreement") (Abkommen zwischen der Europäischen Zentralbank und der Regierung der Bundesrepublik Deutschland über den Sitz der Europäischen Zentralbank vom 18. September 1998, BGBl. 1998 II, p. 2745).

The Headquarters Agreement is an agreement under public international law and is binding on the EU Member States legislator and the EU authorities. The status of international organizations under international law is similar to that of sovereign states. Both enjoy privileges and immunities vis-à-vis other states. However, the scope and nature of their respective privileges and immunities differ. Whereas states enjoy worldwide unlimited immunity for *actaiureimperii* (activities undertaken in the exercise of their sovereign powers), they are not immune with regard to *actaiuregestionis* (activities which are not part of the state's sovereign power, such as the procurement of shoes for soldiers).

In contrast to this, in principle international organizations enjoy full immunity for all their actions regardless of their nature.

According to Article 12, second paragraph, of the Protocol, European Union staff “shall be exempt from national taxes on salaries, wages and emoluments’ paid by the European Union institutions. However, income from other sources (e.g. interest income and rents) is fully subject to national tax law. According to Article 13 of the Protocol, such income is taxed in the country where the member of staff had their domicile before entering the service of the European Union institutions. The exemption from national taxation, which is often criticized, reflects a well-established international practice. The reason underlying this exemption is that the taxation of salaries in accordance with national law would raise a number of difficult legal questions. If the salaries were taxed in accordance with EU Member State tax law, that state would realize an unjustified profit from the fact that the seat of the European Union Institution is in that state. Alternatively, the salary received by a member of staff could be taxed in the staff member’s country of origin. Due the different tax systems this would, however, entail unequal treatment of staff members. In order to avoid such distortions, the EU has established its own tax system for salaries, wages and emoluments paid to its servants. According to Article 12, first paragraph, of the Protocol “Officials and other servants of the Communities shall be liable to a tax for the benefit of the Communities on salaries, wages and emoluments paid to them by the Communities...” (Seidl-Hohenveldern & Loibl, 1996, p. 281; Commission de Recours de l’Organisation de Coopération et de developpement économiques 23 November 1985, Decision No. 115 - unpublished).

Such an internal tax system is fully in line with the general rule that servants of international organizations are exempt from tax; that exemption is limited to national tax law. On the basis of Article 12 of the Protocol, the Council adopted Regulation No 260/68which also applies to European Union staff. It allows the refutation, at least in part, of the criticism that EU officials and European Union staff, unlike all other European citizens, are exempt from taxation. The implementation of Article 12, second paragraph, of the Protocol exempting salaries, wages and emoluments from national taxation has raised a number of legal questions. In a number of judgments the ECJ has stressed that the provision must be interpreted broadly. This applies initially to the terms “salaries, wages and emoluments”. These include all kinds of payments received from the European Union in consideration for services rendered by the member of staff. The term ‘emolument’ covers all kinds of allowances, including for instance widows’ allowances. The term “taxes” has equally to be interpreted broadly. Article 13, paragraph 2, precludes any national tax, regardless of its nature and the manner in which it is levied, which is imposed directly or indirectly on an European Union staff member by reason of the fact that they are in receipt of remuneration paid by the European Union, even if the tax in question is not calculated by reference to the amount of that remuneration.

Taking into account the staff member's income for the calculation of the tax rate applicable to other income of that person or to the income of the spouse in the case of joint taxation is also prohibited. However, staff members are not exempt from charges and dues that are paid as a fee for services rendered by a public authority. Such charges and dues are not taxes within the meaning of Article 12 of the Protocol, even if they are calculated on the basis of the staff member's salary. The fact that the member of staff does not pay taxes to the national treasury does not, however, justify any kind of discrimination. It also merits attention that the scope of Article 12, second paragraph, is limited to taxes that are levied periodically and does not exclude the imposition of one-off taxes such as inheritance tax.

Recently, the question was raised whether the import of cars by ECB staff from their country of origin to Germany is subject to VAT. Article 12(d) of the Protocol provides that European Union staff may, under certain conditions, been titled to import free of duty their furniture and effects at the time of first taking up their posts. The Protocol was adopted before the concept of turnover tax was introduced into the Community framework, so under a wide interpretation this provision also includes the import of vehicles free of VAT. The term "effects" includes, inter alia, a vehicle personally owned by an ECB staff member. Article 12(d) of the Protocol is implemented by Article 12 of Headquarters Agreement. In 2006 the German Federal Finance Court (Bundesfinanzhof) decided on the case of a former EMI staff member who had purchased a new car from a car dealer in her EU home state and had brought it to Germany when taking up her position. The supply of the car by the Danish dealer was treated as an intra-Community supply and was accordingly exempt from Danish VAT. Subsequently, the German tax authorities sent the plaintiff a VAT assessment for personal vehicle taxation and determined the VAT due on the intra-Community acquisition of the car. Unlike the court of first instance, the Federal Finance Court ruled in favour of an exemption from VAT. Article 12(d) reads: "In the territory of each Member State … officials and other servants of the Community shall … enjoy the right to import free of duty their furniture and effects at the time of first taking up their post in the country concerned … subject in either case to the conditions considered to be necessary by the government of the country in which this right is exercised". The existence of Article 12(e) of the Protocol, which also refers to the import of a vehicle free of duty, does not contradict such an interpretation, as it does not deal with the specific case of a member of staff taking up their post, but applies without a time limit. Article 12(e) reads: "… officials and other servants of the Community shall … have the right to import free of duty a motor car for their person use, acquired either in the country of their last residence or in the country of which they are nationals on the terms ruling in the home market in that country …". The provision reads as follows: "At the time of first taking up their post in the Federal Republic of

Germany, employees of the EMI and family members forming part of their households shall be exempt from customs and excise duties in respect of the import of their furniture and personal effects which are in their ownership or possession. Vehicles shall likewise be exempt, though where a vehicle is imported from a third country only if it is has been used there by the employee for a period of at least six months prior to being imported …" (First instance Hessisches Finanzgericht AZ 6 K 1971/02, decision of 17 September 2003, second instance, Bundesfinanzhof AZ V R 65/03, decision (Gerichtsbescheid) of 28 September 2006).

Furthermore, the Federal Finance Court stated that the import of the car must ensue within 12 months of the date of first entry, without it being decisive in that regard on what date the post was taken up. The Federal Finance Court considered this interpretation of Article 10 of the EMI Headquarters Agreement to be free from doubt in Community law, so that it refrained from making a reference for a preliminary ruling under Article 234 EC. Furthermore, it did not decide on the application of Article 12 of the Protocol to this case.

On 8 December 2005 the ECJ issued its final ruling in a case between the ECB and the Federal Republic of Germany (ECJ- 5 December 2005, C-220/03, European Central Bank v Federal Republic of Germany [2005] ECR I-10595).

The case concerned the European Union's claim for reimbursement of the VAT included in the rent for its premises and in the ancillary costs and investment costs related to this rent. The background to the case is the following: The inclusion of VAT in the rent and the ancillary costs paid by the ECB arose from the specific provisions of German tax law. Under normal circumstances, a company can offset the VAT it pays to its suppliers (input tax) against the VAT it charges to its clients (output tax), and as a result it only pays the difference between these two amounts to the tax authorities. For normal commercial undertakings, therefore, VAT should be a neutral tax. Charges for the supply of rented property (rent and ancillary services) are not in principle subject to VAT under German law. However, a landlord has the possibility of opting for the VAT regime (to "opt to tax") and, if it does so, it can offset the VAT it receives against the VAT it has paid. The right to opt to tax is only available, however, if the tenant is carrying on commercial activities. Since the ECB is a public institution, it cannot be considered a commercial company for tax purposes. This means that the ECB's landlords cannot opt to tax. To avoid a financial loss resulting from the inability to offset input tax against output tax, landlords therefore compensate by including the input tax in the rent. The ECB's landlords did indeed increase the monthly rent charged correspondingly, once they were aware that the ECB could not be considered a commercial undertaking. The ECB considered that it suffered a de facto VAT charge, although de iure it is exempt from VAT. The German tax authorities had rejected the ECB's claim with the argument that the invoices of the ECB's suppliers did not show the tax separately. The ECB had argued that the Headquarters Agreement, construed in the light of the Protocol, supported its claim. In particular, the ECB argued that the obligation of Member States laid down in Article 3 of the Protocol to refund, “wherever possible”, turnover tax which is ‘included in the price of movable or immovable property’ does not require the tax to be ‘invoiced separately’. By insisting on the tax being invoiced separately, Germany obtained a fiscal advantage which is exactly what the Protocol and the Headquarters Agreement are aimed at avoiding. The Court decided that Article 8.1 of the Headquarters Agreement expressly makes the refund of turnover tax subject to the condition that the tax is invoiced separately. It continued that, although some other interpretation of the Headquarters Agreement might be possible in the light of its legal context, in the opinion of the Court, this was not possible in this case because of the clear wording of the relevant clause. The Court ruled that this wording was not contrary to the aims of the provision of the Protocol which regulates the refund of turnover tax. The Court considered that refusing the refund of a tax which is not invoiced to the ECB, but which is paid as input tax by the other parties, does not go beyond the margin of discretion granted to the Member States and EU institutions concerning the implementation of Article 3 of the Protocol.

5. CONCLUSIONS

Romania has and will continue to enter into agreements with other countries or international organizations that may have impact on the taxability of certain types of income derived from certain activities. These agreements, as bilateral or multilateral agreements of the government of Romania, will prevail over the Romanian Tax Code, according to Romanian constitutional provisions. Although these provision cause a lot of work for the Romanian Tax System and for the Revenue Services it is very important for the Romanian foreign policy and for Romania’s positions in a growing economy to engage in such treaties and create exemptions for taxation.

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THE COMPETENCE OF THE ANTI-FRAUD DEPARTMENT TO ADMINISTER EVIDENCE DURING CRIMINAL PROCEEDINGS

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Abstract
The present paper aims to analyze the legal framework of the Anti-Fraud Department (hereinafter DLAF), focusing on the competence of this body to hear witnesses in a control action initiated at the request of the National Anti-Corruption Division (hereinafter DNA). DLAF is a legal structure within the Government's working apparatus and can not be considered a criminal investigation body as defined by criminal procedural provisions.
Academic and practical importance of this approach lies in linking the provisions of art. 10 of Law 61/2011 on the organization and functioning of DLAF with those of art. 114 and following from the Criminal Procedure Code. Without wishing an exhaustive approach, this paper aims at highlighting, on the one hand, the quality of DLAF as an official examiner within the meaning of art. 61 C.pr.pen., and on the other hand, the competence of this entity to hear witnesses, with emphasis on the use of the statements obtained by DLAF, outside of the criminal procedure framework, in criminal cases.
The purpose of this paper is to highlight the criminal procedural implications of DLAF's activity with emphasis on the criminal proceeding stage in which the proposed solutions can be used.
Keywords: *anti-fraud department, anti-corruption division, unlawfull hearing.*
JEL Classification: K14, K40

1. FACTUAL SITUATION

The premise of this endeavor is the existence of a criminal case in which the Anti-Fraud Department (hereinafter DLAF) carried out a control action, at the request of the DNA prosecutor, parallel with the criminal prosecution.

At the end of the control action, DLAF submitted DNA both the control note and the statements of the witnesses audited. Although all these documents were submitted to the criminal prosecution file prior of the indictment, the DNA prosecutor did not re-examine the witnesses heard by DLAF in accordance with the procedural provisions, but limited itself to using statements in the indictment and mentioning the witnesses at the end.

During preliminary chamber proceedings, the defendant requested the exclusion of the statements made exclusively to DLAF, motivated by the fact that they were not heard by a criminal prosecution body but only by an administrative entity.

Further, we will analyze the argumentation of the preliminary chamber judge, who ordered the rejection of this request, stating that *„the defendant proceeds from a completely erroneous premise: respectively, on the assumption that the statements of the above-mentioned witnesses (heard by the DLAF inspectors in the control activities) are retained by the prosecutor as being part of the means of evidence on which the accusations against the defendant are based in the indictment.*

However, it is noted that among the means of evidence on the basis of which the prosecutor considers that the factual situation is proven in the indictment, the prosecutor does not retain and as such does not base his allegations on the statements given by the aforementioned witnesses at DLAF, in the course of the control action, but the prosecutor bases his accusations, altogether with other means of evidence, also on the statements given by the witnesses indicated in the indictment, witnesses who were heard in the case after the initiation of the criminal investigation by the police".

As a result, the defendant's request for "evidence exclusion" – of the statements given by witnesses motivated by the fact that such statements were made at DLAF - is groundless, as long as the prosecutor does not base his accusations on the statements of these witnesses, the statements not being used as evidence in the case file, the only means of proof resulting from the control activity performed by DLAF based on the provisions of Law no. 61/2011 and used as such (as a means of proof) by the prosecutor in the present criminal trial, constituting the control note drawn up by DLAF and the documentation underlying the drawing up of the respective control note, acts, which according to the provisions of art. 11 par. (3) of Law 61/2011 may constitute evidence in the criminal proceeding. Article 11 paragraph (3) of Law No 61/2011 states that: *„The department shall draw up control documents which may constitute evidence, in accordance with the Code of Procedure Criminal, republished, with subsequent amendments and completions"* (Court of Iasi, Criminal Section NCPP, preliminary chamber of the case (file 7231/99/2015/a1), Closing of the council chamber meeting on 21 January 2016).

We note that the preliminary chamber judge has built up an erroneous reasoning because by the claims and the exceptions invoked it was requested to exclude the statements of the witnesses heard at DLAF, motivated by the fact that they are obtained in an extraprocessary framework by an entity that can not be considered as a criminal prosecution body within the meaning of procedural rules.

The preliminary chamber judge motivates that the prosecutor did not understand to use the statements of the witnesses heard by DLAF in the indictment, which is why it is not necessary to exclude them.

If we admit that statements made at DLAF are not used by the prosecutor, then the court should have sanctioned their presence in the case file by excluding them from all the evidence. The error of the preliminary chamber judge is all the more obvious as, according to the indictment, the prosecutor understands to take over entire passages from statements given at DLAF.

Moreover, on the indictment summit we find witnesses heard exclusively by DLAF, without ever being heard by the DNA. It is thus attempted to accredit the idea that although a witness was not heard during the criminal prosecution, it may be proposed by the prosecutor in indictment for the purpose of his hearing for the first time before the court of first instance after the preliminary camera procedure, which is unacceptable.

Even in these circumstances, it is irrelevant whether the prosecutor has capitalized or not the statements given to DLAF, the preliminary chamber being obliged to exclude absolutely any document, declaration or "so-called evidence" obtained outside the procedural framework by an organism that has no jurisdiction in criminal proceedings.

2. LEGAL FRAMEWORK

The law regulating DLAF's activity expressly and exhaustively provides in the art. 20 as: *"The control action is completed by a control note approved by the Head of the Department. The control note may be accompanied, as the case may be, by the minutes of the finding, the minutes attesting to the performance of procedural documents and the minutes of finding and sanctioning contraventions.*

(5) The control note and the annexes constitute the control acts of the Department, according to the Law.

(7) In the case of finding elements of a criminal nature, the Department shall notify the competent prosecution offices to carry out the criminal prosecution, also communicating a copy of the Control Note".

Thus, according to the DLAF framework law, only the control notes, not other documents, statements or annexes, could be submitted to DNA, motivated by the fact that only the control acts expressly provided by the law can be considered means of proof in criminal proceedings, according to art. 11 par. 3 of Law no. 61/2011.

Since the law expressly provides that DLAF communicates a copy of the control note, not other documents, and that only the control notes are means of proof within the meaning of the law, we consider it is necessary to exclude any acts transmitted by DLAF to the DNA, excepting the control notes.

Under such circumstances, documents of probative valencies can not be attached to the case file without being used as means of proof, and the preliminary chamber judge to refuse their exclusion.

3. THE JURISDICTION OF DLAF

DLAF is a legal personality structure within the Government's working apparatus, coordinated by the Prime Minister, and is not a criminal investigation body within the meaning of criminal procedural provisions.

Under its legal powers, the Control Division performs administrative investigations, on-the-spot checks, documentary analyzes and verifications, or conducts control actions in the exercise of the control function.

We observe that DLAF has the status of administrative research organ and can not be assimilated to criminal prosecution bodies.

DLAF has the status of a finding body with regard to acts that may constitute crimes against the EU's financial interests, thus the control measures drawn up by the DLAF control team may be used as evidence in criminal proceedings.

In the event of any evidence of a criminal nature, the Department will notify the competent prosecution office to carry out the criminal investigation, while communicating a copy of the control note.

Another reason why DLAF can not be considered a criminal investigation body is that, in fulfilling its duties, according to the law, DLAF acts on the basis of functional and decisional autonomy, independent of other authorities and public institutions.

According to art. 10 of Law 61/2011 on the organization and functioning of the Anti-Fraud Department, *„The department has jurisdiction as a finding body, within the meaning of art. 61 of the Criminal Procedure Code, regarding acts that may constitute crimes that violates the financial interests of the EU into Romania. The Department may, at the request of the prosecutor, carry out controls on compliance with legal provisions on the protection of the EU's financial interests*"

Art. 11 para. 3 of Law 61/2011, expressly states that: *„The Department shall draw up control notes which may constitute evidence, in accordance with the Penal Procedure Code, republished, with subsequent amendments and completions".*

However, DLAF inspectors are not criminal prosecution bodies, the provisions of the Criminal Procedure Code being as clear as possible in this regard. Art. 55 par. 1 C.pr.pen. provides that the criminal prosecution bodies are: *"the prosecutor, criminal investigation bodies of the judiciary police and the special criminal investigation bodies".*

The attributions of the criminal investigation bodies of the judicial police are fulfilled by specialized officers from the Ministry of Administration and Interior designated under the special law, who received the assent of the General Prosecutor of the Prosecutor's Office attached to the High Court of Cassation and Justice or the assent of the designated prosecutor in this regard.

Special criminal investigation bodies are officers specifically appointed under the law, who have received the assent of the Prosecutor General of the Prosecutor's Office attached to the High Court of Cassation and Justice.

Both the criminal investigation bodies of the judiciary police and the specialized criminal investigation bodies carry out their criminal prosecution under the direction and supervision of the prosecutor.

Under such circumstances, given that DLAF inspectors are under the Prime Minister's coordination and have not received the assent of the General Prosecutor, they can not be considered as criminal investigation bodies and as a consequence can not administer evidence within a criminal proceeding, but only as part of a control action.

In addition, art. 97 C.pr.pen. expressly states that: „the evidence is obtained in the criminal trial"; per a contrario, the evidence can not be obtained as part of a controlling action of an institution subordinated to the Prime Minister.

Moreover, art. 100 par. (1) C.pr.pen. states that: „during the criminal prosecution, the criminal prosecution body gathers and administers evidence both in favor and against the suspect or defendant, ex officio or upon request".

Therefore, the only person authorized to administer evidence according to the law in the criminal prosecution is the criminal prosecution body, which is why, according to art. 102. par. (2) C.pr.pen., it is necessary to exclude all evidence obtained by DLAF in the control action, and these evidence can not be used in the criminal proceedings being administered outside the procedural framework and with the non-observance of the procedural provisions regarding the administration of the evidence.

The same conclusion is drawn from the provisions regarding the rogatory commission. According to art. 200 C.pr.pen. „when a criminal investigative body or court can not hear a witness, make an on-the-spot investigation, proceed with the removal of objects or conduct any other procedural act, it may address another criminal investigative body or other court that has the possibility to carry them out".

The fact that the evidence can be administered only in a criminal trial is also apparent from the provisions of art. 306 C.pr.pen., which highlights the procedural course of the prosecution. It is noted that *"criminal investigation bodies have the obligation, after the referral, to seek and collect data or information on the existence of offenses and to identify the persons who have committed crimes, to take measures to limit their consequences, to gather and to administer the evidence in compliance with the provisions of art. 100 and 101"*.

Under such circumstances, it is obvious that the lawmaker has allowed the administration of evidence in the criminal trial only to a criminal prosecution body or to the court, DLAF not falling into any category, thus having no jurisdiction in administering evidences.

4. CONCLUSIONS

In conclusion, we believe that regardless of the administrative competencies of DLAF, this institutional body subordinated to the Prime Minister can not administer evidence that may be subsequently used in a criminal case.

An alternative to this proposal would be that the DLAF framework law be amended and explicitly mentioned in the normative text that DLAF inspectors should follow the criminal procedural rules on hearing witnesses.

Also, to the extent that DLAF audited witnesses in the control action, we consider that the case prosecutor should have a hearing of all these witnesses in a procedural framework, respecting the right to a fair trial, context in which the defendant`s lawyer can assist and address questions in contradictory conditions.

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ON THE EVOLUTION OF THE ROMANIAN ACCOUNTING RULES FOR LEASING CONTRACTS

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Abstract
The explicit legal rules on leasing operations appeared in Romania in 1997. The accounting rules have been adapted and we find, firstly, an accounting model taken from French accounting and according to which all leasing contracts are recognized in a single category, without any classification of these contracts. With the introduction of some accounting principles of Anglo-Saxon origin (initially as a result of the suggestions made by the international financial institutions), the premises were created for the classification of the leasing contracts into two categories - financial and operational - with different accounting rules. This happened in 1999 and the accounting rules after that date have always kept in mind the separation of the two types of contracts. Considering the history of Romanian accounting, strongly influenced by a continental European patrimony conception, the first solutions proposed by the accounting standard setter are characterized by some inconsistencies, compared to the international accounting rules for the recognition of assets and liabilities. As the Romanian accounting regulations improved, leasing solutions became close to those of international standards, but there remain specific elements that significantly simplify the accounting treatments applied.
Keywords: *leasing contracts, substance over form principle, finance lease, operating lease, accounting recognition criteria.*
JEL Classification: M40

1. INTRODUCTION

In financing the acquisition of fixed assets, Romanian companies choose frequently the leasing operations. This alternative to bank loans or other medium and long-term sources has advantages that make it accessible to a large number of companies at acceptable costs.

In the following, we propose to analyse the evolution of the Romanian accounting rules for leasing contracts. To do this we have chosen to identify the evolutions in the specific regulation of the leasing operations as well as in the related tax rules. Our goal is to highlight the important changes in the accounting mechanisms, as well as the influences that have led to these changes.

Leasing transactions are currently accounted for on the basis of rules that have adapted an Anglo-Saxon accounting principle – substance over form. Thus, a distinction is made between finance lease and operating lease, with consequences on accounting recognition. This distinction is valid since 1999 and can be said to be the result of the Romanian accounting orientation towards the international standards (under the influence of the World Bank and the International Monetary Fund: King *et al.,* 2001; Jianu & Jianu, 2012; Albu & Albu, 2012). Until that time, all leasing contracts were considered, from the point of view of accounting, as operating leases, and the lease recognized all the rent as an expense.

2. EVOLUTION OF SPECIFIC REGULATIONS ON LEASING OPERATIONS

After 1990, the first explicit regulation of leasing operations emerged in 1997 - it is Government Ordinance 51/1997 (OJ 224/1997). Prior to this, in the absence of any specific clarification, the regulation of the leasing operations and, in particular, of their accounting, was made in accordance with the general legal rules. Regarding accounting, the specific norm of that period - GD 704/1993 - had no explicit specification, so that the lease was treated as an ordinary rental operation. In the initial version of GO 51/1997 no specific provisions were made regarding the classification of leasing contracts, so the current accounting of these contracts remains the pre-existing - as regular rental of fixed assets - with some additional disclosure obligations in the notes. This manner of accounting is in line with the continental European patrimonial conception, according to which, in general, only the assets over which the entity possesses all attributes of the property right appear in the balance sheet. This way of accounting is still valid for companies' individual accounts in countries such as France (Colasse, 2015; Richard *et al.,* 2014).

From an accounting point of view, in the original version of GO 51/1997 (slightly amended in 1988), we retain the elements regarding the composition of the rate and those regarding the depreciation of the assets that are the object of the leasing contract. Thus, it is stated that the rent paid by the user is calculated taking into account a profit margin and the depreciation of the given asset, according to the agreement between the parties and in compliance with the special law on depreciation. Regarding the information to be disclosed by the financial statements about leasing contracts, it is stated that the following will be provided: the value of the goods at the beginning of the contract, the total amount of the rents to be paid, the payment of the amortisations (by the lessor), the measurement at the closing date of the remaining rents. For the user, most such information is found in off-balance-sheet accounts, while at the lessor, the value of the good, the receivables, the depreciation are taken from current assets, liabilities or expense accounts, as well as from accounts in off-balance-sheet (especially the collection rents).

The Romanian economy's reform in the 1996-2000 political mandate was carried out with the assistance of the international financial institutions: the International Monetary Fund and the World Bank. Funding from these bodies was not without the imposition of conditions to guide the reform. One of these conditions was to modernize the financial reporting system and, implicitly, the accounting system. For this, the source of inspiration proposed by the two bodies and accepted by the Romanian authorities were international accounting standards (IAS at that time). These rules were built especially to operate in a predominantly Anglo-Saxon economic, financial and cultural environment. Thus, in Romanian accounting regulations, the consequences of accounting principles unknown until then and even unsupported in mainland Europe have occurred. As far as we are concerned, we retain the substance over form principle. By virtue of this principle, transaction accounting should not only reflect the legal appearance of the contracts and other documents that justify them, but rather the economic substance of those transactions. This accounting principle of Anglo-Saxon origin also influenced the legal regulation of leasing operations. Law 99/1999 (OJ no. 236/1999) significantly amended GO 51/1997, including by introducing a classification of leasing contracts specific to the substance over form principle.

Thus, the two types of leasing contracts - finance lease and operating lease - specific to rules applied on some developed financial markets - were introduced into the specific leasing legislation and the separate model of accounting for these two types of contracts is created, according to the substance over form principle. Thus, OG 51/1997 states that finance lease is a lease that meets one or more of the following conditions:

- the risks and rewards incidental to ownership of a leased assets are transferred from the lessor to the lessee at the inception of the contract;
- ownership of the assets is expressly transferred to the lessee by the end of the lease term;
- the lessee has the option to purchase the assets at a price which represent no more than 50% of the initial cost of the assets, at the date when the option can be exercised;
- the period of the contract covers at least 75% of the economic life of the assets, even if the ownership is not transferred.

These conditions are only a copy-paste followed by a partial adjustment of the rules present in the international accounting standard in force at that time (IAS 17). Contracts that do not meet any of the four conditions listed above are operating leases.

Of course, the distinction between financial leasing and operating leases also has consequences for the calculation and composition of the rents as follows:

- for finance lease, the rent is calculated taking into account the cost of the assets and the related lease interest, spread over the period of the contract; purchases of fixed is treated by the lessee as investments and subject to depreciation in accordance with specific regulations;

- for operating leases, the rent is calculated taking into account the profit negotiated by the parties and the depreciation of the cost of the assets; the depreciation regime is determined by the parties by mutual agreement in accordance with the specific regulations;

- the calculation and recognition of the depreciation of the asset covered by the contract is made in the case of operating leasing by the lessor and, in the case of finance leasing, by the lessee.

The criteria for classification of finance and operating lease contracts were presented in Government Ordinance 51/1997 (republished in Official Gazette no. 9/2000) until 31.12.2013, being removed from the ordinance to be explicitly taken over in the first version of the fiscal code (Law 571/2003): the limits of 50% of the price to purchase the assets was removed.

After this date (1.01.2004), the amendments to GO 51/1997 did not significantly affect the classification of leasing contracts in finance lease and operating lease, making at the most the reference to the composition of the leasing rent, distinguishing between the two categories of contracts: capital restitution plus interest – in the case of the finance lease – , respectively, the negotiated rent between the parties, in the case of operating lease. However, we can see an evolution in the classification criteria by adjusting some of the initial ones or adding some new, as we will see below.

3. TAX RULES ON LEASING OPERATIONS

Until the tax code was taken over by the tax classification of finance and operating lease contracts, income tax rules did not expressly limit the deductibility of the costs incurred by lessee in leasing contracts. Thus, the rent, for operating lease, and depreciation expense plus interest-bearing charges, for the finance lease, were deductible under the normal conditions for expenses that were of this nature.

Since 2004, in the first version of the Fiscal Code, the criteria for classifying leasing contracts are the three above mentioned, which refer to the transfer of risks and benefits, to the explicit option of purchasing the assets and the duration of the contract. Further developments in the tax law have led to the completion of the definition, so at present there are five criteria invoked by the tax code to distinguish between financial and operational leasing:

a) the risks and benefits of ownership of the leased asset are transferred to the user at the inception of the lease contract;

b) the leasing contract expressly provides for the transfer of the ownership on the leased asset to the lessee at the term of the contract;

c) the lessee has the option to purchase the asset at the term of the contract and the guarantees residual value in percent is less than or equal to the difference between the normal maximum operating duration and the duration of the leasing contract in relation to the normal maximum useful life expressed as a percentage;

d) the leasing period exceeds 80% of the normal maximum fiscal life of the leased asset; within the meaning of this definition, the lease period includes any period for which the lease may be extended;

e) the total value of the lease rents, less the contingent rent, is greater than or equal to the initial cost of the asset.

We will see that these criteria do not entirely overlap with those retained by the accounting rule.

4. ACCOUNTING RULES ON LEASES AND THEIR EVOLUTION TO REFLECT THE SUBSTANCE OF TRANSACTIONS

Until the Romanian law took over the distinction between financial lease and operating lease contracts, all contracts were considered as regular rentals, i.e. the assets remained in the lessor's balance sheet (the leasing company), where they were depreciated. The lessee had only to recognize rents as expense invoiced by the lessor - rent which, for the latter, represented income. This accounting model was completed by the presentation of off-balance-sheet information on the collection/payment rents.

4.1. The first accounting regulation on financial leasing contracts

The introduction by the law 99/1999 of the two categories of leasing contracts made the accounting regulation to date to be filled in with specific provisions, allowing the recognition of the financial leasing operations to both the lessee and the lessor. Thus, the order of the ministry of finance OMF 686/1999 *approving the regulations on the accounting of leasing operations* was issued, trying to adapt accounting standards at that time. Considering the strong patrimonial character of the Romanian accounting in the 1990s and the predominantly francophone influences on it, as well as the fact that the new approach was a profoundly economic one, the solution given by OMF 686/1999 was a bold one, but today it seems to be partly inconsistent with the current criteria of assets and liabilities recognition. This solution is still proposed by the *OMPF 306/2002 approving Simplified Accounting Regulations, harmonized with EU directives*, in force till 2005. Our next comments therefore refer to both orders of the Minister of Finance.

To pinpoint the main milestones of the discussion, it is useful to identify the main parties that typically enter into a finance lease:

- the lessee, that is, the person who will receive and exploit the asset covered by the contract in exchange for the payment of the lease rents;

- the lessor (the leasing company) who, in the case of a contract relating to an asset it does not possess, buys from the supplier the asset covered by the contract, pays the supplier and transmits the assets to the lessee;

- the supplier who invoices the asset to the leasing company and sends it to the lessee, receiving the price from the lessor.

We do not retain the operating lease in our analysis because it is still recognised for as an ordinary lease: the asset appears in the leasing company's accounting (which depreciate it), it recognise on revenues the full rent invoiced, and the user has the accrued rent of expense. We also do not take into account the recognition of amounts in off-balance sheet accounts (rentals, payable/ receivable).

OMF 686/1999 introduces new rules for accounting for financial leasing, but can not rely on the substance over form principle, because this principle was not yet present in the accounting regulation. In table 1, we sum up these accounting rules for finance lease to the lessor, with observations regarding their suitability at that time and thereafter. We also mention the fact that in the OMF there are explicit accounting formulas for recording the operations we are dealing with.

Table 1. Rules for accounting for leases in OMF 686/1999 and in OMFP 306/2002, at the lessor

Operation	*Rules in OMF 686/1999*	*Observations*
Procurement of the asset to be the object of the contract	Recognised as a fixed assets.	Recognising the good as a fixed asset is exaggerated because the leasing company does not intend to use the assets as such, but to lend it.
The asset transfer to the lessee	The cost of the good is transferred from fixed assets to long term receivables.	Long-term receivable is normal, the transfer from the fixed assets is covered by our previous comment.
Recognising of the interest of the contract	The interest is recognised as a distinct long-term receivables in correspondence with deferred income.	The long term receivable and the deferred income do not meet the current recognising criteria: there are not the results of some past events. At most, they can be accepted in the current accounting, but only in the case of their set-off (one against the other) at the presentation of the balance sheet.

Operation	***Rules in OMF 686/1999***	***Observations***
Invoicing a rent	There is a short term receivable in correspondence with an operating revenue (non-interest rate) and deferred interest account. Income from interest appear that transfer to income in advance (472 = 766) and decreased lease receivables the principal is recognised by transferring the long term receivables to expenses (658 = 267)!	The revenue of the leasing company (like any other financial institution) is interest and the recognition of the principal component of the instalment revenues is exaggerated. Interest income appears as a transfer from the deferred income, while the receivable decreases by its staggered transfer to the expense: there are unjustified expenses and revenues on the nature of the transaction.
Invoicing of the residual value of the good	No explicit explanations appear.	We can imagine that the logic is the same: there will be a revenue and an expense equal to the balance of the long term receivables - both unjustified.
Asset recovery as a result of the restitution from the lessee (this latter does not purchase the assets)	No explicit explanations appear.	Probably the assets is re-recognised by the lessor as a fixed assets (in the same manner as to the beginning of the contract), which is again exaggerated, except where the leasing company intends to use it as such.
Another contract with an assets the lessor already possess (for example, it was recovered from a previous contract)	Not explicit explanations appear	Perhaps the lessor begin again the same accounting records: transferring the assets to long-term receivable, recording the interest as deferred income etc.
Lease-back operations	No explicit explanations appear	The accounting formulas related to standard lease contracts are likely to be adjusted.

From table 1, but also from table 2, it appears that, in its original form, the regulation of accounting for financial leasing operations suffers from the lack of sound criteria for recognition of assets and liabilities, and also from the rather rigid way in which the income classification is made. Thus, with regard to the general accounting rules that we apply today and which are decisively influenced by IAS/IFRS, we find the following inconsistencies in the initial regulation:

- the asset purchased by the leasing company from the supplier to be transferred to the user goes first to PPE, while he participates in a single operating cycle, being at most inventory, if it goes not directly to long-term receivables, in correspondence with the recognition of the liability to the supplier;

- the recognition of the interest as a deferred income (to the lessor) and to deferred expense (to the lessee) is not justified, especially since the interest is essentially a result of the passage of time and we cannot really recognise interest for future periods - we only recognize the past interest, the expenses / income of the period to which it relates; this is perhaps also the reason why some more fundamental accounting rules require the presentation of interest payable in off-balance sheet accounts;

- for recording the rent, the best solution is the transfer of the long-term receivable / liability to the short-term receivable/liability with the direct recognition of the interest on the specific income/expense;

- even if the operation is a loan to which only an interest correspond to a revenue, OMF 686/1999 impose to recognise all the rent in revenues - this situation is specific to the operating lease.

In OMF 686/1999 there is no explanation as to how transactions such as the non-exercise of the purchase option could be accounted for by the lessor or the consequences of such non-exercise on future transactions with the asset. Normally, the assets (re)acquired are inventories and their sale or transmission in new financial leasing contracts should take account of this classification. This solution is recommended by IAS 17, which may be a basic benchmark, in the absence of another rule that addresses the issue.

Table 2. Rules for accounting for leases in OMF 686/1999 and in OMFP 306/2002, to the lessee

Operation	***Rules in OMF 686/1999***	***Observations***
Receiving the asset in a finance lease	Asset is recognized as non-current asset, according to this nature (tangible or non-tangible) in correspondence with a long-term liability.	The solution is correct, discussions arise about the amounts to record.
Interest of the contract	The interest is recognised as a deferred expense in correspondence with another long-term liability	No liability or prepaid expenses are to be recognised: they do not meet the criteria for the accounting recognition – especially they do not arise from a past event. At most, we could accept them in the current accounting, but in the balance sheet, they must to be set-off one against the other.

Operation	*Rules in OMF 686/1999*	*Observations*
Invoice of rent	There is short term liability transferred from a long-term one: for the principal and for the interest. Also, the interest appear as a current expense transferred from the deferred expense (666 = 471).	The initial recognition of the interest as a prepaid expense impose the transfer to the current expense.
Depreciation of the asset	Accounting for depreciation is normally done, but the lessee has not the option to choose to depreciate on the minimum economic life and contract period.	The consequence of substance over form is that the lessee has to recognize two expenses: the depreciation and the interest (there are some other expenses, but not really specific only to leasing contract: insurance, any commissions, exchange rate differences).
Invoice for the residual value	Close your long-term debt account.	The solution is correct.
Return of the asset to the lessor: lessee renounce to the contract or it doesn't purchase the assets at the end of the contract	No explicit explanations appear.	We have to balance all the accounts involved: tangible/intangible asset, cumulated depreciation, long-term liability, recognizing an expense or an income to arrive at the equilibrium debit = credit.
Lease-back contracts	No explicit explanations appear.	This operation was probably recognised according to the documents: sale of an asset, followed by a new finance lease contract, with all the gains, expenses involved.

In the case of the lessee, the most important difficulty was the initial recording of the interest on prepaid expenses and liabilities: the recognition criteria are not meet. The solution could have become acceptable in the current accounting, provided that in the balance sheet there is a set-off of the two accounts. However, this solution does not go too far into an accounting system where accountants often expect official solutions in the accounting regulations and in which the balance sheet format come with algorithms imposed by the standard setter.

In terms of lease-back contracts, there is nothing explicit about their accounting until 2008, so we can imagine that the general rules have been adapted:

- the supplier-lessee sells the asset and, after, enter in a leasing contract, showing separately each transaction (sale, derecognition of the assets, acquisitions of an assets in a leasing contract, depreciation of the new cost...);
- the leasing company purchases an asset and then transferred it to long-term receivables, followed by the normal accounting records.

4.2. Better adaptation of the accounting regulation, with substance over form as an explicit accounting principle

After applying OMF OMPF 686/1999 and 306/2002, i.e. until 2005, the OMPF 1752/2005 *for the approval of accounting regulations compliant with European directives* eliminates most of the inadequacies of the old rules, regarding the accounting for leases. Moreover, in the content of OMFP 1752/2005, it is explicitly stated that the substance over form principle applies in accounting for finance lease contracts.

In the original version of the OMFP 1752/2005, the criteria for classifying leasing contracts are not explicitly presented, as they are added at the end of 2006 (by OMFP 2001/2006). The criteria thus retained are the same as those in the regulation specific to non-banking financial institutions and differ slightly from the fiscal ones (see table 3). A similar analysis, which compares the Romanian accounting rules with the Romanian tax rules and the provisions of IAS 17, and comments on the differences and similarities between the norms we find in Cristea & Jianu (2010).

Table 3. Accounting and tax criteria for identifying a finance lease in 2007

Overall criteria	***Normal accounting rules - OMPF 2001/2006***	***Accounting rules for non-banking financial institutions (IFN) - 24/2006 OBNR***	***Tax rules - Law 571/2003 modified***
Transfer of risks and benefits related to the property from the lessor to the lessee	Yes, a general condition, from which derives the five criteria listed below. Transferring ***most*** of the risks and rewards of ownership of the asset.	Yes, a general condition, from which derives the five criteria listed below. Transferring ***substantially*** the risks and rewards of ownership of the asset.	Yes, but it is one of the five conditions listed in the code, in line with the others, without specifying that the other ones are derived from it.
The explicit ownership transfer at the end of the contract	Yes, identical wording.		Yes, the provision in the contract must be **explicit.**
Low price to exercise the	Yes, identical wording: the price of the purchase is estimated to be **small enough**		Yes, but with a formula to apply: in

Overall criteria	*Normal accounting rules - OMPF 2001/2006*	*Accounting rules for non-banking financial institutions (IFN) - 24/2006 OBNR*	*Tax rules - Law 571/2003 modified*
purchase option, so buying is very likely	compared to the fair value at the date the option becomes exercisable.		percentage, the residual value is less than or equal to the difference between the economic life and maximum lease term, relative to the economic life
Duration of the contract in relation to the economic life of the asset	Yes, an identical condition: the contract should cover, ***for the most part,*** the economic life of the asset, without specifying an explicit threshold		Yes, but the duration of the contract must be at least 80% of the economic life of the asset.
The minimum lease payments in relation to the initial cost of the asset	Yes, identical formulation: the total lease payments, except any contingent rent, is greater than or equal to the cost of the asset as it is identified by the lessor.		Yes, without detailing what the cost means.
The special nature of the asset subject to the contract	Yes, common condition, explicitly presented.		Doesn't appear.

The main changes made by these regulations in the sense of alignment to international standards were:

- the annulation of the obligation to recognize interest on prepaid incomes/expenses;

- taking into account the previous observation, accounting for invoicing the rent at the lessor becomes the normal one – only the interest is recognized in revenue, and the repayment of principal is a simple transfer from the long-term receivable to the short-term receivable;

- in order to ensure fair and suggestive financial reporting to leasing companies, OMFP 1752/2005 states that the interest income invoiced to users will be shown in the profit and loss account in the revenues.

However, there are elements taken from OMFP 306/2002 and which do not correspond to the economic background of transactions. Thus, for the financial leasing company, the initial accounting for tangible assets of the asset subject to the contract remains valid, after which it is transferred to financial receivable - this solution is explicitly presented in OMFP 1752/2005; Instead, the IFN accounting rule does not say anything explicit about this, which may mean that the solution is not necessarily the same. We reiterate that the best solutions are that:

- in the case of a new asset purchased from the supplier for transferring to the lessee, its recognition as an asset of the leasing company is not necessarily a good solution, because it is sufficient to recognize the receivable to the lessee;
- if the asset return to the lessor as a result of the renouncement of the lessee to exert the purchase option or for other reasons, then the asset must be taken to inventory and only to be acquired (and depreciated) if it has been intended for use as such by the leasing company (we join for this topic Păunescu, 2009).

Another problem solved by OMFP 2001/2005 is the explicit regulation of how a lease-back contract, including a financial one, is accounted for to the lessee. In the case of financial leasing, the solution is in total agreement with the substance over form principle: independent of the existence of supporting documents (the sales invoice from the supplier to the leasing company, the leasing contract itself), the recognition is done exclusively as a long term financing operation, without any derecognition of the asset without recalculation of depreciation. The solution has remained so far and can bring a significant difference between tax records (taxable income and deductible expenses on sale and depreciation determined on the basis of the value negotiated of the financial leaseback) and accounting records.

4.3. Switching financial leasing companies under the direction and supervision of NBR

By GO 28/2006 *on regulating certain financial-fiscal matters* financial (non-banking) institutions, including financial leasing companies, are subject, in terms of accounting rules (but also in terms of the authorization, functioning and financial reporting), to the regulations issued by the NBR (see also Păunescu, 2009). This rule is continued by law 93/2009 *on NFIs*. In this context, accounting and financial reporting of financial leasing companies (and other IFN) is organized and governed by specific rules set by the NBR (with the Ministry of Finance and in accordance with the accounting law) and not by the general rules applicable to other companies. In table 4, we present the successive regulations for the accounting and financial reporting of companies, starting with 2007 (in 2006, OMPF 1752/2005 applies to all entities, except for credit institutions).

For 2007-2008, the specific rules of financial leasing companies are almost identical to those of OMPF 1752/2005, even if the symbols of the accounts are different. The same happens in the accounting of the lessee; for the latter, the rules remain valid and continue as long as OMPF 1752/2005 applied, and even after the entry into force of OMPF 3055/2009, continued along the same lines and OMPF 1802/2014 (both in classifying leasing contracts, as well as in the recognition of lease-back contracts).

Since 2010, OMFP3055/2009 doesn't establish any explicit rules for financial leasing companies (lessors) - this is justified by the fact that financial leasing companies are not subject of OMPF 3055/2009, the rules relating to them are exclusively specific to NFIs (see table 4). Thus, for lessors, we continue to look in successive orders of NBR regulating the accounting of IFN.

Table 4. Evolution of financial leasing accounting rules starting in 2007

Period	*Finance lease to the leasing company (and lessee as credit institutions and IFN)*	*Finance lease to the lessee (other than credit institutions and non-banking financial institutions)*
2007 - 2008	NBR Order no. 5/22.12.2005 for the approval of accounting regulations compliant with European directives, applicable to credit institutions modified by the NBR Order 24/2006	OMPF 1752/2005 for the approval of accounting regulations compliant with European directives
2009 - 2011	NBR Order no. 13/19.12.2008 for the approval of accounting regulations compliant with European directives, applicable to credit institutions, non-banking financial institutions and the Deposit Guarantee Fund in the Banking System	Until 2009 including: OMPF 1752/2005 for the approval of accounting regulations compliant with European directives
		2010 and 2011: OMPF 3055/2009 for the approval of accounting regulations compliant with European directives
2012 - 2015	NBR Order no. 27/27.12.2011 for the approval of accounting regulations compliant with European directives	2012 to 2014: OMPF 3055/2009 for the approval of accounting regulations compliant with European directives
		2015: OMPF 1802/2014 for approval of accounting regulations on the individual and consolidated financial statements
2015 - present	NBR Order no. 6/17.07.2015 for the approval of accounting regulations compliant with European directives	OMPF 1802/2014 for approval of accounting regulations on the individual and consolidated financial statements

OBNR 13/2008 defines and classifies leases just like for the others companies, and establishing identical rules on lease-back and amortization of the assets subject to the lease contracts. For the specific accounting for financial leasing companies, details of initial recognition are: "Lessors shall recognize assets in a finance lease as a receivable at an amount equal to the value of assets leased". I could not find anything about the possible recognition of the location of the goods covered by the lease immediately after its purchase from the supplier for transmission to users nor to the recovery of these assets if the user does not exercise the purchase option or if it terminates.

Only in OBNR 27/2011 we could explicitly find a solution for the recognition of the assets recovered from lessees: they go to inventories and become non-current assets only if the leasing company decides to use them as such. This provision near to IFRS is supplemented by the rule that the assets are sold as inventory and generate revenues and expenses accordingly. Besides these novelties, OBNR 27/2011 retains the same rules as the previous order on the definition, classification, depreciation, composition of rents, lease-back.

On the same line that keeps going and OBNR 6/2015 which was the previous order regarding classification and accounting for leases.

5. CONCLUSIONS

The purpose of our study is to analyze the evolution of the accounting rules for leasing contracts, highlighting the legal and fiscal context in which these operations take place in Romania. Our primary goal is to highlight the important changes in accounting mechanisms, as well as the influences that have led to these changes. Starting from the original French inspired accounting models, the solutions proposed by the present accounting regulations are more close to those recommended by international standards (of Anglo-Saxon origin).

The first explicit regulation of the leasing operations in Romania appears in 1997 and, until 1999, this law does not make any distinction between different categories of lease contract. However, starting with 1999, the influence of international standards is also felt in the regulation of leasing, so the distinction between operational leasing and financial leasing is introduced, by analyzing four criteria (very partially) taken from the IAS 17: transfer of risks and benefits, the promise of purchasing the asset by the user, the proportion of the purchase price in the cost of the assets, the duration of the contract in relation to the economic life of the assets. These criteria have been completed and adjusted, both on an accounting and a tax basis, so that today they are closer to IAS 17, without overlapping this norm. In fact, IAS 17 is to be replaced by IFRS 16 (starting with financial years beginning on or after 01/01/2019 - Săcărin, 2017), and this replacement will significantly modify the financial-operational classification criteria. It is to be observed to what extent and when the Romanian authorities will consider this evolution of the international norm.

From the fiscal point of view, the recognition of the leasing operations is in a very close manner to the accounting one, with insignificant differences in the duration of the leasing contract. We can assume, however, that for the vast majority of Romanian companies the accounting recognition overlaps the fiscal one, especially because of the criteria stated by the two norms, only one must be fulfilled in order for the contract to be financial leasing.

The main issues that we can highlight in terms of accounting for financial leasing contracts (both in the general accounting regulations and in the one specific to credit institutions) can be summarized as follows:

- at the lessor, the newly purchased asset subject to a finance lease is not a fixed tangible asset, but goes directly to long-term receivables;
- the rent is composed of interest and capital repayment, which means that the leasing company's revenue is limited to the perceived interest and is recognized as the rates are invoiced;
- if the asset reaches the leasing company as a result of the user not having exercised the option of purchase or as a result of the cancellation of the contract, then the asset must be taken to inventory, and only to be recognized as a tangible fixed assets (and depreciated) if it has been intended for use as such by the lessor;
- financial lease-back contracts do not generate any kind of asset outflows in the lessee's account, the only influence being the financing operation.

The main limit of the study is its descriptive nature, without any empirical observations on how the accounting rules of leasing operations are applied by Romanian companies and the impact of these operations on the information disclosed in the financial statements.

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STATUTORY AUDIT IN EUROPE – STATE OF THE ART, CHALLENGES, AND TRENDS

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Abstract
In the last years, in European Union, some new rules were adopted for the statutory audit of the public interest entities (PIEs) by the Directive 2014/56/EU (an amending directive) and by the Regulation No 537/2014. The purpose of these rules is to enhance the independence and the professional skepticism of the statutory auditors. The main requirements for statutory auditors are mandatory audit firm rotation and prohibition of non-audit services for the audit clients. In addition, the amending directive sets out a framework for the statutory audit and tries to improve the public oversight of the audit profession and the cooperation between authorities in the field of the statutory audit in the EU. In this context, the purpose of this study is to discuss the state of the art, the challenges, and the trends of the statutory audit in European Union. Because the primary objective of the reform of the statutory audit is to increase the quality of this important service for the orderly functioning of markets, this study contributes to the literature by identifying new changes that are necessary for the audit profession.
Keywords: *statutory audit, public interest entities, European Union, reform.*
JEL Classification: M41, M42, M48

1. INTRODUCTION

In this study, I analyze the level of implementation of statutory audit reform in European Union, the challenges of this process, and the trends as a consequence of this reform, by addressing three research questions. First, what are the European countries that have implemented the new audit requirements? Second, what are the most important difficulties in implementing these requirements? Third, in what way will the accounting profession be influenced by the changes occurred?

The research questions are of interest for researchers, regulators and auditors because this reform is in progress and the consequences for the future of the audit profession will be important and not easy to predict.

In the effort to improve the public oversight of the audit profession and the cooperation between authorities in the field of the statutory audit, and to enhance the independence and the professional skepticism of the statutory auditors, some new rules were adopted in the European Union (Directive 2014/56/EU and

Regulation No 537/2014). In this context, we discuss in the paper the new requirements for the statutory auditors for identifying challenges and trends in the audit profession in the EU.

2. BACKGROUND

According to the International Standards on Auditing and to the European Directives, the role of a statutory audit is to certify the financial statements of companies or public interest entities, providing an opinion on the accuracy of companies' accounts. Stakeholders expect from the auditors the improvement of the confidence in the integrity of financial statements because it is the directors or management who prepare the accounting information.

Nowadays, the main debate is about mandatory auditing, but "the existence of a public or regulatory demand for auditing does not diminish the relevance of an analysis based on voluntary demand" (Arruńada, 1999, p. 6).

Anyway, there is a gap between voluntary demand for auditing in USA and in continental Europe, as for the mandatory demand. If in USA mandatory auditing of the public companies was adopted by the Securities Act in 1933, in Europe, only in 1978, auditing of public interest companies' financial statements starts to become mandatory, by adoption of the different Community directives (Arruńada, 1999).

In the last years, we assist to an increasing level of globalization. In this context, the European Union cannot stay away from the new challenges that appeared in the field of statutory audit. However, in the last two decades, maybe more than in other periods, auditing is in a state of crisis. But this is not a new situation, because after each crisis in business take place, appear a crisis in auditing. As a consequence, after such a cycle, the rules have become tighter. It is the case of the recent reform in the field of statutory auditing in European Union imposed by the Directive 2014/56/EU and the Regulation No 537/2014.

In 2017, European Commission declared that her goals in the field of statutory auditing are to (EC, 2017):

- improve the independence of statutory audit firms and auditors from the entity being audited;
- enhance the informational value to investors of audit reporting;
- help cross-border provision of statutory audit services in the EU;
- contribute to a more dynamic audit market in the EU;
- enhance audit supervision;
- foster convergence and cooperation with non-EU countries.

In this context, I notice that EU regulation providing a new EU framework for statutory audit was adopted in April 2014, but the law should have been applied (with exception of mandatory audit firm rotation) in EU members to the first financial year starting on or after 17 June 2016. Unfortunately, not all EU countries adopted the national legislation for implementation of the new EU regulatory framework for statutory audit.

Anyway, there are many opportunities for research, some of them driven by the new rules established for the EU Member States. But it must be accepted that actual reform in statutory audit is different from the previous reforms (Hay, 2015). For many years, the auditing profession has fought for self-regulation and this objective has been achieved. Now, one of the requirements from the new European legislation is to enhance public oversight of the profession. On the other hand, is not sure that self-regulation is the cause of the catastrophic failure of the last two decades. Nobody can be sure that independent regulation will be more successful.

3. REASEARCH METHODOLOGY

In order to estimate the degree of implementation of EU regulatory framework for statutory audit in the national legislation, I performed, first of all, an analysis of the European legislation on the statutory audit. Then, I analyzed the information available on the site of European Commission and on the site of KPMG on the topic of EU audit reform in order to obtain an understanding of what are the challenges for EU members in the context of the audit reform imposed by new directives and regulation. Also, in order to study the evolution in the process of implementation at European level of these new rules, I included in the analysis the study performed by Dumitru (2016) which also started from the information presented by the interactive country map from KPMG site. In the same time, to better understand why the EU Member States established different rules for audit firm rotation and for non-audit services, I used a very consistent research made by Arruńada (1999). The recent researches made by Hay (2015) and Lombardi *et al.* (2014) on the topic 'future of audit' were very useful for the purpose of my study.

4. STATE OF THE ART IN STATUTORY AUDITING

From the beginning, I think it is important to observe that Regulation No 537/2014 refers explicitly to the following: (a) statutory auditors and audit firms carrying out statutory audits of public-interest entities; (b) public-interest entities. According to this regulation, public interest entities (PIEs) are listed companies, credit institutions, insurance undertakings, or other undertakings designated by EU countries to be of public importance. For the PIEs, these new rules established two main requirements: auditors will rotate on a regular basis and will no longer be allowed to provide certain non-audit services to their audit clients.

According to the Article 17 of the Regulation No 537/2014, duration of an audit engagement is established at 10 years, but in special conditions this period may be extended to the maximum duration of:

- 20 years, where a public tendering process for the statutory audit is conducted;
- 24 years, in the case of joint audit.

In a recent study, Dumitru (2016) realized an analysis, based on the data from KPMG interactive country map, on the stage of implementation of audit reform in the EU, until October 2016.

I continued the analysis started by Dumitru and I found that, compared to October 2016, when just 10 countries had adopted new rules, in May 2017, the list of countries that have completed the process of adopting the new rules on statutory audit includes 22 countries: Austria, Belgium, Bulgaria, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Malta, Latvia, Lithuania, Luxembourg, Netherlands, Portugal, Slovakia, Spain, Sweden, United Kingdom. For United Kingdom, the information is not available on the KPMG interactive country map.

On the issue of the mandatory audit firm rotation in the EU Member States, the results are presented in the Table 1.

Table 1. Rotation of the audit firm

COUNTRY	STANDARD ENGAGEMENT (YEARS)	PUBLIC TENDERING PROCESS (YEARS)	JOINT AUDIT (YEARS)
Regulation No 537/2014	10	20	24
Austria	10	10	10
Belgium	9	18	24
Bulgaria	7	7	7
Czech Republic	10	20	10
Denmark	10	20	24
Finland	10	20	24
France	10	20	24
Germany			
- All PIEs, except banks or insurance companies	10	20	24
- Banks or insurance companies	10	10	10
Greece	10	10	10
Hungary			
- All PIEs, except banks or insurance companies	10	10	10
- Banks or insurance companies	8	8	8
Ireland	10	10	10
Italy	9	9	9
Malta	10	20	10

COUNTRY	STANDARD ENGAGEMENT (YEARS)	PUBLIC TENDERING PROCESS (YEARS)	JOINT AUDIT (YEARS)
Latvia	10	20	10
Lithuania	10	10	10
Luxembourg	10	20	10
Netherlands	10	10	10
Portugal	8/9	8/9	8/9
Slovakia	10	20	24
Spain	10	10	14
Sweden			
- All PIEs, except banks or insurance companies	10	20	24
- Banks or insurance companies	10	10	10

Source: own processing based on KPMG (2016) and Dumitru (2016)

But the new rules for EU Member States also established an appropriate gradual rotation mechanism with regard to the key audit partners carrying out the statutory audit on behalf of the audit firm. In this respect, they must "cease their participation in the statutory audit of the audited entity not later than seven years from the date of their appointment and they shall not participate again in the statutory audit of the audited entity before three years have elapsed following that cessation" (Regulation No 537/2014, Article 17.7). I present below (Table 2) the rules adopted by the EU countries regarding the rotation of key audit partners and the 'cooling –off period' as it is result from KPMG interactive country map.

Table 2. Key audit partner rotation

COUNTRY	KEY PARTNER ROTATION (YEARS)	PAUSE BETWEEN CONSECUTIVE ENGAGEMENTS (YEARS)
Regulation No 537/2014	7	3
Austria	7	3
Belgium	6	3
Bulgaria	4	3
Czech Republic	7	3
Denmark	7	3
Finland	7	3
France	6	3
Germany	**7**	3

COUNTRY	KEY PARTNER ROTATION (YEARS)	PAUSE BETWEEN CONSECUTIVE ENGAGEMENTS (YEARS)
Greece	5	3
Hungary	5	4
Ireland	5	3
Italy	7	3
Malta	7	3
Latvia	7	3
Lithuania	5	3
Luxembourg	7	3
Netherlands	5	3
Portugal	7	3
Slovakia	5	3
Spain	5	3
Sweden	7	3

Source: own processing based on KPMG (2016) and Dumitru (2016, p. 54)

For many EU countries, (for example, Czech Republic, Latvia, Luxembourg) – local legislation does not provide any specific guidance on key audit partner rotation, therefore the "EU baseline" requirements apply. These rules apply for the majority of EU countries for the "cooling-off period".

Some countries go beyond the EU baseline both in terms of mandatory audit firm rotation and in terms of key audit partner rotation. The most restrictive legislation is in Bulgaria (7 years for audit firm rotation and 4 years for key audit partner rotation).

Another issue that has generated many controversies and discussions is that of other services than the statutory audit which audit firms can provide. In fact, the new legislation established rules forbidding or restricting the supply of certain non-audit services (NAS) by a statutory auditor to their PIE audit clients.

Faced with earlier permissive legislation, the new rules set out the following categories of services to be prohibited (PwC, 2015):

- Tax and tax compliance services (with some exceptions);
- Services that involve playing a part in the management or decision making of the audited entity;
- Bookkeeping and preparing accounting records and financial statements;
- Payroll services;
- Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial IT systems;
- Valuation services, including valuations performed in connection with actuarial services or litigation support services (with some exceptions);

- Legal services;
- Services related to the audit entity's internal audit function;
- Services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity.

Nevertheless, for some of these services (for example, tax and valuation services), EU Member States can allow exceptions and, even is unclear at this moment which countries can do this, the states can add services to the list of prohibited services.

I notice variation in the type of non-audit services that different legislative systems allow auditors to provide for their audit clients. Table 3 summarizes the current rules in the EU countries. For some countries, it is presented the situation before the adoption of the new rules.

Table 3. Non-audit services (NAS) that audit firms are allowed to provide to their statutory audit clients

COUNTRY	TAX SERVICES	VALUATION SERVICES	NAS ACCEPTED BEFORE CURRENT RULES
Austria	Yes	Yes	- Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery
Belgium	Yes	Yes	NAS prohibited
Bulgaria	Yes	No	N/A
Czech Republic	Yes	Yes	N/A
Denmark	Yes	Yes	- Bookkeeping and accountancy - Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery
Finland	Yes	Yes	- Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery
France	Yes	Yes	NAS prohibited

COUNTRY	TAX SERVICES	VALUATION SERVICES	NAS ACCEPTED BEFORE CURRENT RULES
Germany	Yes	Yes	- Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery
Greece	No	No	- Tax - Consultancy - Financial advisory services - Corporate recovery
Hungary	Yes	Yes	N/A
Ireland	Yes	Yes	- Bookkeeping and accountancy - Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery
Italy	No	No	NAS prohibited
Malta	Yes	Yes	N/A
Latvia	Yes	No	N/A
Lithuania	Yes	No	N/A
Luxembourg	Yes	Yes	- Bookkeeping and accountancy - Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery
Netherlands	No	No	- Bookkeeping and accountancy - Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery
Portugal			- Bookkeeping and accountancy - Tax - Consultancy - Financial advisory services
Slovakia			N/A

COUNTRY	TAX SERVICES	VALUATION SERVICES	NAS ACCEPTED BEFORE CURRENT RULES
Spain	Yes	Yes	- Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery
Sweden	Yes	Yes	- Bookkeeping and accountancy - Tax - Legal services - Consultancy - Financial advisory services - Corporate recovery

Source: own processing based on KPMG (2016) and Arruńada (1999, p. 141)

If there are two countries (Portugal and Slovakia) that have not introduced a list of permissible services, Netherlands is in the opposite situation, because this country has a complete ban on services except for the ‘whitelist’ of assurance services. The situation from Netherlands is surprising because, in the past, it was one of the most permissive countries from OECD regarding NAS.

Close to Netherlands is France who has added the following services to the blacklist (KPMG, 2017):

- Services relating to the preparation or communication of financial information;
- Services relating to legal advice, drafting legal acts or Corporate secretarial services;
- Providing contribution in-kind reports or fairness opinions in the context of a merger or a contribution in-kind;
- Full or partial provision of outsourcing services;
- Cash handling services.

France is one of the countries who have prohibited all NAS in the past, so the current situation is not very surprising. Italy was consequent and kept the rules of not allowing NAS until now.

5. CONCLUSIONS

In the EU countries, can be observed consistency in setting the initial duration of engagement period at ten years, with divergences in the extension of the initial duration in case of tender or joint audit (6 different periods for public tendering process and for joint audit).

Regarding the rules for audit firm rotation and for key audit partner rotation, the majority of the countries follow the recommendations of EU

Directive and Regulation, but many others go beyond the EU baseline, being more restrictive.

The new reform in statutory audit in EU generates modifications needed to occur in the audit profession. In these conditions, after a long period when auditors have accepted that their responsibilities increased in line with the public expectations, nowadays, we assist to a withdrawal imposed by the new expectations in matter of independence. In this respect, the NAS allowed to be provided for the audit clients are much less now than in the past for EU Member States, as a result of the new rules imposed by the Directive 2014/56/EU and by the Regulation No 537/2014.

On the other hand, despite of international harmonization, reform in a separate jurisdiction generates an issue. One of the concerns is about the content of audit report that is now in a new and developed format. This is a direct consequence of the new and revised Auditor Reporting standards developed by International Auditing and Assurance Standards Board, especially the International Standard on Auditing (ISA) *701 Key Audit Matters in the Independent Auditor's Report.*

According to the new requirements is assumed that the audit report will be more transparent and detailed, but 'the major problem faced by auditors is the lack of users' understanding of what auditors do and how to interpret the audit opinion' (Kiss *et al*., 2015, p. 70).

Another issue is about the importance of internal control the company and the implication of a strong or weak internal control on both financial reporting process and statutory audit. At the moment, reporting on internal control is still not mandatory in EU despite of emphasis of this issue in USA by Sarbanes-Oxley Act.

There are not enough evidences about the joint audit and I think that this will be very challenging for the auditing profession in terms of cost and ethics requirements.

Europe cannot stay away from the rest of the world especially in the actual context when the other controversial aspects of statutory audit come from the new ISAs: requirements for auditors to introduce in their reports on financial statements of PIEs key audit matters; reporting on the going concern status of client audit; disclosing the name of the audit partner (Coram, 2014, p. 291).

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TAX ON PROPERTY:
EU EXPERIENCE AND OBJECTIVES FOR UKRAINE

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Abstract
In this article are examined modern approaches to process of property taxation and its particular qualities.
At first, was detected, that in conditions of globalization is very important the task of improving the competitiveness of the economy, which depends on its ability to ensure economic growth.
Realization of this task requires financial support that is difficult to implement in countries with underdeveloped economies, especially in the need to respect the concept of sustainable development, which implies more attention to solving social and environmental problems.
So, actual problem, nowadays, is to find ways of financial provision of positive changes in the economic development in the long term, especially at the regional level, for reduce social tension and differences in socio-economic development of regions.
For filling of local budgets in many European countries contributes the property tax, which can provide the necessary income standards by introducing reasonable considering the financial requirements and property values.
The experience of developed countries shows that this tax has the right to life, though the approaches to the tax base vary depending on the specific traditions and characteristics of public administration in the country.
Author has been proposed necessary elements of mechanism for property taxation, which have to assist to motivation for replenishment of local budget.
The tax base is slightly dependent on the current results of economic activity in the region.
Therefore revenues have to be predictable and stable.
Therefore, in opinion of author, an effective mechanism for property taxation contributes to social justice and faithful implementation of citizens' responsibilities.
At the same time property tax should be counted in proportion to local and national budgets, which will strengthen the finances of local communities and not lose control of the process by the central government.
Keywords: *tax on property, public economics, real estate.*
JEL Classification: H240

1. INTRODUCTION

In conditions of globalization is very important the task of improving the competitiveness of the economy, which depends on its ability to ensure economic growth.

Realization of this task requires financial support that is difficult to implement in countries with underdeveloped economies, especially in the need to respect the concept of sustainable development, which implies more attention to solving social and environmental problems.

So actual problem nowadays is to find ways of financial provision of positive changes in the economic development in the long term, especially at the regional level, for reduce social tension and differences in socio-economic development of regions.

For filling of local budgets in many European countries contributes the property tax, which can provide the necessary income standards by introducing reasonable considering the financial requirements and property values. The presence of property to hide much more complicated than revenues. The tax base is slightly dependent on the current results of economic activity in the region. Therefore revenues have to be predictable and stable.

However, the introduction of this tax in Ukraine is perceived ambiguously.

The Constitution of Ukraine (Article 13) notes that "land, minerals, air, water and other natural resources within the territory of Ukraine, natural resources of its continental shelf and exclusive (maritime) economic zone, are objects of ownership of Ukrainian people. Every citizen has the right to use the natural property of the people according to the law". But almost nowhere and never noted on another paragraph of the Basic Law that "property must obligate," in other words, the property should not be used to the detriment of a person and society. Thus, the property tax is one of the tools of public administration to implement equitable distribution of public goods.

According to Article 14 of the Constitution of Ukraine "... land is the main national wealth that is under special state protection" (Ministry of Justice of Ukraine, 2006, p. 9). Thus, the right to receive income from the national wealth should, as individuals as well the state. Buildings also are the embodiment of income (not always legal). Therefore property taxation requires balanced approach taking into account the interests of both the state and citizens of Ukraine.

2. HISTORICAL TRADITIONS OF TAXATION OF PROPERTY

Taxation of individual property is not a new step in the historical context of revenue part of local budgets. Even during times of Kyiv Rus (IX - XIII cent.), Starting from the XI cent., Real estate and land (smoke, plow) was the object of levying tax. However, if the first economic opportunities and the size of the economy is not taken into account, then later in the norm "plow" understood certain size a plot of land, taking into account quality indicators of soil. To the "plow" was attributed all agricultural population of a territory and expansion of taxes on individual farms carried village elder (Pasichnyk, 2003, p. 68 and 69). During the Polish-Lithuanian period (XIV - XVI cent.) used a variety of approaches to tax in rural areas, depending on how the law regulated relations in the territory, Russians, German, Moldavian or Wallachian. Therefore, the taxes collected in the countryside called differently: "smoke" – in Ukraine, "plough" – in Belarus (Pasichnyk, 2003, p. 97). As noted by Pasichnyk (2003), on the Hetman Land (XV – XIII cent.), practically to the middle of XIII century, there was no clear legal framework of internal rules on taxation. However, one of the income in Zaporizhzhya Sich (XVII – XVIII cent.) there was a tax on houses in villages inhabited by non-Cossacks who were subjects of Zaporozhian Army. Since the late eighteenth century, when the territory of Ukraine was divided between the Russian and Austro-Hungarian empires, and so far, real estate tax was not going.

The experience of developed countries shows that this tax has the right to life, though the approaches to the tax base vary depending on the specific traditions and characteristics of public administration in the country.

For example, in the UK only taxed incomes from property, from ownership of land and buildings, the payment of transfer for renting apartments. In the 1923/24 fiscal year in England the amount of income from the land tax amounted to 0,6 million pounds (just under 0,1% of total revenues), and the tax on homes – 1.9 million pounds (slightly more than 0.2% of total revenues) (Pasichnyk, 2003, p. 32). At least the last 5 years the UK is the leader among OECD by size of property tax (table 1, table 2).

3. INTERNATIONAL EXPERIENCE

In France, the land tax on built-up areas; land tax on undeveloped land; tax on the habitation included in local taxes. The first tax is levied at 50% of the cadastral value of land on which is buildings, structures etc. From this tax are exempt, areas which are state-owned; land used for agricultural production; individuals who over 70 years old who receive assistance from social funds and other low-income individuals.

The second tax is levied at a rate of 80% of the cadastral rental value area (subject fields, meadows, forests, swamps, building plots, etc.). Exempt from taxation areas which are state-owned; the artificial afforestation and plot for agriculture development (temporarily). Tax on habitation is charged with both homeowners and tenants with. The size of the tax depends on the quality of housing (apartments there are five categories in terms of comfort), location, etc. (Pasichnyk, 2003, pp. 462-463).

In Germany property tax was first introduced in 1278r. However, unlike the aforementioned countries, taxable market value of property, not the land on which it is located. For individual tax rate is 1 percent of the property value, and for legal entities - 0.6%. However, if individuals at the beginning of the millennium was not subject to tax property worth up to 120 thousand marks, for legal entities - only to 20 thousand marks (Pasichnyk, 2003, p. 470).

Table 1. Tax on property, % of GDP

Country	Year					
	2010	2011	2012	2013	2014	2015
United Kingdom	3,92	3,884	3,882	4,012	4,073	4,065
France	3,513	3,618	3,759	3,817	3,88	4,065
Belgium	3,082	3,149	3,264	3,516	3,561	3,516
Luxembourg	2,687	2,631	2,733	2,785	2,976	3,289
Italy	2,022	2,205	2,705	2,735	2,901	2,795
Spain	2,007	1,884	2,026	2,214	2,374	2,393
Ireland	1,43	1,644	1,75	2,016	2,196	1,507
OECD – Average	1,731	1,753	1,787	1,855	1,862	
Denmark	1,856	1,895	1,786	1,82	1,852	1,953
Netherlands	1,389	1,23	1,094	1,238	1,449	1,438
Greece	1,655	2,334	2,53	2,99	1,437	1,955
Poland	1,32	1,282	1,335	1,396	1,396	
Finland	1,115	1,086	1,182	1,278	1,324	1,443
Hungary	1,154	1,127	1,227	1,293	1,297	1,296
Portugal	1,075	1,105	1,05	1,124	1,244	1,319
Sweden	1,037	0,999	1,019	1,092	1,07	1,056
Latvia	0,869	0,968	0,96	0,958	1,03	0,99
Germany	0,814	0,852	0,891	0,924	0,963	1,077
Slovenia	0,612	0,595	0,63	0,646	0,624	0,625
Austria	0,528	0,511	0,557	0,726	0,602	0,579
Czech Republic	0,414	0,507	0,506	0,469	0,444	0,373
Slovak Republic	0,411	0,406	0,436	0,443	0,438	0,429
Estonia	0,349	0,309	0,326	0,301	0,295	0,283

Source: OECD (2017)

In Poland, the tax on real estate that belongs to the property tax was introduced in 1991. The payers of this tax are individuals, legal persons and organizational formation with no legal status. Taxed: buildings (or parts thereof); structure related to agricultural activity (other than arable land and forests); land that is not subject to tax on agricultural activities and on forest land. Enjoying privileges (that is not taxed), public sector facilities; public roads with them from their lands; buildings and land assigned to cultural monuments; buildings related to agricultural activity (Fedan, 2000).

Table 2. Tax on property, % of Taxation

Country	Year					
	2010	**2011**	**2012**	**2013**	**2014**	**2015**
United Kingdom	12,05	11,627	11,872	12,357	12,7	12,501
France	8,371	8,384	8,482	8,438	8,531	8,934
Belgium	7,231	7,299	7,389	7,806	7,913	7,848
Luxembourg	7,069	6,947	7,045	7,308	7,757	8,901
Ireland	5,276	6,071	6,374	7,156	7,65	6,388
Spain	6,367	5,992	6,244	6,658	7,013	7,069
Italy	4,83	5,261	6,163	6,22	6,64	6,449
OECD – Average	5,498	5,47	5,471	5,598	5,569	
Poland	4,237	4,054	4,185	4,378	4,35	
Greece	5,134	6,926	7,132	8,402	4,018	5,317
Netherlands	3,848	3,432	3,039	3,39	3,861	3,809
Denmark	4,12	4,2	3,898	3,891	3,734	4,188
Portugal	3,537	3,417	3,304	3,299	3,641	3,824
Latvia	3,091	3,484	3,369	3,359	3,567	3,413
Hungary	3,076	3,09	3,18	3,39	3,393	3,291
Finland	2,735	2,584	2,769	2,93	3,02	3,279
Germany	2,326	2,386	2,452	2,535	2,634	2,915
Sweden	2,4	2,35	2,395	2,546	2,502	2,437
Slovenia	1,657	1,631	1,708	1,757	1,711	1,706
Austria	1,292	1,245	1,336	1,706	1,406	1,331
Slovak Republic	1,465	1,42	1,538	1,464	1,401	1,331
Czech Republic	1,272	1,524	1,503	1,376	1,343	1,115
Estonia	1,048	0,98	1,032	0,956	0,911	0,844

Source: OECD (2017)

Other countries in Central and Eastern Europe on different approaches to determining the tax base for real estate. The market value of objects used Bulgaria (0.01-0.45%), Macedonia (0.1-0.2%) and Montenegro (0.1–1.0%). In Estonia, the property tax is 0.1-2.5 % from taxable value of the land. In Latvia, the tax base serves cadastral value. The tax ranges from 0.2% to 3.0% (KPMG, 2016). Romania changed tax base from gross book value to taxable value.

The ambiguity of existing approaches to taxation of real estate in different countries, and long-term absence of this instrument in the budget system in Ukraine, resulting in the current situation - the absence of an effective mechanism taxation of real estate.

4. TAXATION OF PROPERTY IN INDEPENDENT UKRAINE: MODERN EXPERIENCE

The question of the introduction of property tax in the independent Ukraine has its own history. Since 2007, the Verkhovna Rada of Ukraine introduced a few projects.

For the first project was a tax paid by individuals - owners of buildings, including residential houses, cottages (garden) houses, any premises, including apartments and adjoined rooms, garages and other buildings, in addition to assets under construction. The tax was accrued by state tax authorities for each individual inventory of the property, based on the data on their market value as of January 1 of each year. Scale the size of taxable market value of real estate has four categories and subject to annual indexation based on inflation. The project was supposed four categories of beneficiaries that are fully be exempted from paying taxes (Verkhovna Rada of Ukraine, 2007)

The second project was distinguished primarily the taxation base. The object of taxation is determined immovable property located in the customs territory of Ukraine and are the property of the taxpayer (except for assets under construction). Tax rates are set as a percentage of the subsistence minimum at the beginning year per square meter total amount of taxable property owned by individuals and legal entities. The tax rate was five categories (from 1 to 5%). It was proposed not to tax real estate area of 300 square meters for individuals and up to 100 square meters for businesses (Verkhovna Rada of Ukraine, 2008).

In the third project by objects of taxation were defined buildings (other than those owned by the state or local communities or institutions and organizations of foreign countries, which enjoy diplomatic immunities and privileges under international treaties of Ukraine). The tax rates proposed to establish differentiated depending on the administrative-territorial location and type of property tax (buildings or buildings) per year in UAH per 1 sq. m. the area object of taxation. As for the privileges: exemption from tax buildings with a total area up to 150 sq. m. (Verkhovna Rada of Ukraine, 2008)

Certainly, the idea of introducing such tax in Ukraine, have more opponents than supporters. As arguments against its introduction been cited poor performance of technical inventory, lack of differentiated regional approach, some legislative unresolved issues. Thus, the proposal for transfer of property tax in local budgets (for all projects) contrary to the law as part of the 7 paragraph 1 of Article 14 of the Law of Ukraine "On taxation system" established that the tax on real property (real estate) is a national taxes and duties (mandatory payments). This approach is somewhat contrary to the Constitution of Ukraine concerning that property, which is owned by the local community is the material and financial basis of local government (Ministry of Justice of Ukraine, 2006, p. 87). However, in our opinion, the lack of control over the process taxation by public authorities at the national level can lead to a reluctance of local communities in general to establish a mechanism of tax collection.

Law of Ukraine No. 71-VIII of December 28, 2014 enacted amendments to the Tax Code regarding including and taxation of residential and non-residential real estate. The rate of property tax, which established the relevant local council, made up no more than 2% of the minimum wage and does not depend on the market value of the object. The law provides tax benefits to pay that tax base decreases for residential property owners of apartments in 60 square meters and owners of buildings – 120 square meters, and if owned a few properties Flat / apartment and house / houses – 180 sq. m.

In 2015 the tax rate for objects of non-residential real estate owned by individuals and legal entities specified in paragraph 266.5.1 of the Tax Code does not exceed 1% of the minimum wage set by law at 1 January of the reporting (tax) year for 1 square m. for residential real estate objects.

In 2017, the marginal rate of property tax set at 1.5% per 1 square meter (vs. 3%). The rates for the current year are set solutions councils. Exempt property in the area of anti-terrorist operation (ATO) and the contact line for the period from 14 April 2014 until the end of ATO (Verkhovna Rada of Ukraine, 2017).

5. CONCLUSIONS

Summing up the above, we note that, from the point of view of the author, for Ukraine is the most acceptable draft of France, which is the basis for taxation as land and buildings. In the future (assuming completion of the land cadaster system and system of permanent accounting value of property that can be the basis for insurance and taxation) should calculate the tax as a percentage of the appraised value of a property and the land on which it is located. This approach is considered more acceptable as long as there is a threat of subjective approach to determining the value and abuse (possibly understate the value of the object, and the area cannot be hidden). It is also advisable to set a taxation rate as per unit area of land as well buildings. The estimated difference in cost may consider using correction factors for different regions in determining land tax rates for apartment buildings should take into account the location and comfort of home.

To address the issue of poor protection offered, above all, to leave for all "non-taxable housing" - which already have guidelines in setting rents. (Standard housing - 21 square meters per family member and an additional 10 square meters, for some categories - office or otherwise established by law), excess area is paid at a higher rate. Just the "Charge" area will be subject of taxation, the tax may be progressive depending on the degree of excess regulatory support (the minimum for most areas in 1,1-2 times, an increase of 25% standard taxation in excess of the regulatory support area in 2,1-3 times 50% in excess in 3,1-4 times 75% - 4,1-5 times 100% in excess of more than 5 times).

At the local level will be determined by adjusting the rates to reflect comfort and attractive locations in the region.

Distribution of tax in proportion of 30% to the state budget 70% to the local should provide both maintenance costs of this tax and replenishment of local budgets.

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THE IMPACT OF THE PROPOSED DIRECTIVE FOR A COMMON CONSOLIDATED CORPORATE TAX BASE (CCCTB) IN ROMANIA FROM LEGAL PERSPECTIVE

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Abstract
The proposal made by the European Commission in 2016 for a new Directive aiming to establish in two steps the Common Consolidated Corporate Tax Base (CCCTB) at the EU level for those groups of companies fulfilling several criteria is under debate by the interested scholars. This new approach is part of a 5 key areas for action published by the Commission in 2015 in order to address the issue of harmful corporate tax competition. As EU promotes the BEPS project, the Council decision to integrate the results of the BEPS project as identical as possible for all member states was implemented by the Commission by proposing a set of directives. One of these proposals was adopted by the Council in 2016, Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices (ATAD) that directly affect the functioning of the internal market. The CCTB Directive is still pending in Council.
The scope of this article is to make a short presentation of the new ideas for computing the tax base of companies and permanent establishments included in the EU proposal and to analyse the legal effects of these provisions at the transposition into the Romanian Tax Code. It is quite obvious that the Tax Code requires modifications in order to implement the new set of rules.
Keywords: *common corporate tax base, consolidation, profits, multinational groups, base erosion, profit shifting.*
JEL Classification: K34, K33, H26

1. PRELIMINARY REMARKS

On 25 October 2016, the European Commission published the proposal for a Council Directive on the Common Corporate Tax Base (COM (2016) 685 final). This proposal is intended to replace the first initiative of the Commission of 2011 which referred to a Directive for a Common Consolidated Corporate

Tax Base (CCCTB). The first initiative is still pending for approval in the Council but some member states expressed their clear disagreement for it.

The proposal of 2016 is different in the sense that the new rules for corporate taxation will be applied in two steps. First step is represented by the proposed Directive for a Common Corporate Tax Base (CCTB). Based on this directive, the member states will implement standard rules for the calculation of the corporation tax base. During the application of the first step the rules related to allocation of the taxable profits between member states will the same based on residence, permanent establishment and transfer pricing files.

The second step is Common Consolidated Corporate Tax Base (CCCTB) and it comprises of the consolidation of the profits and losses at the EU level for the multinational companies and the allocation of profits to each member state using an apportionment formula.

This proposal included in the EC Communication "A fair and efficient corporate tax system in the European Union: 5 key areas for action" (COM (2015) 302 final) added more argument to the debate related to fiscal sovereignty in EU. One of the fundamental principles of the European Union is considered to be the fiscal sovereignty, as in the doctrine is mentioned that member states did not transfer the fiscal competency to the EU. By way of consequence, member states hold full sovereignty with regards to the establishment of the fiscal system, the collection of tax and duties, the enforcement of tax laws and the operation of the tax administration, as well as the prevention of tax evasion. This principle of tax sovereignty is not explicitly mentioned in the TEU or TFEU, but it is the result of the interpretation of article 5 of the TEU, according to which the Union only holds the competencies explicitly established through the treaties and all other competencies belong to the member states, corroborated to the provisions in article 113 of the TFEU, which stipulates that the Union holds limited competencies in the field taxation, including the regulation of indirect tax, „*if such harmonization is required to ensure the establishment and operation of the internal market and in order to avoid the distortion of competition*".

With regards to direct tax, the doctrine (Fabbrini, 2016, p. 24) states that the European Union does not hold the explicit competency to issue legislative harmonization regulations, but it does have this possibility, in so far as the operation of the internal market is affected, requiring the unanimous consent of the Council (of the member states). Further to the decisions of the Court of Justice, the concept of fiscal sovereignty in the field of taxation was amended in the sense that the national regulations must observe and comply with the EU treaties (Isenbaert, 2010, p. 188).

Moreover, the member states gradually waives fiscal sovereignty, which was affected by the duties transferred to the European Union in the taxation, through various European regulations, but especially through the ones established with regards to the member states' budgetary policy.

In the current context, the European fiscal policy supposes, apart from the observance of the provisions in TFEU and the enforcement of the principles regarding the harmonization of the tax laws, „*in order to ensure the establishment and operation of the internal market and avoid competition distortion*" (article 113 TFEU), with regards to the indirect tax, as well as in the field of direct tax, the adoption of measures meant to eradicate negative fiscal competition, fraud and tax evasion, as well as the aggressive tax planning and to promote administrative cooperation between the fiscal and customs member states' authorities.

In this context, the CCCTB proposals are seen by several member states as breaching the subsidiarity principle mentioned in the article 5 TFEU.

For example, Cyprus has the opinion that "*proposals restrict the autonomy of EU member states to make their own decisions regarding their tax systems*" and "*expresses its disagreement with the content and the objective of the legislative proposals, calls upon the EU institutions to take seriously into consideration the legitimate concerns based on the particularities of the economy of the Republic of Cyprus as well as other EU member states and further expresses the opinion that the proposals should be withdrawn*". (Opinion, Cyprus, 2017). Also Swedish Parliament voted against this proposal considering that it breached subsidiarity principle.

The same opinion is shared by Denmark, Ireland, Luxembourg, Malta and The Netherlands.

The Romanian Chamber of Deputies expressed also its opinion but it is ambiguous as it states on one hand that the documents drafted by the Commission contains good measurements but on the other hand Romania "*does not support the proposed approach which allows to maintain a national fiscal incentive in the form of tax credit or to opt for over-deduction for research-development, and considers appropriate the incentive provided under fiscal over-deduction from the tax base for research-development, which allows uniform application in all Member States and provides comparable fiscal outcome between taxpayers / Member States*" (Opinion, Romania, 2017).

2. THE SCOPE OF THE EU PROPOSAL

The new CCTB rules included in the proposed Directive have as objective according to the European Commission documents to facilitate cross-border trade and investments in the EU internal market. Currently, the corporate tax at EU level means 28 different systems that are onerous for multinational companies.

It was necessary a new draft, that is quite different from the one promoted by EC in 2011 as important changes happened at international level (BEPS project and the Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting signed on 7 June 2017) and EU level (ATAD).

This new proposed system will be mandatory for multinational companies having consolidated annual revenues exceeding EUR 750 million. The same rules will be applied also to the permanent establishments of third countries incorporated companies if are situated in one or more member states and are fulfilling the conditions provided in the directive. The definition of the permanent establishments subject to CCTB is following the concept promoted by the OECD in the BEPS project. Also, EC is proposing a so-called "super-deduction for R&D costs" (article 9, paragraph 3) applicable by small starting companies which do not have any associated enterprises. These companies may deduct 100% of their costs but no more than EUR 20 million.

In article 11 of the Proposal is comprised the allowance for growth and investment ("AGI") having as purpose to neutralise the existing rule that discourages equity financing and favours debt financing. The allowance is given to a taxpayer in relation to the equity financing based in a defined yield equal to the yield of the euro area 10-year governmental benchmark bond. EC is empowered to adopt delegated acts against potential cascading effects (double-dipping structures) and anti-tax avoidance rules.

An inquiring rule included in this proposal that follows the debate under BEPS project and is mentioned in ATAD refers to the limitation of interest deductibility in order to fight practices of profit shifting to low-tax countries (article 13).

The benefits presented by the EC refer to the fight against tax avoidance, as it is considered that 70% of the profit shifting at EU level for tax purposes should be eliminated and to the reduction of administrative cost compliance for the taxpayers (Neidle, 2016).

The CCCTB is considered to be "*full and ambitious agenda for EU corporate tax reform*" (Quest, 2016), but with remote prospects to enter into force (Neidle, 2016). The rejection of this proposal become more clear at the beginning of 2017 after several member states (Cyprus, Denmark, Ireland, Luxembourg, Malta and The Netherlands) delivered their veto due to breach of subsidiarity principle.

Nevertheless, this new tax system is seen, at least by the EC, as a "*modern, efficient and fair corporate tax system*" (Quest, 2016), but as mentioned above it diminishes even more the fiscal sovereignty of the member states and levels the playing field in direct taxation. It is a huge step for the member states and it seems that only few are willing to accept this trend.

For the time being, scholars are interested in analysing the proposal to provide some comments on the effects on the national tax systems. Also, multinational companies with turnover of EUR 750 million could be interested in starting an analysis of the proposal in order to understand the impact of this regulation on their business.

3. TRANSPOSITION IN THE ROMANIAN TAX CODE

The Romanian Chamber of Deputies agrees with the introduction of the super-deduction for research and development costs, as it is considered also by the European Commission to be supporting innovation in the economy (COM (2016) 685 final, p. 9), but considers necessary to introduce in the CCTB Directive the certification of those activities by the national competent authority. One comment is required in relation with this proposal. The Romanian Tax Code provides currently for a special deduction of 50% for the R&D expenses but the certification of the R&D activities shall be made by an expert included in a register to be published by the competent authority. Up to now the register of experts on research and development domains is not published.

One other proposal rejected by Romania refers to the "*national incentive in the form of tax credit*" due to the national lack of administration capacity to verify the compliance to the proposed rules. Nevertheless the explanation included in the proposed Directive is quite straightforward: "*In order to facilitate the cash-flow capacity of businesses – for instance, by compensating start-up losses in a Member State with profits in another Member State – and encourage the cross-border expansion within the Union, taxpayers should be entitled to temporarily take into account the losses incurred by their immediate subsidiaries and permanent establishments situated in other Member States*" (COM (2016) 685 final, p. 15).

3.1. Romanian entities affected by the Proposal

According to the articles 2 and 3 of the Proposal, the entities affected should be one of the company forms listed in Annex I, meaning only limited liability companies (SRL), joint-stock companies (SA) or partnership limited by shares ("societate în comandită pe acţiuni").

The rules for the limited liability companies or joint-stock companies are quite similar to other countries, the form of the partnership limited by shares is not very often used, taking into consideration that in the Trade Register only 7 companies are registered as of 1 January 2015 (OECD, 2015, p. 17).

Any of the Romanian companies mentioned above could opt to apply the CCTB rules even if would not fulfil the criteria of the turnover exceeding the turnover of EUR 750 million or the parent company or qualifying subsidiary for a period of five tax years. It is obvious that these rules would be applied by those companies dealing at EU level, in more than one member state.

3.2. New rules for Romanian entities

ATAD and this Proposal are forcing in the Romanian tax system new rules quite different from our current one that should generate also interpretation issues in practice. The current tax system is considered to be a simple one, the only main issue being rapidly changes of the rules without consistency in the fiscal policy and without proper impact assessments.

In order to give an idea of what this Proposal will modify in our current Tax Code, we included in this presentation a short analysis of several provisions.

As mentioned above, in article 11 of the Proposal is included a new rule related to an allowance for growth and investment ("AGI") having as purpose to neutralise the existing rule that discourages equity financing and favours debt financing. The allowance is given to a taxpayer in relation to the equity financing based in a defined yield equal to the yield of the euro area 10-year governmental benchmark bond and shall be deductible from the taxable base of the taxpayer. This provision is included currently in the Italian legislation, for instance under the "allowance for corporate equity", according to the Decree of the Italian Ministry of Finance of 14 March 2012 (Grilli, 2017). An interesting analysis published this year offers some historical and economical details about this rule (Nicolay *et al.*, 2017, p. 3). In Belgium this rule is called notional interest deduction, was introduced in 2005 and is considered to be an attractive rule for businesses in this country. The Italian rules limit the deduction only in case of equity increase whilst in Belgium this regime caused substantial revenue losses. The Proposal is not providing too many details as the EC is empowered to approve delegated acts related to anti-tax avoidance rules which are considered to be quite important (Nicolay & Spengel, 2017, p. 4).

It is clear that for the implementation of this rule related to the deduction of an amount related to the equity financing the Romanian Tax Code have to be modified but also the conception of the tax administration employees.

An inquiring rule included in this proposal that follows the debate under BEPS project and is mentioned in ATAD refers to the limitation of interest deductibility in order to fight practices of profit shifting to low-tax countries (article 13).

Currently, in the Romanian Tax code the rules dealing with interest deductions are thin capitalisation and safe harbour rules. The thin capitalisation rules mention that interest expenses resulting from associated enterprises loans are deductible, provided that the debt to equity ratio is lower than or equal to three. In case the debt to equity ratio is negative or higher than three, interest expenses are non-deductible in the current year and can be carried forward to subsequent years.

The safe harbour rules provide for the limited deduction of interest expenses resulting on associated enterprises loans to maximum the monetary policy rate published by the National Bank of Romania for loans denominated in local currency and to a maximum 4% for the loans denominated in any other currency than the local currency. Interest expenses exceeding these limits are non-deductible and cannot be carried forward to subsequent years. This limitation is applied separately to each loan before the thin capitalisation rules.

The interest expenses and net foreign exchange losses related to loans are deductible if the loans are contracted from credit institutions or non-banking financial institutions. The interest expenses related to bonds traded on a regulated market are also deductible. In case the loans are contracted with any other entity, including intra-group loans, the 3 to 1 debt to equity test is applicable.

The new Proposal establishes that the any interest costs are deductible only if there is an interest or other taxable revenues from financial assets received by the taxpayer (article 13, paragraph 1). In case there is any exceeding interests costs there is a limitation up to 30% of the EBITDA (earnings before interest, tax, depreciation and amortisation) or for a maximum EUR 3 million, whichever is higher (article 13, paragraph 2).

This new rule was promoted by the OECD following BEPS project and is already included in ATAD. Romania has the obligation to transpose it into Romanian Tax Code until the end of 2018 and there is no much room for innovative ideas.

4. CONCLUSIONS

The post-BEPS world is quite different than the previous period. It is worth mentioning that on 7 June 2017, around 70 countries signed the Multilateral Convention to implement tax treaty related measures to present base erosion and profit shifting ("MLI"), including Romania. As mentioned by OECD the scope of MLI is "to offer to governments concrete solutions to close the gaps in existing international tax rules". If prior to 2013 the governments were not coherent in their actions, now the implementation of BEPS project is offering many opportunities to coordinate and to understand the problems related to aggressive tax planning and tax avoidance.

One visible effect of the BEPS project at EU level is the rapidity in adopting ATAD. It is not very clear if all member states, including Romania, understood the effects of ATAD but maybe a more vivid debate on CCTB and CCCTB will take place in the Council. After the adoption of CCTB will be very difficult to sustain that any fiscal sovereignty of the member states exists in EU.

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THE VAT DEDUCTIBILITY AND THE PREVALENCE OF SUBSTANCE OVER FORM. RELEVANT EU CASE-LAW

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Abstract
From the legal point of view, the prevalence of form over the substance in taxation disputes is a fundamental principle, which aims at insuring the respect of fundamental rights and liberties. However, the recent experiences in the courts of law of the Member States of the European Union required a different approach, which deserves further investigation. An increasingly number of cases concerning the VAT are finally presented to EUCJ; some of them raised the question of the legality of exercising fiscal rights when the supporting documents do not contain all the elements provided by tax and accounting legal framework. Analysing this jurisprudence, the paper points out that the court in Luxembourg focuses primarily on ensuring the prevalence of substance over form in fiscal case law. The general rule of prevalence of form over the substance is reversed, stressing the domestic courts and the national administrative authorities. The influence of the EUCJ jurisprudence on the national courts is pointed and its role in strengthen the EU law is enhanced.
Keywords: *substance, form, principle, EU case-law, VAT.*
JEL Classification: K34, K41

1. INTRODUCTION

In a global world, taxation is not international, as it refers to a particular system of taxation, in a certain state (Malherbe, 2017). Each state is allowed to define its own tax policy but in the context of the EU cooperation, the taxation is influenced by the rules of the free market.

VAT is one of the taxes with double regulation: at the EU level, there is a system of regulation concerning the VAT and also at the Member States level, there are 28 (27 to be) different particular regime for VAT (Saguna & Tofan, 2010).

The deduction of VAT is a mandatory mechanism that insures the neutrality of the this tax (Costea, 2016) and in the context of the EU law, each Member State is required to respect the general framework that is described in regulation of wider legal force (Bercu *et al.,* 2015).

The Romanian National Fiscal Authority settlement body breached the principle of prevalence of substance over form. Deduction system is meant to relieve the traders entirely of the burden of VAT; it ensures neutrality perfect taxation of all economic activities, whatever the purpose or results of such activities, under the condition that the activities referred to are, in principle, themselves subject to VAT. The principle of fiscal neutrality requires that deduction of VAT for input of goods is allowed if the substantive requirements are satisfied, even if certain formal requirements were omitted by taxable persons (Bilan *et al*., 2016).

The firms' right to deduct VAT must be respected even if the documents do not fulfil all the formal requirements, the High Court of Cassation and Justice said in a decision, of after a lawsuit between a firm and ANAF. The Supreme Court ruled that companies are entitled to deduct VAT even when the documents do not fulfil all the formal requirements; deductibility cannot be conditional on the existence of supporting documents, except appropriate invoices (Paun, 2015).

2. NIDERA CASE IN ROMANIAN COURTS

In Romanian legal system, the decision of the High Court of Cassation and Justice HCCJ's have a consistent influence on the interpretation and applicability of the law (Lazar, 2013). One of the most recent and interesting case law in the Romanian courts is the Nidera case. The dispute was for the annulment of the National Authority of Fiscal Administration (NAFA)'s decision to deny the right to deduct VAT, on the basis that certain documents do not contain all the formal elements. Fiscal authorities arguments used the previous decision of HCCJ from 2007, which cancelled the right of deduction of a company. The decision from 2015 showed once again the prevalence of the substantive elements (the right of deduction) to the form (how the documents are completed) in tax law; also, the 2015 decision removes the 2007 decision's effects, although adopted after Romania's EU accession. This solution confirms that an appeal in the high court cannot be enforced against European Union (EU) law.

2.1. The circumstances of the dispute

The applicant company, Nidera ROMANIA, is a limited liability company, which has main activity wholesale of grain, seeds, animal feeds and unmanufactured tobacco (Cristea & Stoica, 2008). In order to achieve the object of activity, the company is purchasing for resale agricultural products from domestic, on the EU free market and third countries markets. Also, the company acquired the services necessary to achieve the object of activity, such as warehousing, auditing, accounting, transport, freight certification services etc.

As the company does not have the necessary storage space for received goods, it uses various logistics operators who hold special places (silos), drawing in this regard contracts with various independent companies for services of reception, supervision and certification of the products. The procurement contracts for agricultural products mainly provide one of the following two delivery clauses:

- INCOTERMS CPT - Delivery place when the receipt of the goods is done by the depositary at the agreed deposit and the operation is overseen by an independent company
- INCOTERMS FCA - loading place, when the products are weighed at the moment of uploading by the supplier, or by another person designated by him, in the presence of a representative of the company

In the period 2008-2011, the applicant company was subject to general tax auditing, carried on many taxes, contributions and VAT for the period May 2004 - August 2011.

For the period 2004 - 2006, the tax authority refused the deduction of VAT for the invoices issued by GRAIN HOUSE, on the ground of partially filling of the invoices and notices accompanying the goods, and for CEREAL CARGO invoices, for not filling the cartridge bottom left of the invoices. For the period 2007 - 2009 fiscal authority refuse deduction of VAT for the invoices issued by several partners (CEREAL CARGO, WESTERN GRAIN, FOREST, ANPO, PRIMERA AGRO, IULIS TRANS, ANDOFLOR, GILACOM, FLORCEREAL, PRIMERA TRADING), each time blaming omissions on the invoices issued, such as lack of unit price, no date of issue, the lack of signature, time and date of the expedition, miss-recording of the names of the company on the documents accompanying the goods etc.

The applicant company drew a complaint and then a legal action in front of the contentious administrative courts, addressed to the competent judge at the Court of Appeal from Bucuresti, Romania.

2.2. Main topics of solution of the court of first instance (Court of Appeal)

Court of first instance held that this case raises the question of the legality of the tax authority's refusal to recognize the right to deduct VAT on the grounds for which the invoices do not contain all the elements provided by fiscal and accounting legislation.

The Court notes that, pursuant the art. 145 par. (8) of the Tax Code, the taxable person must hold an invoice that includes all information provided in art. 155 par. (8) Fiscal Code (applicable for the period prior to 1 January 2007), in order to exercise the right to deduct VAT on the purchase invoices. Also legislature provided at pt. 51 par. (2) in the Methodological Norms the possibility of justifying the right to deduct VAT on "[...] documents referred in art. 145 par. (8) of the Tax Code and / or other specific documents approved by Government Decision no. 831/1997 (...) or by order of the Minister of Finance issued under Government Decision no. 831/1997, as amended. "

Accordingly, the right to deduct VAT shall be exercised:

- Mainly, only on the invoice (art. 145 par. (8) of the Tax Code);
- Alternatively,

- Based on the invoice and other documents provided by Government Decision no. 831/1997 for the approval of the models forms regarding financial and accounting activities and detailed procedures for establishing the utilization thereof (Government Decision no. 831/1997);

- Either only on the documents provided by GD. 831/1997, which contain all the information required by art. 155 par. (8) of the Tax Code (Bufan, 2016).

First, the Court notes that tax authorities, in tax inspection report, specifically says that invoices from Grain and Cereal House Cargo contain all mandatory elements specified in art. 155 par. 8 Tax Code, namely: a) series and the invoice number; b) date of invoice; c) the name, address and tax identification code of the person issuing the invoice; d) name, address and tax identification code, if applicable, of the recipient of goods or services; e) the name and quantity of goods delivered, name of the services; f) The unit price without value added tax and the tax base for each rate or exemption; g) value added tax rate applied; h) the amount of VAT payment.

Second, the Court notes that the information in the cartridge below the invoice contains information on shipment of goods (name of the person delegated, identification number of the person delegated, number of means of transport, date and time to which they dispatch the goods signatures) and these information was identified as missing or incorrectly filled out by tax inspectors - and that it is the only reason for what the tax authority refused the right to deduct VAT for the applicant. The missing information is not included among the mandatory elements required by art. 155 paragraph (8) of the Tax Code for exercising the right to deduct VAT on purchases of goods.

The court notes that the legislature has regulated the content of "cartridge" in the bottom of the invoice by GD 831/1997, which includes descriptions of models of forms for financial and accounting activity, including model (form) for the invoice, containing a cartridge comprising consignment identification elements, as follows: "data expedition, delegate name .... ID. Series ... no. ... Issued (a) ..., the number of transport; Sending was performed in our presence, on…, Time ... signatures …".

In accordance with Articles 3 paragraphs. (2) the Minister of Finance Order no. 29/2003 on the implementation of Government Decision no. 831/1997 for the approval of the models forms regarding financial and accounting activities and detailed procedures for establishing and using them, "in the bottom left of invoice will be mentioned and the identification of the person delivering the goods, ie: name and surname series and number of identity document (identity card or passport), identification number." But the GD 831/1997 or MFP Order

No.29 / 2003 do not expressly establish formal requirements beyond those imposed by the Tax Code for exercising the right to deduct VAT.

Moreover, such an amendment, made through acts of lower legal power would be illegal, because it would add to regulations and texts which provide limitations on the right to deduct VAT, covering exceptional situations; these norms must be interpreted restrictively and not extensive. Also, it would be impossible to make changes on the legal framework regulating the forms to be used in relations between operators (invoices, slips, etc.) in terms of the issuance, redemption and acceptance of transport documents, which are governed by lower power legal acts. The fiscal liabilities are subject only to the tax Code and the regulations issued on its basis (Gherghina, 2015).

Accordingly, the findings of the tax authority regarding the lack of the above mentioned elements from the documents can not have any relevance regarding the possibility of deduction of VAT by the applicant company, as long as the rules of tax legislation binds only justification for the right of deduction on the possession of an invoice containing the information described in art. 155 par. 8 Tax Code.

Regarding the errors found on the other documents, the Court also notes that there is no provision of lawful order to condition the exercise of the right to deduct VAT on the content of delivery notes, which remains exclusively subject to the conditions imposed by art. 155 paragraph 8 from the Tax Code. The errors occurring on the documents can not have the effect of removing the right of deduction, as long as the applicant company exercised its right on a correct invoice.

2.3. Decision V from 2007 of the HCCJ

The fiscal authority raises the arguments in the Decision V of 15.01.2007 issued by the United Sections of the High Court of Cassation and Justice, in which the court held that "value added tax is not deductible nor taxable base may be diminish for the establishment of the corporation tax if the supporting documents do not contain or do not provide all information required by the laws in force at the time of the operation for requesting the deduction of value added tax".

The decision V / 2007 should be interpreted in light of considerations that straight it. As can be gleaned from decision text, it uses the term "supporting documentary" for both income tax and VAT. Therefore, for explaining the decision in the part concerning VAT deduction, we should consider only the arguments that aimed at a particular matter of law. Regarding this aspect, the text of the Decision V / 2007 provide: "(...) in all normative acts adopted before or after the Tax Code, in cases of performing operations to deduct VAT, there is ruled the express liability to provide supporting documents, legally or under law issued", without namely indicating, however, the type of document required.

The Accounting Law no. 82/1991 and the Regulation for its application did not contain claims or criteria to determine what information should contain the supporting documents, and by Law no. 345/2002, applicable from 1 June 2002-31 December 2003, it is ruled for the first time the liability to provide supporting documents, specifying particular information that they should contain; the Law no. 571/2003 unitary ruled on the obligation to provide supporting documents and the particular information that result from them (Tofan, 2016). In this regard, the Decision V / 2007 recalls the art. 145 of the Tax Code, that provided at par. (8) that "to exercise the right to deduct VAT, any taxable person must demonstrate the right of deduction, depending on the kind of operation", stating in the regulations issued at point a) and b) the documents to be presented to prove each specific situation.

Therefore, the analysis of the arguments above clearly indicates that in Decision V / 2007 High Court made a summary analysis of legislation on "supporting documents", prior and after the entry into force of the Tax Code, concluding that in light of the latter, the "supporting documents" (in the broad sense) are clearly specified in art. 145 a and b of the Fiscal Code. In addition, it is important to note that Decision V/2007 can be applied only in the light of European Union law and the case-law of the Luxembourg Court on VAT, as detailed in the following sub-section.

3. ANALYSIS OF THE CONTESTED ACTS IN THE LIGHT OF EU LAW

The Court considers that the national judge became after January 1, 2007 the judge in the EU area, so he is obliged to directly apply EU law if he finds it incompatible with national law, in compliance with the principles and the direct effect of its rule. Any national court must apply EU law in its entirety and protect rights, which it confers on citizens, in a case falling within its jurisdiction. The national court is bound, as such, not to apply any provision of national law which may be in conflict with EU law, either adopted before or after the entry into force of the EU rule (Romanian High Court of Cassation and Justice HCCJ, Civil and Intellectual Property Section, civil decision no. 2119 from 31 March 2008).

As regards to EU law, the dispute raises the question of knowing whether the VAT Directive 2006/112 allows imposing any further condition for the exercise of the right to deduct VAT for the purpose of accounting nature that are not mentioned in the Directive, respectively if the VAT deductibility condition may refer to:

- The existence of the original of the notice of delivery, with all the information required by the regulated standard, when the goods are circulating without invoice and the invoice issued after transportation refers to this notice of delivery;

- The filling of other forms of claims on invoices of the supplier, when they are not included among the requirements laid down in art. 226 of the VAT Directive.

At the same time, the court has to examine whether art. 168 of the VAT Directive and the principles of neutrality and proportionality allow a Member State to refuse the right to deduct VAT on purchases of goods, only to the failure to specify the content of the invoice date of delivery of goods, when all other requirements of form and substance to exercise of the right of deduction are met.

Art. 167 of the VAT Directive 2006/112 regulates the right of taxable persons to deduct VAT paid upstream for the supplies of goods or services used for the taxable transactions, stating that "the right to deduct arises when the deductible tax becomes due". Art. 168 lit. (A) of Directive 2006/112 provides that "To the extent to which goods and services are used for taxable transactions, the taxable person shall be entitled, in the Member State where these transactions are carried out, to deduct from the tax which is liable to pay the following amounts: VAT payable or paid in the Member State in respect of goods which are or will be delivered or services which are or will be provided by another taxable person". Art. 178 of Directive 2006/112 provides that "to exercise the right of deduction, a taxable person must meet the following conditions: for deductions under Article 168 (a) in respect of the supply of goods or services, it is obliged to hold an invoice issued in accordance with Articles 220-236 and art. 238, 239 and 240; [...] "

Under art. 226 of Directive 2006/112 "without prejudice to any special provisions of this Directive, for VAT purposes, on invoices issued pursuant to art. 220 and 221 there should be only the following details:

a) date of issue;

b) a sequential number, based on one or more series, which uniquely identifies the invoice;

c) identification number for VAT purposes under art. 214 under which the taxable person supplied the goods or services;

d) identification number for VAT purposes the client referred to in Article 214 under which the customer received a supply of goods or services in respect of which he is liable to pay VAT, or received a supply of goods, as provided in Article 138;

e) the name and address of the taxable person and the customer;

f) the quantity and nature of goods supplied or the extent and nature of services rendered;

g) date when the delivery of goods or services was made or completed or the date on which the payment in advance referred to in paragraphs 4 and 5 of Article 220, as far as it can be determined and it differs from the date of issuing the invoice;

h) the taxable amount per rate or exemption, the unit price exclusive of VAT and any discounts or rebates if they are not included in the unit price;

i) the VAT rate applied;

j) the VAT amount payable, unless they apply for special treatment for which this Directive excludes such a detail".

According to the case law of the EUCJ, the invoice is a document that certifies a transaction between two traders, containing data about transaction (transaction date, the transaction purpose, the transaction value) and information about participants (name, address and Taxpayer Identification Number), and lack of evidence of the information that the control bodies refer to can not constitute a sufficient and essential element in the exercise of the right of deduction; it is required to be taken into account all relevant aspects of the case in this regard. The EUCJ ruled that the right to deduct laid down in art. 167 et seq of the VAT Directive and it is part of the mechanism of VAT and, in principle, it may not be limited (see judgment of 21 March 2000 Gabalfrisa Cases C-110/98 -C-147/98, ECR. 1-1577, paragraph 43, Judgment of 15 December 2005, Centralan Property, C-63/04, ECR. 1-11087, paragraph 50, judgment of 6 July 2006 Kittel and Recolta Recycling, C-439/04 and C-440/04, Rec. p. 1-6161, paragraph 47, and Case and David Mahageben June 21, 2012, C-80/11 and C-M2/11, paragraph 38.

Deduction system is meant to relieve the traders entirely of the burden of VAT, due or paid in all economic activities in which they engage. Common system of VAT consequently ensures neutrality perfect taxation of all economic activities, whatever the purpose or results of such activities, under the condition that the activities referred to are, in principle, themselves subject to VAT (see Case February 14, 1985 Rompelman. C-268/83, ECR. 655, paragraph 19, judgment of 15 January 1998 Ghent Coal Terminal, C-37/95, ECR. 1-1, paragraph 15; Case Gabalfrisa and others cited above, paragraph 44, judgment of 3 March 2005, Fini H, C-32/03, ECR. I-I599, paragraph 25, judgment of 21 February 2006, Halifax Cases C-255/02, Rec, p. 1-1609, paragraph 78; Case Kittel and Recolta Recycling, cited above, paragraph 48, judgment of 22 December 2010, Dankowski, C-438/09, Rep., p. 1-14009, paragraph 24, and Case Mahageben David, cited above, paragraph 39).

Also, the EUCJ held that the principle of fiscal neutrality requires that deduction of VAT for input of goods is allowed if the substantive requirements are satisfied, even if certain formal requirements were omitted by taxable persons (judgment of 30 September 20l0, Uszodaepito C-392 / 09, paragraph 39; Case 8 May 2008 Ecotrade C-95/07 and C-96/07, Rep., p. 1-3457, paragraph 63).

Moreover, the combined cases C-l23/87 and C-330/87 "Jorion Lea, nee Jeunehomme, and Sociele anonyme de gestion immobiliere EGI v. Belgian State" ("Cause Lea Jorion"), the ECJ decided that Directive VI VAT (which underpins the current VAT Directive) provides imperatively that Member States must include into their national legislation two formal requirements on the right of deduction of VAT by taxpayer, namely the provisions of art. 22 par. 3b the content of the 6th VAT Directive, which refers to the amount invoiced and share of the applicable VAT.

However, in case law Lea Jorion ECJ stated that VAT Directive allows Member States to make the right deduction of VAT on the basis of existence of an invoice containing the elements to ensure the levy and to allow supervision the tax authorities. Without these elements, by the number or by nature, the right to deduct is impossible or excessively exercised.

4. THE RELATIONSHIP BETWEEN THE SUBSTANTIVE AND FORMAL CONDITIONS FOR THE DEDUCTION OF VAT

4.1. The arguments of the EUCJ

Ab initio, the court noted that the company respects all the substantive conditions for the right to deduct VAT and conducted effectively taxable transactions in the exercise of its object, collected and paid to the state budget the VAT and the substantive conditions are demonstrated by an expert report given to the court. In the light of the EUCJ's opinion, in Case C-146/2005 Albert Colee, the fiscal authority settlement body breached the principle of prevalence of substance over form when ejecting the appeal: "The principle of fiscal neutrality requires that exemption is allowed if the substantive requirements are satisfied, even if certain formal requirements were not met by taxpayers, the VAT exemption of an intra-Community supply, which actually took place, can not be refused simply because proof of such delivery was not filed in a timely manner".

Also, in Case C-368/09 Pannon GEP Centrum Kft, the ECJ held that Community law "precludes a national practice under which national authorities refuse the right to deduct the VAT to a taxable person which must pay the amount of tax due or paid for services that have been provided, for reasons that initial invoice, in its possession at the time of deduction, contained a wrong date of completion of service provision and that there was a continuous numbering bill corrected later and the credit note cancelling the initial invoice, if the substance of deduction are met".

The judgment of the Court from 15.07.2010 in Case C-368/09 Pannon GEP Centrum Kft against EH AP KÖZPONT Hatosagi Foosztaly Hivatal Del-DUNÁNTÚLI Kihelyezett Hatosâgi osztály court in Luxembourg showed that Article 167, Article 178 (a), Article 220 paragraph 1 and Article 226 of Directive 2006/112 / EC of 28 November 2006 on the common system of value added tax, must be interpreted as precluding legislation or a national practice in the terms that the authorities national refuses a taxable person the right to deduct from the value added tax they have to pay the amount of tax due or paid for services that have been provided, for reasons that initial invoice, in his possession at the time of deduction, included a wrong date of completion of service provision and that there was a continuous numbering of the bill subsequently corrected and the credit note cancelling the initial invoice, in case the substance of deduction are satisfied and, before the decision by the authority concerned, the taxable person latter provided a corrected invoice, which stated the exact date of ending the services that, even if there is a continuous numbering of that invoice and credit note cancelling the initial invoice.

In joint cases C-l23 / 87 and C-330/87 "Jorion Lea, nee Jeunehomme, and Societe anonyme d'etude et de gestion immobiliere" EGL "v. Belgian State" Belgian tax authorities refused the right to deduct VAT for purchases made by Ms. Jorion and EGI on the grounds that the purchases invoices do not contain all the information required by Belgian law: beneficiary's address, registration code for VAT purposes, description of goods and services (Sararu, 2012). Thus, the EUCJ ruled that the Directive VI VAT provides the imperative obligation of Member States to take into their national legislation two formal requirements on exercising the right to deduct VAT by taxpayers, those provided by art. 22 para. 3 letter b) the content of the Directive, which refers to the invoiced amount and rate of VAT applicable.

The ECJ held that it is possible, according to art. 22 paragraph 8 of the sixth VAT Directive, Member States should impose in their national legislation other formal requirements to be included in the taxpayer invoices, for exercising the right to deduct VAT, in order to ensure fair settlements VAT and enable tax authorities to exercise control of the VAT system (para. 16 of the judgment).

4.2. The arguments of the Romanian courts

This principle and ECJ decision was considered by the Romanian HCCJ - Department of administrative and fiscal decision in a particular case (decision no. 4739 / 14.10.2011), stating that "first court correctly granted priority for the substance elements for VAT exemption with deductibility retaining occurrence of intra-community supply of goods to a taxable person established in the community by promoting the prevalence of substance over form (in this respect the ECJ rulings in court cases Cole Connon, Teleos). However, the principle of formalism must not take precedence over the essence of the dispute, namely the occurrence highlighted by the submitted supporting documents and reviewed by the court. The recent European regulation and the practice in the field showed that payments of VAT by the company are not in direct connection with the errors occurred in commercial transactions, the essence is the reality of trade".

However, the right of Member States to impose additional formal requirements for the content of the invoices, as a condition for exercising the right to deduct VAT by taxpayers, is not absolute and it must be limited to what is necessary to achieve the pursued aim (par. 17 of the judgment). Such additional requirements may not limit the right to deduct VAT, not by their number or by technical nature, in such manner so it becomes practically impossible or excessively difficult. Therefore, the fiscal authority arguments, based on Decision V / l5.01.2007 of the ICCJ, that the prevalence of form over substance is established and that it is inconsistent with EU regulations and case-law of the EUCJ. On the other hand, when the reality of the operation presented on the invoice and the existence of commercial relationship which led to issuing that invoices were determined by tax inspectors, not allowing the deduction of VAT by the control bodies would contravene obviously not only the principle of proportionality but also to that of the neutrality of VAT relief steadily in ECJ case law (Case Jeunehomme)".

Against the decision of the Court of Appeal, the National Authority for Fiscal Administration appealed, considering that the solution was pronounced with the wrong application of the law in terms of VAT and its related accessories. Given that the applicant did not submit documents to provide all information required by applicable regulations, designed to ensure complete registration of the transactions and to confirm the respect of the cumulative conditions for exercising the right to deduct VAT, the applicant company has, in NAFA's opinion, the right to deduct VAT on the purchase invoices from 11 partners. The National Fiscal Authority considers that the court which solved the conflict has misinterpreted the provisions of Decision V / 2007 United Sections HCCJ regarding the right to deduct the VAT shown on the invoice that does not contain or does not supply all the information provided by legal provisions in force on the date of the operation for requesting a VAT deduction.

The HCCJ found there are no grounds for reforming the solution pronounced by the court of first instance. Solution of the Court of Appeal is correct and has been maintained by the HCCJ, after conducting its own examination of the case.

Refusal of the tax authority has no legal justification, as long as there is the deductibility of VAT on invoices submitted by suppliers for procurement when the following conditions are fulfilled:

- the operation substance (art. 145 par. 3-4 Fiscal Code in force before the date of January 1, 2007 and the respectively art. 146 alin. 2 of the Tax Code in force after 1 January 2007.

- the form of the provided documents relating to operations performed, art. 145 Fiscal Code in force before 1 January 2007 respectively art. 146 Fiscal Code in force after 1 January 2007.

The judge who solved the case in the first instance correctly observed that the National Fiscal Authority did not deny the reality of the transactions made by the applicant company. On the one hand, these operations were noted throughout the report of fiscal inspection, and although later, in the decision rejecting the applicant administrative request. The National Fiscal Authority body has an oscillatory position, proving no occurrence in their arguments and concluding that the documents presented did not justify correlating invoices opinions accompanying the goods or other documents and, moreover, the applicant is not entitled to deduct VAT.

Regarding the conditions of form, HCCJ notes that first court concluded judiciously that the lack of elements mentioned by National Fiscal Authority in the invoices can not have any relevance regarding the possibility of the tax authority to deny the right of deduction of VAT by the applicant company, as long as the tax legislation binds owning this right exclusively on justifying that the submitted invoices include the information in the art. 155 par. 8 Tax Code.

High Court holds that regulation on the content of the cartridge at the bottom of each invoice was made by GD 831 / 1997 and by Order 29/2003, but none of these acts do not contain additional requirements as those stipulated in the Fiscal Code. The provisions of the Tax Code can not be modified or supplemented by acts of lower power, regulating model invoiced used in the relations between economic agents. The errors in the delivery notes accompanying the goods do not justify denying the right to deduct VAT because no legal provision condition the right to deduct VAT for the accuracy of the accompanying documents for delivering goods, but condition the deduction of VAT by complete documents imposed law but also VAT Directive.

5. CONCLUSIONS

From the jurisprudence of the EUCJ in the matter of VAT, we notice that the court in Luxembourg focuses primarily on ensuring the principle of VAT neutrality and proportionality of the measures imposed by Member States relating to the right of deduction of value added tax. When they verify the conditions for exercising the right to deduct, the administrative authorities of Member States shall ensure in particular that the requirements were met, permitting to accept a deduction, even if certain formal requirements were distort by the taxable person.

Both in administrative appeals and during the first instance lawsuit, the domestic courts stated that the principle of prevalence of substance over form should prevail. As a direct consequence, if the tax auditors raised no objections to the substance of transactions, but found only some flaws form, than these arguments cannot be accepted in a settlement favourable to grant the right to deduct VAT. The taxable person who purchases goods on the basis of invoices and who accepts the registration in supporting documents as taxable transactions, is responsible for receiving and recording in its accounts the improperly prepared documents, incomplete, not in accordance with the legal provisions in force. The domestic courts ruled that the decision to reject the appeal in this regard is unlawful, as it is contrary to the settled case law of the EUCJ, that the information to be included in the invoice should not be a determining factor in granting the right to deduct VAT, as long as other elements can attest commercial relationship between the parties to the transaction.

This ruling is binding for Romania upon accession and applied priority, recent case law proving its effects. Still, the effects are mainly present in the courts of law and there is certain inertia in improving the fiscal authority action.

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TAX EVASION IN ROMANIA

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Abstract
The phenomenon of tax evasion in Romania is more and more widespread due to multiple specific causes to an emerging economy. Thus, o series of geo-political changes in Southeast Europe have led to the inclusion of Romania in the branches that shift its profits from Asia and Africa to Western Europe. There is also a lack of taxpayers's tax culture. And the Romanian taxpayer has to create a habit to pay his taxes. The present article proposes a brief theoretical and empirical outlook on this phenomenon in Romania.
Keywords: *tax evasion, tax payer, profit.*
JEL Classification: H20, H26, K34

1. INTRODUCTION

The phenomenon of tax evasion is constantly changing this due mainly to the phenomena of modernity emerged and the development that allowed the emergence of new phenomena new forms of misappropriation and money laundering.

We can mention that the term tax evasion occurs with the emergence of taxes and taxes. We can even catalog the occurrence of tax evasion with the time of the emergence of finances and this mention can be certified with very old writings from the time of Plato himself.

At this time, there is no unanimously accepted definition of the concept of tax evasion. Latto sensu, tax evasion is the total of licit or illicit procedures by which those interested are wholly or partially evading the taxable matter within the tax obligations established by law (Saguna & Tutungiu, 2010).

The phenomenon of tax evasion is complex as a study of nature through its interdisciplinary character at the border of the legal and the economic. It is known today and it is well-known that the expression of tax fraud is synonymous with the tax evasion in the tax evasion literature was associated with several meanings that we considered the closest to the truth. The one to which we rally as an opinion is the one that defines tax evasion as a tax escape; This definition is broader and includes the meaning of tax fraud.

2. CAUSES OF FISCAL EVASION IN ROMANIA

In Romania after 1989 the phenomenon of tax evasion has developed in parallel with the development of the economy and with the transformation of Romania into a developing economy. Thus, we find that the phenomenon of evasion is an omnipresent phenomenon from a simple seller to a grocery store that does not issue tax vouchers to the big retailers, waiters who serve in restaurants and who receive money in the form of tips and to farmers.

We note that starting with 2013-2014 this phenomenon in Romania has begun to be greatly overcome by a set of measures aimed at strengthening the rule of law.

Farmers who do not declare their source of income in their entirety or simple traders who sell various products in this way this phenomenon in Romania is a widespread one and is based on many specific causes. Thus, one of the specific causes that can be mentioned in the case of Romania is a set of geopolitical changes.

Geopolitical changes that have included Romania on the map of countries where they move their profits from countries like Asia and Africa now to Western Europe. Perhaps the second cause of the phenomenon would be responsible for tax evasion in Romania is a shaky state that it may be weakened by a state governed by the rule of law based mainly on a fiscal regime on a strong tax. Under these conditions we find that starting with 2013-2014, this force pillar in the Romanian state is strengthened.

Another case for Romania is that of a lack of tax culture. This triggers the cause of the taxpayer's mentality is widespread, and if a survey were made it would be found that most people have a wrong perception of why they have to pay a tax or a fee. Many of them find it natural if they could not pay taxes at the same time with great expectations of what the state should offer or what the state should do, and there is no such civic spirit.

We can say that there is no such civic spirit to combat this phenomenon of tax evasion and to disclose the names of those who practice tax evasion or to support and help the competent bodies in Romania to fight this phenomenon.

Moreover, people from this lack of fiscal culture often accept even non-legal employment, directly prejudicing the state and, above all, them for their lack of contribution to their own pension source. For the years to come, another issue of multiplying the phenomenon of tax evasion Romania is that of targeting large sums of money from activities registered by companies in Romania to tax havens and we can say that it has become almost a fashion to direct your income to Offshore companies.

Another cause that persisted and allowed up to the level of 2013-2014 this phenomenon of tax evasion was the use of cash on a very large scale. Thus, no restrictions were allowed, including land purchases of buildings on cash transactions, which automatically allowed the use of unreported and unregistered tax money. The legal circuit was hard to control, because by the purchase of various buildings, services, or other values in the market afterwards they were resold and became money from previous legal transactions.

This phenomenon is corroborated with a high level of corruption among civil servants due firstly to a low salary level. However, we can see that this high level of corruption is, maybe in fact, due primarily to a lack of tax culture not only of the taxpayer but also of the civil servant and we can only pass the low level of payroll. This is corroborated with the inefficiency of public administration in the collection of taxes and duties.

Last but not least, we include on the list of specific causes the lack or permissiveness of the legislative system in certain sectors and the soft sanction for acts of fraud and deception. The phenomenon of using tax evasion and gaining impressive amounts of money among the population has become well-known. Everyone finds that those who are incriminated and presented in the media and are notorious people are just condemned, but they remain with illegally obtained money, so the negative phenomenon tends to become more accentuated in the collective mentality.

So, among the population, an extremely dangerous idea for society was inserted, namely that if you are offered the opportunity to evade today and acquire illegally or steal a large amount of money, you are tempted to do so at the risk of jailing between one and two years or earlier for good behavior, but to remain at the end of these years with that taxable substance with the full amount of money resulting from the theft. This is a legislative lacuna and must be combated as such in order to fundamentally eradicate this phenomenon.

3. FORMS OF TAX EVASION

In Romania there are several forms of tax evasion described as offenses under the new article of Law 241 of 2005. Thus, a first form is the hiding of the good or of the taxable or taxable source, sanctioned by article 9 of Law 241/2005.

This offense is represented by false or incomplete tax returns. From this perspective, two types of this phenomenon of tax evasion can be associated: one can be a physical concealment and the other can be in the legal segment (Anitei & Lazar, 2016). As far as the first phenomenon of physical concealment is concerned, it is especially in a set of hard-to-control activities that can be reminded of the agricultural sector, where taxation is based on statements that are difficult to control.

The agricultural sector where large traders in this sector declare a much diminished taxable matter. Everyone declares as production per hectare one the realization of one or two tons and in fact it produced 5 or 6 7 tons; the difference being a taxed income. The second legal phenomenon is to fill in the tax declarations incompletely/pincorrectly. This phenomenon is once again quite common. As an example, we can recall income from rents.

Lease agreements between individuals and between individuals and legal entities not declared and not registered in finance fall within this broad category of concealment of taxable matter in a legal sense.

The second form of tax evasion falling under the article of Law 241 is the omission in whole or in part of the disclosure in accounting or other legal documents. The commercial acts performed in this case are accounting documents or any other legal documents that show the commercial operations or revenue received. This phenomenon is still widespread and we may say that it may not be the same as in the 1990s when this technique was used.

Thus, in the 90's especially due to a lack of education of the taxpayer, this phenomenon of non-registration in the accounting and evidencing of taxable material was largely rewarded. Simply by failing to register a raw material purchase invoice or a sales invoice to a partner agent, the value of the tax could be reduced. Soon the economic agents realized that a way to control this phenomenon was to perform a cross check by finding the corresponding invoice registered by the partner agent; they could ask the other partner to highlight this invoice in their own accounts.

Notorious for this phenomenon of omission in part of the accounting acts is the case of soccer agents Ioan and Victor Becali and soccer player Gică Popescu. According to the data provided by the media, they sold in the 90s more players to the clubs in Italy. The values declared for finance were much lower than those in reality; The authorized inspection bodies have cross-checked and have requested the football clubs in Italy to send information; the results were incredible.

Another form is to highlight in the accounting documents some non-real-cost expenditure (Cigu, 2014). The aim being to reduce taxable material. For Romania, the period of the 90's remains notorious, when at the entrance to the capital of Romania dozens of people were flocking to false invoicing; For that time, anyone could buy such a fake invoice or receipt and by completing invoices and receipts to reduce taxable profits. It should be recalled the decision of the ICCJ which established that if the expenses entered in the accounting records of a company were subsequently corrected and the annual balance reflects the reality of the operations, it can not be sanctioned for the tax evasion offense (Minea & Costas, 2006).

Alteration or destruction of accounting or electronic money stamps is another form of tax evasion. This time, this type of procedure is recently emerging as a phenomenon in Romania. Thus, starting with 2014 and 2015, due to extensive checks by the authorized inspection bodies, a set of marking machines has been identified, which has been modified precisely in this purpose. In particular, there were found marking machines that when delivering the voucher to the customer provided the value exactly but in the memory of the machine and in the internal roll / tape which remained at the disposal of the trader, the value charged to the customer was much lower. The Anti-Fraud

Directorate found that such a vast phenomenon was being offered by a software firm in Constanta, which provided Romania with such a chargeable device to many retailers and led to a wide-ranging phenomenon of evasion.

Other forms of tax evasion, such as evasion of tax or customs financial verification by fictitious or inaccurate declaration of primary or secondary premises or in another form such as the alienation of seized property by the debtor or third parties, in accordance with the provisions of the Tax Procedure Code and the Criminal Procedure Code, these are aggravating forms of tax evasion. These fall into the direct line of crime and organized crime groups that deal with a suite of illegal and automatic actions of non-declaring this income, even with violence.

These aggravating evasion spheres that come within the sphere of organized criminal groups will always exist, but they will always find good ground in a weak state of law. The Romanian state tends to become a powerful state of law based on force and law enforcement, and over time, we hope these kinds of activities are dimmed.

4. CONCLUSIONS

The phenomenon of tax evasion will always exist as long as the phenomenon of taxation will exist and the states will exist. It is a psychological link between the duty of taxation and the need not to conform, not to respect, not to obey.

In Romania, research into the phenomenon of tax evasion is still at the beginning. If in the 1990s this phenomenon was generalized and it gradually came to a normality of mentality now is the time to look at where it will go in the future.

We know that no state resembles another, but the methods of counterfeiting remain but in the same time the speed of technological development and electronic exchanges, virtual money such as bitcoin, can raise problems and bring about a change in the phenomenon of tax evasion in the future.

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