

**ROMANIAN ECONOMIC  
AND  
BUSINESS REVIEW**

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The *Romanian Economic and Business Review* (ISSN 1842-2497) intends to provide a forum for academic analysis of the economic phenomena and institutions affecting the world economy in general, and Romania, in particular. *REBE* examines a wide variety of phenomena related to economic growth and business development and attempts to publish high quality research focusing on the role of institutions and public policy, within both a national and international context. *REBE* encourages cross-disciplinary research work of Romanian and foreign scholars.

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The ROMANIAN ECONOMIC AND BUSINESS REVIEW (REBE) is a refereed journal published four times annually by the Romanian-American University. The editors invite submissions of articles that deal with important issues in economy and business. Papers that focus on specific phenomena and events affecting Romanian economy are particularly encouraged. Because REBE seeks a broad audience, papers should be comprehensible beyond narrow disciplinary bounds.

Manuscripts should not exceed 8,000 words and must conform to the REBE's style requirements, which are guided by The Chicago Manual of Style (14<sup>th</sup> edition). All submissions must include a cover sheet explaining the scope of the article, and including the authors' names and affiliations, telephone and e-mail address. The text should be single-spaced. References are cited with parentheses using the author/date/page style. *Example:* (Marcus, 2005, p. 74). Authors should use footnotes, not endnotes to add only short comments. Bibliography should include only references cited in the text, in the alphabetical order of authors. An abstract of no more than 200 words should be included.

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# THE ROLE OF AUDIT IN IMPROVING THE QUALITY OF INFORMATION PRESENTED IN THE FINANCIAL STATEMENTS

Vasile Dumitraș<sup>1</sup>

## Abstract

*The general objective of financial statements is to provide information about the financial position, performance and cash flows of an enterprise that is useful for a wide range of users in making economic of business decisions. The financial statements also present the results of resources management by the company's management. For this reason, financial statements prepared and published by organizations are of interest for a wide range of users: investors, managers, employees, customers, creditors, bankers, government and its institutions, citizens. Experience has shown explicitly that there is a conflict of interest between those who collect, process and agregate accounting information and the information users. Often, users show a lack of confidence in accounting information, because the users who produce this information usually are not independent from the operations and the situations presented. Possible major economic consequences that may result have determined as necessary interposing financial auditors with the main objective of increasing credibility of the financial statements published by companies..*

**Keywords:** financial statements, true and fair view ,creative accounting, reasonable assurance, random sampling and statistical techniques, computer-assisted techniques.

**JEL Classification:** M400; M420; M480.

## Introduction

The need of international investors to understand and analyze financial statements prepared under different rules has created a strong pressure from their part, in their willingness to compare the equity placement opportunities by applying equivalent criteria and to have a confirmation regarding the safety of operations. This pressure as well as the presence of global markets enforced performing several actions towards creating an international and unitary framework regarding to financial statements should be prepared and presented.

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The European Union decided for the idea of *harmonization*, considered to be a more flexible process, while the *International Accounting Standards Board* (IASB) selected *normalization* as the mean aligning international standards. The visible trend now is that European directives on accounting and financial activity are modeled according to International Accounting Standards (IAS). Accounting is standardized: it relies on rules concerning the production, presentation and use of accounting information. Normalization is imposed by the need for harmonization and uniformity in accounting, in terms of objectives, concepts, methods, rules and procedures for production and use of accounting information, representing a reference system for the production of accounting information and social validation of the financial statement.

IAS 1 standard covers both the presentation of general purpose financial statements as well as the elements which provide the possibility of ensuring comparability – both with the company's previous years' financial statements as well as with others organisations' financial statements. This Standard shall be applied in presenting the general financial statements prepared and submitted in accordance with International Financial Reporting Standards (IFRS), except the condensed interim financial statements which are presented in accordance with IAS 34 "*Interim Financial Reporting*". This standard applies equally to an individual enterprise's financial statements and to the consolidated financial statements for a group of companies.

### **1. Content and presentation of financial statements**

The objective of financial statements is to provide information about the *company's financial position, results (performance) and changes in the company's financial position*. All these satisfy the common needs of most users. Pieces of information regarding the financial position are provided mainly by the balance sheet, the result (performance), by the profit and loss account and the changes in financial position by other distinct statements, the most relevant being the cash flow statement.

Financial accounting provides information that presents interest to all economic and social environment components in which the organisation operates. Information provided by financial accounting are abstracted and synthesized through the annual accounts, subject to publication. The concern for better information regarding the financial status of a company has led to a requirement of true reflection of the reality.

*True and fair* became an European concept in 1978, when it was introduced for all EU member countries, at an UK initiative, by the Fourth Directive,



which states: “*The year end financial statements should give a true and fair view of the business environment, financial status and results of the company*”.

*IASB Framework* does not address directly the concept of true and fair view but expressed ideas such include such an approach: “*The financial statements must provide a true and correct view and shall present fairly the financial position, results and changes in financial position of an enterprise*”. It also assimilates the concept of *true and fair view* with the concept of the *fair presentation of the financial status*. The Romanian legislation assimilated the concept of true and fair view through the Accounting Law no. 82 /1991. The introduction of the *true and fair view concept* has been done primarily for normalization reasons of, representing a binder for accounting practices of different countries and imposed itself as a dynamizing and unifying factor for accounting normalization.

*Fidelity* refers to the intrinsic characteristic of the accounting information, compliance or noncompliance with reality, compliance or noncompliance with accounting rules, regulations and methodologies. The data reflecting the reality, which represents the raw material, is converted by processing it into information, which is enabled to provide a true and fair view of the economic environment, through financial statements.

Reference financial statements which provide a true and fair view are:

- a) *The balance sheet* – reflecting the *financial status*;
- b) *Profit and loss account* – reflecting the *obtained result* or the *performance*;
- c) *Statement of changes in equity*;
- d) *Cash flow statement* – reflecting *changes in the financial status*;
- e) *Explanatory notes* or *Balance Sheet appendix*.

The accounting rules are presented, on one side, as *principles, rules and procedures* set as reference system information production, and on the other side, as a certification system of the financial statements used by accredited and certified accounting professionals. The object of accounting normalization can be the annual financial statements (in Anglo-Saxon countries) or the *general account plan* (in continental European countries).

The IASB accounting framework includes theoretical concepts and principles which together constitute the reference system for preparing and presenting financial statements for external users. It also provides support in helping auditors to express opinions regarding the conformity of IAS financial, and in supporting the auditors to interpret the information presented in financial statements prepared in accordance with IAS. For accounting information to meet the requirement of *true and fair view* of the economic situation, financial condition and results of a business or a group of companies,

it must meet certain quality criteria. A piece of information that does not meet the quality criteria is not sufficient to ensure meeting the fundamental objective of accounting and annual accounts. As stated in the *IASB Framework*, for the preparation and presentation of financial statements, the main qualitative characteristics that financial statements must meet are: *comprehensibility, relevance, credibility and comparability*.

*Comprehensibility* is a quality characteristic specific to users and requires information to be easily understood by decision makers. Comprehensibility requires ease of understanding of information by users by providing a reasonable balance between the knowledge on business accounting and economic activities of a user who has sufficient knowledge, and the expression of content in an accessible way of understanding this content.

*Relevance* provides assurance that the information contained in the financial statements is in line with the requirements for assessing the dynamics of economic and decision-making processes throughout their life cycle. Focusing on the economic processes life cycle enables a systemic approach to business, and thus ensures corrective actions in case of disfunctionalities. According to *the IASB Framework*, the relevance of information is influenced by its nature and materiality. In Romanian accounting regulations materiality is presented as an accounting principle: „*Any item that has a significant value is retrieved and presented separately in the financial statements. Items with insignificant amounts which have the same kind or similar nature will be summed, without the need of separate presentation.*” The accounting information are relevant to the extent they influence the economic decisions of users, having a *confirming* role (*historical financial statements*) or a *predictive* role (*forecasting financial statements*). The relevance of accounting information enforces the development and presentation of *interim financial statements* are during the financial year, quarterly or bi-annually.

A particular category of financial statements frequently required by users (investors, banks, suppliers, customers, public, etc.) to rely on them in taking business decisions, is the forecast financial statements. These are estimated or expected situations, prepared for a future period (profit and loss statement) or to a future date (balance sheet). Users are looking for reliable forecasting information in order to reduce information risk. There are two types of forecast financial statements: predictions and projections.

*Predictions* are forecast financial statements showing an expected level of the financial position, operations' results and entity's cash flows, within the limits of knowledge and conviction of the parties responsible for issuing them. Predictions are usually required by banks as part of loan applications.

*Predictions* are forecast financial statements showing the financial position, operations' result and entity's cash flows, within the limits of knowledge and conviction of the parties responsible for issuing them, considering one or more hypothetical assumptions. An example is the preparation of forecasting statements, assuming that its main product price increases without reducing the quantity of products sold.

Both types of forecast financial statements are prepared by the company's management. To ensure methodological support, IACPA / AICPA has developed the publication *Guide to elaborating forecast financial statements*. The recommendations contained in this document form a set of predetermined criteria that constitute a reference for certifying forecast financial statements. Predictions can be made both for general and limited usage, but the projections have only a limited usage. Because users may encounter difficulties in understanding the significance of financial information without obtaining additional information, standards prohibit the use of such large-scale projections. An exception to this rule is the cases when publication of projections is allowed as an appendix to a projection of general use.

The *credibility* of the information contained in financial statements characterizes the degree of confidence provided: they don't contain significant errors, they are impartial, and users can be confident that they present fairly the aimed information, or what is reasonably expected to represent. To be credible, the information must be free of error, distortion or bias, and users can be confident that the real situation is represented fairly, reasonably and rationally. Also, they should provide a true image of the company's results and financial position, to reflect economically and legally the events and transactions. A reliable information is neutral, prudent and complete in all relevant aspects. Credibility is based on the premise that the information drawn accurately reflects reality. In this regard, the usefulness of information is directly proportional to its credibility. Credibility is conditioned by the fidelity of the representation and prelevance of economic over legal.

*Comparability* of information contained in financial statements is a characteristic that allows comparisons of financial statements over time and space. Comparability over time implies consistent methods, while comparability over space requires uniform methods.

In this case, the current hyperinflationary environment raises difficult issues in updating the accounting methods and ensuring relevant criteria which allow comparability. In order to overcome this obstacle, the usage of a proper methodologic and procedural framework becomes necessary, ensure

compatibility and conversion of information, under the conditions of drastic economic and regulatory changes.

*Opportunity* refers to providing timely information when needed and not after its obsolescence, in order to be useful during the decision making process. The obsolescence of information alters also its relevance.

The *cost – benefit balance* implies satisfying the restriction that benefits derived from information are greater than the cost of obtaining it. Analysis may refer to both information provider and information beneficiary. Benefits and costs evaluation is performed through professional judgement, because in most cases, costs are not incurred directly to information beneficiaries, and many categories of users may draw benefits out of information.

*The balance between qualitative characteristics* also represents an issue of professional judgement, for which analysis may refer to both information provider and information beneficiary.

## **2. Misrepresentation of information contained in financial statements**

The results presented in the financial statements must be interpreted with caution by users, considering that enterprises have the possibility of using multiple means of information distortion. Detection of erroneous presentations impose a different treatment, whether they have been committed unintentionally or intentionally, i.e., whether error or fraud.

A calculus mistake when registering the value resulted by multiplying the quantity with the unit price, is an *error*. Failure to record transactions in the Sales Register at the receipt of cash when a sale is performed is a *misappropriation of assets (fraud)*. The deliberate overstatement of sales in the balance sheet (turnover) shortly before closing the financial year is another type of fraud, aiming to present greater profits (fraudulent reporting). All type of fraud is a deliberate overstatement of sales (turnover) just before the closing date balance sheet in order to increase reported profits (reporting fraudulent). In addition, a set of accounting policies is used for smoothing the results during result manipulation. The aggregation of such policies may lead to an alteration of the information towards a desired direction from the real situation. The literature characterizes the financial statements information handling policies as *creative accounting practices*. Creative accounting is mainly characterized by subjectivity. As a result, the reality expressed by accounting and its annual accounts is characterized to a certain degree by the subjectivity of the human factor.

*Creative accounting* is a term which should not be used only with a negative meaning. The evolution registered in accounting would not have been

possible without the intervention of creative and inventive spirit of professional accountants. Development of creative accounting has occurred in parallel with the notion of true and fair view. However, creative accounting may target manipulating the size of the financial result for the financial statements to present to the users the most favorable image of the performance and financial situation recorded by the enterpris. TIn order to raise the value of the result one can use practices which ensure an artificial growth of it (especially, the mechanism of evaluations), or one can perform profit generating options before closing the financial year. If the objective is to reduce the result, one can use the same evaluation mechanism or one can perform loss generating operations.

*Disregarding the objective, manipulating the result has negative effects on accounting information quality.* While using these manipulation policies, several actions may be performed, such as: adjusting the values of balance sheet elements, the inventory outputs, the provision, tax incentives, the artificial manipulation of expenses and income, transfer pricing provisioning mechanism, tax incentives, atrificial manipulation of income and expenses, adjustment of transfer prices between organizational subdivisions of the same company or between companies of the same group, manipulation of accounts for stock market quotation etc.

### **3. Creative accounting techniques**

Sometimes, the rules and regulations allow choosing between different accounting methods (alternative processing), which may lead to different results, different images of the financial statements. A number of items require estimates or forecasts. For example, the life of a fixed asset is estimated by the company in order to calculate depreciation. This estimate allows a pessimistic or optimistic approach, which may lead to different representations of the financial statements. Artificial transactions may be performed to manipulate the values in the balance sheet or to smooth the result. For example, engaging in the sale of a machine and, simultaneously, its renting it for the remaining life. The selling price may be higher or lower than the actual value of the machine, because the difference can be compensated by rents lower or higher than market price.

The moment of trading is carefully chosen in order to provide a certain image of the accounts. For example, the company owns a real estate property purchased at a price whose market value has quadrupled. The company's management will decide to sell property during the year when it intends to increase the result. Specifically, creative accounting techniques are used for their effects:

a) **Artificial manipulation** of expenses and income. Usually, such manipulations are applied at year end in order to achieve the desired result. The main ways of adjusting the income and expenses are:

- issuing invoices for the following year's goods deliveries, or delivering goods with invoices issued the following year ;
- recording of invoices for works and services to be performed in the following period or not recording works and services from the current period, for which invoices have been received ;
- over-or undervaluation of work in progress and of unfinished assets production at the end of execution;
- overvaluation of assets, based on inventory results, higher than economic depreciation;
- late registration of interests to pay or to receive, coming from financial activity or from purchases or sales with installment payments;
- failure to record expenses or revenues from concessions, venue management or rentals.

Accounting rules leave some margin for maneuver in quantifying the expenses pertaining to a fiscal year. For example, for certain assets only the maximum number of years to be amortized is indicated. A longer or shorter depreciation period affects the size of the result. In some cases, revenue recognition can be speeded up or slowed down by applying the prudent principle or the principle of linking expenses to revenues

b) **Deviations** from the real value in assessing some balance sheet items. Such deviations are easier for elements obtained from own production, for which the assessment is performed at production cost determined by the enterprise, but may occur also for purchased goods. In the first case, the evaluation accuracy depends on the correctness of the cost determination in management accounting and on the degree of incorporation of expenses in costs (partial or complete cost). The financial position and the result can be modeled through adjustments in management accounting, which can under or overestimate costs, especially in durable goods for internal use. Since the elements that make up the cost of these goods are distributed in all classes of accounts, the adjustment possibilities are numerous and harder to detect.

Also, under or overestimation of work in progress at year end, especially in units where this amount is significant, can be used as solutions for transferring the results from one period to another. For the purchased goods, the manipulation possibilities are offered by the elements of the supplier's purchase price (from the structure of the purchase cost) that can be included in the value of purchased goods or directly in operating costs.

c) **Applying different methods of inventory evaluation.** Choosing one of the stock evaluation methods - *FIFO (evaluation of inventory at the value of the most recent entry)*, *LIFO (evaluation of inventory at the value of the oldest entry)*, *WAC* (weighted average cost method) - associated with the characteristics of the Romanian economy during inflation periods, determines under or overestimation of inventory outputs withdrawals, leading to expenses minimization and income increase for FIFO, and overvaluation of expenses and underevaluation of income for LIFO. The WAC method allows smoothing the cost variations, providing a compromise between the two methods described above.

Another aspect that can be modeled is the method chosen for including as expenses the value of assets in use: fully when putting into use, or staggered over several periods of management.

d) **The provisioning mechanism.** The appearance of provisions in accounting is in line with the requirements imposed by the principle of prudence in evaluation. Modeling the financial result through provisions is an easy and indisputable method, at hand of every business. Reflected in their accounting mechanism (by increasing spending during the formation or supplementation, respectively increase revenue in future periods when consumed, cancel or decrease) can be used as an effective means of transferring the results from one year to another . Also, provisions can generate tax benefits.

The practice shows that a firm with the more prosperous it will be more tempted to cut down to a greater extent the result and hence the tax burden, being higher provisions. These are actually disguised own resources. A thriving business will be less tempted to be as small reserves, not lower their profits or limit loss size. In both cases, the true image has suffered, provisions, by their inaccurate coverage, helping to reduce the quality of financial information.

Their mechanism of reflecting in accounting (by increasing expenses during the constitution or supplementation, respectively increase of revenues in future periods when consumed, cancelled or decreased) can be used as an effective mean of transferring the results from one financial year to another . Also, provisions can generate tax benefits.

The practice shows that a firm the more prosperous, the more tempted will be to cut down the result to a greater, hence the tax burden, by constituting higher provisions. These are actually *disguised own resources*. A less thriving company will be tempted to be to constitute smaller provisions, not to lower their profits or to limit the size of the loss. In both cases, the true and fair view has suffered, provisions, by their inaccurate reflection, contributing to reduce the quality of financial information.

e) **The policy of adjusted prices** between organizational subdivisions or between constituent units of a group. Adjusting prices for intermediate consumption between organizational subdivisions seeks to delay or to accelerate the deduction of expenses from the result of the financial year. Adjusting prices for intermediate consumption between the constituent units of a group has tax incentives.

f) **Arranging the accounts** with the purpose of listing on the stock exchange consists in overstating the assets and results and understating the liabilities, in order to present the financial position and the performance in a positive outlook for investors.

g) **Handling of information presented in the annex.** The lack of relevant information may affect the decisions of the to external users

The criteria used in presenting the accounting information may represent a loophole for the manifestation of creativity. The analysis of the evidence submitted reveals that companies often take advantage of existing gaps in rules and their flexibility in order to distort the published information. Although there is a clear difference between creative accounting and deliberate violation of the law, both phenomena occur in financial difficulty and are based on enterprises' intention to cheat. Consequently, even if the use of creative accounting is not illegal, it indicates that managers under financial pressure seek solutions without questioning if they respect the ethical standards.

#### **4. The role of audit in ensuring the quality of information presented in financial statements**

The most common method by which users can obtain reliable information is providing *audited financial statements*. The audit of financial statements is performed for determining if the financial statements as a whole are presented according to certain criteria. Normally, the criteria are the generally accepted accounting principles or any other accounting method adapted to the specific of the organization. Most of the times the financial statements included in the audit are: *the balance sheet* (statement of financial position), *income statement*, *statement of changes in equity*, *cash flow statement*, as well as the accompanying notes and annexes.

In addition, to meet the complexity of information requested by users, the auditor must not ensure only an improved credibility of the financial statements but, also provide services that add value, such as *reporting irregularities*, *identifying business risks* and *providing advice* in relation to weak points of internal control system. In modern auditing, the assessment of



financial statements is often supplemented by findings resulted from the audit of financial flows, which provides a supplement of reliable financial information.

The overall objective of a financial audit is to provide *assurance that the examined financial statements are complete and accurate, and economical operations were performed in accordance with relevant laws and regulations in force*. Achieving this objective in terms of absolute certainty, even if feasible, requires an expensive activity. To reduce these costs, there is the possibility of using the audits based on tests. In this context, auditors, through their reports, sees to provide **reasonable assurance** - not absolute assurance - that the financial statements are complete and in accordance with relevant laws and regulations in force. According to the principle of good practice, the audit institution designs the audit process in order to obtain a certain level of *confidence that the audited financial statements do not contain material errors or irregularities*.

During the planning phase, the materiality is determined, a preliminary estimation of the errors within financial statements is performed and the size of the statistical samples to be selected for testing is calculated. Typically, the auditor determines a level of materiality for each group of financial statements according to the type of audited entity. The following may be considered the basis of calculation: *the total gross expenditure* (for entities engaged primarily in expenses), *the income level* (for entities that collect revenue), *the total gross and net assets, profits, turnover, accounts surpluses* (for entities form the banking system).

To calculate the sample size, the auditor estimates the errors within financial statements, based on the errors detected during the previous year's audit (if they were detected), or estimates them (if there are no previous information available). Also, the auditor separates the financial statements in categories of economic transactions (wages, salaries, purchases, grants, subsidies and income) and for each assesses the inherent risk and the control risk.

For financial statements included in the balance sheet, the transactions categories concern tangible fixed assets, inventories, debtors, creditors and other monetary obligations, various liabilities, prepayments etc. The financial auditor identifies and evaluates the risk for each category of economic transactions. At the same time, the auditor has to consider whether there is a risk that the entity's audited financial statements contain errors, as well as if they were made intentionally or unintentionally.

Auditors must report if he finds: internal control weaknesses, inconsistencies in preparing the financial statements, errors, unusual transactions or results, which indicate the existence of fraud, lack of probity or

corruption. Financial auditors provide assurance services, particularly on information contained within historical financial statements, but lately have expanded the range and scope to include also financial forecasts. Also, the increasing amount of information available on the Internet and development of electronic commerce, currently generate specific requests from the public, involving changing the approach towards assurance services.

Online trading determine a shift from the need of assurance over existing historical financial information, such as financial statements, to the need of assurance regarding of reliability of the processes generating information. For example, many functions within an enterprise, such as issuing orders and payments, are performed through the Internet, communication being performed directly between two computers, through programs of electronic data interchange (EDI) without human intervention over the information contained therein. Online, real-time transfer of information requires specific assurances regarding the protection and assurance of information security, including information technologies of managing web sites that host such systems. In order to meet the growing needs assurance over performing Internet transactions, the International Association of Certified Public Accountants (IACPA) has created services with an assurance component such as CPA WebTrust which apply an electronic seal of applying on the certificated website, to ensure users that the owner of the site meets the criteria for working practices.

### Conclusions

The primary objective of audit has evolved from detecting fraud and errors in *certifying financial statements* to verifying their compliance with certain predetermined criteria. The change of audit objective required the development of audit techniques. In the globalized economy and internationalization of financial markets, traditional methods of verification, which involved an exhaustive scrutiny of transactions proved too costly and time consuming. For this reason they were replaced by *random sampling and statistical techniques, computer-assisted techniques*, the auditor emphasising at the same time on *efficiency and effectiveness of internal control*.

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13. Declarația internațională privind practica de audit 1003 - *Medii IT – sisteme de baze de date*
14. Declarația internațională privind practica de audit 1008 - *Evaluarea riscurilor și controlul intern – caracteristici și considerente privind CIS*
15. Declarația internațională privind practica de audit 1009 - *Tehnici de audit asistate de calculator*
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# THE ROLE OF LEADERSHIP IN THE MANAGEMENT OF CRISIS SITUATIONS

Iulian Mituț<sup>1</sup>

## Abstract

*Crisis situations are inherent in the activity of any modern organization, regardless its type – public, military or private – and they affect the efficiency of human resource or even organization's excellence. For nearly two years, the organizational environment has been marked by the effects of the latest economical and financial crisis, which amplified the organizational tensions, highlighting, in the absence of leadership, dysfunctions or organizational issues. In crisis situations, leadership can make the difference between organizational success and failure, having a strong motivating and organizational effect. The European statistics indicate that in recent economic crisis, the countries with a culture of leadership, an organizational environment orientated to own human resources and managerial competence exceeded more easily social, economic and financial problems. So, leadership becomes a savior for organizations and even for state, if it is manifesting in many public, military and private organizations.*

**Keywords:** organization management, leadership, managerial motivation, human capital, professional performance.

**JEL Classification:** M 2; M51; M54; O15.

## 1. Introduction

*Leadership* means to integrate all the values and principles of the organization in employees' daily routine, to communicate periodically the outlook and back each employee in achieving professional and organizational excellence. So that leadership can be functional it requires beside emotional intelligence (EQ), beside the specifications in the job description, as leadership implies interpersonal relationships based on: encouragement of sincerity, appreciation of initiatives, proof of availability to subordinates, manifestation of emphatic attitude and lacking favoritism, representation of subordinates and stimulation of fair competition.

Concurrently, the management or coordination of the human resource is mainly defined by the direct relation established by manager with his

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subordinates, a relation which represents expertise transfer and trust investment, which become essential in crisis situations.

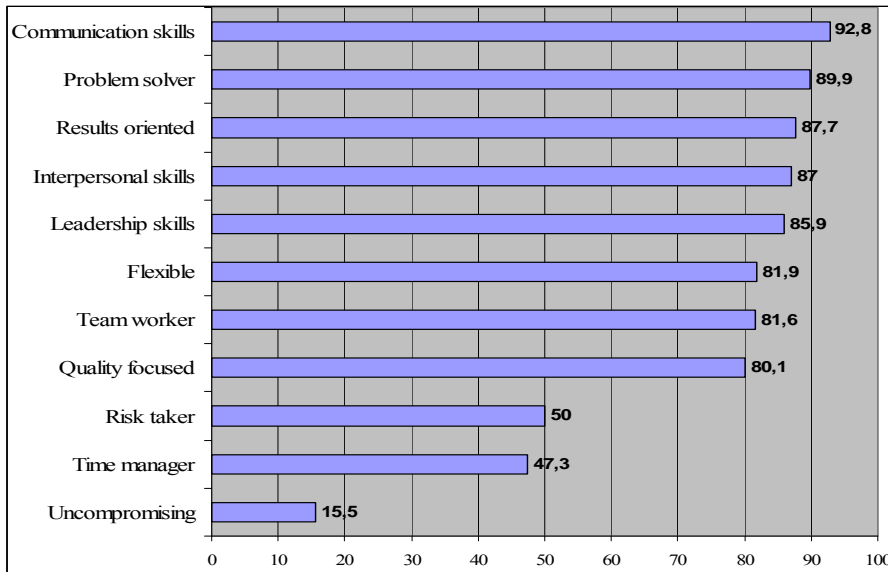
## 2. Manifestation of leadership in organization, society and modern market economy

The human resource is the only non – preservable, unstorable organizational resource, with potential for growth and development, with capacity to accumulate knowledge and overcome boundaries, characteristics that set it apart from other organizational resources. Regardless organization's type and structure, not using this resource when offered means unrecoverable loss in terms of competitiveness. In times of crisis or risk of occupational diseases, in the context of labor migration, of low birth rate and aging population, the surest way for organization's profitability is the efficiency of the available staff. In this respect, the management decision requires leadership and it must be (Deaconu, Podgoreanu & Rasca, 2004, p. 100):

- *Grounded* - choosing the best alternative relies on as many elements as possible described in realistic terms;
- *Made in due time* – by proper organization of the reporting activity and with the support of a proper information system;
- *Consistent with other decisions of the organization* – aspect which presupposes interdepartmental cohesion;
- *Clearly stated* – decision's notification is as important as choosing the best solution.

Coordination, motivation and effective human resource crisis situations depend on the relationship the manager establishes with subordinates, this relationship's functionality being influenced by leadership through: *managerial competence, promotion of confidence, proper motivation, objective assessment of subordinates work results and communication.*

*Managerial competence* – ability to work with subordinated people, to motivate, mobilize and train them to achieve organizational objectives and tasks. Regardless manager's hierarchic level, fairness, correctness, honesty, good faith, objectivity are minimum conditions for an effective and competent leadership. Survey data released in 2000 (with 277 organizations) by State University of New York indicate that managerial competence is evaluated by: good oral / written communication skills, problem solver, results oriented, interpersonal skills, leadership skills, customer focus, flexible, team worker, dependable, quality focused, technical expertise, business expertise, hard worker, staff developer, safety conscious, imaginative, risk taker, time manager, purposeful, professional dress, uncompromising, proficiency in foreign language and experience in living / working in foreign country (Abraham et al., 2001, p. 846).

**Chart 1 – Manifestation of managerial competences (%)**

Source: adapted from Abraham et al. (2001), p. 846

Also, manifestation of managerial competence depends on the job hierarchic level. Thus, the low and middle management type coordination requires empathy, operational planning ability, resource allocation, organization of work, motivation, delegation, management of subordinates and development of personal skills. The strategic management competence (top management) requires, beside the above-mentioned skills, decision-making capacity, strategic planning, negotiation capability and allocation of human, material, financial resources, etc. The higher the hierarchical level of the position, the more prevailing strategic managerial competence should be.

**Promotion of confidence** – is the basis of the manager - subordinate relationship, essential in achieving long-term performance or in consolidating working group cohesion. Confidence is influenced by:

- asserting and proving manager's or leader' confidence in subordinates, as confidence is earned through confidence and it generates reciprocity;
- the trust of subordinates in leader's professional ability, fairness and team spirit, which requires a model of professionalism and ethical conduct.

The manifestation of leader's disbelief in subordinates originates in the erroneous assumption that employees are not capable of taking responsibility, of showing creativity and initiative and that achieving objectives requires coercion. Such an attitude creates professional tension, negatively affects the manager - subordinate relationship and group performance, being recommended expression and encouragement of a confidence-based attitude.

The leader must prove empathic capacity, listen to subordinates, encourage them and interact with their needs because this is the only way to truly rely on the staff, on subordinates' expertise, participation and initiative, and, only with such an attitude, the request for professional performance becomes legitimate. A confidence-based attitude means encouragement of subordinates' independence and initiative, their training to acknowledge and be aware of the necessity of the carried professional activity.

*Proper motivation* – is the main condition that determines employees to work, be responsible, creative and enterprising. For the motivation to be effective, subordinates must get involved in the creation, definition and implementation of the motivational program. The financial reward based on objective criteria, known to subordinates and respected by managers strengthens leadership and influences the proactive attitude. In addition, non-financial motivation is an attribute of leadership, being influenced by: communication, management through objectives, delegation, and participative management. In the motivation process, the manager should know his subordinates, know their needs and expectations, hobbies and passions.

*Objective assessment of subordinates work results* – influences competitiveness and employees' desire to excel professionally. Non-recognition of personal merit, unfair criticism, giving underserved credits or accidentally stated unfavorable words destroy subordinates' ambitions and motivation. However, constructive criticism is welcome as long as it respects employee's dignity, by encouraging and convincing him that he can act by himself in the interest of the organization. Every employee has negative attitude and positive attitudes, a management approach which shows that some have only the positive parts (reward, frequent praise and encouragement), and others have only other negative parts (criticism, punishment or no reward) demonstrates side-taking, subjective evaluation and lack of leadership. In addition, manager's admittance of his own mistakes proves leadership, the attitude of admitting errors is directly proportional to the possibilities of overcoming them, without affecting management authority.

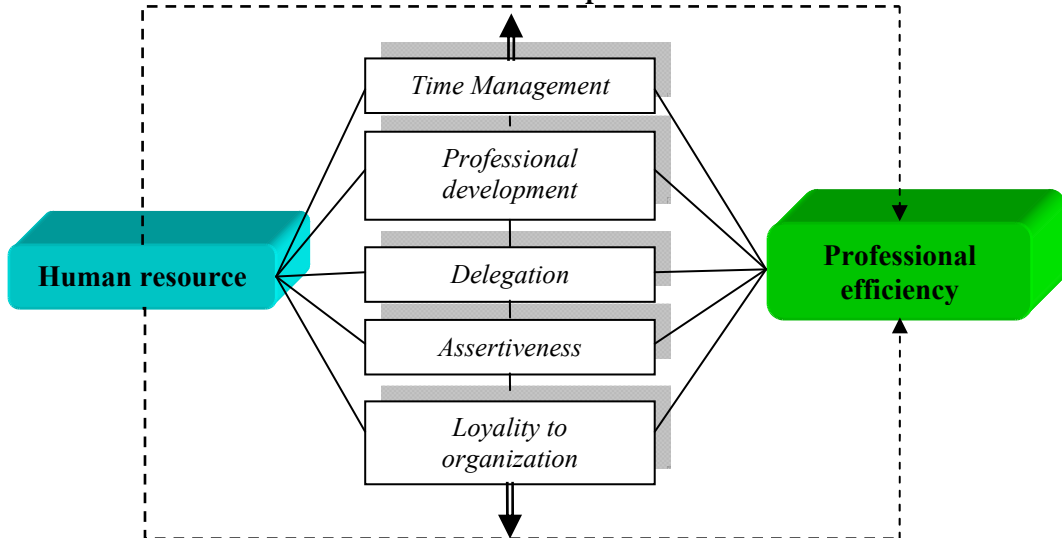
*Communication* – is key-element of leadership, with positive effects in influencing employees' attitude towards the right direction. In any organizational environment there are several forms of leader - subordinate communication: ignorance, feigned listening, selective listening, empathic listening, empathic listening being advisable in any organizational situation as it inspires and encourages the speaker to freely and openly express. Empathic listening does not reduce leader's authority and it does not involve subordinate's approving attitude, but a more profound intellectual and social

comprehension. The cases problematic individuals, with poor results or disciplinary acts, are often caused by ineffective communication and less by intellectual limitations or lack of skills. Empathic listening can solve the organizational problematic situations if it is not manipulative, which triggers interlocutor's insecurity.

### 3. Effectiveness of human resource through leadership during crisis situations

During crisis situations, leadership becomes a true driver of organizational profitability, with the ability to substitute lack the financial, economic or organizational means, to maintain functional work environment of the organization, to raise employees' moral and even determine an increase in their professional efficiency. Regardless the intrinsic or extrinsic type of the crisis, managers who understand that profit and organizational success are directly proportional to employees' efficiency and know to maximize their capabilities, provide competitive advantages on medium and long-term to the organization. In normal economic and financial situations, but especially in crisis situations, the manifestation of leadership is reflected by: *time managing and prioritizing activities, development of own skills and emphasis on training, task and responsibilities delegation, development of assertiveness and loyalty to the organization.*

Chart 2 - Manifestations of leadership on human resources



*Time Management* or *effective time administration* is one of the most commonly used methods to reduce occupational tensions and boost work efficiency of employees, especially those with dynamic profession. The modern



employee can barely share his time between family, work environment and own aspirations. Every person has 168 hours per week to generally use as follows: 40 hours for professional activities, 56 hours for sleep and 72 hours for various personal activities. But in the EU the most employees work between 34 and 41 hours / weekly. (EU OSHA, 2009, p. 15).

**Table 1 – Weekly working hours in EU**

Working hours	Percentage (employees in EU)
<i>less than 20 h</i>	<i>10,9%</i>
<i>21 – 34 h</i>	<i>10,5%</i>
<i>35 – 38 h</i>	<i>21,3%</i>
<i>39 – 41 h</i>	<i>32,5%</i>
<i>42 – 48 h</i>	<i>11%</i>
<i>More than 48 h</i>	<i>13,8%</i>

Source: adapted from EU OSHA (2005), p. 23

During the hours dedicated to professional activity, each employee takes into account the three aspects of time management: planning, organization and control (Deaconu, Podgoreanu & Rasca, 2004, p. 148), using time wisely - productively in accordance with its personnel pace and available resources. Thus, leadership is manifested by objective assessment of time required to achieve professional activities (*planning*), carrying out work through all possible efforts (*organization*) and constant evaluation of the results (*control*). In any professional environment time management is affected by:

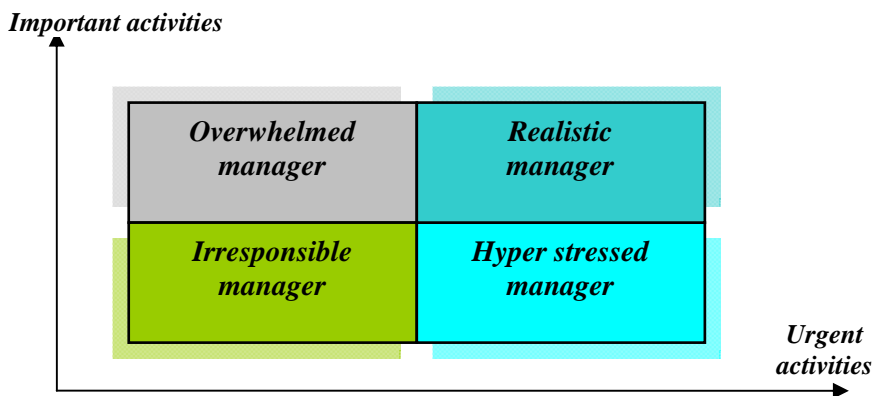
- The level of organizational stress level or the psycho-physical condition of the employee, which adversely affect the action, work capacity, work efficiency and results orientation. Professional effects of stress correlate with employee's ability to control and professional coercion, with disorganization and nonproductive behavior (Karasek, 1990, p.89), lack of leadership affecting employee's organizational and working capacity;

- *Interruptions* caused by visits, unannounced phone calls or various emergencies, the attitude towards these situations ranging from one individual to another depending on the position in the organization, on the type of organization or social environment. Thus, an employee in India will react to professional disruptions in one way and another is the attitude of an employee in Germany. Similarly, a manager's reaction will be different from the reaction of an executive or the reaction of a member of a military organization will differ from that of an employee in the constructions.

• *Meetings* usually have an incontestable utility, but there are situations when they end up being a waste of time, especially when: they are too frequent and inadequately prepared, they are too long, do not comply with the agenda or do not solve all problems, are not held in appropriate locations or debate parasitic objective usually detected and sanctioned by participants (flattering of a person, avoiding responsibility for a decision, direct and indirect control of team's attitude, meeting a method, a justification of a subjective decision, etc.).

Time management is a managerial challenge involving decisions-making according to the importance and urgency of actions. Considering these two criteria for time management, specialized literature describes four types of managers: hyper stressed, irresponsible, overwhelmed and realistic (Stanciu, 2001, p. 60), leadership being only specific to the last mentioned category.

**Chart 3 – Correlation of importance - emergency in management activities**



Source: Stanciu (2001), p. 60

The *overwhelmed manager* knows which are important activities and acts to solve them, but he does not pay proper attention to secondary activities, thus losing important opportunities and benefits for the organization.

The *irresponsible manager* organizes activity but is unable to predict the effects of the coordinated activities, which triggers lack of efficiency on all organization levels as subordinates will not be optimally represented, and the shareholders / heads will not be able to implement large projects with such manager.

The *hyper stressed manager* pays attention to the activities which require fast completion, to the detriment of the postponed activities, although important, which highlights a poor prioritization of tasks, equivalent non-performance on medium and long term.

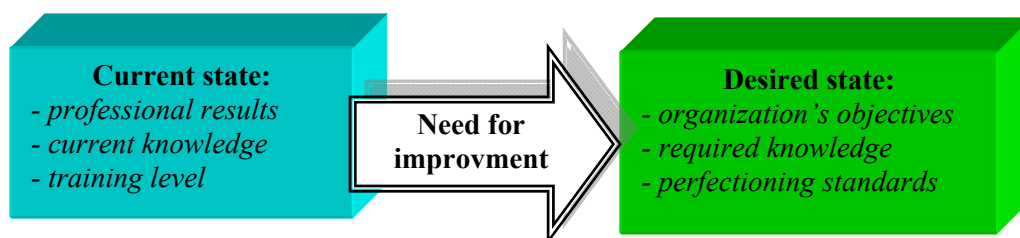
The *realistic manager* is the effective manager who succeeds in properly prioritizing and ranking main and secondary activities, both urgent and less urgent, depending on the available resources available. He has the capacity and capability to increase efficiency through human resources by: permanently identifying time waste, setting clear priorities, making optimal decisions, exploitation of subordinate staff's skills, motivation and determination of all subordinated employees, enhancing group cohesion and focusing on relevant activities. Such a manager proves leadership, avoids tense situations or even conflicts and manages best both his time and the time of subordinates irrespective of the crisis situation.

*Professional development* is diminished or even ignored in crisis situations because of poor specific conditions, although most organizations realize that the training of employees is one of the most profitable investments with a positive effect on reducing organizational stress and increasing professional performance.

Personal development is yet inefficient in the context of a shortage of financial resources, impoverishment of the population, of moral crisis, of economic or social disorder and indiscipline.

The planning of human resource training is usually determined by factors such as: low productivity, occupational injuries, occupational test results, the need to achieve higher standards and objectives. Regardless of the situation, the need to improve human resource is identified according to the report between the current situation and desired status of the organizational performance (Stanciu, 2001, p. 190).

**Chart 4 – Need for improvement**



Source: adapted from Stanciu (2001), p. 190

Skill development or personal development are achieved through personal *strategies* (courses in the public sector or in universities), through *training* (internal or external courses focused on thematic knowledge and skills) and experiential learning (learning by performing professional activities under the guidance of superiors and / or colleagues).

The European survey data indicated that higher education is influencing labor market force and organizations' efficiency. In 2009 (crisis year), personal strategies had a good ratio and these correlated with labor force participation (The World Bank, 2011).

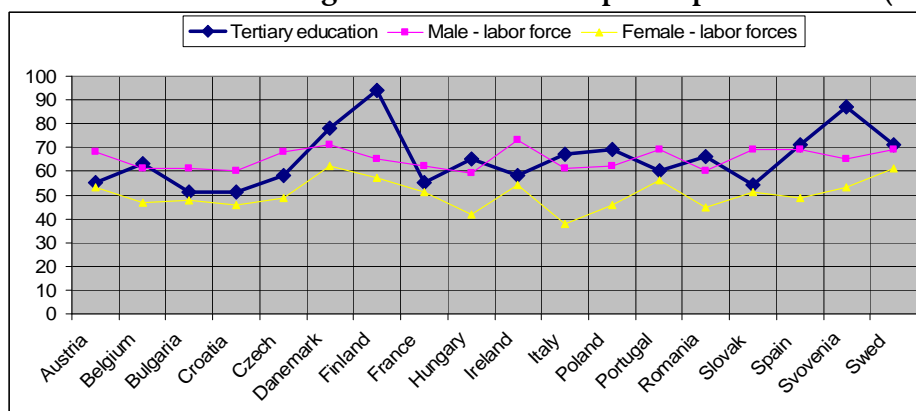
**Table 2 – Implication in work and study in EU (2009)**

<i>EU Countries</i>	<i>Tertiary education (%)</i>	<i>Male labor force (%)</i>	<i>Female labor force (%)</i>
Austria	55	68	53
Belgium	63	61	47
Bulgaria	51	61	48
Croatia	51	60	46
Czech	58	68	49
Denmark	78	71	62
Finland	94	65	57
France	55	62	51
Hungary	65	59	42
Ireland	58	73	54
Italy	67	61	38
Poland	69	62	46
Portugal	60	69	56
Romania	66	60	45
Slovak	54	69	51
Spain	71	69	49
Slovenia	87	65	53
Swede	71	69	61

*Source:* adapted from The World Bank (2011), pp. 80 – 82, pp. 40 – 42

In the table, *tertiary education* is percent of the total enrollment to the population and *labor force participation (male and female)* is proportion of the population age 15 and older engages actively and the labor market, either by working and looking working.

Chart 4 – Personal strategies and labor force participation in UE (2009)



Training and guidance involves experiential learning through discovery: an employee supports another employee and a manager supports a subordinate or another manager to become effective professionally, which requires leadership.

In crisis situations, experiential learning is preferred by most modern organizations because it is less expensive and focuses exclusively on developing skills, but a good manager uses all these professional development strategies to know, select and train employees.

*Delegation* understood as "sequence of activities from total control to total failure" (Armstrong, 2004, p. 67), the temporary assignment of duties and responsibilities, accompanied by the appropriate authority in their performance is a useful tool in any social and economic conditions if it is not practiced in excess. However, in crisis situations when it comes to strategic task or activities which may have major consequences for the organization, and when subordinates are not sufficiently trained, task delegation is not recommended.

The delegation is appropriate when a manager may not allot sufficient time to the specific work, due to the busy schedule, when motivation or evaluation of a member of the organization are intended or when testing the ability of employees who seek relative independence to prove certain competences and capabilities. In carrying out the delegation, a manager is not absolved of responsibility, bearing the responsibility for the results of the delegated person and, manager's confidence in the delegated subordinate is essential and requires reciprocity in crisis situations.

*Assertiveness* involves expressing ideas, opinions and feelings openly and directly without neglecting or offending the other members of the organization, driving them towards better performance, for professional development, improve cooperation, building relationships of trust and mutual respect. Assertiveness is an effect of manager's assuming leadership,

communication with employees, earning their confidence, providing explanations on organizational changes and work concepts. Manager's credibility is very difficult to obtain in crisis situations when organization's strategy is based on staff downsizing, restructuring or job re-positioning, measures which attract discontent and disgust. Such measures may however be viewed with confidence by employees if they felt their manager's assertive attitude in the past. To be assertive, a manager must know how to listen to employees, leaving aside criticism and fears as this is the only way to achieve high performance. Manager's ability to discern the times when to be authoritative from the moments when to make any compromises or his ability to express an intelligent feedback which that does not destroy, but helps the employee, supports organization's performance and excellence, offering possibility to assert by respecting others and recognition of their achievements and capabilities (Saunier, 2007, p. 157).

*Loyalty to the organization* is a cause and a way to streamline the human resource, as it creates a source of valuable and useful intellectual capital for the organization. Loyalty means total trust and commitment to the organization, being the exclusive effect of leadership manifested by: encouraging employees to participate in decision making, objectively and unbiased distribution of bonuses for excellent results, importance given to career development, support in employee's training and the appeal to *face to face* communication.

Low attachment to the organization generates: non-performance, increased staff fluctuation and absenteeism and lack of loyalty in crisis situations is equivalent to employees' and lack of involvement, lack of bonuses and harassment for disloyal attitude. The effects of low attachment are similar at both the individual and the organization level with those generated by organizational stress, even being a mutual influence between stress and lack of loyalty. At the opposite, encouraging a high level of loyalty risks effects such as: low creativity, overload, stress, professional resistance to change, inability to find balance between personal and professional life. Also, excessively loyal employees can develop predisposition to adopt an illegal or unethical behavior "to the good of the organization".

*Proper motivation* aims to boost employee's satisfaction at workplace, being responsible for human resource efficiency or lack of efficiency. Satisfaction generates performance and performance generates satisfaction provided it is admitted and rewarded. The efforts laid by the human resource to achieve own satisfaction is a function dependent on possible rewards and on the possibility that additional effort be additionally rewarded.

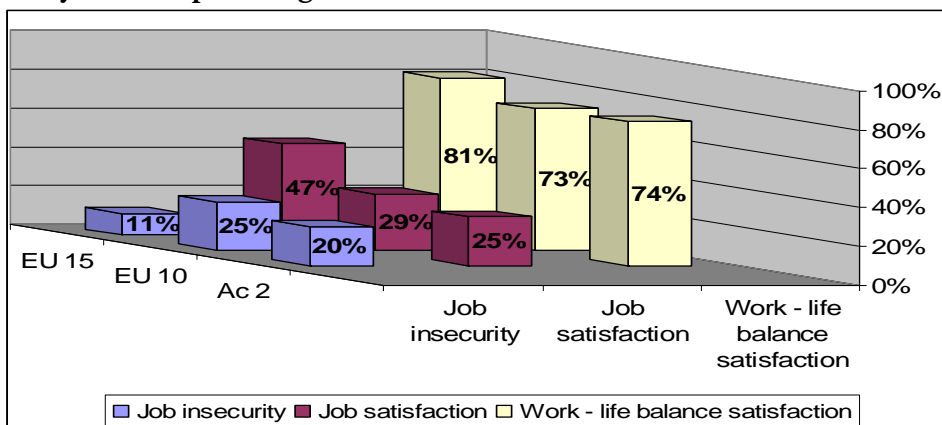
Proper motivation, assertiveness and loyalty are influenced by job satisfaction, work – life balance and perception of job security which involve leadership. In 2005, European survey data indicated that in *EU 15 (states of the UE before may 2004)* 47% of the employees declared that they had been well paid for the work they had done and they believed that their jobs offers good prospects for career advancement. Also, 81% of employees said that they are happy with the way in which their working hours fitted with family or social commitment. About job insecurity, in *EU 15*, 11% of employees considered that *they lose the job in next 6 month*. Compared to *EU 15*, in *EU 10 (countries which joined the EU in may 2004)* and *AC 2 (acceding countries in 2007 – Romania and Bulgaria)* feeling of job insecurity, job dissatisfaction and work life balance dissatisfaction are more prevalent (EU OSHA, 2009, p. 25), which shows lack of leadership.

**Table 3 – Job satisfaction, work life balance satisfaction and job insecurity in EU 15, EU 10 and AC 2**

EU	Job satisfaction	Work - life balance satisfaction	Job insecurity
<i>EU 15</i>	47%	81%	11%
<i>EU 10</i>	29%	73%	25%
<i>Ac 2</i>	25%	74%	20%

Source: adapted from EU OSHA (2009), p. 25

**Chart 5 – Job satisfaction, work life balance satisfaction and job insecurity in European organizations**



In a crisis situation, when additional rewards or bonuses of additional effort are not achievable the use motivational strategies is advisable, achievable through leadership, namely:

- *Direct influence* – strategy which refers to direct interaction between the manager and human resources. Depending on the organizational climate, the manager may choose to implement a series of methods to reward human resources by: providing a training course chosen by employee or organization, purchase of books or tickets to an event paid from the fund of the organization, taking over a part of employee's responsibilities for a short period, providing a meaningful gift for employees, etc. Such a strategy has a beneficial effect on the employee if his needs were properly analyzed, only requiring managerial creativity.

- *Situational adaptation* – strategy relating to human resource's adaptation to the work environment in view of influencing situation from inside the organization: feedback, management by objectives competitiveness boost.

The first salary bonuses are the easiest form of motivation of the human resource, but there are situations when such bonuses cannot be awarded by organizations (low yield, loss of competitiveness of the organization), situations when any form of bonus inefficient (high inflation) or situations which affect organizational communication, management style and professional performance, which is why manager's leadership and his ability to work with people definitely influence the conduct of human resource and organizational success.

## **Conclusions**

In modern organizations, indicators relating to time management, work-life balance, professional education or training, job satisfaction, job security vary from country to country and from organization to organization. In this context, leadership makes difference and influences productivity / competitiveness of the organization or the state.

In the current organizational society, characterized by the fast pace of changes, by continuous technological learning and elimination of communication barriers, any team, group or organization needs leadership to be more efficient, more competitive and more effective. The organization which lack leadership is vulnerable and lacks insight into crisis situations, risking loss of control over human resources, loss of competitiveness and even lost off efficient employee, which equals to organizational failure.

The idea that "leadership is not learnt, you are born with it" is difficult to prove, but it is certain that the manager who is aware and understands, at least



in theory, the role and organizational significance of leadership, who invests time and effort into practicing empathy, in the control of his own pulses and in analyzing the opportunities of moments when to be authoritative, offering his effort of will, can create competitive solutions for his subordinates even in organizational crisis.

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# THE IDENTIFICATION OF THE MARKETING NEEDS AND MEANS OF COMMUNICATION OF THE ROMANIAN MARKETING COMPANIES - A MARKETING RESEARCH -

Tudor Edu  
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## **Abstract**

*The marketing needs of the Romanian marketing companies are very diversified, commencing with the research of the needs and demand on the target market, going down to the 4Ps (Product, Price, Promotion and Placement) and their components.*

*The present marketing research was performed using 7 categories of information sources: specialised publications in marketing; specialised publications in economics; information provided by specialised institutions in consultancy and marketing research; information provided by individual marketing specialists; information provided by advertising agencies; information provided by the economic sections of the daily newspapers; job web sites.*

**Keywords:** marketing needs, Romanian companies, secondary data

**JEL Classification:** M31

## **Introduction**

The Romanian marketing companies, especially those activating in consultancy, marketing research and promotion, have developed tremendously in nearly 20 years of open economy. These companies grew and diversified their businesses and, as a consequence, their marketing needs evolved continuously. In order to determine the current situation of the involvement of marketing, in general, and its specialised branches in the activity of the Romanian marketing companies we consider that a good starting point would be the assessment of the secondary data available on these topics. The novelty of our approach consists in the fact that we wanted to determine these needs

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through mining into the existent data obtained for other purposes while it is accustomed in theory and practice to conclude about needs through direct research.

In order to perform such a marketing research, the sources of information were grouped in 7 categories: specialised publications in marketing; specialised publications in economics; information provided by specialised institutions in consultancy and marketing research; information provided by individual marketing specialists; information provided by advertising agencies; information provided by the economic sections of the daily newspapers; job web sites. Out of these 7 categories, 290 relevant references were identified.

The present research was conducted in 2011, between January and April.

### **Literature review**

The secondary data already exist. They were collected in research studies performed at a prior date. The secondary data are very useful, because they can provide useful insight on various matters. The conclusions drawn after analysing secondary data can be sufficient for the researcher. If they are not sufficient, they can represent a starting point for further research studies, such as a focus group, an in-depth interview or a survey.

### **Research methodology**

#### **1. Research purpose**

The identification of the types of marketing needs and means of communication used by the Romanian marketing companies.

#### **2. Research objectives**

1. The identification of the Romanian marketing companies' needs in relation to the marketing environment.

2. The identification of the Romanian marketing companies' needs in relation to the determination of the buying and consumption behaviour on a particular market.

3. The identification of the Romanian marketing companies' needs in relation to their offers and their clients' ones.

4. The identification of the Romanian marketing companies' needs in relation to the setup of their prices and their clients' ones.

5. The identification of the Romanian marketing companies' needs in relation to the promotional options for their offers and their clients' ones.

6. The identification of the Romanian marketing companies' needs in relation to the distribution possibilities for their offers and their clients' ones.

7. The identification of the communication means used by the Romanian marketing companies.

### **3. Research hypotheses**

1. The Romanian marketing companies need information about the marketing environment related to:

- the features of the industry/market and tendencies on it
- acquisitions and diversification
- market share
- its employees

2. The Romanian marketing companies need information about the buying and consumption behaviour in relation to:

- brand preferences
- attitude toward a brand
- product satisfaction
- buying behaviour
- buying intentions
- brand awareness
- segmentation studies

3. The Romanian marketing companies need information for their offer and their clients' ones in one or more of the following categories:

- concept development and testing
- brand name generation and testing
- test market
- product testing
- package design
- competitors' products

4. The Romanian marketing companies need information regarding their prices and their clients' ones gathered from:

- cost analysis
- profit analysis
- price flexibility
- demand analysis: market potential; sales potential; sales forecasting
- competitors' price analysis

5. The Romanian marketing companies need information regarding their promotional options and their clients' ones obtained from:

- the research of the motives which determine the choice for a means of communication

- the research of the mass communication means
- the research of the advertising message
- the research of the advertising efficiency: before/after broadcasting
- the research of the competitors' advertisements
- the research of the public image
- the research of the sales force's compensation
- the research of the sales force's shares
- the research of the sales force's areas
- the research of promotional instruments such as prizes, coupons etc

6. The Romanian marketing companies need information for their distribution possibilities and their clients' ones obtained from:

- the research of the office/factory/warehouse location
- the research of the distribution channel's performance
- the research of the distribution channel's coverage
- the research of exports and international trade

7. The Romanian companies use a great variety of communication means, such as: newspapers, magazines, TV channels, radio, and online services.

#### 4. Research variables

Variable	Definition	Directions for research
Marketing needs	The necessity to obtain the information which will help the organisation understand the environment and adapt accordingly to it	<ul style="list-style-type: none"> <li>- information about the marketing environment</li> <li>- information about the buying and consumption behaviour</li> <li>- information about the traded offer</li> <li>- information about the prices</li> <li>- information about the promotional options</li> <li>- information about the distribution possibilities</li> </ul>

		<ul style="list-style-type: none"> <li>- information about the communication means</li> </ul>
Marketing environment	The sum of forces which act in a direct or indirect manner upon the organisation	<ul style="list-style-type: none"> <li>- the features of the industry/market and tendencies on it</li> <li>- acquisitions and diversification</li> <li>- market share</li> <li>- employees</li> </ul>
Buying and consumption behaviour	The sum of individual or group decisions directly connected to the acquiring and use of goods and services for the satisfaction of the current and future needs, including decision processes which precede and determine these acts	<ul style="list-style-type: none"> <li>- brand preferences</li> <li>- attitude towards a brand</li> <li>- product satisfaction</li> <li>- buying behaviour</li> <li>- buying intentions</li> <li>- brand awareness</li> <li>- segmentation studies</li> </ul>
Offer	The product, service, idea or combination of these with which the organisation is present on the market	<ul style="list-style-type: none"> <li>- concept development and testing</li> <li>- brand name generation and testing</li> <li>- test market</li> <li>- product testing</li> <li>- package design</li> <li>- competitors' products</li> </ul>
Price	The sum of money which must be paid by the buyer to the seller in order to acquire the offer	<ul style="list-style-type: none"> <li>- cost analysis</li> <li>- profit analysis</li> <li>- price flexibility</li> <li>- demand analysis: market potential; sales potential; sales forecasting</li> <li>- competitors' price analysis</li> </ul>

Means for promoting an offer	The ways in which the prospect is informed about the organisation's offer and persuaded to purchase it	<ul style="list-style-type: none"> <li>- the research of the motives which determine the choice for a means of communication</li> <li>- the research of the mass communication means</li> <li>- the research of the advertising message</li> <li>- the research of the advertising efficiency: before/after broadcasting</li> <li>- the research of the competitors' advertisements</li> <li>- the research of the public image</li> <li>- the research of the sales force's compensation</li> <li>- the research of the sales force's shares</li> <li>- the research of the sales force's areas</li> <li>- the research of promotional instruments such as prizes, coupons etc</li> </ul>
Means for placing (distributing) an offer	The processes and routes through which an offer reaches a client	<ul style="list-style-type: none"> <li>- the research of the office/factory/warehouse location</li> <li>- the research of the distribution channel's performance</li> <li>- the research of the distribution channel's coverage</li> <li>- the research of exports and international trade</li> </ul>
Means of communication	The channel used by an organisation to communicate with its target	newspapers, magazines, TV channels, radio, online services.

## 5. Population

The researched population is represented by the Romanian marketing companies. Due to the fact that a broader coverage is desired, the data will be collected without any restrictions tied up to the type and size of these organisations.

## 6. Secondary data study guide

The study guide was designed in accordance with the research purpose and objectives. This guide was structured in the following chapters:

- business/economic or company research
- product research
- price research
- promotion research
- distribution research
- buying behaviour research
- communication means used by a company

For each section, the study guide had the following structure:

Business/economic or company research						
the features of the industry/mark et and tendencies on it	Studies about acquisitions and diversification	Studies about market share	Studies about employees	Other	Description	Source

Buying behaviour research									
Studies about brand preferences	Studies about attitude towards a brand	Studies about product satisfaction	Studies about buying behaviour	Studies about buying intentions	Studies about brand awareness	Segmentation studies	Other	Description	Source

Product research								
Information about concept development and testing	Information about brand name generation and testing	Information about a test market	Information about product testing	Information about package design	Information about competitor's products	Other	Description	Source



Price research						
Information about cost analysis	Information about profit analysis	Information about price flexibility	Information about demand analysis; market potential; sales potential; sales forecasting	Information about competitors' price analysis	Other	Description
						Source

Distribution research						
Studies about office/factory/warehouse location	Studies about distribution channel's performance	Studies about distribution channel's coverage	Studies about exports and international trade	Other	Description	Source

Promotion research						
Studies about the motives which determine the choice for a means of communication	Studies about the mass communication means	Studies about the advertising message	Studies about the advertising efficiency: before/after broadcasting	Studies about the competitors' advertisements	Studies about the public image	Studies about the sales force's compensation
					Studies about the sales force's shares	Studies about the sales force's areas
						Studies about promotional instruments such as prizes, coupons etc
						Other
						Description
						Source

Communication means used by a company	Description	Source
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### 7. Sources of secondary data

The secondary data sources were structured in several chapters to facilitate the study:

1. Specialised publications in marketing
2. Specialised publications in economics

3. Information provided by specialised institutions in consultancy and marketing research

4. Information provided by individual marketing specialists

5. Information provided by advertising agencies

6. Information provided by the economic sections of the daily newspapers

7. Job web sites

### **8. Research conclusions**

After analysing the secondary data sources structured in: specialised publications in marketing; specialised publications in economics; information provided by specialised institutions in consultancy and marketing research; information provided by individual marketing specialists; information provided by advertising agencies; information provided by the economic sections of the daily newspapers; job web sites- 290 relevant references were identified.

In order to match these references with the research objectives, each objective was analyzed.

**Objective no. 1-** The identification of the Romanian marketing companies' needs in relation to the marketing environment.

After analysing the data it was concluded that this objective had been accomplished. In this regard it was found that the Romanian marketing companies' needs related to the environment could be grouped mainly in;

- the necessity to study the features and tendencies of a market/industry;
- the necessity to study acquisitions and diversifications;
- the necessity to study market shares;
- the necessity to study the employees (their morale, the internal communication etc.).

Also other marketing needs pertaining to this objective were discovered. These needs could be grouped in needs for:

- information about the recession and recovery of the European economy;
- information about countermeasure actions regarding the economic downturn and their impact;
- macroeconomic studies;
- inter-industry studies;
- auditing studies of the managerial activities;
- studies about mergers between Romanian companies.

The hypothesis formulated for this objective was partially confirmed because other needs were found besides the ones asserted in this hypothesis.

**Objective no. 2-** The identification of the Romanian marketing companies' needs in relation to the determination of the buying and consumption behaviour on a particular market.

The analysis of the collected data concluded the accomplishment of this objective. The Romanian companies' marketing needs related to the buying and consumption behaviour could be grouped mainly in needs for:

- information about brand preferences;
- information about the attitude towards a brand;
- information about product satisfaction;
- information about buying behaviour;
- information about buying intentions;
- information about brand awareness;
- information about segmentation studies.

Other marketing needs pertaining to this section were identified and grouped in needs for:

- studying the buyer-supplier relationship and ways in which a supplier is selected;
- studying the consumer and his/her evolution;
- correlation of factors influencing the marketing environment and consumer behaviour;
- correlation of the current economic situation with changes of the buying behaviour.

The hypothesis formulated for this objective was partially confirmed because other needs were found besides the ones asserted in this hypothesis.

**Objective no. 3-** The identification of the Romanian marketing companies' needs in relation to their offers and their clients' ones.

Based on the analysis of the collected data, the third objective was accomplished. The marketing needs of the Romanian marketing companies related to their offers were grouped partially in needs for:

- concept development and testing;
- brand name generation and testing;

- test market analysis;
- product testing;
- package design;
- competitors' products.

Other marketing needs related to the offer were identified. These marketing needs referred to:

- brand management;
- branding projects;
- brand reinforcement;
- brand strategy;
- local product concept;
- product certification;
- brand repositioning;
- brand usage studies;
- brand change;
- brand loyalty;
- brand image assessment;
- brand map;
- ideal brand;
- brand strategy assessment;
- brand performance;
- brand research;
- brand identity;
- personal brand;
- exclusive brand.

The hypothesis formulated for this objective was partially confirmed because other needs were found besides the ones asserted in this hypothesis.

**Objective no. 4-** The identification of the Romanian marketing companies' needs in relation to the setup of their prices and their clients' ones.

The analysis of the collected data concluded the accomplishment of the 4<sup>th</sup> objective. The price-related marketing needs of the Romanian marketing companies were found, mainly, within the categories mentioned below:

- cost analysis;
- profit analysis;
- price flexibility;

- 
- demand analysis: market potential; sales potential; sales forecasting;
  - competitors' price analysis.

Other price-related marketing needs were identified. These needs refer to the following concepts:

- the concept of quality/price ratio;
- the concept of preset price;
- the concept of preferential prices;
- the concept of price level;
- the concept of purchasing power;
- the concept of penetration prices;
- the concept of top load prices;
- the concept of product line price;
- the concept of reinvested profit;
- the concept of hedging operations;
- the concept of reference price.

The hypothesis formulated for this objective was partially confirmed because other needs were found besides the ones asserted in this hypothesis.

**Objective no. 5-** The identification of the Romanian marketing companies' needs in relation to the promotional options for their offers and their clients' ones.

The analysis of the collected data concluded the accomplishment of the 5<sup>th</sup> objective. The Romanian companies had marketing needs related to the promotional activities mainly drawn from:

- the research of the motives which determine the choice for a means of communication;
- the research of the mass communication means;
- the research of the advertising message;
- the research of the advertising efficiency: before/after broadcasting;
- the research of the competitors' advertisements;
- the research of the public image;
- the research of the sales force's compensation;
- the research of the sales force's shares;
- the research of the sales force's areas;
- the research of promotional instruments such as prizes, coupons etc

Other marketing needs pertaining to this section were identified and grouped in the following topics:

- viral marketing- the advertising impact;
- communication strategies;
- unconventional advertising;
- movies as mega-advertising means;
- brand and urban artistic events association and outdoor media forms;
- online PR and consultancy;
- brand engagement PR;
- commercial promotion through virtual exhibitions;
- brain reaction analysis to advertisements using scanning devices;
- good advertising and bad product situations.

The hypothesis formulated for this objective was partially confirmed because other needs were found besides the ones asserted in this hypothesis.

**Objective no. 6-** The identification of the Romanian marketing companies' needs in relation to the distribution possibilities for their offers and their clients' ones.

Based on the analysis of the collected data, the 6<sup>th</sup> objective was accomplished. The Romanian marketing companies had needs pertaining to distribution which could be grouped mainly in the following research studies:

- research of the office/factory/warehouse location;
- research of the distribution channel's performance;
- research of the distribution channel's coverage;
- research of exports and international trade;

Also, other needs were identified. These needs were grouped in several sections;

- manufacturer-retailer relationship;
- new distribution channels;
- distribution adaptation strategies;
- classic and online distribution strategies;
- logistics.

The hypothesis formulated for this objective was partially confirmed because other needs were found besides the ones asserted in this hypothesis.

**Objective no. 7-** The identification of the communication means used by the Romanian marketing companies.

Based on the analysis of the collected data, the following communication means were identified:

- daily newspapers;
- specialised publications;
- TV channels;
- Radio;
- web sites;
- online search engines;
- e-mails;
- short messages;
- multimedia messages;
- sales force;
- direct response letters;
- newsletters;
- outdoor;
- transit;
- point-of-sale display;
- promotional catalogues;
- brochures;
- instructions;
- flyers.

The hypothesis formulated for this objective was partially confirmed because other needs were found besides the ones asserted in this hypothesis.

### **Conclusions**

It can be concluded that the needs of the Romanian marketing companies are very diversified, commencing with the research of the needs and demand on the target market, going down to the 4Ps (Product, Price, Promotion and Placement) and their components. A company's marketing needs vary according to its size, market and objectives.

These findings can be very useful for companies and individuals interested in grasping the first ideas about the areas of interest and resources needed by the marketing companies, broadly grouped in: information, skilled labour and infrastructure.

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# REJOINDER TO BERTRAND ON LIGHTHOUSES

Walter E. Block<sup>1</sup>

## Abstract

*Coase (1974) claimed that private lighthouses were operational in the 18<sup>th</sup> and early 19<sup>th</sup> centuries. Barnett and Block (2007) took the position that Coase's (1974) understanding of the difference between private and public enterprises was confused, and that as a result his thesis was false. Bertrand (2006) supported the position espoused by Barnett and Block (2007) vis a vis Coase and his so called private light houses. However, Barnett and Block (2009) maintained that Bertrand (2006) committed numerous analytic errors. Bertrand (2009) defends the position of Bertrand (2006) and rejects the criticisms made of Bertrand (2006) by Barnett and Block (2009). The present paper is a rejoinder to Bertrand (2009).*

**Keywords:** Efficiency; liberty; lighthouses; Coase; privatization

**JEL Classification:** K3

In this rejoinder of ours to Bertrand (2009) we shall follow the same organizational pattern that she employs.

## 1. Different accounts of the lighthouse story

Bertrand (2009) in our view is compatible with our Barnett and Block (2009) assessment of Bertrand (2006): it gets the main point right,<sup>2</sup> but, while doing so, falls into error on a host of other issues.<sup>3</sup> Let us list and comment on them.

### 1.1 Optimal price

Bertrand (2009, 1) refers to the claim that “private enterprisers are unable to set an optimal price.” There are two problems here. First, private

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<sup>2</sup> She took the position that Coase was in error in claiming the existence of private lighthouses, which is no small accomplishment given the prestige of this Nobel Prize winning economist to the contrary.

<sup>3</sup> For related material, see Van Zandt, 1993, and Barnett and Block. 2007.

enterprisers do not “set” any price, let alone an optimal one. Rather, prices are determined through the market process, via the intermediation of marginal buyers and sellers.<sup>4</sup> Second, optimal price is only a theoretical construct, best confined to the blackboard. In the real non equilibrium world, there is no way to discern any such thing.

### 1.2 Optimal quantity

Bertrand (2009, 2) says “Light dues were too high compared to what was sufficient to maintain existing lighthouses and build more; their levels and the collection procedures were heterogeneous; and many lights worked poorly.” These criticisms are problematic. Prices were higher than needed in order to build *more*? How many more? How does Bertrand know the optimal number of additional lighthouses? And, why should collection procedures be homogeneous? In the modern era, some firms bill by the week, others by the month. Some accept credit cards, other do not; in some restaurants, the customer pays the waiter; in other establishments, this is the job of the cashier. Why is any of this a problem, either in the present century, or in the one under discussion?

### 1.3. Empirical

Bertrand (2009, 2) claims that her article (Bertrand, 2006) “is empirical, and as such they (Barnett and Block, 2009) do not disagree with my conclusions that the English lighthouse system as described by Coase was neither private nor efficient.” But whether something was efficient or not is not merely an empirical issue. Efficiency transcends that limitation. Empiricism has no answer to the question: “efficient at what goal?”

## 2 The three types of providers of lighthouse services

### 2.1 Compulsion

Bertrand (2009, 2) maintains the following:

“Barnett and Block, 2009, pp, 2-3) distinguish government/coercive from private/voluntary (including charity and for-profit firms) in the English lighthouse system. They (2009, p.2) characterize the system described by Coase

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<sup>4</sup> What about monopoly? This is indeed an exception for mainstream economists. But for Austrians, among whom we count ourselves, there is and can be no such thing as monopoly for a private enterprise. Rather, monopoly is necessarily a result of governmental grants of privilege. See on this Anderson, et. al., 2001; Armentano, 1999; Block, 1994; DiLorenzo, 1997; Rothbard, 2004

as an example of ‘governmental, not market-based, supply’ since compulsory levies are ‘not compatible with the free enterprise system.’ We can be more precise and think of a continuum between a minimum role of the State (enforcing private property rights and voluntary contracts) and a public provision of goods.”

In contradistinction, we reiterate our position that “compulsory levies are not compatible with the free enterprise system.” It cannot be denied that Bertrand (2009, 2-3) is correct in her claim that there is a continuum<sup>5</sup> between the purely private and the purely public. But this is hardly more “precise.” Indeed, it is *irrelevant* to our position. Just because there are gradations, it does not mean that “compulsory levies are ... *compatible* with the free enterprise system.” Moreover, it would appear to be a logical contradiction to say (Bertrand, 2009, 2) “The legal statute of Trinity House, however, was private, even if the organization was not strictly private since it was mandated with a public mission and supervised by the government.” How can an organization “mandated with a public mission and supervised by the government” (over and above the supervision by government of all people and enterprises, such as forcing them to obey the laws, pay taxes, etc.) be “private,” no matter what the technicality of the legal status of Trinity House?

This is akin to positing that the Fed, or Fannie Mae or Freddie Mac, or the U.S. Post Office, are really private, even though they are “not strictly private.” This is all but indistinguishable from claiming the companies Krupp, Stuka and BMW were really private, although the Nazi party controlled them totally, in all important decisions. This is a position difficult to defend.

## 2.2 Voluntary government levies?

The next howler to fall from Bertrand’s (2009, 2-3) pen is this: “Barnett and Block (2009, 3) write that their research has not uncovered ‘any for-profit lighthouse providers during this era in history.’ Although property rights were not strictly private (e.g., they specified a compulsory levy), the fact that private organizations and individuals embarked on lighthouse construction with a profit motive cannot be ignored.”

But how can property rights be private *at all* given that they “specified a compulsory levy?” If Wal-Mart or McDonalds were suddenly allowed by law to seize money from anyone (competitors, suppliers, customers, employees, anyone at all), then it would at that precise moment cease to be purely private. It is surely a crucial distinction between a private and a public entity that the

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<sup>5</sup> See on this Block and Barnett, 2008.

latter may legally place compulsory levies on the property of its citizens, while the former certainly may do no such thing.

Bertrand in the above quote places great weight on the “profit motive” of the supposed private lighthouse organizations. She appears to think that this motive can transform an otherwise public enterprise in the private column. Nothing could be further from the truth. If there is *anything* that the Public Choice philosophy has established (Buchanan and Tullock, 1962) over and over again, it is that when men depart the private sector and enter the government bureaucracy, they do not alter their basic motives. They bring with them the same goals and aspirations they had when they were employers, employees, entrepreneurs, etc. And, among them, we go so far as to say *chiefly* among them, is the profit motive. So, retention of profit seeking by no means serves as evidence that an ostensibly public enterprise is really private.

### **2.3 Private sector**

Nor can we see our way clear to agreeing with Bertrand when she refuses to acknowledge that lighthouses managed by “religious orders or hermits and financed by voluntary contributions” are indeed part of the private or voluntary sector. Just because the profit motive may not be first and foremost does not preclude an entity from being part of the private sector.

### **2.4 Linguistic confusion?**

This author seems to be confused about just what “voluntary” means in yet another context. She (Bertrand, 2009, 3) states: “... if I want to buy a car, I would have to pay for it: the exchange is voluntary, but the payment is not. In the case of the lighthouses with voluntary payments, it is not clear whether the ship owners had the choice to use the lighthouses service.” Yes, the present authors join with Bertrand, and enthusiastically so, when she regrets she must pay for her purchase of the automobile. We would all like to have vehicles for free. But it is very far from the truth to say that the payment for a voluntarily purchased car is “not voluntary.” This strains credulity to such an extent that we may be excused for wondering if there is a language comprehension difficulty afoot here. Let us assure Bertrand that when she, or we, or any of us, agree to buy an automobile, *both* parts of this transaction are strictly voluntary. Look at this matter from the other side of the transaction. The automobile dealer, too, would like something for free. Nothing would make him happier than if Bertrand paid for one of his products, but then neglected to drive it off his lot, leaving it for him to “sell,” yet again, to someone else. Is it coercive on Bertrand’s part when she demands to be given the vehicle she just purchased, to

the consternation of the vendor, who was hoping for a freebie? Not a bit of it. *Both* parts of this transaction are voluntary, even though Bertrand regrets she must pay for her purchase, when receives her new car. Her supplier, equally, is unhappy that he must then part with some of his stock, after Bertrand has paid him for it.

### **2.5 We are not neo classical economists**

We are also puzzled by Bertrand's (2009, 3) allusion to neo classical economic theory in her critique of Barnett and Block (2009). We do not consider ourselves as members of this particular school of thought, and have a long paper trail that can serve as evidence for this contention of ours. But, we welcome her acknowledgement that we three concur in the conclusion that Coase was in error when he claimed that "for profit firms with a minimal role of the State did ... exist."

## **3 The effectiveness of government and private cooperation**

### **3.1 Libertarianism**

Bertrand (2009, 3) mistakenly attributes to us the view that the lighthouse system was "public and inefficient for this very reason." Unfortunately, she provides no cite to Barnett and Block (2009) to buttress this allegation. She rejects this view, attributing it to our over use of "libertarian theory as a starting point." But, in the very next sentence she quickly reverses field and claims that she said in her earlier article (Bertrand, 2006) that government regulation was inefficient. Could it be that she herself is a closet libertarian? But then, in yet another reversal of field (e.g., logical contradiction) after saying that it "is exactly what I stated" (that government regulation as inefficient) she denies this, and asserts (Bertrand, 2009, 3) that she "did not answer that question." For good measure she tacks on the thought that "problems were actually solved by government," thus yielding her already very shaky libertarian credentials.

### **3.2 Marginal cost pricing**

Bertrand rejects our characterization of her as anti market. By her own admission, as a good neo classical economist, she (2009, 4) sees lighthouse taxes<sup>6</sup> as too high, since this is an industry earmarked by "zero marginal cost." But it

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<sup>6</sup> They are *not* "dues." This latter term implies voluntary payments. For example, you pay "dues" when you voluntarily join the chess or golf club. If you do not do so, and must pay these organizations anyway, then these payments are compulsory levies, or taxes, and not "dues" at all.

is only a neo classical economist who could take an objective perspective on costs. In the Austrian view (Buchanan, 1969; Buchanan and Thirlby, 1981; Mises, 1998), in sharp contrast, costs are subjective, and thus unknowable to third parties such as Bertrand. They consist of the next best opportunity foregone, whenever the human actor engages in economic behavior. So, Bertrand has no warrant for concluding that the lighthouse industry was earmarked by zero or any other marginal costs. Nor is there any case for assuming that prices are too high, even, stipulating, arguendo, that marginal costs are indeed zero. For with prices compulsorily set at zero private enterprise would be impossible.<sup>7</sup>

While we are positing zero marginal costs for lighthouses, we might as well assume the same for hotels, theaters, schools, indeed for any industry earmarked by less than 100% capacity, which pretty much means virtually *all* of them. To this list must be added still others with perishable products that can spoil if not sold, for example, tomatoes, bananas. Here, the costs, at least from an objective perspective, might even be negative, in that their owners will have to pay to have unsold merchandise carted away as garbage. The implication is that the government should compel negative prices in such cases.

### 3.3 Prices too high?

With regard to our disagreement 7, Bertrand is changing the topic and evading our criticism. In our critique of Bertrand (2006), we (Barnett and Block, 2009) did not even mention the compulsory fees<sup>8</sup> present in other countries, her present line of defense. Rather, we criticized Bertrand's (2006) claim that market prices were too high, on the ground that they were not market prices at all, but rather stemmed from governmental grants of market privilege. On the other hand, as we said in (Barnett and Block, 2009) "... given that the prices were set by the government, and the government shared in the profits, it is a reasonable assumption that they were set above the levels which would have resulted in a free market." We stand by that evaluation.

### 3.4 The violin maker

After sharply criticizing the quality of lighthouses in Bertrand (2006, 398) this author attributes this failure to "eccentric inhabitants who did not avail themselves of all the technical guarantees required." As an example of this failure Bertrand (2006, 398) mentions that "the first Smalls lighthouse ... was built by a violin maker. In Barnett and Block (2009, 6) we charged that

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<sup>7</sup> This is something that would not appear to perturb Bertrand greatly.

<sup>8</sup> Not, we insist, "dues."

“Bertrand (2006, 398) takes umbrage at the fact that a ‘violin maker’ constructed a lighthouse.” In her 2009 article, Bertrand (2009, 4) attributes to us the view that she had said that “entrepreneurs far from the lighthouse business could not build a lighthouse.” But, this is a fabrication. We did not at all say that Bertrand held the view that violin makers “could not” build a lighthouse. This is a falsehood, since a violin maker *did* build one, to wit, the first Smalls lighthouse. Rather, we said that Bertrand “took umbrage” at this fact, and indeed she did, her denial to the contrary notwithstanding.

Nor did we “suggest” (Bertrand, 2009, 4) that Bertrand contradicted herself when she (Bertrand, 2006, 399) noted that a silk mercer built a lighthouse “much more solidly.” She cannot be allowed to have it both ways. She cannot both say that a violin maker is “eccentric,” lacks “technical” expertise, and *therefore* cannot build a good lighthouse, on the one hand, while on the other hand maintaining that a silk mercer, who is just as far removed from the lighthouse industry, can do so. Nor is it acceptable that after being caught in a contradiction, she denies it, despite clear evidence to the contrary.

### 3.5 Invisible hand

There are difficulties with Bertrand’s present position on our disagreement 8 as well. In Barnett and Block (2009, fn. 18) we claimed that Bertrand (2006) ignored Smith’s (1776) invisible hand insight in taking the position that public welfare and private financial gain are necessarily at odds with one and another. As well, this author played fast and loose with a key emphasis of the Public Choice School, that men do not grow angel’s wings when they enter the public sector. Her defense? Bertrand (2009, 4) claims that Smith (1776) only mentioned this doctrine once, and that he allowed exceptions to it.<sup>9</sup> True, all too true. But, irrelevant. Despite these truths asserted by Bertrand, it *still* cannot be denied that she failed to apply this Smithian insight in her analysis of lighthouses. It matters not one whit, for present purposes that the “invisible hand” argument was all too little used by Smith himself, nor that he allowed exceptions to it. The fact remains that as charged by Barnett and Block (2009), Bertrand (2006) failed to apply it to lighthouses, and nothing said in Bertrand (2009) gainsays this fact.

And, as for ignoring Public Choice insights, her defense is that in another context she *did* apply them. But we did not aver that Bertrand *never* employed them. Only that on that one occasion this was a serious lacunae in her (2006) essay. Bertrand (2009) acts as if the truth of her contention is incompatible with

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<sup>9</sup> For a criticism of Smith as a fair weather friend of free enterprise, see Rothbard, 1987

the legitimacy of our critique. Not so, not so. It is as if Bertrand said that  $2+2=5$ , and we corrected her, stating that  $2+2=4$ , and in her defense of her first erroneous claim, she then asserted that  $3+3=6$ . Yes,  $3+3$  does indeed equal 6, but this correct statement scarcely undermines our critique of her initial error with regard to  $2+2=4$ .

### 3.6 Empirical argument

Bertrand's (2009, 4) defense against our criticism 14.2 is as follows: "Barnett and Block ... confuse my empirical arguments on the actual problems of, and actual solutions to, the English lighthouse system, with the general claim that all public goods should be provided by the government. Now, as a matter of fact, the problems of lighthouse services were solved by the centralization, which was not required in my mind but in the politicians... My argument is empirical and it cannot be contradicted by the assertion that the problems could also have been solved by less government."

But we did not attribute to her the view that "all public goods should be provided by the government." Unhappily, she vouchsafes us no cite to our work to buttress this charge. So it is difficult to know, precisely, what she has in mind in this regard.

As to her substantive point, how does Bertrand know that the "problems of lighthouse services were solved by ... centralization?" On what basis does she reject the contrary contention that lighthouse service problems were solved *in spite of* centralization? Her "empirical argument" is, A preceded B, therefore A caused B. This simply will not do. It most certainly can be contradicted by the assertion not only that the problem could *also* have been solved by less government, but, further, that less government is the *only* way to solve them, and, still further, that government was not a help but rather a hindrance to this solution.

### 3.7 Mises's insight: government intervention snowballs

Bertrand (2009, 4) takes issue with our critique of her point 14.6. We offered the Misesian (1998) analysis that government intervention leads to problems, which calls forth more such interference with the market, which eventuates in still more difficulties, in ever widening circles. She disagrees on the ground that it "is a general statement, not supported by any fact about the case debated here." True enough, it is a general statement, but that does not mean it is not supported by facts pertaining to lighthouses. By her own admission the government made errors in the lighthouse industry. These led to



problems, which the state felt compelled to address in turn. It is difficult to see how Bertrand's mention of this overturns our contention.

### 3.8 “Better” government regulations

Bertrand (2009, 4-5) replies to our charges 11, 14.4 and 14.5 in one fell swoop. Her summary of these critiques: private enterprise is preferable to government provision of services. And her reply? Why could we not imagine better statist regulations, exactly as we imagine improved contractual arrangements between lighthouse and ship owners? There are several reason we gave (2009), and now give again, short shrift to the possibility of “better” government regulations. These explain why it is no accident that state initiatives such as social security, welfare, the post office, the Motor Vehicle Bureau, Freddie and Fannie, and the Fed are symbols of government ineptitude and mismanagement.

First, and most important, there is the calculational chaos engendered by lack of a price system.<sup>10</sup> As the state takes over more and more enterprises, there are fewer and fewer market prices. The only reason the USSR lasted as long as it did as an economic entity is that their central planners had access to western (relatively free market) prices. Without them, the bureaucrat has no idea, for example, as to whether to build row boats out of plastic, metal or wood; railroad tracks out of tungsten, steel or platinum.

A second important point was stressed by Hayek (1937). Without a free market, the economic dictator would lack the information concerning local conditions and would thus be unable to plan. Even if everyone cooperated with him and sent him information from all over the country, this would just gum up the lines of communication. And, how would the economic czar evaluate this information, separating the wheat from the chaff. In contrast, if the price of tin rises, we need not know precisely why, in order to act rationally in response. But, for this to occur, there must a *price* of tin based on the freely made commercial decisions of millions of people, something only a free market can supply.

Then there is the market weeding out system stressed by Hazlitt (1979). Under laissez faire capitalism, there will be good and bad contractual arrangements undertaken. But the former will bring profits in their train, and the latter losses. Thus there will be an automatic 24/7/365 push toward efficient economic decisions, and away from bad ones.<sup>11</sup> In the government

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<sup>10</sup> See Mises, 1975, 1981; Hoppe, 1989A.

<sup>11</sup> This of course assumes no bailouts of failing business, something that is anathema to the free enterprise philosophy.

sector there will be good<sup>12</sup> and bad regulations. But those bureaucrats and politicians responsible for the former will not automatically earn money, votes, political power, etc., nor will those guilty of the latter lose them. The FDA is responsible for gross errors, in an earlier epoch for Thalidomide, in the recent past for unduly slowing down the rate of new approvals. FEMA and the Army Corp. of Engineers between them killed some 1500 people in and around New Orleans in the aftermath of Hurricane Katrina. Did these entities go broke? Did they even lose money? Did they suffer a loss of influence? No. Since they did such a poor job, *more* power and pelf was showered over them. This is why Barnett and Block (2009) do not contemplate “better” government regulations.

### 3.9 Voluntary payments impossible?

Let us consider the contrary to fact conditional posed in our dispute with Bertrand regarding point 14.1. First, we quote from our own (Barnett and Block, 2009, 7) paper with regard to Bertrand (2006, 401):

“... dues for ‘private’ lighthouse services, collected by public officers,” could only be obtained with State coercion. Her case is not proven. She merely showed that dues *were* collected with State coercion, and not that revenues could not have been generated by voluntary payments. In fact, Bertrand (2006, 397) herself contradicts this point: “In the competition for Royal privileges, Sir John Clayton obtained, no less than five patents, all with voluntary contributions.”

Here is Bertrand’s (2009, 5) non responsive reply: “... as a rebuttal, it would be necessary to find a strictly private market for a public good that would be produced in optimal quality and quantity.”

It is difficult to know how to reply to a non responsive rejoinder. Just because payments *were* forcibly mulcted does not prove that voluntary ones would not have been forthcoming. Bertrand (2006, 401) supplied evidence (Sir John Clayton) to support our contention, against her own. The assertion Bertrand made in 2006 is not rectified by her reply in 2009. How she can continue to maintain that voluntary lighthouse payments could not have been made when she herself asserts that they *were* made (in Corton, by Sir John Clayton) is beyond us.

But what of her challenge? Is there “a strictly private market for a public good that would be produced in optimal quality and quantity?” Can we point to it? In our view, optimal quantity and quality are only achievable when markets fully clear, and in the real world they never do. But this goes for *all*

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<sup>12</sup> Please do not ask us to specify any. We are talking hypothetically, here.

goods, both private and (supposedly) “public.” Assuming away this complication, *arguendo*, let us attempt to meet this challenge. We claim that the number and quality of lighthouses is now, and always was, optimal. Does Bertrand have any proof that we are in error in this claim of ours? Does she have a criterion for optimality she is not sharing with us? The burden of proof, it seems to us, rests with those, such as Bertrand, who maintain that the market (theoretically, when it fully clears) is *not* optimal regarding price, quantity, quality, location, whatever. The presumption we hold is that if the market is not optimal in this sense, then there will still be unrequited trades to be made, that is, we have not yet achieved a market clearing status. We can deduce that when a trade takes place in the market, both parties gain in the *ex ante* sense. Bertrand is attempting to prove that when trades do *not* take place (e.g., there are too few lighthouses to suit her tastes) we can demonstrate that welfare *would have increased* had they but occurred. Fine. Let her prove this contrary to fact conditional.<sup>13</sup>

### 3.10 Calling for overcoming market failures

In Bertrand’s (2009, 5) replies to points 10 and 12, she has occasion to assert: “I was not calling for anything.” This seems singularly problematic, in that Bertrand (2006, 2009) was patently supporting government ownership, management and/or regulation of lighthouses, since they are in her view a public good, and public goods are a market failure, and it is a neoclassical shibboleth that it is the duty of the state to overcome such failures.

### 3.11 Corporate welfare

Bertrand (2009, 5) charges that the present authors “misunderstand my conclusion that the lighthouse service was made profitable by the actual regulation, interpreting it as saying ‘that without government favoritism lighthouses would have been unprofitable (Barnett and Block, 2009, p. 10).” We have no doubt that government regulations can render an industry more profitable than would otherwise be the case. We do not at all buy into Rand’s

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<sup>13</sup> For a critique of the “public goods” as market failure literature predicated upon considerations of rivalrousness and excludability see: Barnett and Block, 2007, 2009; Block, 1983, 2000, 2003; Cowen, 1988; De Jasay, 1989; Holcombe, 1997; Hoppe, 1989B; Hummel, 1990; Osterfeld, 1989; Pasour, 1981; Rothbard, 1985, 1997; Schmidtz, 1991; Sechrest, 2003, 2004A, 2004B, 2007. Rothbard’s (1997, 178) *reductio absurdum* of public goods is as follows: “A and B often benefit, it is held, if they can force C into doing something. . . . [A]ny argument proclaiming the right and goodness of, say, three neighbors, who yearn to form a string quartet, forcing a fourth neighbor at bayonet point to learn and play the viola, is hardly deserving of sober comment.”

(1993) claim that business is government's most persecuted minority. The situation is far more complicated. Yes, government often hurts the corporate sector. But there is also such a thing as "corporate welfare," and it surely predates the Bush – Obama bailouts of automobile and financial corporations that are supposedly "too big to fail." That this would also include the lighthouse industry in this earlier time should occasion no surprise.

In the view of Bertrand (2009, 5) in order to successfully contradict the claim "that without government favoritism lighthouses would have been unprofitable" we would have to "provide the example of a profitable and strictly private lighthouse." This is not strictly true. We now claim that without government favoritism a new product, the zilch (we just made this one up) would be profitable. We are not logically required to point to an actual profitable zilch firm. For we are making a contrary to fact claim: if the zilch existed, which it does not, *then* it would be profitable with no government subsidy. But returning to the real world and accepting Bertrand's false premise, the present authors need not "provide the example of a profitable and strictly private lighthouse" for Bertrand has already done this for us! The cases of the private religious and hermit lighthouses fit this bill precisely. They were profitable (at least in the sense of psychic profit), otherwise these people would not have provided them, and the government did not subsidize them.

### 3.12 Efficiency

Bertrand uses "efficiency" as a stick with which to beat down our (Barnett and Block, 2009) claims that a private lighthouse industry could have been viable. She says the following:

"Barnett and Block prefer a private lighthouse system and the main appeal of free market is, in their view, that it is 'free.' Consequently, most of their contentions against my article come from the fact that they evaluate the English lighthouse system in terms of freedom, whereas I used, as Coase and standard microeconomics, the economic efficiency criterion.

"Barnett and Block imagine a lighthouse system that would be strictly private, but they do not prove that the level produced would be efficient, therefore, not refuting the neoclassical theory."

Unhappily for her position, she nowhere offers any criterion for her "efficiency." Perhaps she will not object if we supply one for her. We offer the Pareto welfare criterion: a system is efficient in this sense if and only if there is no change in the economy that would make at least one person better off, without making at least one person worse off. That is, we cannot wrest any

welfare gains out of the system for anyone without reducing the situation for at least one other person.

It is a bit harsh to apply this to *any* industry, which has not achieved full market clearing; for, in the real world, none ever does. Of course, when neoclassical blackboard economics is applied to reality as a welfare or efficiency criterion, the latter comes off a distant second best, but this applies to *all* industries, not only to lighthouses. In other words, her criticism is “too good.” Not only does it show that the private lighthouse industry is “inefficient,” it demonstrates that they all are. But, if so, that is, if the lighthouse industry is no different than any other in this regard, this service can hardly be singled out for special treatment as a “public good.”

### 3.13 Public goods and monopoly

Bertrand’s (2009, 5) next sally against our thesis concerns our supposed failure to “overcome the problems of non excludability and non rivalry and of bilateral monopoly.” But a careful reading of Barnett and Block (2007) indicates that we have done just that. Just because the inefficient government cannot exclude non payers does not mean that private entrepreneurs would have this difficulty. As for non rivalrousness, anytime there is a business operating at less than full capacity (hotels, theaters, apartment houses, schools), there is a lack of full rivalrousness. Should all such industries be nationalized? This would appear to be the logical implication of Bertrand’s critique, but it is surely a recipe for complete socialization of the economy. As for monopoly of any kind, bilateral or not, this is necessarily a product of government interference with the free enterprise system, and *cannot* obtain under *laissez faire* capitalism.<sup>14</sup>

### 3.14 Marginal cost confusion

We are also grateful to Bertrand (2009, 6) for pointing out our confusion regarding marginal costs: “The authors avoid handling the zero marginal cost problem (disagreement 6), arguing that there is no such thing – they actually confuse the marginal cost of an additional vessel using the service and the cost of turning on the light to deliver the first unit of service.” We promise to never again make this particular mistake. We would be even more grateful to her if she would point out precisely where made this error in the present case. Perhaps a quote of what we actually said in this regard might point us in the

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<sup>14</sup> See fn. 3, *supra*.

right direction. In fact, we beseech her to do so. How else are we to learn from our many errors?

And, while she is at it, instructing us as to our oversights, we would also ask how she (Bertrand, 6) comes to the view that we “interpret this Coase’s study as pro-market.” We were under the impression that we were criticizing Coase for his *anti* market stances.

#### 4. Conclusion

We agree with Bertrand’s (2009) criticism of Coase (1974). We applaud her for taking this unpopular stance, given the eminence enjoyed by that author. Coase (1974) claimed there were private free market lighthouses in operation in that early epoch, and Bertrand (2006) showed this was simply not so. Bertrand’s analysis on this point is certainly compatible with our own Barnett and Block (2007). However, in the course of writing that masterful debunking of Coase (1974), Bertrand (2006) committed numerous errors that we addressed in Barnett and Block (2009). Her (2009) rejoinder that that critique of ours, gives us no reason to alter our assessment.

Bertrand’s emphasis on “empirical” matters is really an attack on economic theory per se, not merely normative or libertarian perspectives as she supposes. It is a throw back to the views of the German Historical School.<sup>15</sup> Here, there were only “facts.” Theory was an irrational will o the wisp.

But it is more than passing curious as to the precise “facts” adduced and relied upon by these empirical “economists.”<sup>16</sup> They never attempt to quantify the number of dogs who barked in any given year or the proportion of workers who are left handed nor the number of grains of sand on the beach in their analysis of the business cycle, for example. Why not? Because behind every supposed “empirical” economist there is a theoretician, yearning to break free. In a word, the *theory* of these presumed empirical economists is such that these considerations are irrelevant to their concerns, and on *theoretical* grounds. It is much the same with Bertrand. Notice, that she, too, in this “empirical” tradition, totally ignores such considerations as the number of waves in the sea, or the temperature of the water in that epoch. Why? As a *theoretician*, she (correctly) deems them unimportant, indeed, irrelevant.

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<sup>15</sup> Hildebrand, 1848; Knies, 1853; Roscher, 1843; Schmoller, 1910, 1984; Sombart, 1915, 1937; for an Austrian critique, see Hildebrand, 1848; Knies, 1853; Roscher, 1843; Schmoller, 1910, 1984; Sombart, 1915, 1937; for a critique, see Menger, 1871; Bohm-Bawerk, 1890-1891; Mises, 1981, 1984

<sup>16</sup> A later follower in their tradition was Mitchell, 1903, 1908, 1913, 1927, 1951

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# THE IMPACT OF FOREIGN DIRECT INVESTMENTS ON CENTRAL AND EASTERN EUROPEAN ECONOMIES FROM A POLITICAL ECONOMY PERSPECTIVE

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## Abstract

*This paper aims to analyze the role played by foreign direct investments (FDI) in the restructuring of some Central and Eastern European economies with special emphasis on Poland, Czech Republic, Slovakia, Hungary and Romania. While it is generally accepted that FDI have had a positive impact on host Central and Eastern European (CEE) economies during the last 20 years and have contributed to the economic growth of the respective countries it is less obvious what really explains the differences in the volumes of FDI attracted by these countries. It is also of interest how can we measure the impact of FDI on the respective economies in order to obtain meaningful information for the design of effective economic policies that can support further growth.*

**Keywords:** foreign direct investments (FDI), political economy, economic policies, Central and Eastern European (CEE) transition, incentives for investors.

**JEL Classification:** F2; F5.

**Setting the stage: A back to classics (i.e. Adam Smith and David Ricardo) approach**

After more than 20 years of transition, of more and more intense connection to a globalized world, after joining the European Union and NATO, after experiencing the glory of the boom years and the difficulties of the crisis years, the CEE economies are a mixture of global and local investors, of private and public entities and of (moderate) success or (almost) failure. How can we explain that? Which are the factors that really determined such results? Are there common denominators or just plain differences determined by

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chance? Or, to ask the so-called **Adam Smith question** – what are the conditions for successful economic growth and development?

Obviously, the usual approach is that any additional investment creates wealth thus the question is which entities have performed better? **The local companies** - private or still state owned, or **the subsidiaries of foreign companies established after 1990** which benefitted of the proper know-how and capital and which were able to compete both locally and internationally in a very competitive and often adverse business environment?

What CEE economies developed faster and better, those which deliberately attracted more FDI and were oriented to export or the others which relied more on laissez faire (in this case that is lack of clear and consistent FDI attraction policies), domestic capital and internal consumption?

In this context we consider of interest to perform a qualitative and quantitative assessment of the foreign investments in CEE countries in order to commensurate their performances and the significance of the economic policies promoted by host countries in attracting foreign investments.

In doing so, we fully agree with George Friedman who remembered us recently that, “classical political economists like Adam Smith or David Ricardo never used the term “economy” by itself. They always used the term “political economy.” For classical economists, it was impossible to understand politics without economics or economics without politics. The two fields are certainly different but they are also intimately linked. The use of the term “economy” by itself did not begin until the late 19th century. **Adam Smith understood that while an efficient market would emerge from individual choices, those choices were framed by the political system in which they were made, just as the political system was shaped by economic realities. For classical economists, the political and economic systems were intertwined, each dependent on the other for its existence.**”<sup>3</sup>

As we are fully convinced that one can not separate economy from sociology, politics, anthropology, we propose the study of factors of influence for FDI decisions into CEE countries and of the impact of these FDI on the respective economies in the context of political economy. The paradox is that such an approach is nowadays unconventional or less conventional exactly because it is classical. In a world of economic analysis largely dominated by econometrics (which, by the way, is as good as the model is – that is largely incomplete and artificial) and propose a return to classics.

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<sup>3</sup> George Friedman, Global Economic Downturn: A Crisis of Political Economy, Stratfor Geopolitical Weekly, August 9, 2011.

Therefore, a **political economy approach** is one based on “a much more expansive mixture of philosophy, political science, history, economics, anthropology, and sociology”<sup>4</sup>. In this approach we also include the fact that during the transition period those who studied the CEE countries re-discovered (like Jeffrey Sachs did) that “History is important” (that is what happened to the CEE countries starting 15 – 16 th century till present), but also “Geography is important” (that meaning the importance of existence or non-existence of direct borders of CEE countries with Western countries).

These being said it is clear that not all CEE countries were “born” in 1990 equal and that those inherited characteristics shaped to a large extent their economic transformation, the role of FDI included. Our research is not done in view of justifying failures of some countries in harnessing the potential of FDI, but rather in view of learning useful lessons and looking for “best practices” that can be applied elsewhere.

### **CEE and FDI: The facts**

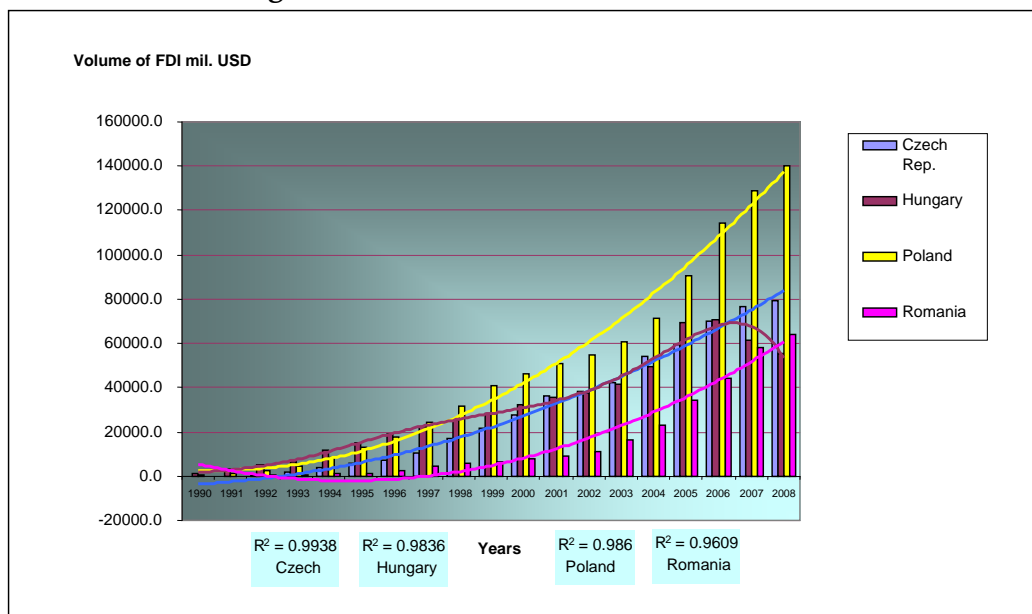
The CEE countries have started their transition period from rather different backgrounds. Some of them already experienced economic reforms (Poland, Hungary), while others had no such experience (Romania). Some of them had some private sectors in their economies (like Poland or Hungary), others very little (again Romania). Some of them had a long term developed industrial base (Czech Republic), others had an industry developed more on quantitative terms rather than qualitative (Romania).

During the past 20 years, Poland attracted the highest volume of FDI in the CEE group of countries followed by the Czech Republic and Hungary with relative similar patterns, although the economic under performance of the latter during the past years has been reflected also in a decrease of foreign investments level, phenomena accentuated by withdrawal of funds which led to a decrease of FDI stock as shown in the graphic below.

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<sup>4</sup> Internet Encyclopedia of Philosophy, article on Adam Smith, at <http://www.iep.utm.edu/smith/>

**Graph 1: Evolution of FDI stock in Czech Republic, Hungary, Poland and Romania during 1990 – 2009.**



**Source:** Author calculation based on data from [www.worldbank.org](http://www.worldbank.org)

Our further analysis is based on the latest ranking Top 500 CEE (“Top 500”) as published by Coface<sup>5</sup> which include the first 500 companies from Poland, Czech Republic, Hungary, Slovakia, Romania, Ukraine, Croatia, Bulgaria, Slovenia, Lithuania, Estonia, Latvia and Serbia ranked by year 2009 turnover. In this ranking the financial services providers such as banks, insurance companies, leasing firms and brokers excluded.

Certainly, we are fully aware that there are annual fluctuations of economic indicators and also that the year 2009 was the first full year of the financial crisis in Europe but the population of firms – 500 items – is strong enough to enable us to identify a trend, to understand what are the industries favored by the foreign investors and what are the stimulants behind their decision to invest. Most important, we try to determine **whether the policies promoted by host governments count or the investors rely solely or mostly on their own internal assessments in the decision making process for investing abroad.**

<sup>5</sup> [http://www.cofacecentraleurope.com/CofacePortal/CE/en\\_EN/pages/home/ne/Top\\_500](http://www.cofacecentraleurope.com/CofacePortal/CE/en_EN/pages/home/ne/Top_500)

In addition we want to establish if there is any direct connection between foreign investments and the fact that the CEE champions of economic development namely Czech Republic, Slovakia, Poland and Hungary have attracted the highest volume of FDI in sectors with highest spillover effects.

As shown above, it is well known that the respective countries have started their transition from **different stages of economic development and different social and political environments**. While Czechoslovakia, Poland and Hungary were more economic developed and had some private sector economy experience in Romania it was only at the beginning of '90s that the subject was brought on the public agenda. An interesting aspect is that in Hungary discussions about the role of FDI in economic development had started almost 20 years before 1990 and this long period of time allowed both researchers and civil society to reach a relatively good understanding and agreement on the acceptance of FDI<sup>6</sup>. In contrast, the Romanian opening to FDI started for real only in 1990 so that for some years large strata of society as well as populist politicians claimed loudly that "we are not selling our country" and by that practically opposed the entrance of FDI.

Under these circumstances, while the basic legal and institutional framework regarding investment and trading activities liberalization was adopted more or less synchronous across the entire CEE region, the practice was uneven till this day, more than 20 years later. The Top 500 numbers and structure reflect the different performance of the CEE economies and the role played by foreign investments.

As anticipated the first country in this top is Poland with around 132 billion Euro cumulated turnover from 142 companies followed by Hungary with 85 billion but with a record of approximately 1 billion Euro average turnover for each of the 83 companies included in the top.

At the opposite end of the scale we find Romania ranked the fifth country with cumulated turnover value of 33 billion Euro, after Poland, Hungary, Czech Republic and Ukraine, but with only 692 million Euro average income per company in 2009 against a medium level of 913 million for the entire region.

Certainly, the data included in Top 500 may contain errors and omissions. Information is based on the companies annual statements submitted with local Ministries of Finance or Trade Register (according to each country's legislation). There could be some missing data but we consider that the results of our analysis will not be affected given the magnitude of the numbers.

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<sup>6</sup> Peter Mihalyi, Privatization policies to attract FDI – lessons from the experiences of Hungary, Central European University, Budapest, 2001.



Table 1 Top 500 country ranking and number of companies

Country	Turnover Top 500 * [thou. Euro]	Number of companies included in Top 500*	Turnover / Number of companies [thou. Euro]**
Poland	131,927,082	142	929,064
Hungary	85,635,578	83	1,031,754
Czech Republic	68,055,405	69	986,310
Ukraine	39,824,099	43	926,142
Romania	33,209,703	48	691,869
Slovakia	31,707,707	32	990,866
Lithuania	14,369,892	16	898,118
Bulgaria	13,189,287	18	732,738
Slovenia	12,495,100	17	735,006
Croatia	12,451,764	17	732,457
<b>Total</b>	<b>442,865,617</b>	<b>485***</b>	<b>913,125</b>

\* Coface; \*\*Author calculation, \*\*\* The remaining 15 companies up to 500 belong to Serbia, Latvia and Letonia to small to be included in the table

Taking into account that the Top 500 includes foreign and local companies with public and private ownership and that foreign subsidiaries are uniformly run across the region and do not rely on national consumption, one of the conclusions for the low performance of the Romanian companies could be that local firms included in the top are managed under their potential as opposed to similar companies from other CEE countries.

Before assessing the structure of the economic sectors and the equity structure of the companies included in Top 500 it is of significant importance to review their financial performance and contribution to national wealth.

Thus, although the number of persons employed in Top 500 companies at regional level is only around 4% of the active population, their turnover represents 38% of the cumulated GDP. This indicate without any doubt that the productivity is much higher in the affiliates of transnational corporations than in the rest of the companies.

There are still some notable exceptions. In the case of Hungary, the turnover of the 83 companies included in Top 500 amount to 69% of the country's GDP employing 9% of the total workforce against the region's averages which are 50% of Hungary's numbers.

At the other end, we find Bulgaria whose 18 Top 500 companies employ only 0.64% of the active population which basically leads to the conclusion that

the largest Bulgarian firms are in majority just trading companies with little value added to the economy.

Romania is in a slightly better position than Bulgaria with almost 2% of the active population working in the country's 48 largest companies signifying that, besides trading companies there are also some manufacturing entities with substantial revenues.

**Table 2 Top 500 selected performance indicators**

Country	Turnover Top 500 [th. Euro]*	Employees Top 500*	Active population*	Net profit ratio (Net profit / Turnover)**	Turnover/ Employees**	Turnover/ GDP**	Employees Top 500/ Active population**
Poland	131,927,082	729,635	17,279,200	4.64%	180,812	31.19%	4.22%
Hungary	85,635,578	373,955	4,202,500	3.63%	229,000	68.93%	8.90%
Czech Republic	68,055,405	260,532	5,296,500	6.52%	261,217	35.88%	4.92%
Ukraine	39,824,099	684,579	21,150,300	1.74%	58,173	34.42%	3.24%
Romania	33,209,703	196,846	9,924,100	5.34%	168,709	20.67%	1.98%
Slovakia	31,707,707	102,161	2,689,800	5.69%	310,370	35.91%	3.80%
Lithuania	14,369,892	57,592	1,640,900.00	1.70%	249,512	39.96%	3.51%
Bulgaria	13,189,287	22,348	3,491,600.00	1.97%	590,178	29.45%	0.64%
Slovenia	12,495,100	45,198	1,014,700.00	3.79%	276,452	27.49%	4.45%
Croatia	12,451,764	68,275	1,765,000.00	4.14%	182,377	20.17%	3.87%
	442,865,617	254,112	68,454,600.00	3.92%	174,280	37.73%	3.95%

\* Top 500, \*\* Authors calculations

An important indicator which also reflects the structure of each country's Top 500 companies is the productivity calculated as Turnover/Employee ratio.

Bulgaria establishes a record high, a new indication that the Bulgarian largest companies in terms of turnover are in majority trading companies. By contrast, Slovakia is the most competitive among countries with largest manufacturing facilities, outperforming in terms of employee productivity all neighboring countries such as Poland, Czech Republic, Hungary and Ukraine.

Romania is under performing with only 65% of the Czech and 74% of Hungary levels but close to Poland's. As previously mentioned Romania is under performing in the category of average turnover per firm as well, with 692 million Euro, only 67% of Hungary's amount, the best placed country in terms of median company income.

### FDI inflows into CEE countries and the role of economic policies

The four top performing countries namely Czech Republic, Hungary, Poland and Slovakia **have clearly and transparently established the priority sectors** for the economy where governments have granted subsidies schemes in order to stimulate fast development.

The common priority sectors are: automotive, electronic equipment and engineering, pharmaceuticals, biotechnology, professional services, research and development, information technology, telecommunications and software.

Separately, each of the previously mentioned countries has added other priorities according to their own competitive advantages such as: aviation, clean technologies, renewable energy and nano-technologies.<sup>7</sup>

As regards economic policies and particularly FDI attraction policies, we have to note that not only a clear decision on priority sectors is important, but also the consistency of these policies. Foreign investors need a clear picture on the economic options of a host economy and also need the perception of consistency and stability. An important positive message for foreign investors regarding economic policies refer to the stability of main objectives beyond political cycles.

From this point of view the messages sent by Romania to the foreign investors community has been rather unclear, unstable and often confusing. While in the first years of transition (1991 – 1996) there was a general differentiation of economic activities supported by government, differentiation achieved by offering longer tax holidays to industrial investments as compared to those in agriculture and constructions and those in trade, after 1997 even such a general differentiation was eliminated and the remaining incentives referred only to the value of investment, but not to the sector of activity.

Contrary to common sense, the Romanian approach to FDI especially after 1996, based on an undifferentiated openness (“the foreign investors can invest in any region, in any sector, in any proportion of capital ownership”) is less attractive than an approach based on different levels of incentives for different sectors of economy. The fact that a country has some targeted sectors for particular development does not signify the interdiction of investment in the rest of the economy; it just gives a message about the areas of interest of a government for the long term development of a country.

Similar comments related to the economic policies in the CEE countries can be done in relation to FDI infrastructure, that is the existence, stability and attributions of institutions dealing with FDI. While in early 1990s all CEE

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<sup>7</sup> Data based on economic policies presented by the investment promotion agencies of the respective countries at : [www.czechinvest.org](http://www.czechinvest.org), [www.itdh.com](http://www.itdh.com), [www.paiz.gov.pl](http://www.paiz.gov.pl)

countries had investment promotion agencies which were more or less similar in size, shape and attributions, after 1996 Romania started to differ due to high institutional instability. Starting 1997 to 2002 Romania changed almost every year the institution dealing with FDI while diminishing constantly the budget, staff and attributions of the respective entities. After 20 years the Czech Republic, Poland or Hungary have well established and reputed investment promotion agencies (CezchInvest, PAIZ and ITD Hungary<sup>8</sup>) while such a Romanian counterpart is non-existent. Even the low profile Romanian agency established in 2002 (ARIS) has been abolished in 2010 as result of reduction in government spending and replaced by a mere department in the Romanian Centre for Trade and Investment<sup>9</sup>.

### Largest FDI players in CEE countries

As result of all these aspects involving both legal and institutional FDI related aspects the structure of largest FDI companies from CEE whose turnover represent approx. 35% of the region's GDP, follows different patterns according to the development stage of the respective states.

Thus, we recognize three groups:

- i) **most advanced:** Czech Republic, Poland, Hungary, Slovakia and Slovenia which have significant electronic components, automotive and pharmaceutical companies;
- ii) **intermediate:** Romania with significant automotive companies but with limited electronic components and pharmaceutical companies;
- iii) **Remaining countries.**

Overall oil and gas represents the most significant activity in the region in terms of turnover (24%) followed by electricity generation, transmission, distribution and supply (12.64%), retail and wholesale (12.19%), automotive (9%), electronic components (7%) and pharmaceuticals (3.8%).

**Table 3 Distribution of selected activities within Top 500 CEE\***

	Oil & Gas	Electricity	Telecom	Retail & Wholesales	Mining & Metal	Automotive	Electronic component	Pharma
<b>Poland</b>	28,752,325	19,266,249	7,105,222	11,383,735	8,534,625	11,972,217	8,916,275	6,534,684
<b>Czech Republic</b>	9,544,093	6,322,268	3,037,064	8,556,636	6,430,329	12,196,797	5,410,473	2,317,146
<b>Hungary</b>	23,154,203	8,277,366	3,507,351	8,594,304	4,251,054	6,903,895	12,224,838	4,643,501
<b>Romania</b>	10,401,696	3,818,056	3,153,083	7,733,263	1,179,255	2,811,644	1,027,793	463,667

<sup>8</sup> Which has been replaced since January 1<sup>st</sup>, 2011 by the National Foreign Economy Office.

<sup>9</sup> <http://www.traderom.ro/>

Slovakia	6,407,938	6,141,000	1,812,532	2,188,193	2,247,480	4,821,016	3,575,102	937,435
Bulgaria	6,388,840	2,461,161	1,538,577	863,505	-	-	-	-
Ukraine	13,362,084	6,122,815	2,339,384	3,445,192	7,797,273	-	-	389,569
Slovenia	2,867,466	803,499	886,070	2,966,874	-	1,290,986	-	1,521,861
Lithuania	3,960,250	1,113,296	-	5,434,441	-	-	-	-
Croatia	2,685,295	1,652,639	2,142,438	2,799,886	-	-	-	-
Total	107,524,190	55,978,349	25,521,721	53,966,029	30,440,016	39,996,555	31,154,481	16,807,863
	24.28%	12.64%	5.76%	12.19%	6.87%	9.03%	7.03%	3.80%

\* Indicative authors calculation based on Top 500 numbers.

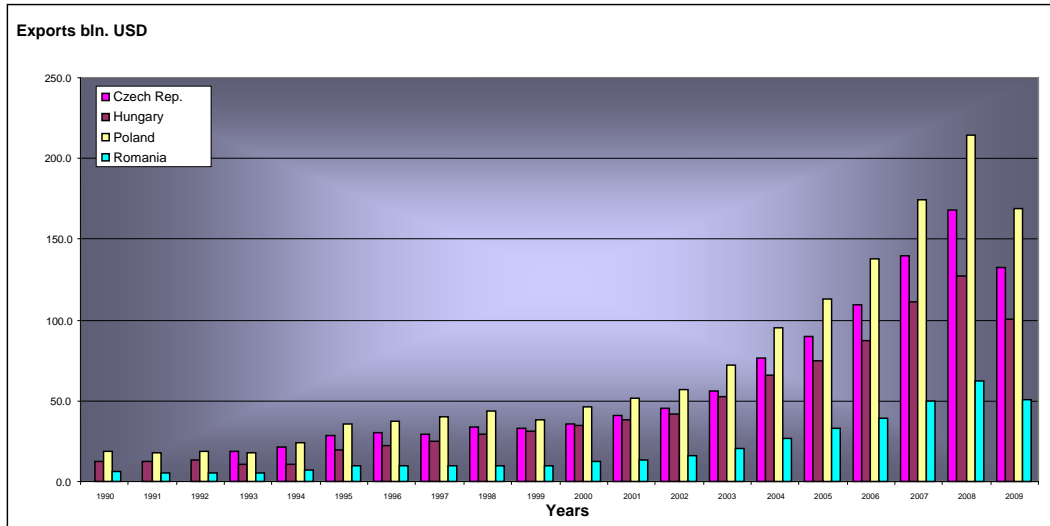
In terms of cumulated value of automotive and electronic components and equipment,

Slovakia ranks the first with 26.48% of the top, followed by Czech Republic with 25.87%, Hungary with 22.34%, Poland with 15.83%, and Romania with 11.55% which in fact has a very limited electronic components and equipment industry in terms of turnover. Those two industries are not only the most internationalized at global level but are generating as well the highest value added in economy creating networks of competitive local suppliers and R&D activities.

It is also important to note that these categories of companies are run based on economies of scale and once an investment is finalized and commissioned, it serves the whole region not only the country where it is legally registered.

Therefore, in terms of consumption the location does not count, the plasma TV sets produced in Poland are shipped in all CEE countries, while Dacia or Skoda cars manufactured in Romania, Czech Republic and Slovakia are sold everywhere in Europe, and the outsourcing centers established in Romania or elsewhere in the region are supporting companies throughout Europe. Cheaper and faster transportation and communication means separated production from consumption and allowed investors to choose the location so as to make best use of local resources, business environment and incentives schemes offered by the governments.

**Graph 2 Evolution of exports Czech Republic, Hungary, Poland and Romania during 1990 - 2009**



In contrast to the export oriented activities, there are also some notable exceptions such as oil & gas, electricity and telecommunications, sectors which attracted high volumes of foreign investments targeting mainly local markets. Major players in these fields of activity in CEE countries are international well established companies, majority of them being included in Top 1000 worldwide.

The structure of the largest firms in CEE shows that some foreign companies have chosen locations in several countries for their investments. Notable example is Nokia with production sites in both Hungary and Romania, Samsung which invested in Slovakia, Hungary and Poland with a turnover of 7.4 billion Euro in 2009 from these sites, Philips in Hungary and Poland with a cumulated income of 3 billion Euro etc.

In fact the automotive and electronic components and equipment sectors are driven by a limited number of world players. Some of them are coming from history and are pioneers in their field of activities, others were established only decades ago but benefited of some new industries opportunities such as mobile communications, video equipment, Internet related equipment, etc. It is thus important to attract the investments of such well established players in order to become a manufacturer in automotive or electronic equipment sectors.

In a recent debate, the National Bank of Romania governor stated that "Only large companies have the necessary force to pull up the economy and who wants to gain market share now needs to think rather to an acquisition,

because the limited growth prospects and relatively high competition make an organic growth strategy too expensive”<sup>10</sup>.

In comparison with its more economically advanced neighbors, Romania is lacking of investments in the electronic components and equipment while automotive sector has not yet reached its potential.

In addition, although Romania has double the population of Czech Republic or Hungary and four times the population of Slovakia, the pharmaceutical sector is only 1.4% of the top Romanian companies against an average of 3.63% for the five analyzed countries.

**Table 4 Contribution of selected sectors to the turnover of Top 500 in some CEE countries**

	Oil & Gas	Electricity	Telecom	Retail & Wholesales	Mining & Metal	Auto motive	Electronic components	Pharma
Poland	21.79%	14.60%	5.39%	8.63%	6.47%	9.07%	6.76%	4.95%
Czech Republic	14.02%	9.29%	4.46%	12.57%	9.45%	17.92%	7.95%	3.40%
Hungary	27.04%	9.67%	4.10%	10.04%	4.96%	8.06%	14.28%	5.42%
Romania	31.32%	11.50%	9.49%	23.29%	3.55%	8.47%	3.09%	1.40%
Slovakia	20.21%	19.37%	5.72%	6.90%	7.09%	15.20%	11.28%	2.96%

Apparently, Hungary is overcrowded with large companies whose cumulated turnover represents over 60% of the country’s GDP. It is obvious that the domestic market cannot ensure the critical mass for their sales and that exports are vital. Global slowdown of world economy during past three years has led to a lower foreign trade activity which in turn put pressure on the profit margins of the companies heavily dependant on regional or international markets.

A more balanced situation is to be found in Poland and Czech Republic where the Top 500 cumulated income represents 31%-35% of the national GDP. This situation leaves enough space for a competitive medium size companies sector gravitating around large regional and international players with local production sites.

It is also worth noting that traditional, vital industries such as oil & gas, electricity and telecommunications are dominating the sector of large enterprises from CEE with over 40% of their cumulated turnover being in majority oriented towards serving the local markets.

<sup>10</sup> Conference, “Companies that overcame the crisis. Lessons for the next economic growth period”, Bucharest, July 5, 2011.

What is somehow surprising is the limited representation in Top 500 of the food sector. Poland with almost 5 billion Euro turnover and Czech Republic with 1 billion Euro are the champions, while Romania and Hungary are lagging behind with around 700 million Euro.

In addition although countries such as Romania and Bulgaria do need complete overhaul in terms of infrastructure and construction of highways, there are no construction companies in Top 500 be it with local or foreign capital. Only Czech Republic and Poland have altogether 2.8% of the cumulated turnover of their Top 500 companies from construction.

This is a clear indication that the two countries have had the highest magnitude in what concerns the opportunities in the field, leading to the conclusion that their infrastructure underwent substantial investments.

Particularly for Romania the poor situation of infrastructure is presented in all international evaluations of business environment as one of the most important (if not the most important) obstacle in attracting foreign investors. Only in the automotive sector Romania lost in 2008 a Daimler-Benz investment of almost 1 billion Euro in favor of Hungary due to poor infrastructure while another investor that came to Romania, Ford, is constantly complaining about the difficulties encountered due to infrastructure.

Retail and wholesales sector is dominated by international chains. There are still some local champions in each country but they do not exceed the threshold of 1 billion Euro turnover. With a lower consumption than of its neighbours, Romania has in turn a record of 24% of its largest companies in retail and wholesales sectors, a confirmation of the fact that production field is under represented.

It is obvious that the top performer is Czech Republic where 47% of its Top 500 cumulated turnover is generated by companies from automotive, electronic components, pharmaceutical, construction, transport, metallurgy and food industries which ensure a solid production base to serve domestic, regional and global markets.

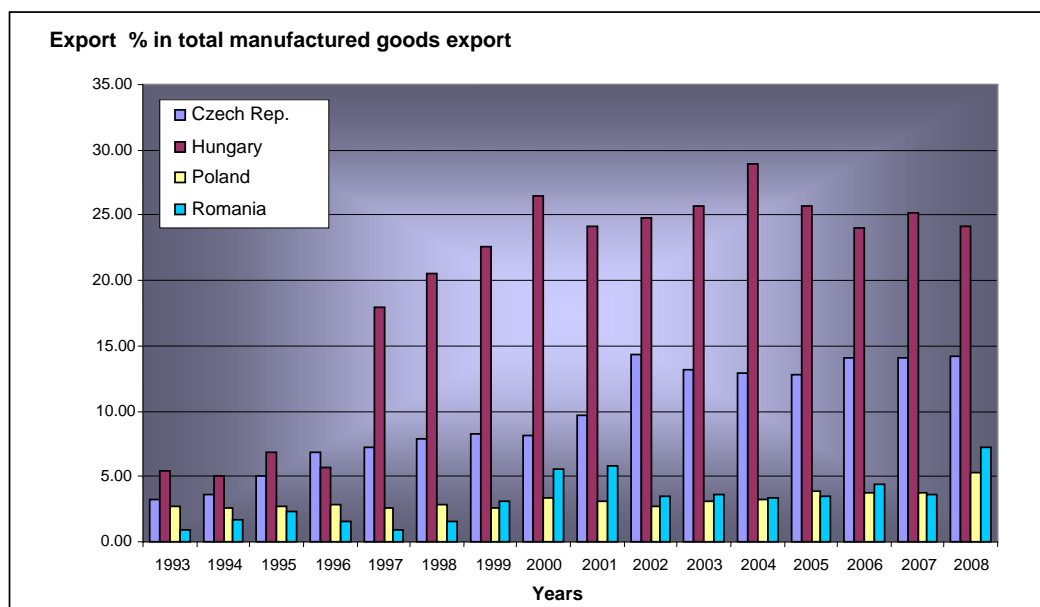
Among the first ranked companies, we recognized some global players such as Skoda Auto (fully owned by Volkswagen group) privatized since 1990 but manufacturing cars since beginning of twenties century with a 6.5 billion Euro in 2009, Foxconn from Taiwan, largest electronic equipment manufacturer employing worldwide over 1 million people (5,000 in Czech Republic), Toyota Peugeot Citroën Automobile Czech Republic with almost 2 billion turnover and 3,386 employees in 2009, Panasonic AVC Networks Czech, s.r.o with 2,200 employees and others.



Hungary belongs to the category of top performers especially in the automotive and electronic equipment sectors. Nokia, Audi, General Electric, Samsung, Philips, Suzuki, Flextronics, Electrolux, Bosch and IBM directly employ over 45,000 people in their production sites located in Hungary.

The concrete results of the FDI impact on Czech Republic and Hungary economies is best evidenced when assessing the high technologies rates of their exports which show record highs for Hungary, followed by Czech Republic.

**Graph 3 High technology exports rates for selected countries in CEE 1993 - 2008<sup>11</sup>**



Obviously, the situation may change if new foreign investments are attracted by Romania and the success of Nokia can be encouraging. In 2010 Nokia recorded a turnover in Romania of 1.6 billion Euro ( 56 % increase over 2009 and a 14 % increase of profit over 2009)<sup>12</sup>. The analysis indicate a clear deficit in the electronic equipment sector therefore targeted policies are needed in order to stimulate the interest of major players for a local production site.

Romania can take advantage of the fact that it is not crowded and has enough unused potential in terms of qualified workforce, relative cheaper utilities and available state aid in order to become the favorite location in CEE for the next generation of foreign investments.

<sup>11</sup> [www.imf.org](http://www.imf.org)

<sup>12</sup> Adrian Secoleanu, Explozia Nokia: de la 6 milioane de euro În 2007 la 1,6 Miliarde de euro În 2010, Ziarul Financiar, August 24, 2011.

Goldstar, Philips Lighting, Samsung Electronics, Sharp Manufacturing, Electrolux have contributed to the transformation of Poland into the largest producer of home appliances in CEE. At the beginning, considerable domestic market able to provide critical mass to achieve break-even was a major advantage. However, given the geographical proximity, production bases could have been located anywhere in the region, especially since the start of accession negotiations with the EU, the convergence of trade policies of Central European countries becoming a fact.

Transnational companies have selected investment locations, especially depending on the quality of business environment, benefits and incentives offered by host countries, the existence of networks of competitive suppliers and of a relatively well-qualified workforce in the field.

Important to note that some companies have made investments in several countries in the region. For example Samsung, Philips and Electrolux, are on top in both Poland and Hungary. By comparison, the only company producing electronic components present in Romania and listed in Top 500 is Nokia with revenues of 1 billion Euro in 2009 (and 1.6 billion Euro in 2010), while in Hungary the same company recorded a turnover of about 4 billion in 2009.

### **Conclusions**

After 21 years since the demise of the centrally planned economies of Central and Eastern Europe, the role of FDI in reshaping these nations is beyond any doubt. The largest companies in each of these countries are multinationals, they have the biggest share of exports as well as highest weight in terms of high technology goods and services.

Anyway, significant differences were recorded between Central European countries and Romania both regarding volumes of FDI attracted and FDI contribution to modernizing and increasing the productivity and efficiency of economy.

Such differences can be explained by:

- Different initial levels of development. In this context the concept of development is understood in its broadest sense, including GDP/capita as a synthetic indicator, infrastructure, technology, etc. The conclusion is that the more developed countries attracted more FDI;

- Different historical experience and geographical location. Historical experience influenced both domestic decisions and attitudes of civil society and position of Western chancelleries towards the new administrations in CEE countries. Geographical position influenced FDI, among other reasons, simply by cost related issues and easiness of access;

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- Different quality of administration and business climate. The countries with some private sector experience, with a partially reformed administration and more business friendly received more FDI;

- Existence or non-existence of clear and consistent economic policies. More FDI was attracted by countries with clear and stable options regarding priority sectors in the economy and interest for predictability and transparency in any decisions affecting the business;

- Existence or non-existence of a clear and stable institutional framework for receiving and supporting foreign investors. While this is not the only significant factor, the more than 20 years of practical experience shows that the countries with such institutional framework succeeded in attracting high volumes of FDI, while the countries that treated the matter lightly obtained much less convincing results.

The FDI sector is more and more important in a global economy. The ongoing economic and systemic crisis adds more dynamism to the existing one and the importance of global players is changing. The competition for capital is increasing and the role of political factor is also on the rise.

In this context all elements are known and best practices are easily available. It only remains that the business sector, the civil society and the politicians find a common denominator for the next two decades and start to adopt and implement the measures necessary for the brave new world to come.

# PRACTICAL APPROACH TO THE VISION OVER CREDIT RISK AT THE LEVEL OF A COMMERCIAL BANK IN ROMANIA. IDENTIFICATION OF CREDIT RISK IN A CREDIT PORTFOLIO GRANTED FOR AGRICULTURE

Ioana Raluca Sbârcea<sup>1</sup>

## **Abstract:**

*The activity of the commercial banks in Romania, in terms of managing credit risk is guided by rules and regulations imposed by the National Bank of Romania, but is also customized through the existence of some personal risk management policies, determined by the nature and scale of each bank. This paper aims to highlight these features in terms of credit risk management and to identify some risks in the credit portfolio granted to customers that engage in agriculture. After the analysis, we have identified a number of proposals that could improve the management of credit risk in agriculture.*

**Keywords:** credit risk, agricultural credit, warranties.

**JEL Classification:** E58; G21; Q14.

## **1. Introduction**

This paper is part of a wider scientific approach in which I analyzed and showed characteristics and risks of agricultural lending. To achieve this goal, besides a theoretical analysis of the way the credit risk is being managed, a practical analysis was needed at the level of a commercial bank of the vision over the credit risk and of the way which the credit risk is being managed, completed by identifying the risks in a credits portfolio and formulating improvement proposals for lending in agriculture. The bank under review, called conventionally Sigma Bank works in the Romanian banking system for over 10 years and currently has a number of 171 operational unit network branches. To reflect the credit risk, we chose to analyze a credit portfolio of 30,000,000 lei, granted by the analyzed bank during the Farmer Program, developed in 2006, 2007 and 2008. This program was developed only by a few banks in Romania, and the credits granted were with interest subsidized by the Government, the purpose of these loans is to boost the absorption of the

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European Funds for agriculture development pre and post accession (Law no. 231 13.07 / 2005 on investment incentives in agriculture).

## 2. General overview of the bank's view regarding credit risk

In acceptance of the bank, *risk* is defined as representing the probability that the internal or external factors are likely to affect adversely the activity, manifesting by failure of the planned objectives, the occurrence of production losses or any other negative effects, and *the credit risk* - the risk of recording losses or failure to achieve estimated profits due to a failure by the counterparty in fulfilling the contractual obligations.

The main objectives of risk management within the Sigma Bank are:

- 1) ensuring the financial health of the bank;
- 2) ensuring business continuity;
- 3) protecting shareholders' wealth;
- 4) protect the interests of clients.

Sigma Bank operates both following the NBR regulations on the principles of prudence, and following their own rules designed to render the possibility of prevention and mitigation of credit risk.

Bank defines exposure as being any risk, actual or potential, that must be highlighted on the balance sheet and / or off-balance and which results from the following, but is not limited to them: loans, investment in shares or other securities, other equities of financial assets nature, bills discounted or endorsed, guarantees issued, letters of credit opened or confirmed.

Credit risk assessment is done through:

**A. credit analysis** - to determine the *current risk individual profile*

**B. credit portfolio analysis** - to determine the *bank's aggregate risk profile*.

Regarding determining the current risk individual profile, approaches that are being used by the bank differ according to the counterparty as follows:

✓ *for individual customers*, the analysis involves a scoring calculation that determines the eligibility of the customer, plus an analysis of the income source, the employer, the permanence of income, and then an analysis of the security offered;

✓ *for legal entities customers* things are more complicated, the analysis begins by calculating a rating credit based on some qualitative and quantitative indicators that allow assigning to a financial performance category (A, B, C, D or E), but this rating offers only an overview over a company's activity, the next steps consist of a detailed analysis of the company, which, in my view, can not be achieved following a "recipe" known to all analysts, in the case of legal persons knowing the activity is very important for understanding the levels

recorded by the main financial indicators, which doesn't reflect at all companies the optimum reflected by the theory, and are influenced by the specifics of each activity.

Thus, I believe, that the correct and complete analysis of a legal entity client, depends heavily on the experience of the lending credit analyst, experience that can allow understanding the company's activity.

In terms of organizing the lending activity, the bank operates on the principle that a risk mitigation method is represented by performing the credit analysis at one of the bank's levels (branches / agents) and the approval to be achieved by the competent bodies from higher levels (regional or central bank centers).

At the bank level several *organs for loan approval* are operating, from the Credit Review Committee, to the Board of Directors, which approve the requests based on the level of responsibility assigned, representing the maximum level to which each committee may approve loans or commitments. (*the deployment phases regarding the analysis and promoting credits* are summarized in chart no. 1). As required by the National Bank of Romania, loans that exceed a certain percentage of equity and / or require a higher credit risk, or those that do not fall in lending policy will be approved by the Board.

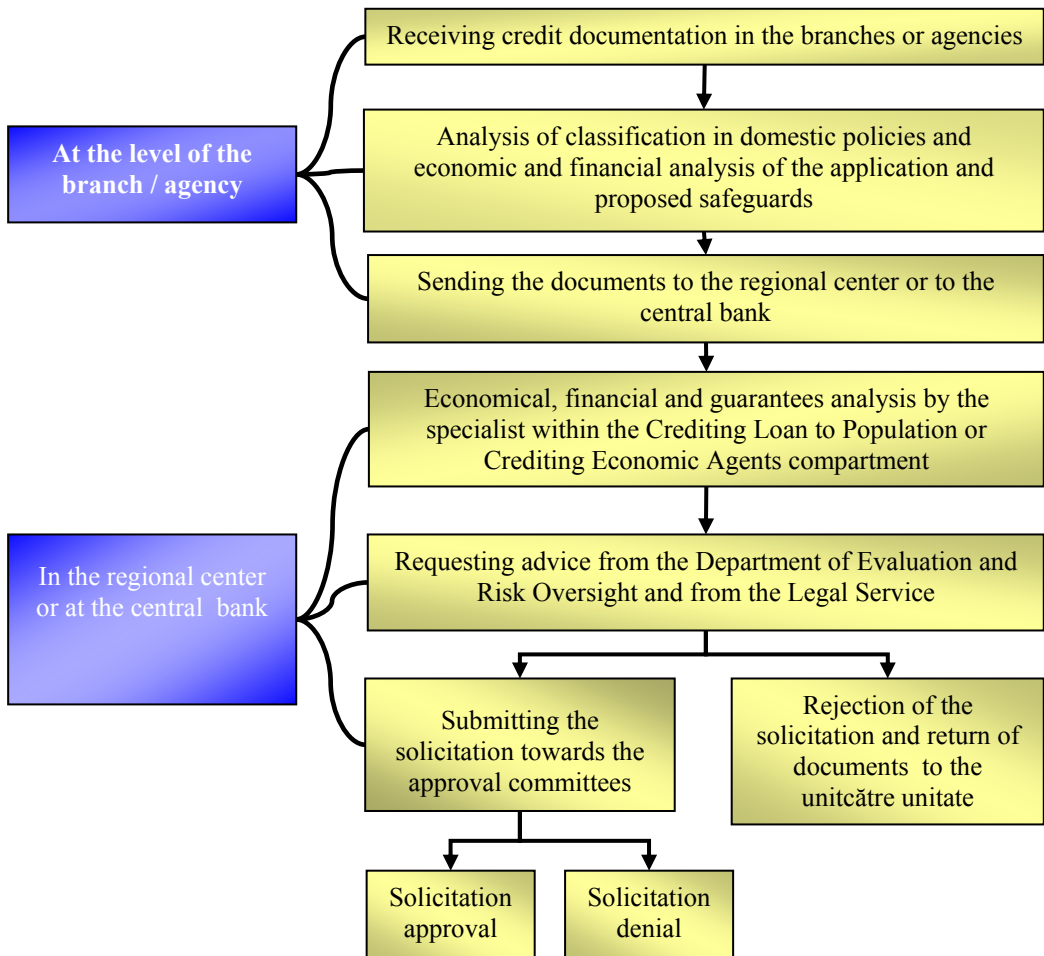
**The credit portfolio management** across all operating units is performed by the Central Bank, where it works:

✓ *The Population Lending Service*, structured in two departments: The Crediting Population Department and the Population Tracking and Recovery Credit, which manages loans granted to individuals.

✓ *The Service for crediting economical agents*, structured in four sections: Section for Lending Economical Agents, Section for Intensive Tracking, Restructuring and Recovery Credit Section and the Risk Assessment and Surveillance Section, which manages loans granted to legal entities (companies, authorized individuals, family associations etc.).

**For evaluating the global credit risk** it aims at the quality of the credit portfolio and of the credit risk management quality. These analyses are performed by each branch of the bank (for its own portfolio), by the Service for Crediting Economical Agents, by the Service for Crediting Population for the entire portfolio of the Bank and independently by the Department of Risk Assessment and Monitoring.

Chart no. 1 - Deployment phases of the analysis process and credit promotion



Also, according to the analyzed bank, an important rule in managing credit risk is represented by the **constant pursuit of the quantitative and qualitative evolution of credits**, which includes:

- *standard monitoring*: monthly monitoring of compliance maturity, field visits to view business and guarantees, injunctions, notices to debtors who record outstanding;
- *specific monitoring*: detecting high risk credits with default loans and their intense monitoring, restructuring loans;
- *tracking credit guarantees*;
- *tracking overdue and bad loans*.

Credit risk issues should be **reported** in due time to the *Directorate for Supervision of the National Bank of Romania*. The information system used should allow:

- registration on time of non-performing loans;
- identifying non-compliances with the established exposure limits;
- credit risk assessment afferent to the balance sheet and off-balance sheet;
- providing adequate information concerning the composition of the loan portfolio;
- providing information that would allow the identification of any risk concentrations.

In order to maintain a quality credit portfolio, Sigma Bank respects the limits imposed by the central bank to limit exposure (according to NBR Regulation no. 16 from 14.dec.2006), but it has also created its **own policy for managing risk**, through which it has established:

- measures or policies concerning the approval competences for the bank's commitments;
- measures or policies meant to limit or reduce credit risk;
- measures or policies on credit classification;
- measures or policies on provisioning.

Sigma Bank permanently monitors the compliance with the **global system of internal limits**. These limits are not as stringent as those imposed by the NBR, and their levels were reached following the analyses made by experts in the field of risk within the Bank, analyses that considered both the history of lending and the field practice regarding the levels that can be recorded by certain indicators. Furthermore, failure to comply with these indicators entails an analysis of the reasons behind this situation, and if it is considered that the registered levels do not generate a very high risk for the bank, or assuming these levels causes significant gains for the bank, then these limits can be revised, and if not, measures are required for admission to the established levels. These limits relate mainly to:

✓ *total value of the credits granted to customers in total assets* - the importance of this limit is very high, because this limit indicates how much of the total assets, represents assets with a risk degree of 100, that is loans (according to Basel II regulations). Furthermore, failure to comply with this limit can determine an additional capital need, so that is why it is carefully monitored.

✓ *the value of the credits in total attracted sources* - bank realizes a plan of use which is then given to the attracted resources trying to achieve both high-risk



investments, but that are income generating and investments with a lower degree of risk, but which ensures their reimbursement;

✓ *focusing on the activity sectors* provides a system of limits that are often revised, according to the general economic context, the bank imposing more restrictive values for the sectors that are most vulnerable at times, thus trying to mitigate the credit risk exposure determined by problems caused by a particular industry;

✓ the bank imposes certain *limits of exposure on the types of credit* on the grounds that an excessive exposure to a particular type of credit may cause risk occurrence, but these limits are also reviewed in order to take full advantage of the opportunities within the market;

✓ also, the bank, through its lending policies establishes *the exposure level towards the counterparty*, respectively towards the granted loans to individuals and businesses, the bank in question is a bank directed mainly to crediting the economical agents;

✓ the bank permanently monitors the *quality of the portfolio for granted loans*, managing a set of limits that would alert in case of its potential problems (the value of the outstanding loans and of those highlighted off the balance sheet, the volume of the specific credit risk provisions (including from interests) expressed as a percentage of the credits balance sheet sold, including claims attached); failure to comply with these limits determines establishing some measures for a closer monitoring of the credit portfolio of bad loans and for recovering outstanding amounts.

In addition to these internal rules of Sigma Bank with direct impact on credit risk management, the focus is set on the Bank's activity and on the internal control and as an element that can reduce risks in the lending activity.

Thus, analyzing the approach of the practiced risk by Sigma Bank, it can be seen that the bank is trying to continuously adapt to the requirements of NBR regarding prudentiality and also it has created its own system for permanent monitoring of each credit, and of the global credit portfolio, that would enable an early notification of the credits that may generate risks to its business.

### **3. The analyzed bank's approaches in terms of covering the credit risk**

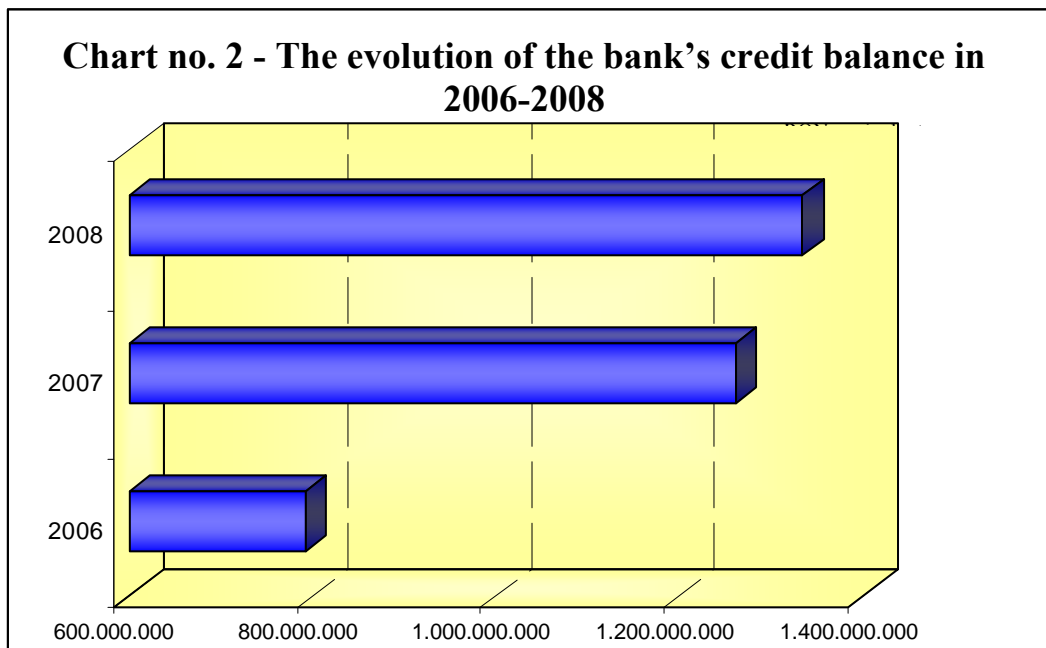
The analyzed bank continuously aims to prevent and mitigate the effects that the credit risk occurrence may have on its business. Next, I will present the main ways of covering the credit risk, which the bank uses for all credits, regardless of the debtors provenience.

The analyzed bank continuously aims to cover the risk related to the credit portfolio. Table no. 1 shows the situation of the credit portfolio granted to legal entities in the period 2006-2008.

**Table no. 1 - Situation of the credit portfolio granted to legal entities in the period 2006-2008.**

	31.12.2006	31.12.2007	31.12.2008
Credit balance	792.565.936	1.261.371.700	1.334.738.766
Increasing percentage	-	+59,15%	+5,8%

It can be noticed a sharp increase in credit portfolio in 2007 (chart no. 2) as a result of increasing the bank's units from 214 at the end of 2006 to 246 at the end of 2007 and of the increased appetite for loans expressed by the banks customers.



Given this intensive increase of the credit balance, **the bank is exposed to a higher credit risk**. Given these elements, Sigma Bank develops a policy for managing the credit risk, that can be reviewed annually and which aims to:

- *Limit or reduce credit risk*, which aims to monitor and limit exposure to credit risk by imposing certain maximum values, towards which the bank may expose itself to a client or to an activity field. Based on this policy sit on the one side the NBR regulations regarding limiting the exposure towards a single

borrower and on the other hand its own regulations regarding limiting the exposure.

- *Credits classification* - these measures are designed to use a standardized classification of loans, which should reflect the associated credit risk of the counterparty. Loan classification is an instrument of credit risk management through which to each credit is assigned a risk level to measure the probability of compliance with the contract. Aggregating all risk degrees associated with them establishes a risk degree at the level of the bank's portfolio. Sigma Bank uses the *classification criteria established by the NBR regulations*, which take into account the financial performance, the duty service, initiation of legal proceedings, the financial performance being in its turn calculated based on an algorithm that takes into consideration numerous aspects of the economic and financial situation of the client ;

- *Creating provisions* - provisions, along with other types of capital are used to cover credit losses, therefore they represent a direct instrument of credit risk management. The method of establishing provisions is made in compliance with the regulations imposed by the NBR.

The method of credit classification and provisioning is established by Sigma Bank through an *assessment of evaluating the financial performances*.

Thus, *determining the financial performance category* is made in order to identify and analyze the credit risk, by considering the non-financial and financial aspects that have impact on the client, on his business, on his profit and on his repayment capacity. Classifying in one of the five financial performance categories has the following meaning:

Performance category	Meaning
A	the financial performances are very good; it is envisaged maintaining into perspective the financial performances at a high level
B	the financial performances are good; the client is stable on a short period of time;
C	the financial performances are satisfying; the impact of the credit can lead to improved performance;
D	the financial performances are low; stable performances on a short period of time;
E	the financial performances are reduced; granting the credit is very risky;

Allocating a client in a particular category of financial performance is done based on *its financial performance analysis*, based on a score obtained from the *quantitative and qualitative indicators*.

The quantitative indicators used in calculating the financial performance are:

- current liquidity;
- patrimonial solvency;
- financial return;
- indebtedness degree;
- the coverage degree of exploitation expenses with the incomes from exploitation;
- the turnover sensitivity at the exchange rate.

These indicators are calculated based on the last financial situations available, elaborated according to the regulations issued by the Ministry of Public Finances.

The financial performance analysis completes itself with the analysis of the **qualitative indicators**:

- management quality;
- the current business history;
- relationship with the bank;
- history concerning crediting;
- payment behavior;
- quality guarantees;
- quality of shareholders;
- market conditions.

The share of the indicators for determining the financial performance category is 70% - *quantitative factors* and 30% - *qualitative factors*.

Depending on the financial performance, the debt service and initiating legal proceedings, a classification of the company in one of the classification categories takes place: standard, in observation, substandard, doubtful, loss (according to regulation no. 3 of 19 March 2009).

In establishing how the provisions are made, an important role is represented by guarantees constituted at credits, that, depending on their quality, are able to reduce the provisioning calculation base.

In the case of Sigma Bank, a **wide range of guarantees** are accepted, including: mortgages on real estate properties (apartments, houses, production halls, livestock farms, lands outside and inside the city), pledges on movable property (machinery, production lines, collateral deposits, goods stocks), assignment of receivables on invoices or contracts, letters of bank guarantee. In

order for a guarantee to be established it must be acquired legally, it has to be in the property of the one who is going to pledge it, he has to have proof of full payment of the property (for movable and immovable properties). The Bank also offers the possibility of pledging future assets (buildings that are going to be build or movable goods that are purchased from the credit), but these are not used to offset the exposure at the time of calculating the base allowance. The situation of the existing guarantees in the bank during the analyzed period is presented in Table no. 2 and 3.

**Table no. 2 - The situation regarding the market value of guarantees in the credit portfolio granted to legal entities, during 2006-2008**

Guarantee type		2006	2007	2008
1	Guarantees received from the public institutions	-	86.558.000	190.351.497
2	Mortgages on housing	435.341.516	682.330.479	697.415.781
3	Mortgages on the halls, commercial spaces, lands	1.527.668.411	2.113.029.171	3.212.534.219
4	Pledges	448.437.336	505.262.525	562.833.644
5	Payment instruments	225.307.026	363.487.190	248.117.571
6	Guarantee funds and policies of default risk	131.825.276	290.332.265	282.632.965
7	Other guarantees	47.190.741	39.286.145	24.613.249
<b>TOTAL GUARANTEES</b>		<b>2.815.770.306</b>	<b>4.080.285.775</b>	<b>5.218.500.934</b>
<b>Legal persons credit balance</b>		<b>792.565.936</b>	<b>1.261.371.700</b>	<b>1.334.738.766</b>

Analysis of the guarantees that the bank has established for credits granted to legal entities reveals that the share held by mortgages on housing in total guarantees has decreased in the period analyzed from 15.46% to 13.36% in favor of the increasing the share held by mortgages on the halls, commercial spaces, lands (Table no. 3).

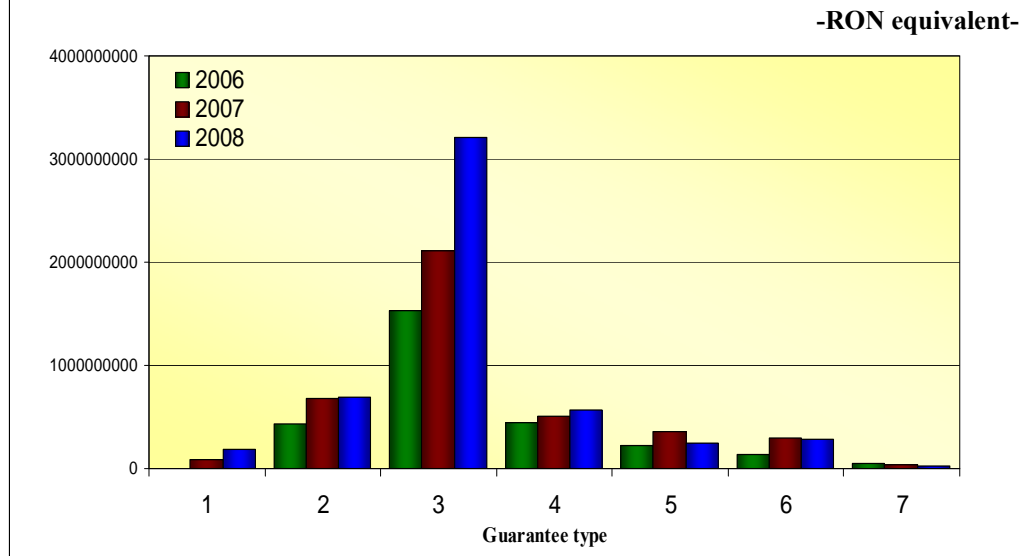
Analyzing the structure of the guarantees (chart no. 3) one can observe a dominant share, throughout the whole analysis period of the type of mortgages over halls, commercial spaces, lands in total guarantees received by the bank, followed by home mortgages.

**Table. 3 - Share of various types of guarantees in total guarantees on loans granted to legal, in 2006-2008**

Guarantee type		2006	2007	2008
1	Guarantees received from the public institutions	-	2,12	3,65
2	Mortgages on housing	15,46	16,72	13,36

3	Mortgages on the halls, commercial spaces, lands	54,25	51,79	61,56
4	Pledges	15,93	12,38	10,79
5	Payment instruments	8,00	8,91	4,75
6	Guarantee funds and policies of default risk	4,68	7,12	5,42
7	Other guarantees	1,68	0,96	0,47

**Chart no.3 – The evolution of the main types of guarantees provided by the Bank in 2006-2008**



The main change in the structure of the guarantees established at the credits granted by the Sigma bank in the analyzed period is to **increase the share of guarantees issued by the Guarantee Funds and the share of insurance policies of default risk** from 4.68% in 2006 to 7.12% in 2007, followed by a reduction up to 5.42% in 2008. In absolute size, the value of the guarantees received from the Guarantee Funds rose from 131 million RON in 2006, to 282 million RON in 2008.

From the analysis of the guarantees that the borrowers have established in favor of Sigma Bank results the fact that the bank's portfolio is covered by the credit risk in a very high proportion, also determined by the prudent policy adopted in the field of evaluating the guarantees and weighting through two coefficients categories of its value.

#### 4. Risks identified at credits granted by the bank during the Farmer Program

On agricultural lending, the analyzed bank was opened continuously to crediting this sector, but the analysis, granting and management of these loans are not made by a department specializing in this area, and by employees responsible for lending businesses, which is why the Bank policies do not distinguish different approaches to credit risk in this sector. I consider this a weakness of the bank, that can be remedied by creating a number of specialists that would manage credits in this sector, given the peculiarities of the activities of entities in agriculture and the importance of knowledge in this field in order to take the best ideas about lending it.

Sigma Bank conducts credit to agriculture since its inception, this also determines a risk associated with the portfolio with this destinations.

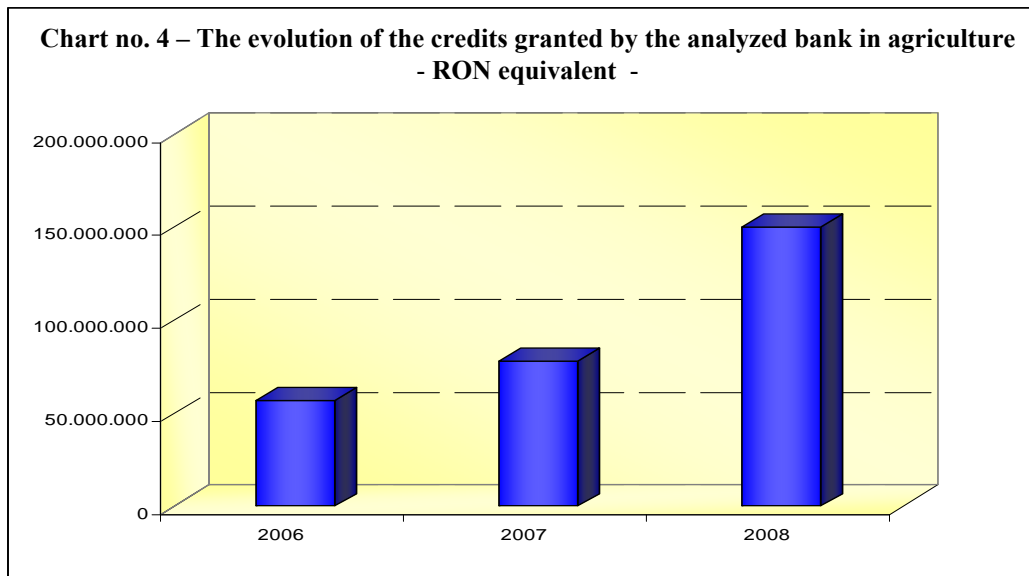
After analyzing the structure of the granted credits by the Sigma Bank on areas of activity we observed that *although the share of loans in agriculture is not very large, it can be seen an increase of it in the period 2006 - 2008, from 7% to 11% of total loans (table 4 chart 4).*

Sigma Bank offers a full range of products to these companies, meaning loans to finance the current business and investment loans and also specific loans, respectively agricultural loans and loans that finance investments in the Farmer Program.

**Table no. 4 – The structure of the credits granted by the bank analyzed on activity sectors**

**- RON equivalent -**

Sold of credit on activity sectors	2006	Total share (%)	2007	Total share (%)	2008	Total share (%)
agriculture	57.005.287	7	78.272.041	6	150.099.917	11
commerce	227.658.413	29	371.678.374	29	319.456.273	24
constructions	77.255.236	10	129.951.870	10	135.989.412	10
industry	250.426.839	31	300.392.077	24	315.546.859	24
services	80.666.878	10	192.812.635	16	289.278.595	22
transports	52.232.764	7	111.927.559	9	105.326.835	8
others	47.320.519	6	76.337.144	6	19.040.875	1
<b>TOTAL</b>	<b>792.565.936</b>	<b>100</b>	<b>1.261.371.700</b>	<b>100</b>	<b>1.334.738.766</b>	<b>100</b>



Sigma Bank runs credits in the Farmer Program since 2006, granting credits co-financing with the SAPARD in 2006 and 2007, and also having in progress a convention concluded for granting credits co-financing with the post-accession EU funds in 2008, but up to now under this agreement credits were not granted, given the shortcomings of this program. In order to identify the credit risks in agriculture, we have chosen a uniform loan portfolio in terms of how the analysis is developed and how are the loans being granted, respectively loans granted in the Farmer program.

**The total value of loans granted under the Farmer Program, from subsidized sources, is:**

- 2006 – 20.000.000 RON
- 2007 – 10.000.000 RON

**The balance of loans granted for financing investments in agriculture, under the Farmer Program has recorded the following values:**

- 31.12.2006 – 18.017.509 RON;
- 31.12.2007 – 25.844.274 RON;
- 31.12.2008 – 23.801.348 RON.

Following the analysis of the bank loans granted in the Farmer Program, from the sources of the Ministry of Agriculture and Rural Development (respectively the 30.000.000 RON won in the auction in 2006/2007) we drew the following elements that can generate risks for the bank :

➤ a large number of clients that are recipients of credits from the Farmer Program are newly created family associations or authorized

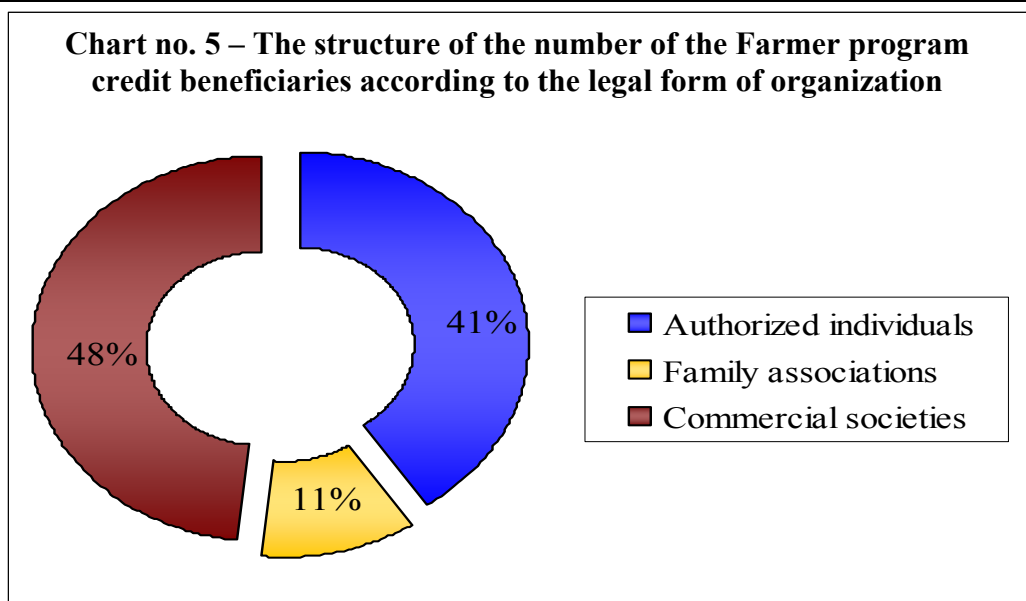


**individuals, inexperienced in managing a business or a bank loan.** Thus, out of the 91 clients funded under the Farmer Program, 47 are family associations and authorized individuals, the value of the loans granted being 7,781,074 RON, from the total of 30 million RON. Customer situation according to the form of organization is as follows (table no. 5, chart no. 5)

**Table no. 5 - Structure in terms of the legal organizing form of client borrowers**

Clients in terms of legal organizing form	Number of clients	Value of the granted credits (lei)
Authorized individuals	37	5.827.750
Family associations	10	1.953.323
Commercial societies	44	22.218.927
<b>TOTAL</b>	<b>91</b>	<b>30.000.000</b>

**Chart no. 5 – The structure of the number of the Farmer program credit beneficiaries according to the legal form of organization**

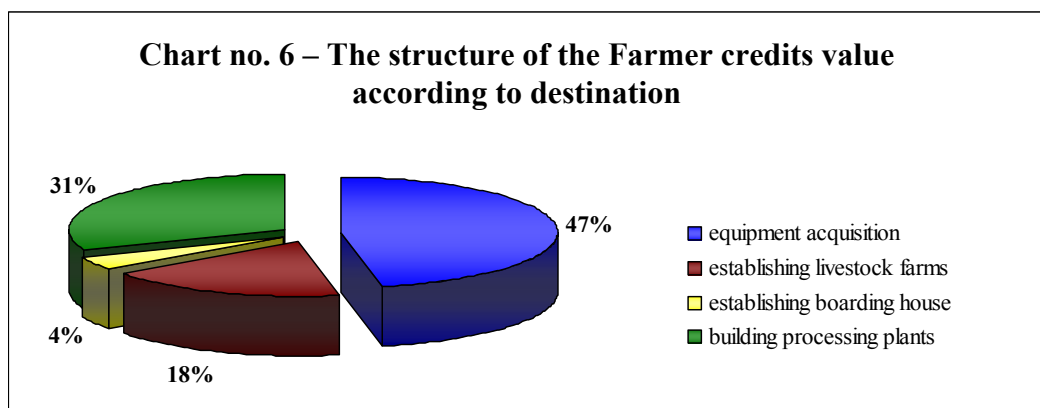


➤ a large number of loans were intended for the purchase of agricultural machinery necessary for primary agriculture, subsistence (tractors, combine harvesters, etc.). Thus, almost half of the amounts carried by Sigma Bank through the Farmer Fund had this destination (table no. 6, chart no. 6), bank granting the loans in the order of their application, without refusing to credit such projects, with a low individual value (the average value of loans granted to such projects was of 200,000 RON). Besides, the elaboration method of these financing projects was much easier and less expensive than

developing a complex project, that would ensure a sustainable development of agriculture. This element can generate the risk of default because the beneficiaries of these loans are very exposed to natural hazards, and their financial power is low. Also, there is a significant share of loans granted to financing some processing plants to the detriment of the projects that could lead to the development of agriculture and animal husbandry in Romania. Another risk posed by the structure of the credits destination from the Farmer Program *is related to the concentration of important sums on projects of high values, namely those that were used to finance the processing plants* (the average value of a loan for this purpose was of 1881. 000 RON).

**Table no. 6 - Structure of loans granted under the Farmer Program according to their destination**

Credit destination	Number of clients	Value (RON equivalent)
equipment acquisition	66	13.889.950
establishing livestock farms	15	5.464.484
establishing boarding house	5	1.238.180
building processing plants	5	9.407.386
TOTAL	91	30.000.000

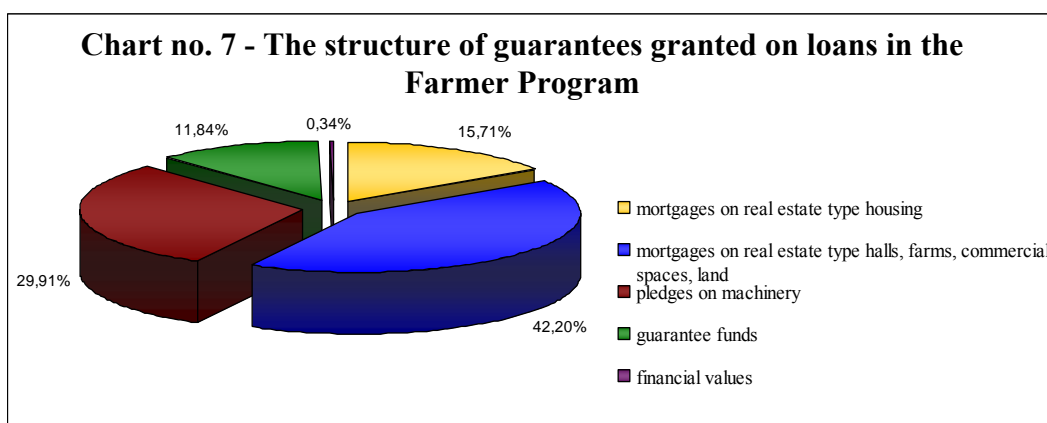


➤ **the structure of the constituted guarantees for this type of loans.** Thus, from the analysis of the credits granted by Sigma Bank during the period 2006-2008 it can be seen that a significant share in total securities is owned by agricultural machinery and by mortgages on real estate type farms or processing plants. These are guarantees characterized by a low liquidity (for mortgages) and by an accelerated depreciation degree (for machinery). Thus, for these loans we can say that there is a **risk guarantee**. The situation of the

guarantees for the loans granted under the Farmer Program at 31.12.2008 (the balance of the credits 23,801,348 RON) is as follows (table no. 7, chart no. 7):

**Table no. 7 - The structure of guarantees granted on loans in the Farmer Program**  
- RON equivalent -

Guarantee type	Guarantee value
mortgages on real estate type housing	10.345.752
mortgages on real estate type halls, farms, commercial spaces, land	27.794.015
pledges on machinery	19.699.563
guarantee funds	7.799.397
financial values	226.930
<b>TOTAL</b>	<b>65.865.657</b>



*Guarantees with the highest weight, given the low liquidity in the event of enforcement, can not cause a reduction in the risk associated with lending these companies.*

After analyzing the conduct of loans designed to finance agriculture, from the Farmer Program 2006/2007, the risks which the bank has assumed and the methods used to cover them, *I consider that the analyzed bank could improve the way of approaching loans in agriculture* (without being limited to these measures) by:

➤ *a development from the Bank of some consulting services for potential "farmers", credit beneficiaries, services which currently are not offered by this bank. These consulting services could bring a double advantage:*

✓ *client would know at first what are the conditions under which he can benefit from non reimbursable funds, the need to turn to a loan if you he does*

not have equity, and its obligations by entering into a loan, meaning the repayment plan, the costs involved and the guarantees required;

✓ the bank, in addition to the incomes received from this service, can know the situation of the client closely, from when the investment project is an idea, respectively it knows its financing need; if the customer would only call a specialized consulting firm, at the time of the meeting with the bank he might face a refusal from it, which basically means a waste of time and money.

➤ a new approach of the guarantees used for agricultural loans, to increase the share of institutional safeguards against collateral with a lower degree of merchantability such as: mortgages on homes, on lands in rural areas and on halls and farms, pledges on agricultural machinery.

➤ *introducing compulsory insurance of crops or animals by those directly involved in agricultural production and respectively in livestock.* Currently there is no such provision in the reviewed bank's policy, something that can cause a credit risk, the more stressed because a very important part of the beneficiaries from the Farmer loans (47% of the loans contracted), for example, were intended for purchasing agricultural machinery, which means that they have lands to exploit that may be affected by natural hazards.

➤ *training*, at least at the level of the central bank, *of some specialists in agriculture, with crediting and analysis, evaluation, monitoring and hedging the risk abilities*, that would be able to recognize the features that are generated by this sector, namely to properly assess the risks to which the bank is exposed to through granting loans for this purpose.

## 5. Conclusions

The analysis of the general vision that the bank has towards credit risk showed that it complies with the industry regulations issued by the National Bank of Romania, but manages credit risk through internal rules and procedures. The credit risk management policy issued by the bank includes measures on skills regarding the approval competences of Bank's commitments, policies meant to limit or reduce the credit risk; policies regarding credit classification and provisioning policies. From the analysis of the practiced policies it has been revealed a constant prevailing concern of the bank to limit credit risk by limiting exposure towards certain customers or to certain sectors of activity, this limits system having the role to provide early warning of increased exposure to credit risk. The limits are revised periodically, in order to adapt them to the domestic context and to the existing competitive context at different times.

In terms of credit risk in agriculture the main deficiency noticed at the analyzed bank is the approach of agricultural credits without taking into account the particularities of this activity sector. This aspect made it possible to identify some significant risks in the analyzed loan portfolio and to propose some measures for improving the approach method of loans granted for agricultural development.

### References

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NBR Regulation no. 3 of 19 March 2009 regarding loans and investments classification, and also the creation, adjustment and use of the risk provisions, published in the Official Gazette, Part I March 30, 2009

NBR Regulation no. 16 of 14 December 2006 published in the Official Gazette, Part I no. 1033 bis 1 27 December 2006 regarding large exposures of credit institutions and investment firms

[www.bnro.ro](http://www.bnro.ro)

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[www.cdep.ro](http://www.cdep.ro)

# THE ROLE OF THE ALBANIAN HIGH EDUCATION IN CREATING THE ENTREPRENEUR

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Andrea Koxhaj<sup>2</sup>

## Abstract

*Following a history of planning and centralization, these last 20 years, with the close down and privatization in Albanian economy, brought about a surplus in the labour offer for some key specialties and professions. The unemployed professionals changed occupation, or emigrated. Now a shortage of different professionals is feeling in the practical everyday life. The new developments have at the same time created a remarked need for some new professions, which for the present, are performed by unqualified individuals. Meanwhile, there is a boom in higher education, not accompanied by the creation of specialists in these professions on demand, many of which can be created by the high school education. The Government of Albania has now understood that there is an imperative need to strengthen the high education that educates professionals. But in spite of the measures taken, there is still not the expected massivity in this kind of education, and potential high quality students prefer the general education, instead. Although there are reports of economic growth, there is not enough growth in the formal side of the labor market that may allow the employment of high school professionals. Those who choose this kind of education have no clear chances of employment, and the majority reorients their career on further education. The only possible way for them to make use of the profession taken by the high education, and for the country to move out of this crossroad, is to engage in private/individual enterprising.*

*As an economy in transition and inspiring European inclusion, Albania needs to create a sustained basis of growth. Self-employment sustained by the entrepreneurial learning is an important way for economic efficiency as well as an alternative way to joblessness.*

*Focused on the role of the Albanian professional education in creating the entrepreneur, the authors of this study analyzed the Strategy of Education, the curricula and study programs of the professional education and conducted half structured interviews with school directors and curricula authors. The purpose was to understand how individual traits and behaviors, such as creativity, opportunity identification, risk assessment and risk taking, and resource management which*

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*make up the entrepreneurial character are included in the curricula. It came out that entrepreneurship is introduced as a key competence within mainstream curriculum. This is made possible by innovative teaching and learning arrangements that are part of the reform in education. Structured interviews with students of the professional schools were conducted, focused on the motives for choosing this education, the perceived possibility offered by the actual study programs.*

**Keywords:** Professional High School Education, Entrepreneurship Education, Curricula.

**JEL Classification:** A; A1; A10; A11; H52; I2; I22.

### 1. The rationale

Until 1990, the words *mass production* and *massivity* were very familiar in Albanian reality. There was mass production in many industries, mass production in agriculture, massivity in education, etc. During the 5-year Plans of the State, the focus on education changed according to the transformations in the economic sphere. Increased industrial investments modified the state's demand for educated people, orientating their capacities toward non-agricultural means of production.

This demand was reflected in the number of vocational schools that sprang up with programs in technical professions that were designed to support industrial technological development. By 1980 the number of schools and teachers had tripled compared with 1960, clearly demonstrating the state's efforts to increase the quality and the quantity of education programs [1]. At the same time, the number of students had doubled, increasing both the average length of study and the percentage of people who completed primary education. The state's vision about secondary education in Albania was ambitious, and included objectives to increase the number of people with vocational training. (Table 1)

Years	1950	1960	1970	1980	1990
<b>NUMBER OF SCHOOLS</b>					
Primary	193	557	1374	1559	1726
Secondary, vocational	17	69	131	263	466
Secondary, general	6	43	46	17	47
Tertiary	1	6	5	8	8
<b>NUMBER OF STUDENTS IN THOUSANDS</b>					
Primary	171	274.9	555.3	552.6	557

Secondary, vocational	5	14.1	50.1	133.1	138
Secondary, general	2	15.8	30.4	30.8	68
Tertiary	0.3	6.7	25.5	14.6	27
<b>NUMBER OF TEACHERS</b>					
Primary	4851	8569	18944	25980	28798
Secondary, vocational	171	511	1205	3660	7390
Secondary, general	91	502	1157	1732	2318
Tertiary	13	288	926	1103	1806

Source: Albanian statistical yearbook 1989.

Each year the number of students in vocational training was greater than the number enrolled in general secondary education, vocational schools far outnumbered those offering a general education.

The vocational schools were diffused throughout the country, which was consistent with the state objective of increasing equity in educational achievement between urban and rural areas. The huge expansion was in response to the economy's need for professional skills in the labor force, mainly in agriculture and industry. On the other hand, general education was not popular and the state was less involved in expanding the number of such schools. They were nevertheless on the increase in the last years of the regime, from 17 institutions in 1980 to 43 in 1989. The number of students in higher education doubled from 1960 to 1980 and reached at 27,000 in 1990. Even so, the state was parsimonious in the recruitment of the students after completion of secondary education and the selection was made by rigorous vetting procedures [2]. About 40 percent of students finishing secondary school entered at the tertiary level in year 1980.

Education was generally of a high quality and based on strict army-like discipline, uniform programs, uniform methods of teaching and studying, uniform dress and uniform models of behavior. Education on all levels was centrally controlled and highly bureaucratic, and was particularly influenced by the need for an instrument of ideological indoctrination [3]. The system rested on a triple foundation of theoretical learning, productive work and physical as well as military training. Above all, the educational system was meant to prepare young people for the entry into the centrally planned economy.

In this kind of system, the level of education attained by individuals had less to do with overall economic success than it typically does in a market economy. Many well-educated people during the communist period earned only a little more (and sometimes less) than production workers, although they did enjoy better working conditions, an important "non-wage benefit".



Centralized planning artificially controlled the demand for education and employment.

To conclude, the communist regime made real efforts to increase of school attendance. At the end of the communist period in 1990, about 45 % of the population between 35 and 45 years had completed secondary education [4].

But there are years now that this *massivity* is no more a matter of fact. Close down, downsize, privatization, are the words in these last 20 years. This of course, was accompanied by a surplus in the labor offer for some key specialties and professions.

After 1990, the Albanian system of vocational education was abandoned in favor of general secondary schools. The ratio of students undergoing vocational training versus the total in secondary education was much lower in 2003-2004 than in 1990 [5], indicating a dramatic change in the educational system. Before 1990, vocational schools provided agricultural and industrial training, and 70% of the students attended those schools. After 1990, the unemployed and unwanted labor power educated in these professions, changed occupation, or emigrated. Most of schools were subsequently closed, and today vocational education does not play an important role in the context of secondary education [1]. The situation has worsened by the failure of vocational training in the regions.

Not only the state withdrew from financing such an expensive network of schools, but young people themselves are showing more interest in general education as a way to build opportunities in various types of postsecondary or higher education.

The specific nature of vocational training is lagging far behind young people's aspirations. The number of vocational schools in 2003-2004 was only 53 (a mere 4 of which were located in rural areas) compared with 454 schools in 1989. Pupils in vocational education represented about 16 percent of children registered in secondary education in 2004 (21,900 students). Vocational schools are a male domain, enhancing their professional orientation toward technical positions.

However, the type of qualifications, as well as the specific knowledge/skills that young people acquire in the educational system, often does not fit the labor market demands. Albania's market reforms did not create efficient links between schools and enterprises. Examples still exist of narrow vocational training for employment in industries for which demand has now collapsed.

The centrally planned economy's historical emphasis on industry and agriculture at the expense of services had major implications for the education system. Every day now, a shortage of different professionals is feeling in the

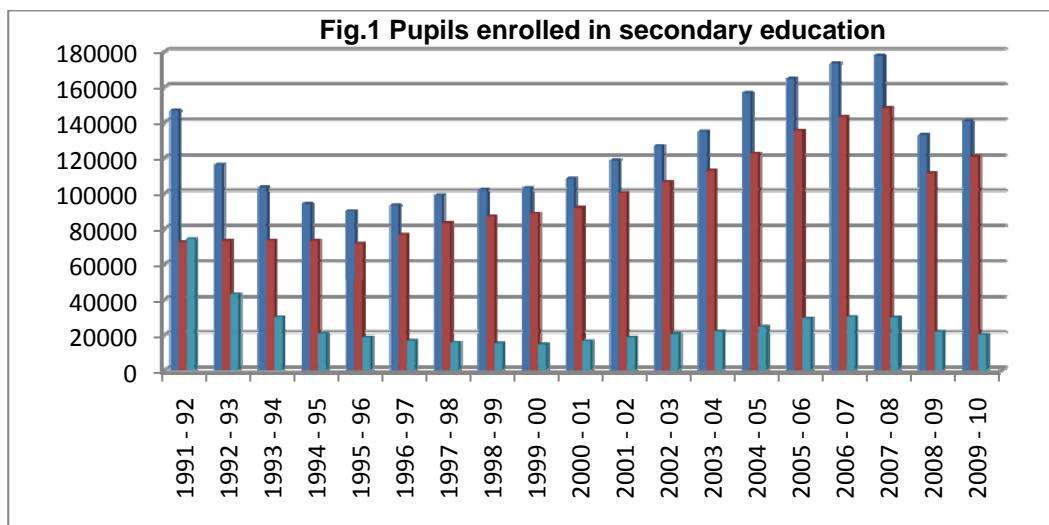
everyday life. The new developments have also created a remarked need for some new professions, which are performed by unqualified individuals by now. Meanwhile, there is an increase in massivity in higher education, not accompanied by the creation of specialists in these professions on demand; many of which can be created by the high school education.

According to OECD evaluation [6] Albania's young people, like those in other transitioning countries, need to prepare for a world where they will have to make intelligent choices, solve un-anticipated problems, and take responsibility for finding their own paths in a rapidly changing economy. None of these skills was highly prized under the old system—centrally planned economies emphasized the learning of carefully selected facts, because they left little room for uncertainty, and they did not encourage independent thought. By contrast, life in a market economy means that most young people will change jobs and occupations several times during their working lives, and to do this they need independent thinking and learning skills[7]. Pupils are probably still over-tested but under-assessed in terms of flexible skills.

The Government of Albania has now understood that there is an imperative need to strengthen the High Education that educates professionals. Vocational Education follows right after the 9-year basic education track and has as its main goal to enable students to develop vocational skills and practical knowledge. This type of education yields craftsmen with the necessary skills for a specific job, but also allows pupils to carry on with higher education.

During the academic year 2009-2010, a new Vocational Education structure (41 vocational schools in total) is introduced. It consists of three levels (2, 3 and 4 years of education). This structure is in conformity to the International Standard Classification of Education (ISCED), with the Albanian Qualification Framework (AQF) and with the European Qualification Framework (EQF). Commencing with the 2009-2010 academic year, vocational schools apply the new Frame Curricula for Level I (covering 22 educational profiles), which is developed by the National Agency of Vocational Education and Training (NAVET). The level II of VET will comprise two or additional profiles, in order to keep up with labor market needs.

But in spite of the measures taken, there is still not the expected massivity in this kind of education, and potential high quality students prefer the general education, instead (Figure 1).



Source: Developed by the authors over the data from the Ministry of Education.

As we see in the red column, the General Education has its high and low developments in these 20 years of decentralized economy, but the Vocational Education enrolment (the turquoise column) are always comparatively low.

Although there are reports of economic growth, there is not enough growth in the formal side of the labor market that may allow the employment of high school professionals. Those who choose this kind of education have no clear chances of employment, and the majority of them reorient their career on further university education. The only possible way for them to make use of the profession taken by the higher education, and for the country to move out of this crossroad, is to engage in private/individual enterprising. In these grounds, many questions arise: How much is the high education, especially the professional direction helping to develop the entrepreneurial capabilities of the students? How many individuals graduated the professional education have opened their own activities? What is the actual entering cost in the actual market for a certain profession? Is there any state policy in favor of this entrepreneurship?

The individual motives and attitudes of the students themselves are the other very interesting side of the token. Are they conscious that many of them will have to cope with the challenge of creating their own employment? How much do they feel supported from the actual study programs to cope with this immediate future challenge? Is there applied any selection policy by the professional schools, based on the knowledge that the entrepreneur has some special personality characteristics? Some of these questions were in the base of

our inquiry and what we discovered is broadly explained in the following parts of this paper.

## **2. Literature review**

For the purpose of this study, a literature review was considered, with the main concern on: The role of formal education in developing the entrepreneurs' characteristics; the characteristics of the entrepreneur, and the role of entrepreneurial education in a country's development.

Empirical data shows that the development of enterprise within a country can create wealth for the country by lowering unemployment levels, reducing the dependence on welfare and generate tax revenue for the country [7]. Governments can take direct policies to promote entrepreneurship within their country ranging from financial initiatives to educational training [8]. Carter and Wilton [7] discuss the importance of entrepreneurial education in government policy citing the example that "just making finance available without the training on its proper management is inadequate". It can therefore be seen that there is a growing desire not only for entrepreneurship within a region but also entrepreneurial education.

Entrepreneurial education is continually increasing in developed countries with the level of courses provided at higher educational institutes greater than ever [9]. According to Chell and Allman [10], "over the last two decades there has been an increase in the number of courses and programs aimed at entrepreneurship and enterprise." There has also been an increase of entrepreneurial education in developing nations with focus on using entrepreneurship as a method of economic development in these regions [11]. As Falkäng, Kyro and Ulijn [12], "The past twenty years have witnessed an enormous growth in the number of entrepreneurship courses at different educational levels□ There are many forms of entrepreneurial education ranging from pre-university entrepreneurial education at both a primary and secondary level and also both publically funded and privately funded entrepreneurial programs at both a local and national level [13].

There is an on-going debate as to whether an entrepreneur is born or can be created through entrepreneurial education [14]. Vivarelli and Santarelli [15] state that the entrepreneurial personality can be described as follows: "innovative, flexible, dynamic, risk-taking, creative and growth-oriented". Drucker [16] on the other hand argues that the viewpoint that one is either born with or without an entrepreneurial personality is false. Instead he concludes that all successful entrepreneurs had made a "commitment to the systematic practice of innovation" [16]. The belief that the entrepreneur can be

created is furthered with the idea that this systemic approach can be fostered through entrepreneurial education.

Policy makers in Europe have identified education as an instrumental factor in developing entrepreneurship. The European Commission in 2006 published the "Oslo Agenda for Entrepreneurship Education in Europe" to ensure that EU members were focused towards increasing entrepreneurial education. According to the European Commission [17], "Entrepreneurial programs and modules offer students the tools to think creatively, be an effective problem solver, analyze a business idea objectively, and communicate, network, lead, and evaluate any given project." By encouraging entrepreneurship in this manner, there is an underlying assumption that policy makers believe that entrepreneurial skills can be taught.

Government backed entrepreneurial programs are also increasing, which demonstrates that there is a belief at an administrative level that this type of education has positive social and economic results. As Edelman, Manolova and Brush [18] discuss, entrepreneurship is a "major public policy concern because of [its] impact on economic growth, particularly job creation." The society and the business world require and demands entrepreneurial competencies, which place more stress on the individual's attitudes and skills than before [19] and that it is of interest to study how entrepreneurial education affects the attitudes and motivations of those undertaking this types of programs. It is now widely recognized in education that it is important to promote entrepreneurial attitudes and behavior. Moreover that Europe must stimulate the entrepreneurial mindset and encourage innovative business and new start-ups [20]. Attitude and motivation have an important role as they have been reported as the most critical factors for success in learning [21]. There is also widespread perception that motivation is the most important factor in educational success in general [21].

Entrepreneurial development is a key focus on any government's agenda due to the fact that it has been shown to provide solutions for a country's social and economic problems.

### **3. The role of the Albanian vocational education in creating the entrepreneur**

Education is a long-term investment widely considered as an important basis of growth and competitiveness [22]. This recognition is generating new policy interest in the potential of entrepreneurial learning for improving productivity, innovation and economic growth. There are two broad considerations about the effect of the entrepreneurial education: it contributes

to the competitiveness (the efficiency model), and it contributes to socio-economic inclusion (the equity model). Theoretical and empirical support is strong for both models [23] and is included in the EU Lisbon Strategy for Growth and Jobs. Being an economy in transition, and inspiring European inclusion, Albanian economy needs to create a sustained basis of growth. Self-employment sustained by the entrepreneurial learning is an important way for economic efficiency as well as an alternative way to joblessness [24].

### *3.1 The Curricula*

As education is considered important in shaping the entrepreneurial mind, the notion of entrepreneurship is a competence that needs to be included in education. Professional high education was in focus of this study. Authors of this study are conscious about the conceptual problem created by concentration only on the high education, while conscious that the society's efforts in education of the new generation are very complex, not only through school.

Focused on the role of the Albanian professional education in creating the entrepreneur, the authors of this study analyzed the curricula and study programs of the professional education. It comes out that entrepreneurship is introduced as a key competence within mainstream curriculum. This is made possible by innovative teaching and learning arrangements that are part of the reform in education.

Authors of the study analyzed the curricula trying to understand how individual traits and behaviors, such as creativity, opportunity identification, risk assessment and risk taking, and resource management which make up the entrepreneurial character are included. It comes out that there are no specific subjects addressing these characteristics in the curriculum of the professional schools, although in The National Strategy of Education [25] there are some provisions focussed on teaching and learning arrangements for entrepreneurial learning (although the term "entrepreneurial learning" can be found nowhere in this Strategy). Although the professional education is now constructed in layers (as mentioned above), there are no specifications in the Strategy about these different levels of education. Curriculum adjustments and teacher training is mentioned in the national Strategy together with compulsory or elected subjects, out-of-the school activities, and cooperation between schools and enterprises, without specifications on levels of the professional education. There can not be found indicators on the built up intelligence on entrepreneurial learning, and nowhere is mentioned how the developed information on this will be reported and broadcasted.

Parallel to that, *half structured interviews with 10 school directors and curricula authors were conducted*, focused on the intended possibility of the

study programs on educating entrepreneurs. The first thing to be discovered was that the discussion could be conducted only for the vocational schools on economy. The other professional schools like those in arts, electronics, etc had no orientation on entrepreneurial education as there are no subjects to address opportunity identification, risk assessment, risk taking, resource management, marketing, or business plan included in their curricula [26].

### *3.2 Pupils' selection*

Based on the knowledge that the entrepreneur has some special personality characteristics, the authors of this study interviewed the professional school directors about the selection policy applied by the professional schools. The selection criteria more frequently mentioned by the professional school directors were: the *overall grade* of the previous level of education, the grade taken in *Mathematics* subject in previous levels of education and the grade in *Albanian language* subject.

### *3.3 Professional practice*

80% of professional school directors interviewed answer positively-to moderate to the question: Do you believe that professional practice really helps pupils to have a sense of reality?

But in a scale from 1(not at all) to 5(completely), only 2 of 7 professional school directors choose nr 5 to answer the question: How much do you think your school makes pupils ready to have a private activity of their own after graduation? Five of them give answers ranging from level 3 to 5, giving a total of 70% moderately positive to positive answer to this question.

### *3.4 Pupils perceptions and motives*

With the purpose of understanding if there were individual motives for choosing this education, and the perceived possibility offered by the actual study programs, authors prepared standard questionnaires. The underlying research questions were: Are they conscious that many of them will have to cope with the challenge of creating their own employment? How much do they feel supported from the actual study programs to cope with this immediate future challenge?

Considering the conclusions taken by the curricula analysis explained above, the authors were concentrated on the professional high schools offering education on *economy*. 150 structured questionnaires were distributed in pupils of 4<sup>th</sup> and 5<sup>th</sup> grade in Professional School of Economy in Tirana. 146 of them were filled by 61 male and 85 female pupils, 34 of which were 4<sup>th</sup> year and 108 in the 5<sup>th</sup> year of education.

Pupils of the professional schools interviewed do not seem to have much aspiration on entrepreneurship after finishing the studies. Only 8.2% of those interviewed (Tot.146) choose “having my own business” as the possible answer to the question: What do you think you will do after finishing this school? 86.99% of them will follow further education.

Pupils see many factors that keep them away from a possible entrepreneurship, but surprisingly enough, 50% of them believe “lack of capital” is the main reason, followed by the “competition” (15.75%) and “lack of experience” (10.96%). This is almost the same for male and female pupils, with the difference that female pupils are afraid from “lack of experience”, while males are more concerned about the “high taxes”. The reason “lack of capital” tells a lot about the level of information these pupils have, and how helpless they feel although they have subjects that teach them how to make a business plan, etc. Authors have reasons to believe this answer is not only a question of personal perception.

Meanwhile, to the question “Explain in a scale from 1(not at all) to 5(very much)how much this education you are getting helps you have your private activity after finishing this level of schooling”, 91.4% answer from a level from 3 to 5, where 54.1% are for a level of 4 and 5.

They mention 18 subjects as a possible answer to the question “What are the subjects that teach you how to open a business of your own?” *Accounting* is the more mentioned subject by 74.66% of the pupils, followed by *Economy of enterprise* (63.7%), *General economy* (27.4%) and *Macro economy* (21.9%).

It is clear that they get a lot of knowledge in the field of economy, but authors are not enthusiastic about the real abilities of these pupils to become entrepreneurs once finished the high school.

### **As a conclusion,**

There is some intention to direct the high education on entrepreneurial learning, but this is not materialized enough in the National Strategy of Education [25] neither in the curriculum of the professional schools. As mentioned above, there can not be found indicators on the built up intelligence on entrepreneurial learning, and nowhere is mentioned how the developed information on this will be reported and broadcasted.

This research did not bring any positive finding on the practice of the selection policy applied by the professional schools. In Albania, high professional schools do not make any selection based on the supposition that the entrepreneur has some special personality characteristics. Selection has no special requirements on applicants.



There is a positive expectation on the side of the school directors. They generally believe their schools make pupils ready to have a private activity of their own after graduation.

On the other side, pupils of the professional schools interviewed do not seem to have much aspiration on entrepreneurship after finishing the studies. Only 8.2% of those interviewed (Tot.146) choose “having my own business” as the possible answer to the question: What do you think you will do after finishing this school? Lack of motivation to follow the entrepreneurial road pairs with inappropriate attitude towards ending the education at this level. 86.99% of them will follow further education.

Pupils of high professional schools feel they take appropriate education on the professional side, but do not feel empowered to begin their own business. In some profiles of education like economy for example, students learn how to prepare a business plan, how to keep the books, etc, but still they do not feel like they are going to start a business of their own. They are not very clear about the fact that in the era of *personal career management* and *self employment* they will soon be faced with the need to create their job. It is clear that they get a lot of knowledge in the field of economy, but authors are not enthusiastic (based on the results of this research) about the real abilities of these pupils to become entrepreneurs once finished the high school.

It is more difficult in other professional schools like in arts, electronics, tourism, culinary, etc. Although some basic knowledge on economy is included in the curricula of these schools, that is not enough in educating entrepreneurial abilities or further more-in creating the appropriate mindset for that. This sends authors to the belief that practical side of entrepreneurial education in professional education in Albania is missing.

### 5. A final note

Authors had planned to include even an evaluation of the actual attitudes of the individuals graduated during last five years, who have their own professional business. Semi-structured questionnaires were constructed to interview individuals fulfilling this criterion. But because some technical problems like: impossibility to identify successful entrepreneurs graduated from the professional high schools and the wide spread of the subjects, this part of research could not be performed. Thus, we are missing important information about the actual value of the professional education on entrepreneurship and self-employment. Authors are also conscious that they have been partial by concentrating only on a certain category of education (high, professional),

while knowing that there is a strong tendency to pursue the university education as the safest possible way of life in Albania.

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# THE EMPLOYER'S LIABILITY FOR THE DAMAGE CAUSED BY POLLUTING THE ENVIRONMENT, IN HIS CAPACITY OF CO-AGENT

George Măgureanu<sup>1</sup>

## Abstract

*The issues regarding environment equally concern all the people of our community, irrespective of the place where they were born or where they perform their jobs. Pollution has no boundaries and does not depend on the political regime in one country or another, on the ethnical origin of the population, the political convictions of the community members, social status or other such criteria taken into consideration, usually, when we analyze a social issue.*

*As a result, people have to abide by the national legal rules of the European Union or international legal rules regarding the environment, which have to be considered at the international level, and when these rules are broken, the body responsible for it should step in to stop the polluting factor and re-establish the broken rightful order.*

*The objective of the European Union in the field of the environment protection, constitutes establishing a liable framework for the damages caused to the environment, based on the principle „the polluter is the responsible one”, including the employer as a co-agent for the act of the agent, in order to prevent and repair the damages caused to the environment.*

**Keywords:** Polluter, employer, co-issuer, rightful order, damage, liability.

**JEL Classification:** K3; K32; Q5; Q50; Q53; Q54.

People have been concerned about the environmental protection ever since the year 242 B.C., when in India, the emperor Asoka decreed the protection of fish, animals and forest by setting up natural reservations<sup>2</sup>.

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<sup>2</sup> For more details concerning the environment and its protection, see: Daniela Marinescu, *Tratat de dreptul mediului*, 4th edition, Universul Juridic Publishing House, Bucharest, 2010, p. 9 and the next; Mircea Dușu, *Dreptul mediului*, 3rd edition, C.H.Beck Publishing House, Bucharest, 2010, p. 2 and the next, Dumitru Mazilu, *Dreptul comunitar al mediului*, Lumina Lex Publishing House, Bucharest, 2006, p. 5 and the next; Gheorghe-Iulian Ioniță, *Dreptul protecției mediului*, Universul Juridic Publishing House, Bucharest, 2010, p. 20 and the next.

Given the obligation of transposing the community legislation, of Romania as a member state in the European Union and the fact that the objective of the enactment and application of the Directive no. 2004/35/CE regarding the liability towards the environment regarding the prevention and remedy of the damage caused to the environment lies in establishing a unitary legal framework in this field, has resulted into a harmonized Romanian legislation for total application and correct implementation of this directive<sup>3</sup>.

Thus, by the Emergency Governmental Ordinance no. 68/2007,<sup>4</sup> regarding the liability towards the environment regarding the prevention and remedy of the damage caused to the environment a they set up legal framework regarding the polluter's liability towards the damage caused, as well as other measures which should be taken by any person, legal or natural person, to prevent pollution and if the pollution was caused, to repair the damage caused.

Article 2 of the Ordinance, defines the terms and phrases used in its contents:

- professional activity – any activity performed within an economic activity, business or enterprise, irrespective of its nature, private or public, profit or nonprofit;
- imminent threat of a damage – a sufficient probability of causing a damage to the environment in the near future;
- damaged right - any fundamental right provided by Constitution or by law, which is prejudiced by an administrative act;
- emission - emission in the environment, as a result of the human activities, of substances, preparations, organisms or microorganisms;
- private legitimate interest – possibility of imposing a certain conduct in achieving a future subjective and predictable right;
- public legitimate interest - possibility of imposing a certain conduct in achieving a fundamental right which is performed either collectively or, accordingly, in defending a public interest;

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<sup>3</sup> Directive no. 2004/35/CE of the European Parliament and the Council of European Union of the 21st April 2004 regarding the liability towards the environment regarding the prevention and remedy of the damage caused to the environment, was published in the Official Journal of the European Union, L 143/56 of 30.4.2004

<sup>4</sup> Emergency Ordinance no. 68/2007 regarding the liability towards the environment with reference to the prevention and remedy of the damage caused to the environment, was published in the Romania's Official Journal no. 446 of 29th June 2007.

The Ordinance was modified, including by the Emergency Ordinance no. 64/2011 regarding the geological storing of the carbon dioxide, published in the Official Journal, Part I no. 461 of 30th June 2011.

- preventive measures- any measures taken as a response to an event, an act or a default, which caused an imminent threat of damage to the environment, in order to prevent or diminish the damage;

- reparatory measures – any act or set of acts, including measures of minimizing the damage or interim measures meant to reproduce, to re-establish or replace the natural resources and/or the services damaged or to provide an equivalent alternative for these resources or services;

- operator – any legal or natural person of public or private right who performs or is in responsible for the control of a professional activity or, in case the national legislation provides it, who was vested with decisive economic power on the technical function of such an activity, including the holder of a regulation document for such an activity or the person who registers or notifies such an activity;

- damage – a measurable negative change of a natural resource or a measurable harm to a service related to the natural resources, which may directly or indirectly occur;

- initial state – the state of the natural resources and of services at the time of the damage caused, which would have been registered if the harm to the environment had never been caused, estimated on the basis of the available information.

According to the provisions of the art. 6 alignment (1) of the Emergency Governmental Ordinance no. 195/2005, environmental protection constitutes the obligation and responsibility of the central and local public administration authorities, as well as of all other natural and legal persons, an important role is assumed by the employers, so that by the measures taken they should prevent some acts, be it personally or by their employees, which may cause damage to the environment, irrespective of the its nature.

By the recent measures, the state acknowledge the right of each person to a healthy and balanced ecological environment, guaranteeing to this purpose by the same ordinance, in art. 5:

- the access to the information regarding the environment, observing the confidentiality terms of provided by the legislation in force;

- the right to association in organizations for environmental protection;

- the right to be addressed in the process of decision-taking regarding the development of the environmental policy and legislation, issuing regulation documentation in this field, developing plans and programs;

- the right to appeal, directly or by environmental organization, to the administrative or/and judicial authorities, accordingly, in issues regarding the environment, whether the damage was caused or nor;

- the right to compensation for the damage caused.

The competent authority for establishing and taking preventive and compensatory measures, as well as the evaluation of the significant nature of the damage to the environment is the County Environmental Agency.

Any natural or legal person who is damaged or may be damaged by a harm caused to the environment or who considers himself/herself damaged in his/her right or in a legitimate interest is entitled to:

a) to send to the county officer of the National Environmental Guard any information regarding the cause of a environmental damage or any imminent threat of such a damage;

b) to request the county environmental agency, in writing or by electronic means of communication, to take the measures provided by the emergency ordinance.

The person may also address the county office of the National Environmental Guard and, respectively, the county environmental agency, any non-governmental organization which promotes environmental protection, fulfilling the terms required by the legislation in force, considering that the person is damaged in his/her right or in his/her legitimate interest.

The above-provided application has to be supported by the relevant information and data which underlie the observations sent regarding the respective damage caused to the environment.

In case the application and the information supporting it plausibly show that there is a damage caused to the environment, the county environmental agency analyses it and requires in writing to the respective agent his opinion on application and the information enclosed to it, within a period of 5 days since the application being registered.

The agent has 5 days' delay since the application being registered from the county environmental agency to send it its opinion on the matter.

Within 5 days since the transmission of the application to the agent, the county environmental agency inform the persons who have sent their comments on the decision to act or to refuse to act.

The decision provided will be motivated in fact and in law and it will contain information on the terms and procedures provided by Law no. 554/2004 regarding the administrative contentious<sup>5</sup>.

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<sup>5</sup> Law no. 554/2004 Law of the administrative contentious, in the Official Journal, Partea I no. 1154 of 07th December 2004. It was modified, including by the Law no. 202/2010 regarding some measures for accelerating the resolution of litigations, published in the Official Journal, Part I no. 714 of 26th October 2010.

In case of an imminent threat of a damage, the county environmental agency inform the persons who have sent their observations, only after taking the necessary measures according to the above-mentioned emergency ordinance.

The persons may address the court of the competent administrative contentious (tribunals in case of the documents issued by the local bodies of the state administration or appeal courts in case of the documents issued by the central bodies of the state administration), in order to attack from the procedural point of view, the documents, the decisions and the defaults of the competent authorities provided by the Emergency Ordinance no. 68/2007.

Resolution of the application forwarded to the court is performed according to the provisions of Law no. 554/2004.<sup>6</sup>

In the matter of environmental law, liability is engaged when by the act which breaks the law, the person caused an effective pollution to it, the key element of the special liability in the environmental law is its pollution.

According the art. 2 point 51 of the Emergency Ordinance no. 195/2005,<sup>7</sup> modified, pollution represents direct or indirect introduction of a polluter (any substance, preparation in solid, liquid or gaseous form, or in vaporous form, or of energy, electromagnetic, ionic, thermic, phonic radiation or vibrations which, introduced in the environment, modifies the balance of its constituents and of the living organisms and brings about damage to material goods, which can endanger human health and/or the environmental quality, cause damage or stop from using the environment in a leisurely manner or for legitimate purposes.

The damage represents the costly quantifiable effect of damage on the health of people, goods or the environment, caused by polluters, harmful activities or disasters (art. 2 point 52).

As far as the employers' liability for the damage caused to the environment by their own facts or those of the employees, there have been opinions according to which the liability for the environment is subjective, being engaged by the rightful subjects to whom they imposed legal obligations which they break by an act or a default, causing damage.

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<sup>6</sup> For more details regarding the procedure before addressing the courts of the administrative contentious and the procedure during the resolution of these litigations, also see Florea Măgureanu, *Drept procesual civil*, 12th edition, Universul Juridic Publishing House, Bucharest, 2010, p. 278 and the next.

<sup>7</sup> Emergency Ordinance no. 195/2005 regarding the environmental protection, was published in the Official Journal, Part I no. 1196 of 30th December 2005, modified, including by the Emergency Ordinance no. 164/2008, published in the Official Journal, Part I no. 808 of 03rd December 2008.



According to the provisions of art. 95 align. (1) of the Ordinance, liability for the damage caused to the environment is objective, irrespective of the guilt, and in case of plurality of the authors, liability is common.

Exceptionally, liability may be also subjective for damage caused to the species and natural habitats, according to the specific regulations (art. 95 align. 2).

What is specific is the capacity of victim of the pollution, namely the environment.

Specific provisions regarding liability for damage caused to the environment, of the Emergency Ordinance no. 195/2005 and the Emergency Ordinance no. 68/2007, are completed by the provisions of common right, namely those of the art. 998 – 1003 Civil Code<sup>8</sup>.

According to the provisions of the art. 998 Civil Code, the core of liability for torts „Any human act which may cause damage to another a human being binds the one whose fault it is or who performs the tort for the second time.”

According to the legal provisions mentioned, art. 1000 Civil Code sets forth “We are equally responsible for the damage caused by the fact of the persons for which we are responsible or for the things which we protect .... The masters and the co-agents (the employers), for the damage caused for their servants and agents (employees) in the positions fulfilled“.

In legal literature they stated that liability for torts is the liability which arises as a result of causing damage by doing wrongs which broke the objective right and the subjective rights of the damaged person<sup>9</sup>.

For engaging liability for torts, in case of damage caused to the environment by torts, general conditions of the liability for torts should be fulfilled, namely:

- a) a wrong was committed;
- b) a damage was caused;
- c) there is a relationship of causality between the wrong and the damage;
- d) the wrong-doer was guilty;

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<sup>8</sup> Romania’s Civil Code was published in the Brochure no. 0 of 26th July 1993. Also see the new Civil Code, published in the Official Journal, Part I no. 511 of 24th July 2009, modified and completed by Law no. 71/2011, published in the Official Journal, Part I no. 409 of 10th June 2011.

<sup>9</sup> For other definitions and details, see: Constantin Stătescu, Corneliu Bârsan, *Drept civil. Teoria general a obligațiilor*, ALL Publishing House, Bucharest, 1993, p. 114; Gheorghe-Iulian Ioniță, the quoted work, p. 406 and the next; George Măgureanu, *Drept curs pentru Facultatea de Economia Turismului Intern și Internațional*, Universul Juridic Publishing House, Bucharest, 2009, p. 307 and the next.

e) the wrong-doer had the capacity of liability for torts at the time the tort was committed, that is to say the person who caused a damage by its tort, to be mentally healthy, to be conscientious of the legal consequences of its harmful wrongs.

Although a person is liable for its own tort, in cases provided by law natural and legal persons, are also liable for the torts committed by the persons under their protection (art. 1000 Civil Code). The basis for the liability is the presumption of guilt which consists in default of protection.

*By these forms of liability for harmful torts of the employers for the acts committed by their employees, their agents, the basis for such a liability lies, on the one hand, on the fact that the authors of the damage possess, generally, no fortune and, as a result, they are incapable of paying the damages to the victim, and on the other hand, on the fact that the employers are considered guilty for not having carefully supervised their employees.*

The liability of employers is total, that is they cannot exonerate the presumption of guilt, pleading that, although they took all the necessary measures, they could not stop the wrong committed, while the other persons responsible for the wrongs committed by the others can exonerate this liability bringing proofs to it, which means that their presumption of guilt is relative. The employers have a regress action against the employee, retrieving in this way the amount paid by the employer for the damage caused by the employee.

However, in the matter of liability for torts to the environment, they tend to harden the position of one's own special liability, the ecologic liability. Emergency Ordinance no. 195/2005, modified, attributed to the objectivity, irrespective of the guilt for the damage caused by the environmental pollution, with the common responsibility in case of plurality of authors.

In the matter of the law on the environment the sanctions applied depend on the seriousness of the tort, as it follows: they represent torts and are fined with an amount ranging between 3.000 lei and 6.000 lei, for natural persons, and between 25.000 lei and 50.000 lei, for legal persons, breaking some legal provisions such as: the obligations of legal persons to achieve self-monitoring systems and to report to the public local authority for environmental protection the results of the self-monitoring and/or other data required, as well as the accidents and incidents which may cause potential accidents; the obligations of the legal persons to track a strict account of the substances and dangerous preparations and to provide the information and the data required by the competent authority for environmental protection; the obligation of the local public authorities not to change the destination of the lands as green spaces and provided as such in the urbanism documentations and/or, not to

diminish their surfaces or the obligation not to alienate them; the obligation of the land-owners with or without an ownership title, to maintain the forest curtains and the protection alignments, the green spaces, parks and green fences for improving the capacity of regeneration of the air, phonic and wind protection; the obligation of the land-owners with or without an ownership title, to prevent, on the basis of the regulations in the field, from ruining the quality of the geologic environment so on (art. 96 align. 1 of the Ordinance).

Also, according to the provisions of the art. 96 align (2) of the Ordinance, torts are considered and are fined with an amount ranging between 5.000 lei and 10.000 lei, for natural persons, and between 30.000 lei and 60.000 lei, for legal persons, breaking provisions such as: the obligation of natural and legal persons to apply for and obtain the regulation documents according to the legal provisions as well as the agreement on the importation/exportation and of the warrants regarding genetically modified organisms, according to the legal provisions, within the time limits established by the authority; the obligations of the authorities of the local public administration regarding the improvement of the urban microclimate, by arranging and preserving the springs and the lakes within localities and the areas surrounding them, to develop and protect the landscape, to keep the localities clean; the obligations of the natural and legal persons to provide and use correct information for performing the environmental assessments, the evaluations of the impact on the environment, of the balances on the environment and the reports on the placement; the obligations of the natural and legal persons to provide measure and special arrangements for the phonic isolation and protection of the sources generating noise and vibrations, to check their efficiency and to turn into account only the ones which do not exceed the agreed phonic level; the obligations of the natural and legal persons to provide, maneuver, transport and commercialize chemical fertilizers and products for plant protection packaged with identifiable inscriptions, weather forecast, security prescriptions and usage, so as they should not cause contamination to the means of transport and to the environment; the obligations of the natural and legal persons not to exercise acts which could destroy the natural habitats, the wild flora and the fauna all over the country; the obligations of the legal persons to apply measures for the dilution of chemical refuse resulted from the activities which imply genetically-modified organisms etc.

Numerous other acts, such as: the obligation of the natural persons to perform according to the provisions of the warrant for the environment protection and of legal persons to perform according to the provisions of the integrated warrant for the environment for the activities which constitute the

objective of the regulation procedures from the point of view of the environment protection; the holder's obligation to notify the competent authority for the environment protection when new elements arise, unknown elements at the time of the issuance of the regulation documents regarding any modification of the terms underlying their issuance, before the modification occurred; the obligations of the natural and legal persons to diminish, modify or cease the activities generating pollution at the express request of the authorities for environmental protection; the obligations of the natural and legal persons to pay the cost for damage remedy and to eliminate the consequences caused by it, re-establishing the conditions prior to the damage, according to the principle "the polluter is the one who pays" etc. constitute torts and are fined in the amount ranging from 50.000 lei to 100.000 lei, for legal persons (art. 96 align. 3 of the Ordinance).

According to the provisions of the art. 97 align. (1) of the Emergency Governmental Ordinance no. 195/2005, the statement of the torts and the application of the sanctions are fulfilled by:

- a) commissars and the persons empowered in the National Environmental Guard and the Administration of the Biosphere Reservation «Delta Dunării»;
- b) the authorities of the local public administration and the personnel empowered by them;
- c) the National Commission for the Control of Nuclear Activities, the Ministry of National Defense and Internal Affairs by the personnel empowered, in their field activities, according to the attributions established by law.

The personnel of the administration departments and the guards of the natural environmentally protected areas are also entitled to sanction torts, only on the environmentally protected area administered.

The wrongs which caused damage to the environment and which represent a higher degree of danger and which are liable to endanger human, animal and vegetal life and health, such as: the burning of clearings, the thatch, bushes and herbal vegetation of the areas protected and the lands prone to ecological regeneration or accidental pollution due to the unsupervised performance of the new constructions, the functioning of the plumbing, the technological equipment and treatment and neutralization, mentioned in the provisions of the agreement on the environment and/or integrated environmental warrant, represent torts and are punishable by from 3 months' to a year's imprisonment or a penal fine ranging from 30.000 lei to 60.000 lei (art. 98 align. 1 of the Ordinance).

Other wrongs with serious consequences, which if they were not likely to endanger human, animal or vegetal life and health, such as: pollution by express exhaustion in the water, in the air or on the soil of refuse or dangerous substances; non-observance of the restrictions and interdictions established by water and air protection, provided by the legal documents in force; the continuance of the activity after the recalling of the agreement on the environment and the integrated environmental warrant; importation and exportation of some dangerous substances and preparations interdicted or restricted, thus breaking the legal provisions in force etc., represent torts punishable by 6 months' to 3 years' imprisonment or fined with a penal fine ranging from 50.000 lei to 100.000 lei;

Even more serious sanctions, respectively 1 year to 5 years' imprisonment, were provided by the Ordinance, for some torts, such as: non-fulfillment of the interdictions regarding the use of products of plant protection on the agricultural lands or chemical fertilizers; unloading dirty waters and the refuse on the ships and floating platforms directly into the natural waters or expressly causing pollution by the exhaustion or emerging in to the natural waters directly or from the ships or floating platforms some substances or dangerous refuse etc., if they were likely to endanger human, animal and vegetal life or health.

Torts punishable by 2 to 7 years' imprisonment are considered wrongs committed such as: the continuance of the activity after the decree of ceasing this activity; not taking the necessary measures for totally eliminating dangerous substances or preparations which were converted into refuse; the decline of intervention in case of accidental pollution of waters and coastal areas etc.

In the event some of the torts provided by the law endangered the health and corporal integrity of a large number of people, or they had serious consequences or caused an important material damage, they are punishable by 3 to 10 years' imprisonment and the interdiction of some rights, and in the event of causing the death of one or more persons or important damage to the national economy, the punishment is 7 to 20 years' imprisonment and the interdiction of some rights.

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# ON SOME ECONOMIC ASPECTS OF THE EUROPEAN COMPETITION POLICY RHETORIC

Andreas Stamate<sup>1</sup>

## Abstract

*Economic aspects are things to look for in any competition policy. The present paper focuses on the European competition policy and its two important general frameworks: Articles 101 and 102 of the Treaty for Establishing the European Community. The two articles prohibit various entrepreneurial actions on a market which can affect the consumer welfare and also, the competition between entrepreneurs. The paper attempts to find economic justifications of the European Commission's interventions on the market, which is the authority responsible for enforcing the two articles, and also to deliver an alternative theory of the market in the tradition of the Austrian school of economics. The reason for this purpose is that the economic justifications would be the only to legitimate the competition laws.*

**Keywords:** competition policy, prohibiting agreements, free competition, utility, efficiency, welfare

**JEL Classification:** B53, D40, P14

While regulations such as antitrust laws have admittedly been judged legal, is such legislation proper in a free society? From a strict natural rights perspective, such regulations and legislation would not be proper. This theory holds that individuals have inalienable rights to life, liberty and property. These rights imply the liberty of any person or persons to enter into any non-coercive trading agreement on any terms mutually acceptable, to produce and trade any factor or good that they own, and to keep any property realized by such free exchange. This perspective would hold that it is right to own and use property; it is right to employ that property in any manner that does not infringe on anyone else's property rights; it is right to trade any or all of that property to anyone else on any terms mutually acceptable; and that it is right to keep and enjoy the fruits of that effort. These activities are right because they can logically be derived from man's natural right to life and life-sustaining action. Consequently, it would be wrong to initiate force against someone else's private

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property; wrong to forcibly interfere with someone else's voluntary property transaction; and wrong to outlaw and regulate certain types of business contracts, organizational structures, or business cooperation. These activities would be wrong since they would infringe upon the natural rights of individuals to do with their own property what they see fit. (Armentano, 1999, pp. 8)

### **Introduction**

It is the role of an economist to describe the functioning of a free market. The entrepreneurial activity is the basic component of a market, because it is the place of birth for every product. But this entrepreneurial activity is based on various needs which the market has and which are represented by the second component, the consumer. EU legislation in economic competition field (primarily articles 101 and 102 of the Treaty for Establishing the European Community<sup>2</sup>) deals with entrepreneurs and consumers. It supposes that the market or the competition and the consumers should be protected against the providential *forces* that entrepreneurs could have and exert. And for this task it uses economic principles and concepts. This research<sup>3</sup> is based on the idea that EU legislation in the field of economic competition doesn't have a coherent and realist theory of the market in general and of the entrepreneurs and consumers in particular. From this perspective, the paper attempts to deliver a theory of the free market based on private property rights and non-aggression, a mark of the Austrian school of economics.

### **The EU great two “pillars” against economic criminality: Articles 101 and 102**

For the beginning we will make a review of article 101 (ex-article 81). This states that are incompatible with the internal market:

all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market (TEEC, Title VI, Chapter 1)

The analysis should start with the position of an agreement in the general problem of competition. It is prohibited any agreement or association which may affect competition. The entrepreneur or the economic agent is described in the European competition law as one who supplies products and services

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<sup>2</sup> Available at <http://eur-lex.europa.eu/en/treaties/dat/12002E/htm/12002E.html>

<sup>3</sup> The present paper is part of a wider PhD research of the author in competition theory



according to the needs of the consumers on the single European market. (EC website, Antitrust Overview) Similarly, the competition is defined as:

A basic mechanism of the market economy and encourages companies to provide consumers products that consumers want. It encourages innovation, and pushes down prices. (DG Competition, Antitrust Overview)

and,

In order to be effective, competition needs suppliers who are independent of each other, each subject to the competitive pressure exerted by the others. (DG Competition, Antitrust Overview)

Thus, in the European view, competition can be affected if agreements and associations between entrepreneurs, by their decisions, would discourage and not encourage innovation, would increase and not decrease prices, and the suppliers would be dependent and not independent from one another.

It is very important to mention that on a market, either it is a hampered market (regulated by governmental interventions) or a free one (there are no governmental interventions except those in order to protect the property rights of the individuals), competition can always *be affected*. (Rothbard, 2004, pp.637) In contrast with the hampered market (which can take the form of tariff or non-tariff protectionism, imposing arbitrary market quotas for companies etc.), on a free market the competition is a set of entrepreneurial actions, each action resulting from the ability of entrepreneurs to exert their property rights. To assume for example that on a free market, the competition will be affected by a hypothetical monopoly is a *non sequitur*. The meaning of competition is not the existence of an infinite number of entrepreneurs on the market (like the perfect competition model stipulates), but the existence of that number of entrepreneurs who can best satisfy the need of the consumers. (Rothbard, 2004, pp. 718) Thus, on a free market, as long as no entrepreneur, participant at the market, is involved in acts of aggression, but he only uses his property without coercively interference with others property, we can't speak about any "prevention", "restriction" or "distortion" of competition.

In the following we will critically analyze the entrepreneur's actions which are prohibited by Article 101.

(a) *Directly or indirectly fix purchase or selling prices or any other trading conditions*

At the first sight, it seems that the above specifications are totally indifferent to what economic laws prescribe. The prices of the goods on the market is given first by the personal evaluation of the producer (a subjective evaluation based on costs and comparisons with the competition) and, then by consumers evaluation. Thus the entrepreneur fixes the prices of his product, or

generally the price of his property, but the final *test* comes from the consumers. (Hülsmann, 1999) He can be in error, in the sense that the price can be too high, but the autocorrecting function of the market will surely leave him without any buyer. How can be an entrepreneur incompatible with the market when he fixes purchase or selling prices for his goods and *enforces* his preferences in a contract agreed with the buyer? If the market is free or unhampered by government regulations, then the actions prohibited are in no way illegitimate. Against to this opinion, they are basic entrepreneurial functions. The limits of their legitimacy should be described economically more clearly by the authority.

(b) *Limit or control production, markets, technical development, or investment;*

Following the same logic, it is obvious that the entrepreneur cannot be incompatible with a free market, when he uses his property in the forms of “limitation”, “controlling”, “trading”, “technical development” or “investments”. If he appropriated his property non-aggressive, then he is free to dispose of it, no matter what form would take this disposal, as long as he doesn’t aggress someone else property. He can easily limit the trade with his product, for example because of some lost stocks of goods, or mistaken calculus regarding the period of depreciation of some stocks of goods, or any other error. Also he can limit his production, as a protection strategy against some competitors who engaged in dumping.

Concerning its technical abilities, how should we evaluate a situation when an entrepreneur limits its own technical development or even to other competitors? For example, if entrepreneur A and B belong to technical automobile field, and A is much more specialized and profitable than B, should we consider B limited in the sense of coercion, because of the success of A? Again, it is very important how we define the term coercion. From the perspective of free competition theory, as long as A doesn’t aggress in any way the property of B, then the latter is absolutely free to compete and become more qualified in the automobile industry. The injury should be directly demonstrated by the authority, and not indirectly, or the problem is in identifying what the natural barriers are in the technical development of an entrepreneur. The only limit for production, trade, technical development, investments and after all profit, is the consumer with his preferences. The consumer agrees by his purchases with the natural leader on the market. (Reisman, 1990, pp. 4)

*(c) Share markets or sources of supply*

The essential form of developing and perpetuate the competition and the property of the competitors is cooperation or *in extenso* the division of labor. (Mises, 1998, pp. 159) This classical principle of economy must be applied with the same stringency not only to individuals but also to associations or firms. Thus it becomes quite clear that on a free market, sharing markets and sources of supply may mean a strategy adapted to the will of the consumers. If the entrepreneurs discover that they can better serve the consumers sharing the markets and sources of supply then it is nothing wrong with that. The position of the authority must be based on a precise evaluation of the will of consumers, although we believe that the will has been already expressed by buying and stimulating the entrepreneurs in their strategy.

*(d) Apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage*

If we consequently apply this disposition we will be trapped in an inescapable error. Inequality is not only a feature of inter-personal economic actions (like for example exchange of goods) but also of social interaction between individuals. (Mises, 1998, pp.731) For example, the fact that we adopt different ways to speak with our parents, friends and strangers should make this statement clear.

In the entrepreneurial or economic field, these unequal conditions which could be named “discrimination” should be absolutely normal actions for any rational entrepreneur. From the perspective of free competition theory, discrimination or disadvantaging other trading parties remains only a good joke in the absence of demonstrated injury. Having exclusive property rights on their own property and limiting the access on it for parties who don’t meet the conditions imposed by the owners may represent discrimination, but not an aggression. If the authorities prohibit these actions, it must demonstrate an effective aggression on property rights. After all, there is no guaranteed right such as equal treatment to everybody on the market.

For example if I appropriated a property on contractual agreement which I decide to use for opening a golf club, with the observation that people with brown hair will not be accepted, can we make a case of aggression against me? It is no doubt discrimination, but such a concept has no economic relevance. It doesn’t have a place in economic theory. It can be a moral or ethical issue, but not an economic one. (Rothbard, 2004, pp. 713) According to the system of private property (absolutely compatible with free competition theory) non-discrimination can’t be a legitimate pretention.

The word discrimination means nothing other than to choose between options in an environment of scarcity... Without discrimination, there is no economizing taking place. It is chaos. (Block, 2010, pp. vii)

And if someone would engage in finding the welfare losses for the discriminated people, we will argue that this task implies objective evaluation regarding the utility of brown heads when consuming golf games. One of the main contributions of the marginalist revolution is to have been established the subjective theory of value and the subjective nature of utility, which is nothing else but a value. (Mises, 2002, pp. xiii) According to this theory, utility is a purely subjective ordinal concept which can't be measured or aggregated.

*(e) Make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.*

If *ex post* (which means after the contract was signed and honored), one of the parties condemns a pretention of the other party, although it was a contractual pretention, the condemnation becomes irrelevant because the contract should be sacrosanct. After the contract was signed (fact which implies a pre-agreement of both parties) any condemnation is irrelevant and puts the claimant in a self contradictory position, because his telling is against the acting (the contract).

If *ex ante* the contract is tied by some supplementary obligations it's probable that these obligations will be part of the contract. If not, it can be viewed as a simple proposal. On a free market there should exist the possibility to accept or refuse a proposal. But the authority cannot decide, and no one except the entrepreneur can decide, if those supplementary obligations have or have no connection with the subject of the contracts.

In conclusion, to tie the conclusion of contracts of the acceptance by the other parties of supplementary obligations, and moreover to refuse to deal with parties who don't (voluntary) comply with this, is a perfect rational attitude in the entrepreneurial field full of risks and uncertainty.

At point 3, the legislator offers the key for understanding the statements of disposition (1). It decrees that all these statements "may be declared inapplicable in case of":

- *any agreement or category of agreements between undertakings,*
- *any decision or category of decisions by associations of undertakings,*
- *any concerted practice or category of concerted practices,*

*which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:*

- (a) *impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;*
- (b) *Afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.*

Thus entrepreneurs can be absolved or not even blamed for their actions. We understand that by this, the legislator makes its own provisions. Practically it describes the legal framework, the *space of the game* for the entrepreneurs, letting to the courts and national authorities from European Union to set the clear limits of them. Here we insist on the need of economic reasons when regulating the market. We believe that with the creating of more and more legal limits for the entrepreneurs and the avoidance of economic explanations, the market, either the free market or the single European market could be transformed in a place where non-aggressive actions will be imprisoned, following the model of USA. (Anderson, 2006)

Regarding article 102 (ex-article 82) we find the following disposition:

Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. (TEEC, Article 102)

After this disposition, the legislator gives some examples of abusive practices, which are four and similar with points a, b, c, d, and e of article 101 of TEEC.

Article 102 doesn't raise different questions than those already discussed in Article 101. It repeats the incompatible actions with the single European market, but without any economic explanations concerning neither the actions nor the single market. Therefore, we need economic arguments for justifying or incriminating entrepreneur's actions on the market. And this necessity is doubled by the Chief Economist Bureau from DG, which has exactly this role: to explain the economics behind the policies. (Muşetescu, 2006)

### **European Advisory Group for Competition Policy (EAGCP) or how to understand correctly Article 102**

In 2005 a group of professors belonging to different universities formed what is called the European Group for Competition Policy. They elaborated an over 50 pages report, named *An economic approach to article 82* (Article 102). According to EAGCP the report has the role to explain by using economic arguments, all the European Commission (EC) actions made in the spirit of Article 102. As can be seen from the report, the EAGCP proposes an analysis

toward effects of the competition problem, more exactly the anticompetitive effects generated by various entrepreneurial practices. The same report takes into consideration the efficiency of the competition policy, because as they say, the efficiency should be reflected in consumer's welfare. In other words, according to EAGCP, Article 102 is describing a medium for creating an efficient policy, because after all:

It is not a question of having more or less intervention, but of more effective intervention. The goal is to focus on the important competitive harms, while preserving and encouraging efficiency (EAGCP, 2005, pp.4)

If we are to judge this statement using free competition theory, then more efficient intervention is also an intervention. And if efficiency means a more strictly control of the market, then this means that we deal with a *de facto* improvement of intervention in the field of economic competition.

The EAGCP report is oriented toward two essential areas of competition policy: the consumers or consumer welfare, and the necessity of a non-authoritarian approach. On one hand, it is communicated the importance of the consumer welfare (by monitoring the present entrepreneurial practices on the market and comparing them with those from the past) and on the other hand, the necessity that this monitoring or control to be non-authoritarian. But for the accomplishment of these objectives it must first be defined the possible injury that an entrepreneur can make. We must have a theory of injury but also a theory of allocating resources on the market. (Armentano, 1999, pp. 14) The authority must base its decisions on certain economic aspects concerning the entrepreneurial practices on the market, before it can sanction entrepreneurs. A very vague explanation is given by the report:

If a particular type of conduct permits a company to succeed and to displace its competitors in the market, by what standard should the competition authority assess whether the conduct in question is detrimental to competition or whether the conduct in question is legitimate and its prohibition by the authority would be detrimental to competition? Ultimately, the assessment of competitive harm must be based on an assessment of how competition in the particular market works and what the practice in question means for market participants. (EAGCP, 2005, pp. 8)

But there are no economic laws to find only looking at the history or just comparing different markets. Theory precedes history, and it is with theory that we judge history. Before make judgments about competition or entrepreneurs acting on a market we must have a theory of how to look at these specific problems. It is like investigating a criminal for murder, but knowing the universal fact that murder is a bad thing. These statements may

seem as tautologies for some critiques but it certainly cannot hide the fundamental problem of the present legislation in the field of competition: the absence of a coherent theory of justice in allocating resources for satisfying consumer needs.

### **Authority versus the market**

The fundamental question is if authority should intervene in any way on the market. If X drives out the competition by simply using his own factors of production and intellectual property, can we impute anything to him? Can be the injury demonstrated? Is there another way for entrepreneurs to compete, other than disposing freely of their property? Market participants can eliminate each other without injuring somehow the market, or the competition. Using the neoclassical concept of equilibrium we could argue that every acquisition or fusion is a new step towards a new equilibrium, the equilibrium of that specific moment or context.

*Inter alia* we can also raise the question of an existing authority with powers in regulating competition. Why it is seemed as essential the existence of such an authority? Although the critiques or those who favor EC intervention on grounds of consumer welfare will disagree, we have to mention that in a free market the only *authority* free to decide if the entrepreneurs have good skills in satisfying the demand, is the consumer. If the consumer is not satisfied, he can substitute or boycott his suppliers, thus causing them losses. Only consumers and no one else can impose a *sanction* to the entrepreneur who is unfortunately using his capital and property not according to their most urgent needs. In a sort of way, we could say that this is the most profitable sanction because it can bring more entrepreneurial efficiency thus creating a competitive market. Entrepreneurs are *forced* to use their resources rational, and this condition is available also for the so called imperfections of the market (e.g. monopoly, oligopoly, and cartel). Even if we suppose that an *imperfect* competitor could develop (although there are no empirical and much less theoretical proofs to maintain this) it is a non-economic statement to say it can be absolved by the constraints naturally imposed by the consumers and the market. The rational allocation of the factors of production is a condition for being competitive, and sometimes to subsist on a market, even for an *imperfect* competitor. If we suppose that he can abuse by his position, we have to also suppose that is indifferent to the problem of rarity. Could this type of entrepreneurial conduct be a competitive and a long-living one?

In conclusion, problems like bad allocation of resources or consumer welfare is not the task of an authority, which by its definition cannot know the

preferences of the entrepreneurs in the allocation problem or those of consumers. Even if we accept the existence of competition authority, a more fundamental problem remains unsolved: what are the criteria used to identify and sanction a specific anticompetitive practice on the market? The efficiency criterion cannot be a universal one. Also, the utilitarian approach which suggests that it can step over the methodological impossibility to aggregate the utility (e.g. social utility or social welfare) has failed to offer an economic explanation.

### **Conclusions**

The state cannot be interested in the consumer welfare problem. This is a virtue of the free market. The state imposes restrictions to the free market, thus infringing on the consumer welfare. What are the fundamental implications of competition authority and its actions (enforcing competition policy) for the consumer?

In the first place, even if we find the consumer as basic element in the competition policy, it is important to mention that no one asked for that. Because the consumer is the supposed victim of the entrepreneurs, he should be able to react in a way, and we detailed his options. If the consumer doesn't react, then how can someone argue that he is affected by the entrepreneurial movements on the market? Even if he reacts, an important question arises: how do we know that his complaining calls for universal and immutable rights and duties of the entrepreneur? Thus, it is not sufficient for the competition policy just to mention the importance of the consumer, but also what are his needs, because we believe we cannot base a law on whatever needs this has. The blind intervention in the name of the consumer can have negative results. For example, in the case of Microsoft vs. EC, we could easily state that the decision of EC to impose penalties (over 1.6 billion Euros) to Microsoft and force the company to sell Windows Media Player (WMP) as a separate product from Windows, practically forced the consumers to pay more for WMP, although it could be delivered cheaper tied by the Windows. If on the other hand the intervention is supported by arguments concerning the necessity<sup>4</sup> to have more entrepreneurs on the market, the question is how many? Also, who decides the optimum number of entrepreneurs on the market?

The questions raised in this paper can be summed up to two. First is the necessity of having an economic explanation for the existence of an authority in

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<sup>4</sup> Which most often appears in cases of monopoly where it is considered that the monopolist refuses to supply at his real capacities and raises the price of the restricted output, and also that *numerous participants* at the market would guarantee a better price and *plenty* of products



the economic competition field, and the second, having agreed with its existence, revealing the economic laws and theories which motivates its intervention on the market. Neither the first problem nor the second are sufficiently discussed in the positions and actions taken up to now by the EC. We believe it is extremely important to base the public policy of competition on strong theoretical backgrounds which have realistic premises. A good proposal for the leaders who designate the public policy would be to identify the existent alternative theories of competition.

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# REQUIREMENTS FOR GETTING CLOSER TO EUROPEAN UNION AND THE POTENTIAL MEMBERSHIP

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## **Abstract**

*Considers the significant conditions set out by the Treaty of Europe particularly the so-called Copenhagen Criteria that requires Western Balkan countries including Albania to fulfil all the conditions as well as the criteria for commencement of accession negotiations in order to obtain membership of the European Union (EU). It expresses the understanding of the integration into the EU including its process. Entails the Western Balkan countries must first meet the criteria established by the Council of Europe in 1997 within the framework of Copenhagen criteria concerning Democratic, Economic and institutional reforms also implementing the Stability and Association Agreement in the Regional Cooperation. Requirements that Albania needs to ensure on negotiations on the Association Stability Agreement such as political dialogue, justice and home affairs. In addition, technical dialogue on free movement of goods, the right of establishment and free movement of workers. It considers a reflection on the progress including further steps needed by the Albanian government in relation to the Association Stability Agreement.*

**Keywords:** European Union (EU) requirement for integration, Copenhagen criteria, EU Treaty, Western Balkan, Albania, Negotiations on Association Stability Agreement, political dialogue justice and home affairs, dialogue on free movement of persons, workers, goods.

**JEL Classification:** B1; B5; P2.

European Union classifies integration, as a fulfilling of various conditions. The approach and membership is a gradual and conditional process, of the state that requires membership, must take and implement a wide range of adjustment of its legislation with that of the EU.

Over time and after a long experience in the practice of expanding the organization, the European Union has established its position on the accession of new states. Conditions to become EU candidate mainly found in the

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provisions or rates of the EU Treaty, although the version of Amsterdam in the EU Treaty stresses the importance Article 49, paragraph 1 and Article 6, paragraph 1. Of a great importance is the so-called "Copenhagen Criteria"<sup>2</sup> of 1993, which even though they were published only for the countries of Central and Southern Europe, have today received a general validity. For the Western Balkan countries the first step before entering the EU is to reach an agreement (MSA) and the establishment of bilateral relations with the European Union.

Conditions required by the EU can be divided into three categories: the political, economic and legal. Analyst will be limited to political criteria, which refers to three major areas - human rights, democracy and the legal rule. Here you will be introduced with the guidelines on institutional capacity building and rule of law. The issue of democracy will be discussed, since it belongs to efficiency, accountability and democratic legitimacy. Human rights will not be handled by the content, since the purpose of this work is to analyse the basic steps, which lead to the construction of a system which will effectively protect and promote human rights. Similarly, are to be considered legal, which are intended to transform and adapt national legislation to that of the European Union law.

At this point will be a direct link to meeting the legal requirements with the requirements of state law.

Analyst begins with the presentation of the conditions of EU integration policy and the introduction of the Western Balkans countries to fulfill these conditions. There will be presented all the conditions of the general membership, as provided in the EU Treaty and the final requirements set out in Copenhagen in 1993, as well as the criteria for starting accession negotiations.

The content of the criteria is outlined on the basis of a document of "Bodies of the European Union (European rights in the strict sense), and the OSCE and Council of Europe (European rights in the broad sense). Additionally the European partnership will be presented which the EU has developed for the Western Balkan countries

### **Integration into the EU a structured process and set conditions**

Integration should not be misunderstood as simple elimination of borders, which would enable free movement towards the richer countries of Europe. Integration into the European Union means, first, aligning and embracement of the fundamental values upon which is built and this great body of interstate

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<sup>2</sup> Final requirements of the Council of Europe in Copenhagen, Bull. BE6-1993, p.8, point I.13.

subsist: Democracy, rule of law, protection of human rights, protection and respect rights of national minorities<sup>3</sup>.

All EU member states operate on the basis of liberal democracies, in which the rule of law is consolidated, the law is equal for all and human rights are sacred<sup>4</sup>. Embracing the values of democracy is crucial and essential for countries aspiring to EU membership. In these circumstances, a considerable portion of aid allocated by the EU for our country aims precisely to construct these values. Functional market economy should be able to withstand competitive pressures and market forces within the EU. Fulfilling the above two criteria, along with the obligation to adopt the European Union legislation, the so-called "acqui communautaire"<sup>5</sup>, are the main prerequisite to enable the introduction of third countries in the European Union. Due to a long history of isolation and economic difficulties, the integration is often perceived as an opportunity to move to Europe, leaving sight of the fact that this convenience comes only as a result of the consolidation of democracy and economic development. The integration process should be understood as a reform program that provides the country with the European model of state, democracy and the functioning of the economy, but not merely as free movement westward.

### **Political conditionality of EU integration**

Political conditionality traditionally used for international financial organisation in the 90s and 20-century were also exercised by the European Union. In relations with third countries the EU implements the method of "Stick under carrot" (the stick approach and promise), and seeks through conditionality<sup>6</sup> to encourage state governments to meet certain requirements<sup>7</sup>. So conditionality can be used in such a way as to serve as either a threat or encouragement. In the first case it's a positive conditionality, where compliance with the prescribed standards is rewarded through the establishment of

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<sup>3</sup> Piazzolo Daniel, *The Integration Process Between Eastern and Western Europe*, Heidelberg, p. 5-7 and European Council, *Conclusions of the Presidency*, Copenhagen, June 1993

<sup>4</sup> Werner Weidenfeld, Wolfgang Wessels, *Yearbook of European Integration 2006* (originale Jahrbuch der Europäischen Integration), Baden-Baden 2007, f.283-287.

<sup>5</sup> Commission Staff Working Document, *Albania 2006 Progress Report*, COM (2006) 649 final. Brussels, 11.8.2006, p.10

<sup>6</sup> Conditionality is a Mutual Arrangement by Which a government takes, or Promises To Take, Certain policy action in support of an International Institution Which Will provide specified amounts of Assistance - usually financial or technical ": Jeffrey T. Checkel, *Compliance and Conditionality*, Arena Working Paper no. 00/18, [www.arena.uio.no](http://www.arena.uio.no), p.2.

<sup>7</sup> Ditto, look, JT Checkel, *Compliance and Conditionality*, Arena Working Paper no. 00/18, [www.arena.uio.no](http://www.arena.uio.no), F.1 ..

relations with the EU at a high level. Whereas negative conditionality means the EU threatens with the withdrawal of benefits for third place or non completion of the relationship if European Union standards are not met<sup>8</sup>. Conditioning is used by the EU in various stages of relations with third countries: part of the accession process, the initial stage of development and commercial agreements, and also in other measures in terms of autonomous or contractual relations<sup>9</sup>. It is important to note the difference between conditions in the accession process and in other relationships. In "The conditionality of accession" the European Union seems to be the beneficiary. The suitability of the candidate with the European Union has to do with member countries of the EU holding a mass homogeneity in their political system, economic and legal<sup>10</sup>. Requirements for candidate countries should not be seen as a series of conditions for granting various benefits, but they represent a broad process of EU enlargement<sup>11</sup>. For this reason membership conditionality comes to "reward" to fit only at the end of this long process<sup>12</sup>. In states that relations with the EU lie in another way, the connection is open and indirect between the conditions and benefits to these countries and therefore conditionality can be considered as a "lever"<sup>13</sup>.

Preconditions, which lie on top of policy conditionality, are different. They can be classified into three major groups: political ways, legal or economical<sup>14</sup>. Political preconditions relate to three broad areas: that of human rights, democracy and the rule of law. Thus reason the conditional Membership reward comes in compatible only in the final long term process. Legal prerequisite involves the compatibility of legislation with that of the European

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<sup>8</sup> A typical example is eg for establishing a klausole human rights agreements with third countries. This point is increasingly discussed.

<sup>9</sup> See: Mary Cremona, Variable Geometry and Setting Membership Conditionality: An EU Perspective, in: Greg Mills / Sidiropoulos Elizabeth (Hrsg.) A Review of Regional Integration in Southern Africa: Comparative International experience (South African Institute of International Affairs 2001), f .194. (Online available at: [http / /: kas.org.za / Publications / Seminar Reports / SAIIA / saaiia.asp](http://kas.org.za/Publications/SeminarReports/SAIIA/saaiia.asp)).

<sup>10</sup> Ditto, f.204.

<sup>11</sup> Heather Grabbe, A Partnership for Accession The implications of EU Conditionality for the Central and East European Applicants, Robert Schuman Center Working Paper 12/1999, p. 5

<sup>12</sup> Ditto, f.8.

<sup>13</sup> Mary Cremona, Variable Geometry and Setting Membership Conditionality, in: Greg Mills / Sidiropoulos Elizabeth (Hrsg.) A Review of Regional Integration in Southern Africa: Comparative International experience (South African Institute of International Affairs 2001), f.204. (Online available at: [http / /: kas.org.za / Publications / Seminar Reports / SAIIA / saaiia.asp](http://kas.org.za/Publications/SeminarReports/SAIIA/saaiia.asp)).

<sup>14</sup> Comparison with so-called Copenhagen criteria, Bull. EU 6-1993, point I.13.

Union, or in compatible with so called "acquis communautaire" part of EU membership. For an effective adaptation and implementation of legislation a key factor is the importance of capacity efficiency of state institutions and particularly the administration. In this way there is a link between the fulfilments of legal precondition directly with that of legal State. On top of the economic preconditions free market is based on fair competition. Besides these three major groups for the Western Balkan countries another prerequisite is that of "close regional cooperation."

In European Union policy conditionality for the Western Balkan countries is based on the Copenhagen criteria<sup>15</sup>, which refers not only to candidate countries but also the potential candidate countries. These are conditions directly raised from the Stabilisation and Association Process<sup>16</sup>, and to those coming from the peace agreements<sup>17</sup>. Under the conditions laid down in legislation are also included measures for financial aid<sup>18</sup>.

### **The situation prior the Treaty of Amsterdam**

Since the foundation of the European Economic Community (EEC) fundamentally important of European Communities<sup>19</sup> was its establishment for new countries admission. Thus states of the European Economic Community Treaty foundation<sup>20</sup> have asked to be saved, strengthening economic values, peace and freedom from other countries who seeking to become part of this organisation<sup>21</sup>. Since the establishment of the European Economic Community

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<sup>15</sup> Final requirements of the European Council in Copenhagen, Bull EU 6-1993, point I.13.

<sup>16</sup> Look over all the final requirements of the European Council on the use of conditionality in development of relations between the EU and the respective countries of South-East, dated April 29, 1997. Source Bull. EU 4 / 97, paragf.2.2.1.

<sup>17</sup> Resolution 1244 of UN Security Council, the Dayton Agreement, the Ohrid Agreement, and Belgrade.

<sup>18</sup> Compare Othon Anastasakis / Dimitar Bechev, *EU Conditionality in South East Europe: Bringing Commitment to the Process*, European Studies Center, Oxford, April 2003, p.7.

<sup>19</sup> The European Union was established by the European Community of Coal and Steel Community, which was founded in 1951. His aim was to unite the steel and coal resources of member states in order to avoid another war in Europe.

European Economic Community and European Atomic Energy Community were established in Rome in 1957, so I called the Treaty of Rome.

<sup>20</sup> Six countries: Belgium, West Germany, France, Italy, Luxembourg and the Netherlands.

<sup>21</sup> The statements set forth in the preamble to the Treaty establishing the European Economic Union.

to the assortment of the Amsterdam Treaty<sup>22</sup> on European Union, the contractual norms based on pre-contractual rates of membership are summarised. With the establishment of the European Union<sup>23</sup> removal of Art.237 of the European Economic Community Treaty <sup>24</sup>(TKEE) gave the opportunity each European country to become members of European Community. However, even in evaluating the first round of enlargement of the Community<sup>25</sup>, European Economic Community bodies, above all, European Commission asked the countries that were preparing to join the community additional criteria. Review of standards and criteria percept: a political democratic system, a stable economy and the ability to absorb the Community legislation and to implement them respectively.

After the fall of the harsh process and the end of the cold war a question asked on the expansion of the community, and the admission capability as a new meaning, considering new circumstances, countries of Central and Eastern Europe sought to be part of this community. For this purpose it was necessary to pre-determined membership more convincing and to show Eastern European countries with a democracy to swing a clear path to European standards.

### Copenhagen Criteria

Even though in foundation of the community the preconditions for membership were not codified in the provisions of the Treaty were now a process of preparations for the expected expansion of the EU in the Eastern Europe. The report of the Commission for the European Council in Lisbon (26 and 27 June 1992) on European Union enlargement, the Commission sets out the conditions and criteria in paragraphs 8-11. The report must be met on three basic conditions: a) European identity, b) democratic forms of government and protection of human rights (paragraph 8). Also were mentioned as prerequisites

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<sup>22</sup> The European Union took a further development of the Amsterdam Treaty which was signed on 1 October 1997 and entered into force on 1 May 1999 after ratification by all member states.

<sup>23</sup> Since the founding of the European Union is possible to join all the European Union, viz. to the three pillars:

1. to the first pillar of European Community, which in itself consists of three European Communities, united together (European Community, European Community of Coal and Steel Community (ECSC) and Euroatom (KEEur).
2. to the second pillar of Foreign Policy and Common Security and
3. to the third pillar of cooperation in the fields of Justice and Internal Affairs.

<sup>24</sup> Corresponding rate contained Article 95 of the Treaty of the European Coal and Steel Community and Article 205 of the European Community Treaty Euro-atom.

<sup>25</sup> Great Britain, Ireland and Denmark, joined in 1973. Greece 1980. Spain and Portugal 1986.

for EU membership functioning and competitive economy, and adaptation of legal and administrative framework in the private and public sector (paragraph 9). Acceptance and Implementation of Foreign Policy and Common Security, as well as the acquisition of all rights and obligations of European Union and its institutional framework, are also 'conditio sine qua non' of being a member of the EU (paragraphs 10 and 11). Based on the Commission formulation an important issue is the key requirements of prerequisites to membership such as in the Copenhagen criteria.

Copenhagen's criteria represent a turning point in the politics of European Union membership. They were formulated as part of final demand of European Council in Copenhagen<sup>26</sup>, as a result of training and transformations that are in the countries of Central and Eastern Europe. These criteria are known and done as a pre-general and essential element for all subsequent membership in the EU<sup>27</sup>.

Criteria were formulated as follows:

"As a condition of EU membership candidate country must have achieved stability of institutions guaranteeing democracy, rule of law, respect for human rights and minority protection;

This requires the existence of a functioning market economy and ability to cope with competitive pressure and market forces within the Union.

Membership also requires that each candidate country to assume the obligations of membership and may make its own goals of joint political, economic and monetary"<sup>28</sup>

These preconditions, as mentioned, can be divided into four groups: political criteria, economic criteria, willingness to integrate the candidate country (obtaining of *acquis communautaire*), and the ability of EU enlargement. Prerequisites for membership, of which the candidate country must achieve, differ in two characteristics. On one side only the so-called 'political criteria' is constituted since the Amsterdam version of the EU Treaty. For others the criteria to be met is in different periods. Thus the political criteria are the main precondition for opening membership negotiation while meeting the so-called economic criteria is necessary towards full membership. Also possession of the "acquis communautaire" should be achieved in time

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<sup>26</sup> European Council meeting in Copenhagen was held on 21 and 22 June 1993.

<sup>27</sup> See, the Thessaloniki Summit between the EU and the Western Balkans: The Declaration of 21 June 2003, 10229/03 (163), available online at: [http://ue.eu.int/ueDocs/cms\\_Data/docs/pressData/de/misc/76317.pdf](http://ue.eu.int/ueDocs/cms_Data/docs/pressData/de/misc/76317.pdf) ..

<sup>28</sup> Paragraph I.13 of the final requirements of the Council of Europe.



until the full membership, but may be postponed even after the full membership by the membership provided in the Agreement<sup>29</sup>.

In this way the Copenhagen's criteria contains a dual function: on the one side are the material requirements, which are important for final decisions under Article 49, parag.1, while on the other are the standard procedures for evaluating the decision on further steps of the initial process of membership<sup>30</sup>.

Copenhagen political criteria do not impose a particular institutional model but rather interpretations<sup>31</sup>. They truly reflect the fundamental principles and values which are based on EU and member states<sup>32</sup>, but leave the candidate countries a sufficient space to build democratic institutions in harmony with their traditions and cultural policy<sup>33</sup>.

### **Interpretive of Article 49, paragraph 1 and Article 6, paragraph 1 of the EU Treaty**

Only with the version of Amsterdam Treaty for the EU were reformulated contractual norms that regulate membership in the European Union and settled political preconditions for membership.

Article 49 of the Treaty on European Union regulates the admission or membership procedures in the European Union, but also provides the material conditions of a membership. Thus, in paragraph 1 in the first sentence states that any European state may apply to join which respects the principles set out in Article 6 paragraph 1 of the Treaty on European Union.

Every European country has a legal right to make an application for membership in the EU but with a form of liberal-democratic government (Article 6, paragraph 1)<sup>34</sup>.

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<sup>29</sup> This is provided as part of the concept of "conditions" in Article 49, parag.2 the EU Treaty. These are set out in Article 2, membership parag.2 Agreement with 10 countries that joined in 2004.

<sup>30</sup> Juli Zeh, *Right on membership?* (Original: *Recht auf Beitritt?*), Baden-Baden, 2002, p.25.

<sup>31</sup> Barbara Lippert, *From Pre-Accession to EU Membership, Implementing Transformation and Integration*, in: Barbara Lippert / Peter Becker (Hrsg.), *Towards EU Membership*, Bonn, 1998, f.17 and p.25.

<sup>32</sup> Juli Zeh, *Right on membership?* (Original: *Recht auf Beitritt?*), Baden-Baden, 2002, f.23.

<sup>33</sup> Darina Malova / Timhoty Haughton, *Emergence and Divergence. Institutional Change in Central and Eastern Europe and the Impact of Europe* (EU Working Paper RSC No.2001/45), p. 5.

<sup>34</sup> Juli Zeh, *Right on membership?* (Original: *Recht auf Beitritt?*), Baden-Baden, 2002, p.13.

## **The importance of membership criteria based on different stages of accession process**

Only in compliance with Article 6, paragraph 1 is not a condition for submitting an application to join the EU, but the country (who submits the application) must meet a real condition of admission to join the EU, which is part of geographical space of Europe<sup>35</sup>. Thus an obstacle to EU membership is that of not being part of Europe, and also dissatisfaction of the definition 'State'. The concept of 'State'<sup>36</sup> should be understood accordingly with the international law definition. When presenting a claim or application for membership in the EU and it exists, the applicant (country) has the applicant status. The transition from 'applicant' to 'candidate status' is necessary and at a subsequent time the political criteria on its satisfaction<sup>37</sup>.

The membership process goes through various stages. During the negotiation process and preliminary will be the country that made the request from 'applicant' to 'candidate country' providing initially the relevant and clear steps as part of the membership procedure. Subsequently follows the stage of an internal decision of the EU bodies following a positive achievement on the final agreement stage in which then leads to a full membership. When full membership, the democratisation process of is not closed, but must be strictly adhered to further substantial provisions of the European Union.

### **Material conditions in Art.6, parag.1 the EU Treaty**

What means the definition of "European" will not be emphasised in this part, but it is important to note that this definition should not only be understood as a geographical concept but also the importance of historical and cultural elements<sup>38</sup> which are fundamental. Additionally in support of defining

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<sup>35</sup> Juli Zeh, *Right on membership?* (Original: *Recht auf Beitritt?*), Baden-Baden, 2002, p.14.

<sup>36</sup> The state should come as a party to international relations, therefore be subject to international law. To be such under international law the state must fill these conditions: a) must have a population, b) should have a place, a territory in which this population lives, c) must have a government d) that the government should have sovereignty. Arben Puto, *International Public Rights*, Albin, Tirana 2004, f.96-97

<sup>37</sup> "The Commission is of the opinion, that respect for political conditions of the applicant country is a necessity but not a sufficient condition for opening accession negotiations", Communication of the European Commission, Agenda 2000. A strong union and expanded, COM (1997) 2000, July 15, 1997, f.46.

<sup>38</sup> Re: Communication of the European Commission to the Council Lisbon (26 and 27 July 1992) on EU enlargement. Bull. Der EU, 3 / 1992, Zif.7, Hans-Joachim Cremer, Art.49 EUV, in: C.Callies / M.Ruffert (Hrsg.), *EU / EG Kommentare*, 2. Auflage, Neuwied, 2002, p. 5.

a European country is the implementment of Article 6, paragraph 1 of the EU Treaty so-called 'essential provisions'<sup>39</sup>.

The observation of Article 6, paragraph 1 of the EU Treaty represents European Union requirements for internal order of the candidate. Candidate country is expected to follow the path of respecting the principles of freedom, democracy, respect for human rights, fundamental freedoms and the rule of law.

These principles, which are laid down in Article 6, paragraph 1, of the EU Treaty, have become central parts and are included in the constitutional provisions of many countries who aspire to join the EU<sup>40</sup>.

### **Legal character of the EU Treaty**

With attention on Article 6, paragraph 1 of the EU Treaty, members of the European Union, the Parties to the Treaty of the EU, have given the so-called 'political conditions' a legal character. In Article 49 comes to a clear legal obligation, which compels organs of the EU and its member states to adhere to membership criteria which lead to understand the non existence of any suspicion on the political and legal character of the membership condition. With forecasts of the EU Treaty, political conditions not only are given the legal character, but also the placement in the classification of primarily legal principles<sup>41</sup>.

### **Special Conditions for the Western Balkan countries (ConditionalityPSA)**

#### **The major legal basis**

Considering the path of Western Balkan countries towards the EU, it was determined at the Summit held in Thessaloniki in 2003 between the EU and Western Balkan countries<sup>42</sup>. This determination is not a new innovation, as a differential integration of Western Balkan countries into the European Union

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<sup>39</sup> Hans-Joachim Cremer, Art.49 EUV, in: C.Callies / M.Ruffert (Hrsg.), EU / EG Kommentare, 2. Auflage, Neuwied, 2002, p. 5.

<sup>40</sup> Amaryllis Verhoeven, Haw Democratic Need European Union Members European Union ", (ELRev), 1998, f.217-230.

<sup>41</sup> See: Rudolf Streinz, European Law (original: Europarecht), Heidelberg, 2005, p.2.

<sup>42</sup> Support for the Western Balkan countries in their preparations for future membership in European structures is a top priority for the EU." Thessaloniki Summit Meeting between the EU und the Western Balkans: The Declaration of 21 June 2003, 10229/03 (163), available online at: [http://ue.eu.int/ueDocs/cms\\_Data/docs/pressData/de/misc/76317.pdf...](http://ue.eu.int/ueDocs/cms_Data/docs/pressData/de/misc/76317.pdf...)

was launched at the Zagreb Summit in 2000<sup>43</sup>. The aspiration to join the EU and the possibility of a membership are related to the Western Balkan countries with a process anyway. This has to do with the conditions set by the EU, which must be met by these countries. However, the Council of Europe has supported the Thessaloniki Summit of the idea of supporting these countries' membership in the EU and their full membership, once these countries have set conditions to be achieved. These conditions are called 'Copenhagen criteria' and the criteria specified in the Zagreb Summit of 2000 in the context of the Association Stability Process. "In Zagreb was referred to the "Conditions defined by the Council on 29 April 1997 concerning Democratic, Economic and institutional reforms" and "progress made in implementing the Stability and Association Agreements, in the particular on Regional Cooperation"<sup>44</sup>.

Having explained by a systematic way, Western Balkan countries must first meet the criteria established by the Council of Europe in 1997, which later lead to the conclusion of a Stability and Association Agreement. After a positive evaluation on the achievements made in the implementation of this Agreement, then we can advance further with EU membership process.

### **Negotiations on the Association Stability Agreement (MSA-albanian) Political Dialogue**

The prime general principles of political dialogue set out the main conditions which are the basis of internal and external policy, such as implemental of democratic principles and human rights, international legal principles and the rule of law as well as the market economy principles respectively. In these principles are included the commitments that the Albanian Government should take over with a further improvement of cooperation and good neighbourly relations with other countries of the region in all areas, that of free movement of persons, goods, capital, services, and the fight against organised crime, corruption, money laundering, illegal migration etc..

#### **Justice and home affairs**

Albania and the European Community emphasise special importance to strengthening the rule of law and institutions, as well as cooperation in fighting

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<sup>43</sup> "[In this context], the way is now open to all the Countries of the Region to Move Closer to the European Union as part of the stability and Association process." Zif.4 Zagreb Summit Final Declaration, 24. November 2000, available online at: [http://www.mvp.hr/summit/001124\\_deklaracija\\_eng.html](http://www.mvp.hr/summit/001124_deklaracija_eng.html).

<sup>44</sup> Zif.4 Zagreb Summit Final Declaration, 24. November 2000, available online at dresën: [http://www.mvp.hr/summit/001124\\_deklaracija\\_eng.html](http://www.mvp.hr/summit/001124_deklaracija_eng.html).

terrorism, money laundering and criminal activity. Negotiations on this field based on two pillars.

The first pillar concerns cooperation in the field of movement of persons and provides provisions regarding visas, asylum, migration and other policies relating to free movement of people. In this area, Albania has achieved considerable progress, especially in terms of improving legislations. However, deficiencies exist in border management, visa, etc...

The second pillar concerns cooperation in the fight against terrorism, money laundering and illegal drugs and provides provisions on police and judicial cooperation in criminal matters. In this field achievements are more modest: generally is not managed to neutralised the phenomenon of money laundering and while some steps have been laid with the adoption of legislation on fighting local drug production and penalizing the offenders, very little is done to prevent serious drug trafficking.

#### **Technical dialogue: Free movement of goods**

In accordance with the Agreement, Albania and the European Community has gradually established a free trade area over a period of 10 years since the entry into force of the Stability and Association Agreement 1<sup>st</sup> of April 2009. In other words, free trade zone between Albania and the Community tend to open the Albanian market for Community exports during the transitional period, aiming the consolidation of the Albanian economy, consumer protection and promoting business. This arrangement is asymmetric in favor of Albania, so the facilities provided by it will primarily be obtained from Albania and later by the EU. In this context, discussions have been involved for industrial goods, agricultural items, etc...

#### **Technical Dialogue: The right of establishment, free movement of workers**

Philosophy and general trend, which is processed through technical dialogue, is equal treatment of Albanian employees and community, employed legally, in order to avoid any kind of discrimination based on nationality as regards working conditions, remuneration or dismissal. However, this does not bring in the near future the greatest opportunities of market access community, but only facilities for legally employed workers, their families, facilities and social security systems and beyond. The right of establishment is concerned with establishing a legal framework regarding the establishment of Albanian companies and community with mutual rights and facilities will be provided to these companies to operate in the relevant markets in order to avoid any

discrimination. Also through this dialogue include issues dealing with the possibility of mutual recognition of professional qualifications and conduct of activities in relevant areas.

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# ECOLOGIC CRISIS AND ECONOMIC CRISIS. IS IT A COINCIDENCE?

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## Abstract

*We constantly speak about the crisis, a phenomenon which characterizes both the individual and the society. The individual is always in a crisis of time, inspiration etc. In turn, society undergoes periods of ecologic, economic, financial, social, political crisis. From among crisis forms, two of them are particularly worth noticing: the ecologic crisis and the economic crisis. Could their coexistence be a mere coincidence or maybe ...?*

**Keywords:** ecologic crisis, economic crisis, effects, environment protection, economic development

**JEL Classification:** G01, G38, K20, K32

## Introduction

Crises are manifestations of economic, social, political difficulties, which are felt by the society. Such situations are characterized by significant instability, accompanied by increasing volatility and uncertainty.

The common feature of these crisis situations, regardless of the form they have, is the constant feeling of anxiety and uncertainty related to the future, fear or even panic (Păun, 2008).

### 1. Ecologic crisis

When we talk about the environment in general and about man's living environment in particular, we forget that man's survival, both as an individual and as a species, regardless of the development stage he has already reached or

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will reach in the future, has depended and will fully depend on the Earth's natural systems and resources (Sandu and Ioniță, 2003, p. 7).

Unfortunately, in this context and as the global economy is constantly expanding, ecosystems are damaged at an increasing pace (Ioniță, 2007, p. 7).

### *1.1. Environmental trends*

Given the current ecological crisis, there are several environmental trends which shape the future of humankind, whether we like it or not (Ioniță, 2003, p. 330).

#### *A. Temperature rise*

Temperature rise is mainly caused by the growth of the concentration of carbon dioxide in the atmosphere (Ioniță, 2007, p. 7).

According to estimates, this growth (IPPC, 2007, p. 37) reached the level of 379 parts per million in 2005 (from 280 parts per million more than 200 years ago). Under the circumstances, also according to estimates (WMO, 2010), the average global annual temperature increased by approx. 0.5°C, from approx. 14°C (1969-1971) to approx. 14.5°C (2009).

If scientists' estimates will become true and the concentration of the carbon dioxide doubles (as compared to pre-industrial concentration) and the temperature rises by approx. 2-6°C (IPCC, 2007, p. 67), a series of consequences will become apparent (Lynas, 2009), which are as "apocalyptic" as possible:

*a) at a temperature increase by less than 2° C:*

- the Arctic ice will disappear, influencing dramatically the Earth's energy balance;
- tropical coral barriers will undergo severe and repeated episodes of "bleaching" and will diminish dramatically;
- draughts in sub-tropical areas will be accompanied by waves of heat and extended fire;

*b) at a temperature rise by 2-3° C:*

- in summer, the waves of extreme heat (such as the one in Europe in 2003) will become annual events;
- a large part of the Amazon jungle will be replaced with savannah or desert;
- carbon dioxide dissolved in water will increase the acidity of oceans, destroying many of the plankton species;
- the sea level will grow by a few meters and the ice blanket will disappear from Greenland;



*c) at a temperature rise by 3-4° C:*

- glaciers and snow from mountainous chains will melt and will no longer supply the drinking water resources of human settlements and agricultural fields at the foot of mountains;

- global food production will be endangered because of the draught and the heat waves that will exceed the tolerance limit of harvests.

- the Gulf Stream will diminish significantly and the ocean changes will modify all the weather patterns;

*d) at a temperature rise by 4-5° C:*

- global warming will be accelerated when massive amounts of methane will be released as a result of defrosting of the Siberian permafrost;

- many human settlements from the South of Europe, North of Africa, Middle East and other sub-tropical areas will become useless because of excessive heat and draught;

- the entire “sea of ice” from both poles will disappear, just like the glaciers in the Andes, Alps and Rocky Mountains;

*e) at a temperature rise by 5-6° C:*

- the entire Arctic region will be devoid of ice all year round;

- most regions from the tropical, sub-tropical areas and even lower parts will be too hot to inhabit;

- cities in coastal areas (around the globe) will be (largely) abandoned;

*f) at a temperature rise by more than 6° C:*

- methane hydrations will be released from the oceans, increasing the danger of “uncontrolled warming”;

- the surface of the Earth might become similar to that of Venus, i.e. impossible to inhabit;

- the largest part of the marine life will disappear;

- over 90% of species are likely to disappear;

- the human population will be reduced dramatically, survivors will take refuge in highlands and polar regions.

### *B. Population growth*

The world population reached 2.5 bn in 1959, amounting to 7 bn. at present (Ioniță, 2004, p. 7).

It is estimated (UN, 2010), even if the natural birth rate decreased all over the world, that by 2100, the population of the Earth average *10.12/15.80 bn.* (depending on estimates).

If until now the population growth has been felt especially in developed and developing countries, in the following years, according to estimates, (Ioniță,

2010, p. 9), the demographic boom will occur in developing countries, which are already overpopulated.

The population growth will trigger (Brown et al., 2000, p. 27-81) a series of other unhappy consequences:

*a) the reduction of agricultural land per capita*

The agricultural land per capita has diminished during the last century from 0.24 to 0.12 ha. and by 2050 it will further diminish to 0.08 ha. (Ioniță, 2007, p. 9); this reduction threatens food supply.

The uncontrolled growth of the population in some countries (Ethiopia, Nigeria and Pakistan) makes that the area of tillable land per capita be even smaller than the global average; in Pakistan, for instance, by 2050, the agricultural land per capita will drop to 0.04 ha.

*b) the reduction of ocean fish resources*

Ocean fish remained the main source of animal protein in the diet of inhabitants from insular countries and those with large coastal lines.

Due to the 5 time increase of ocean fish harvest during the last 50 years, from 19 mil. (in 1950) to 93 mil. t. (in 1997), the resources have dramatically dropped.

It is estimated (Ioniță, 2010, p. 10) that oceans cannot supply an annual harvest bigger than 95 mil. t. and given the population growth, the amount per capita will be smaller and smaller.

*c) the reduction of forested areas*

Forested areas are the "green lungs" of Earth.

During the last 50 years, the dramatic reduction of these areas has been felt especially in developing countries.

It is estimated (Ioniță, 2004, p. 9) that this reduction will continue, from 0.56 ha. (at present) to 0.38 ha. (in 2050), because of the population growth, the transformation into agricultural land and the excess of sustainable production of wood products.

*d) the reduction of underwater levels*

Irrigation at a pace exceeding natural recharging (through rain and snow melting) has led to the reduction of the underwater level; for instance, the over pumping of water in basins of India, China, North Africa, Saudi Arabia and the USA exceeds 160 mil. t. a year.

The situation is critical in two countries (Ioniță, 2010, p. 10):

- India, where the population tripled (since 1980) and water consumption reached double the volume of the sustainable underwater production; this situation may trigger a decrease of the grain harvest by up to  $\frac{1}{4}$  and implicitly

the increase of deaths due to starvation, considering that the population grows by 18 mil./year and ½ of the children are poorly fed and underweight;

- China, which has had an economic growth by 4 times (starting with 1980), its water consumption exceeding by far the level of sustainable production of recharging water basins; the underwater level dropped by 1.6 m. in China's northern plain which provides over 40% of the grain harvest, being able to determine grain imports that would destabilize global grain markets.

### *C. The disappearance of vegetal and animal species*

The only (maybe) irreversible trend, the disappearance of vegetal and animal species, is caused by the alteration or destruction of their habitat, but also by irrational exploitation.

Under the circumstances, this problem cannot be ignored, since there is the risk that the entire ecosystem may collapse because of the destruction of local ecosystems.

According to an international analysis (IUCN, 2010), from the 359,297 vegetal species which are monitored, approximately 8,600 are endangered, and from the 1,368,089 species of animals that are monitored, almost 9,400 are endangered.

### *1.2. Environment protection, an essential issue*

The future threats referring to the environment which were (partly) presented above, do not represent, by themselves, the most dangerous problem, but our perception on them does, since most people are not fully aware of their seriousness (Ioniță, 2004, p. 11).

One may not claim that there is no degree of uncertainty on the complex problems which generate the current environmental crisis and that it would be necessary to have a careful study, since it is highly easy to exaggerate this uncertainty.

However, researchers have to answer issues which seem unnervingly “easy” at first sight, but which are real “mysteries” for science when considered globally (when, where, how much does it rain? How moist or dry is the soil? How will the surface of the Earth be modified?), as well as more “complicated” issues (What amount of ice will melt in the Arctic Ocean?); the answer to these problems is directly related to the degree of responsibility with which the threat is considered (Gore, 1995, p. 41).

It seems that man himself is the most serious threat, since he is personally responsible for creating the issue of omnipresent pollution, a real threat for his existence as an individual and as a species (Ioniță, 2010, p. 16).

The current environmental crisis is nothing else but the result of irresponsible human activities with negative consequences on ecosystems, tending towards and even managing to undermine nature's self-regulating capacity (Commoner, 1980, p. 123-125).

Maintaining the complexity of interactions in their own dynamics is the fundamental condition for observing the relative stability of natural ecosystems (Ioniță, 2010, p. 15).

The more important the modification or damage of environmental factors, the weaker the temporary balance of the society-man-nature system; but in the real, and often simulated, conflict between man and nature, man can decide on the protection and preservation of nature (Sion, 1990, p. 26).

As presented in the field literature (Okita, 1992, p. 155), "the environment is the basic factor for man's survival, and humankind prosperity on the long term is unconceivable if we are not able to ensure for future generations the opportunity to fully enjoy the benefits of nature".

## **2. Economic crisis**

The economic crisis is a situation in which the economy of a country is suddenly faced with a decrease of its power brought about by a financial crisis. An economy that goes through a crisis will most certainly experience a GDP reduction, a volatility of liquidities and an increase/decrease of prices because of inflation/deflation. Economic crises can take the form of a stagflation, recession or economic depression and sometimes they may even lead to economic collapse (Crisis dictionary).

### ***2.1. Economic growth and cycles***

Theory (modern economic theories) rejects the idea that these economic-financial crises may be anticipated and, in this context, the possibility to minimize their negative effects; each economic-financial crisis is deemed unique, being generated by specific factors, in a given social, economic and political context.

In practice, it was proven that although economic-financial crises do not occur and do not bear effects within identical parameters, they are closely related to the cyclic nature of economic processes.

Economic cycles, regardless of term (short, medium or long), have two stages, expansion and recession.

In the expansion stage there is an increase of economic efficiency, generated by the introduction in the economic circuit of significant technological innovations, whereas during the recession stage there is a weakening of factors that produced the economic boost (Florescu, 2009).

Short-term economic cycles, with duration between 10 and 40 months, and long-term economic cycles, with duration between 40 and 60 years end in a period of recession which is characterized by a slow down of economic growth.

Medium-term economic cycles also called business cycles, with duration of 4-6 years, up to 10-12 years end in periods of crisis, characterized by the dramatic decrease of demand, production, labor force occupancy, gross domestic product, liquidity and living standard.

The current financial crisis which began in the United States in 2007, ten years after the last important financial crisis of South-Eastern Asia, which affected Thailand, Indonesia, Hong - Kong, South Korea.

We may claim that it is, on the one hand, a medium-term economic cycle and, on the other hand, the end of a long-term economic cycle.

This crisis seems to be more painful than the economic crisis of the 80s and, maybe, the most dramatic consequence it generates is the strengthening of the power of the state and the decrease of the power of the private sector (Isărescu, 2009, p. 1).

### *2.2. Effects of the economic crisis on developing countries*

According to experts (Lin, 2008, p. 11-13), the following are among the effects of the economic crisis over developing countries:

- substantial reduction of exports
- reduction of main external sources of investment funds
- interest growth
- reduction of consumption goods and industrial products
- increase of the current account deficit
- investment decrease
- increase of the deflation risk
- GDP decrease
- collapse of the domestic market

### *2.3. Errors to avoid in the future*

Specialists (Cerna, 2009, p. 4, 8) draw the attention that, in the immediately following period, certain errors should be avoided

#### *A. At global level:*

- returning to “leftist fundamentalism”, neglecting economic lawfulness, “everything which is not explicitly permitted, is forbidden”;
- preservation of “right fundamentalism and imposing profits as the only valid purpose;

- poor management of irrational frenzy and irrational pessimism – insufficient economic education of the public and political decision-makers of central banks

*B. At European level:*

- the “death” of financial capitalism of the British type;
- returning to controls of capital movements and national protectionist policies;
- Europe as a new leader of world economy, instead of the USA.

*C. In Romania’s case*

- preserving the model of economic growth based on consumption;
- continuing to develop through foreign resources rather than through domestic economies;
- the myth of the “fortress under siege” or why foreign countries are “unfair” to Romania;

#### **4. Ecologic crisis and economic crisis**

One may claim that this economic crisis created the favorable conditions for the next period of recession of the world economy (which may take the form of stagflation) and will be strongly felt in developed countries.

This period of slow economic development is welcome for the protection of natural resources and the environment in general.

The serious contradictions which are currently visible occurred as a result of the lack of correlation between the limited level of (renewable and non renewable) resources of the Earth and the increasingly high level of human consumption, in the context of the demographic boom, technical and scientific revolution and the desire to raise the living standards regardless of costs.

Maybe we will stop and realize that we are the creation and creators of our own environment, which ensures our physical existence and gives us the opportunity of intellectual, moral, social and spiritual development.

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# TAX EVASION DURING AND AT THE “END” OF THE ECONOMIC CRISIS

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## Abstract

*In Romania, tax evasion is a national “sport”, whose consequences can be “noticed” and “quantified”. The frequent and important amendments of the tax and social insurance legislation and policy which have been carried out in a short time interval have had the reverse effect, namely they chased away investors and encouraged tax payers to find various subterfuges to avoid paying their fiscal obligations. In the context of the economic crisis, VAT, minimum tax and health tax increases, the removal of deductible expenses, the reduction of pensions, salaries and the massive layoffs in the public sector have increasingly led to a growth of the tax evasion phenomenon.*

**Keywords:** fiscal pressure, economic crisis, tax evasion, offenses

**JEL Classification:** G01, G20, H20, H26, K14, K20, K42

## 1. Introduction

Taking over some news posted on the web page of a Bulgarian press agency, Sofia News Agency (SNA, 2011), the national media claims: “Only the Italians are better than us at tax evasion”, “Romania, second place in the EU at tax evasion”, “Romania, European vice-champion at tax evasion”.

The study referred to would rely on data from the white collar crime police in the EU Member States.

According to this study, Italy is first in tax evasion in the EU, because over 51% of the taxable amounts remain undeclared, followed by Romania (42%), Bulgaria (38%), Estonia (37%) and Slovakia (32%). In comparison, Sweden is first in declared taxes, because only 8% of the taxable amounts are undeclared, followed by Belgium (10%) and UK (12%).

We do not want to contradict the above-mentioned headlines, but we have to understand what makes the tax payer break the law and avoid paying the amounts due, especially given the fact that the sanctions are quite severe.

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Romania's Constitution stipulates as a fundamental duty in article 56, „Financial contributions”, paragraph (1), „Citizens are under the obligation to contribute to public expenditure, by taxes and duties”. At the same time, paragraph (2) of the same article specifies „The legal taxation system must ensure a fair distribution of the tax burden”.

## **2. Fiscal pressure in Romania during the last few years**

Fiscal pressure expresses the intensity by means of which part of the incomes obtained by natural persons and legal entities is collected through taxation.

This indicates, on the one hand, the extent to which incomes are adjusted through taxation and, on the other hand, the manner in which the state budget builds up its incomes as a result of taxation (Niță, 2010, p. 454-455).

Fiscal pressure has to reconcile two completely opposed tendencies: one is the tendency of the state towards an increasingly high pressure meant to cover the continuously growing public expenses, and the other is the tax payer's tendency towards as low a pressure as possible in order to keep as much as possible from the obtained incomes.

From tax payers' perspective, this involves certain supportability limits which are imposed by their reactions to resist the growth of compulsory taxes (Dobrotă and Chirculescu, 2010, p. 301).

Usually, taxes are willingly paid by the tax payer, up to the point when taxes exceed those supportability limits.

Once such limits are overcome, the tax payer's behavior becomes less normal; practically, he constantly tries, through whatever means, to avoid paying his taxes, hoping in a decrease of fiscal pressure.

The following are among the most important effects of excessive taxation (Niță, 2010, p. 459-461):

- the reduction of productive efforts of companies
- political and social instability
- risks of taxation inflation
- the reduction of the international compatibility of Romanian companies
- the development of economic-financial and fiscal criminality.

The table below presents the fiscal pressure for the year 2009 in EU countries.

Table no. 1: Tax and extra tax pressure level, in the member states in 2009

	GDP	Direct taxes	Indirect taxes	Social contributions	Prfimp	Prcb	Prpo
Belgium	337,758	51,600	42,602	56,535	27,89	16,7	44,6
Bulgaria	66,256	3,982	11,027	5,273	22,65	8,0	30,6
Czech Republic	3,627,188	270,889	413,895	559,654	18,89	15,42	34,3
Denmark	1,657,857	498,907	278,487	31,973	46,89	1,92	48,8
Germany	2,407,200	259,640	303,210	411,120	23,38	17,1	40,5
Estonia	214,828	16,349	32,259	28,828	22,62	13,41	36,0
Eire-Ireland	163,543	16,888	17,987	12,485	21,32	7,63	28,9
Greece	237,494	18,902	26,421	30,328	19,08	12,8	31,9
Spain	1,051,151	101,024	91,796	140,361	18,34	13,35	31,7
France	1,919,316	186,347	284,794	351,271	24,54	18,30	42,8
Italy	1,520,870	222,655	206,956	215,003	28,24	14,13	42,3
Cyprus	16,947	1,890	2,542	1,570	26,15	9,26	35,5
Latvia	13,244	943	1,398	1,160	17,67	8,75	26,5
Lithuania	92,353	5,519	10,468	11,081	17,31	11,99	29,3
Luxembourg	37,755	5,258	4,492	4,576	25,82	6,82	37,9
Hungary	26,094,824	2,546,205	4,261,696	3,401,517	26,08	13,03	39,1
Malta	5,712	795	813	435	28,15	7,61	35,7
Netherlands	570,208	67,682	67,871	83,968	23,77	14,72	38,5
Austria	276,892	35,149	40,415	45,649	27,29	16,42	43,8
Poland	1,342,612	100,015	172,384	152,343	20,28	11,34	31,5
Portugal	163,891	14,998	21,366	22,446	22,18	13,69	35,9
Romania	491,274	32,439	53,920	51,261	17,57	10,43	28,0
Slovenia	34,894	3,132	4,994	5,387	23,26	15,43	38,7
Slovakia	63,332	3,778	6,520	8,095	16,26	12,78	29,1
Finland	170,971	27,818	22,886	22,237	29,65	13,00	42,7
Sweden	3,057,056	519,438	579,205	364,146	35,93	11,91	47,8
United Kingdom	1,395,872	219,012	162,531	119,848	27,33	8,58	35,9

Prfimp - the tax burden of taxes and duties

Prcb - pressure of social security contributions

Prpo - compulsory levies pressure

**Source:** Dobrotă G., Chirculescu M.F., *Analysis of tax and extra taxes pressure in Romania an European Union* (Annals of the „Constantin Brâncuși” University of Târgu Jiu, Economy Series, Issue 4/2010, Table no. 1, p. 303)

According to these data, in Romania, in 2009, the pressure has been compulsory levies a 28% level, i.e. by 12.6 percentage points less than the average in the EU27 and 1.58 percentage points more than the minimum recorded by Latvia.

Unfortunately, starting with 2009, the fiscal pressure grew because of the increase of health taxes, the minimum tax, the removal of deductible expenses, VAT increase etc.

In this context, the above-mentioned consequences were not a surprise.

### **3. Tax evasion and related offenses**

In art. 1, the former law no. 87/1994 for the prevention of tax evasion defined tax evasion as the avoidance, by whatever means, of paying taxes, charges, contributions and other amounts due to the state budget, the local budget, the state social insurance budget and special fund budgets by natural persons and legal entities, Romanian or foreign, who are called (in the law) tax payers.

Although this regulation was abrogated and the applying regulation for the prevention of tax evasion, Law no. 241/2005, no longer defines the term, its meaning was preserved both by theoreticians and by practitioners of financial and fiscal law.

In fact, according to article. 9 paragraph 1 of this regulation (Law no. 241/2005), the following deeds which are meant to avoid paying fiscal obligations are deemed tax evasion crimes and are punished with imprisonment from 2 to 8 years and the interdiction of certain rights:

- a) hiding the taxable asset or source;
- b) omitting, in full or in part, to indicate in accounting books or in any other legal documents, the commercial operations performed or the obtained incomes;
- c) specifying, in the accounting books or in any other legal documents, expenses which do not rely on real operations or other fictitious operations;
- d) the alteration, destruction or hiding of accounting books, memories of taxation devices or any other means of data storage;
- e) keeping double accounting books, using documents or other means of data storage;
- f) avoiding to make financial, fiscal or customs checks by failure to declare, fictitious or inaccurate declarations regarding the headquarters or secondary offices of the checked persons;
- g) substitution, damage or estrangement by debtors or third persons of any assets seized in compliance with the provisions of the Code of fiscal procedure and the Code of penal procedure.

The same paragraphs 2 and 3 stipulate two serious forms of the situation when, through the above-mentioned deeds (paragraph 1), a prejudice exceeding Euro 100,000 and 500,000 respectively was produced in the equal amount of the national currency, the minimum limit of the punishment stipulated by the law and its maximum limit increasing by 2 and 3 years respectively.

In the applying regulation for the prevention of tax evasion, Law no. 241/2005, the following are also sanctioned as crimes:

- the deed of the tax payer who, willfully, fails to redo the destroyed accounting books within the term specified in the control documents, although he could have done so; the sanction is a fine of RON 50,000,000 – 300,000,000 (art. 3)

- the prevention under any form of competent organisms to enter, under the law, headquarters, perimeters or plots of land with the purpose of performing financial, fiscal or customs controls; the punishment is imprisonment from 6 months to 3 years or a fine (art. 4)

- the possession or use without any right of stamps, badges or standard forms used in the fiscal field; the punishment is imprisonment from 2 to 7 years and the interdiction of certain rights (art. 5)

- willingly printing, owning or using forged stamps, badges or standard forms used in the fiscal field; the punishment is imprisonment from 3 and 12 and the interdiction of certain rights (art. 6)

- the tax payer's setting, in bad faith, of taxes, fees or contributions which result in obtaining, without any right, amounts as returns or refunds from the general consolidated budget or compensations due to the general consolidated budget; the punishment is imprisonment from 3 and 10 years and the interdiction of certain rights (art. 7 paragraph 1)

- association for the purpose of committing the above-mentioned deed; the punishment is imprisonment from 5 and 15 years and the interdiction of certain rights (art. 7 paragraph 2).

The law has a double destination, namely, to warn on the consequences of the sanctions tax payers expose themselves to in case they intend to avoid paying their fiscal obligations and to be the legal instrument which is the basis for the penal liability of those tax payers who, in bad faith, breach the provisions thereof (Voicu et al., 2003, p. 103)

#### **4. Special cases**

The public control institution (which has legal personality) that carries out operative and unexpected controls for the prevention, identification and fight of certain deeds and acts in the economic, financial and customs field resulting in tax evasion is, according to art. 1 paragraph 1 of Government Decision no. 533/30.05.2007, the Fraud Squad.

It is organized as a specialty organ of the public central administration subordinated to the Ministry of Economy and Finance – National Agency of Fiscal Administration.

During its activity (ANAF, 2009), the Fraud Squad registered some special situations which are worth mentioned.

#### **A. In the field of oil products**

Following the control of the activity of a trading company in Constanta County, the Fraud Squad officers established for this economic agent a prejudice of over RON 16,800,000. In fact, the controls revealed that during the year 2009, the said company, a certified warehouse operator of energy products, sold the total amount of 4,995,191 l of diesel to a number of 4 beneficiaries without paying the excises. The amounts of fuel provided to these companies were meant for the bunker of four ships. When extending the controls onto the beneficiary companies which operate these ships, the officers discovered that they are inexistent at their declared registered office and their legal representatives systematically avoid any controls. In this context, the control also revealed that three of the ships were not supplied with fuel from Romania in the year 2009, and the fourth ship was delivered to the owner since February 2008 although the company under control issued the delivery documents at a later date, between March and December 2008, for the total amount of 7,253,952 liters of diesel and the documents specified that the fuel had the clear destination of supplying the ship. Corroborating these facts, the officers reached the conclusions that in reality, the fuel meant for these ships was detoured from the legally declared destination. Consequently, under the provisions of Law 571/2003 with the subsequent amendments, the Fraud Squad calculated the unpaid excises and the related VAT. The resulting prejudice was RON 16,879,172. Considering the way in which the payment of such obligations was avoided, in order to continue the investigations, the Parquet near the High Court of Cassation and Justice – the National Antifraud Division was notified. At the same time, in order to calculate all the obligations to the budget, the investigation result were sent to the D.G.F.P.- Constanta and A.N.V.- Division of Supervision of Excises and Customs Operations.

#### **B. In the field of intra-Community procurements**

During an action of a similar nature related to the activity of trading company in Calarasi, the Fraud Squad officers set for this economic agent a prejudice of over RON 23,000,000. In fact, this company which is administered by a Bulgarian citizen, made, according to the information communicated by the Central Relation Service within DIF – ANAF, intra-Community procurements of various products in an amount exceeding RON 121,000,000. On site controls made by the Fraud Squad officers revealed the ghost-like

behavior of this company. This aspect, together with the fact that the statements submitted to the fiscal institutions do not specify the intra-Community commercial operations, determined the intentional nature of the deeds, which is also supported by the fact that, in all the cases, the documents issued by the company in Calarasi are signed by the Bulgarian administrator, and the statements obtained during the cross controls revealed that the deliveries were personally made by him, who presented the offers directly at the beneficiary's headquarters. Considering all these aspects, the Fraud Squad officers established, based on the identified documents and the information in the statements of the commercial partners, the amount of traded goods and, consequently, of the prejudice to the state budget caused by avoiding to declare the commercial operations and to pay the related fiscal obligations. The prejudice was RON 23,014,577. Given the criminal nature of the deeds, DNA Bucharest was also notified. At the same time, the file was sent to the fiscal organisms, in order to detect all the fiscal obligations due.

### **C. In the field of tobacco and cigarettes**

During a traffic control activity, various vehicles meant for the transportation of goods were identified and stopped. Following their inspection, in two of the controlled vehicles, a total amount of 40,000 packs of "Platinum" cigarettes were found. They did not have the marking stamps stipulated by the law for this type of products. When asked to give explanations, the two drivers declared that they did not know about the existence of those cigarettes. Motivated by the aspects resulting from the control, the Fraud Squad officers proceeded, according to the provisions of Government Order 92/2003 with the subsequent amendments, to the civil sanction of the two drivers with fines in total amount of RON 200,000, a measure which was doubled by the confiscation of the 40,000 unmarked packs of cigarettes and of the two vehicles used for their illegal transportation.

### **D. In the grain field**

Following the control on the activity of a group of companies whose shareholders were the members of a single family, the Fraud Squad officers discovered that the state budget was prejudiced with over RON 7,000,000. They discovered that three of the family members (two brothers and their mother) set up five trading companies in the field of grain trade. They operated in Braila County, making procurements from natural persons, producers of grains. Subsequently, the products were transferred to the companies, at higher prices than the real ones, in order to hide the real profit by mentioning false

expenses. The last company in the chain traded in culture products to large warehouse owners (COMCEREAL or ROMSILOZ). Through this fraudulent activity, the criminal group whose activity was stopped by the Fraud Squad officers prejudiced the state budget with RON 7,539,779. After establishing the prejudices to the state budget by each firm, considering the particularly serious nature of the deeds of this criminal group, the file was sent to DNA – Territorial Office Galati. At the same time, the documentation was sent to DGFP Braila for the accurate identification of the prejudices and of the other related payment obligations.

### **E. In the field of financial-accounting discipline**

Following the controls of the activity of a company in Bucharest initiated upon the request of DNA, Fraud Squad officers discovered that this economic agent avoided paying fiscal obligations in total amount of RON 18,000,000. Thus, the controls revealed that the company representative, a Syrian citizen, used the company to cash large amounts of money under illegal conditions from several leasing firms. Subsequently the amounts were directed towards a series of ghost companies, controlled by the same person, from which such amounts were withdrawn in cash. In order to obtain from the leasing companies these amounts, which were requested with the declared purpose of financing the procurement of construction plant, the company representative presented a series of false sale-purchase contracts. At the same time, in order to simulate the existence of commercial operation, the same company falsely registered fiscal invoices with fictitious information in its financial books, which led to the modification of the fiscal obligations, namely the fictitious increase of supply costs and the reduction of the mass volume. The controls also revealed that the representative of the company under control tried to camouflage the illegal operations, transferring the company in September 2008, on which occasion a large part of the accounting books also disappeared, which forced the control team to retrace the company activity based on banking documents. According to the calculations made by the Fraud Squad officers, the state budget was prejudiced with the total amount of RON 18,854,580 (income tax and VAT). In order to calculate all the obligations to the state budget of this economic agent, one copy of the control act was sent to the fiscal organisms. Considering the nature of the deeds, which led to this prejudice, the results were sent to D.N.A. in order to continue the investigations.



## **F. In the field of alcoholic beverages**

A control made together with the workers of IPJ Prahova ended, among others, with the confiscation of approximately 154 tons of wine, whose legal origin could not be set under legal conditions. The checks carried out in a location for wine storage revealed that the entire amount of wine plus approximately 15 tons of wine yeast belonged to a firm in Prahova. It is worth mentioning that the wine was found on the premises owned by another trading company, storage in that location being made under a lease contract and a reception protocol closed by the two firms. Subsequently, when the control team went to the registered office of the firm under control, at another address in Prahova County, they discovered other recipients for beverages, and their inventory revealed the existence of 7.5 tons of white and red wine, plus 4.5 tons of distilled alcoholic beverage. The firm representative could not present any legal documents for the identified beverages, any recorded evidence referring to the company accounting books or the certification documents as a fiscal warehouse operator of production and storage. In this situation, in the first stage, Fraud Squad officers requested O.J.P.C. - Prahova to take samples of beverage and blocked, under the provisions of Law 571/2003 on the Fiscal Code and Government Order 92/2003, republished, the 4.5 tons of alcoholic beverages identified. At the same time, under the provisions of Law 12/1990, republished, they confiscated the total amount of 154 tons of wine and sanctioned the firm with a fine of RON 20,000.

## **5. Are we out of the crisis? What next...?**

It seems that this year has good things in store for us ...

According to the authorities (ANAF, 2011, p. 2), after two and a half years of economic crisis, Romania has finally left the recession, since the gross domestic product registered real increases for two consecutive trimesters (trimester IV 2010 and trimester I 2011). GDP seems to have grown (in real terms) by 1.6% in trimester I 2011 as compared to the corresponding trimester in 2010.

However, the reduction by 22% of direct foreign investments in trimester I 2011 as compared to trimester I of the previous year increased the feeling of market instability, the tendency to protect liquidities, but also determined limited capital movements and negatively impacted the creation of new jobs.

According to the same source, at the end of March 2011, the unemployment rate registered nationally was 5.9% (2.5 % lower than in March 2010), and the number of the unemployed was 539.7 thousand persons

(dropping by 225.6 thousands as compared to the corresponding months of the previous year).

## 6. Instead of conclusions

Certain estimates (Garant) reveal that in Romanian households, around 110-130 mil. liters of alcoholic beverages are produced every year, which stands for approximately 45% of the national consumption. On Romania's territory, approximately 30,000 distillers were found (mainly in the country side), but in reality their number is a lot higher if we also add individual ones.

According to authorities (ANAF, 2011, p. 9-10), only last year, the Fraud Squad made 192,436 controls, applying 122,083 fines in the amount of RON 255.3 million. The confiscations amounted to RON 175.9 millions, and the prejudice raised up to RON 2,778.8.

In the same reference period (2010), the National Customs Authority registered 4,298 frauds and irregularities totaling RON 712.9 million and confiscated 1,445.30 hectoliters of pure alcohol, 62,524.756 cigarettes and 34,135.52 tons of energy products.

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