

The Cognitive Isolationism

The absence of a global theoretical vision, as a necessary referential for insuring the coherence of specialized cognitive initiatives, translates into incoherence in the actional plane; this though, is much more: it is a cumulative counter-performance which produces the critical mass necessary for a social explosion.

The confused conceptual state of Economics is also the result of the constraint-creating division of visions, as an expression of postmodern cognitive specialization. Practically, the communication of methods and the transfer of meanings between the compartments of Economics are proven to be broken, or at least lacking.

The most relevant blockage took place on the bidirectional highways of economic knowledge, which are represented by Economics, as an academic discipline, together with the other theoretical perspectives, especially those centered on functionality. The first to stand apart is Finance, as the center stage for the knowledge on the management of value and the risk of investments, an increasingly closed discipline made so by the ordinate principle of the sufficiency of immediate profit.

The direct expression of financial rationality is the eviction of social motivation and long-term projections from the space of economic rationality. The most perverted form of Finance's specialization, as a science responsible for the knowledge regarding the productivity of assets, lies in the universe of financial derivatives, which fuels speculation in the virtual space. Completely separated from the vision of inter-subjective contexts which is specific to Economics, the science of Finance exiled itself in the territory of conventions and mathematical algorithms, creating its own illusion of succeeding in fusing the desirable and the possible at the level of human condition.

As we can well see in this crisis, Finance has turned into a body of knowledge against-nature and into a set of methods identified as the source of opposing behaviors in the act of government and the reason for the avalanche of unintended social consequences. The absence of a global theoretical vision, as a necessary referential for insuring the coherence of specialized cognitive initiatives, translates into incoherence in the actional plane; this though, is much more: it is a cumulative counter-performance which produces the critical mass necessary for a social explosion.

In this perspective, understanding the functioning of the economic whole is no longer possible because there isn't any unit of measure in the creation of

particular solutions given to the problems of the component parts. The result is the use of an ultra-specialized procedure, by means of thousands of simultaneous operations for each suffering organ, in the hope that the organism will be kept functioning as a whole. The hypothesis stems from a determinist and absolutely linear understanding of things, with no connection to the rational approach of complex situations. Inexcusable reductions of sense are made, complemented by hazardous assumptions. As if, in physiology, the increased speed in the circulation of blood would represent the lead cause of increased efficiency in the mental abilities of the brain. Cognitive isolationism came to provide the tools for micro-level performance, all the while dissolving the meaning of the context which assembles, in a vital order, the parts into a whole.

Even worse is the fact that, in the present system of economic sciences, cognitive isolationism most often absolves its assertions from the obligation of respecting the coherence with the fundamentals of Economics. Every discipline searches for truth by its own rules and finds a universe of significations and representations which could only by chance be in concordance with the general context. The absolutism injected into the efficiency function of fashionable financial theories meant the absolute reduction of the social function of Economics.

There is no other explanation for the fact that, for instance, the phenomenon of speculation in asset values, which gives the measure of performance in today's financial theory, was proven to be at the same time the measure for failure in the normal functioning of the economy as the space of rationality configured as a single unit. Of course that the detachment of parts from the whole was in itself a triumph in the conquest of nature originating in the Baconian dream, but it was also proven to be the method through which the whole is functionally spent and collapses for lack of energy, while from a cognitive point of view it become an abstract, non-anthropocentric convention – an uninhabitable Utopia.

The path followed by Finance from an epistemic point of view is, *mutatis mutandis*, that of the extinction of the living, of eroding the most relevant whole which is the societal body, the world. The profit which is mostly targeted through calculation in fictitious elements and in the bluffing from the “game of leverage”, points to a space where there cannot reside the arguments of inter-subjective contexts, of complex interactions between agents who have values, expectations and ideals.

The cognitive responsibility of disciplines caught in the obsession of focusing uniquely on partial performances is urgently demanded by the crisis-prone economy of the present. These disciplines also need to be rethought by reattaching them to the epistemic stream of Economics, as a whole which certifies its relevance in the unitary contextualization of the economical.

Marin Dinu

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Antithetic Foundations of Economics

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Abstract. *This paper aims at decrypting the manner in which the foundations of Economics as a science and the meanings of the relevant explanatory formulas are being shaped. My analytical endeavor focuses on understanding the peculiarities of what is referred to as the object of study of the science known as Economics, an academic synthesis of concept-related breakthroughs regarding economicity. The explicit purpose of this analysis is to identify perennial benchmarks in economic cognition whereby this ensures its consistency. The implicit purpose is to shape a cognitive model in line with the specifics of the conceptual universe of Economics, as well as with the sources of the economic realities that are subject to a sui-generis relativism. The primary benefit of this endeavor consists in systemizing the conceptual prospects with an antithetic nature that allow for the explanations of the state of economic rationality and generate the understanding of what the source of economicity is and how it behaves. As such, the conclusions are marked by the stringent need of more precisely defining economic knowledge in order to match the changing nature of economic reality, as an expression that embraces the meeting point of two ontological vistas that are methodologically separated by some theories: human nature and human condition. Economics as a science thus features, apart from a conceptual substrate that needs to be spotted, an ontological background that needs to be revealed. The role played by this background appears to be most frequently ignored. The joint identification of both direct and contextual determinants for a sensitive area of humankind, i.e. the economy, is a direction to be followed by the royal path of rational knowledge.*

Keywords: conceptual substrate; inter-subjective contexts; state of economic rationality; consistency of Economics.

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Introduction

What we understand as *economic science* is a coherent set of antithetic conceptual benchmarks with an explanatory function for the state of rationality observed between action-oriented intentions motivated by measurable needs and consequences. From this perspective, economic science observes the generic scheme of any rational knowledge formula rated as a science from Enlightenment onwards and is based on the cognitive algorithms validated by the cause-effect determinist principle. The pragmatic option, confirmed by focusing on the final result in its specific wealth version, awarded Economics the epistemic comfort of methodological conformity, on the one hand, and the benefit of de-subjected, rational knowledge of things as such, on the other hand. In a “placenta-like” physicalist fashion ensured by natural philosophy, economic cognition had to bear an illegitimate offspring of human condition rationalized by abandoning human nature. But the genetic heritage cannot be annihilated by the exclusive taking into custody of the illegitimate offspring. The absolute rationality of *homo oeconomicus* has always proved a typical assumption of mono-parental mythology, since the texture of the economic universe reveals the leitmotiv of the heir’s double descent.

The entire conceptual architecture of Economics is based on the genetic signs of mating. In fact, these constitutive signs make up a genuine *substrate* of the epistemic constitution of Economics. It is the substrate that ensures the specificity of economic knowledge, which stands out by its antithetic configuration arising directly from the dual origin of cognitive genes. Things were consolidated by the fruitful communion between human nature (adventure-prone, vagrant and whimsical, egoistic and imprecise) and human condition (stable, calculated and real, pragmatic and dedicated). The substrate of Economics has double fundamentals: the irrational fulgurations of human nature and the imposing materiality of human condition. Even in the cases where the original sources are lost, centring Economics upon the strength of human condition elements (e.g., Labour Economics, Product Economics or Money Economics) finds out that the sense of solutions to the yield problems also pertains to the ineffable condition of human nature, and even goes beyond that. The antithetic constitution of economicity signifiers is organic in nature and any detachment of one or another of the epistemic foundations from the viable whole only tampers the essence.

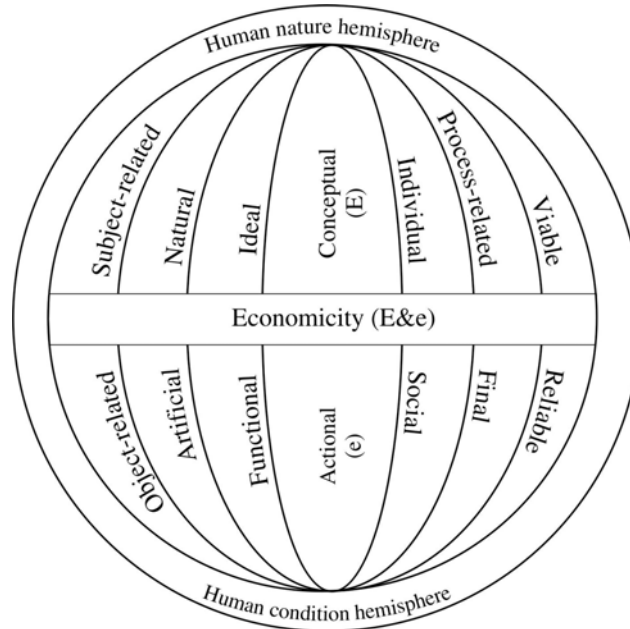


Figure 1. *Antithetic version of Economics
(organic vision)*

The economicity signifiers are the result of the unification of antithetic descriptors of human nature and human condition by the rules of the body. This natural feature expresses the understanding of confluences between real and abstract actions, between the material world and the ideas' world. It is in this particular way of setting economicity that the eternal openness of its finality to either gain or loss should be sought. In a formula spearheading free will, economicity is a fine tuning between rational and irrational determinants of humankind.

Economicity is at the same time calculation and hazard. As a calculation, it aims either at a rational combination of the factors underlying predetermined finality or at preserving the target functions, in line with its foundation: human nature or human condition. In the former case, it is marked by the regulatory approach, while in the latter case by the positive approach. Moreover, in the former case, it is a science similar to physics, while in the latter case it borders on metaphysics. Economicity has a double constituency, as it comprises both empiric and ineffable parts. It is equally a handy object and an expectation of the object to materialize.

The fate of Economics of being driven by the will to be part of the glorious platoon of natural philosophy opened *en fanfare* by Physics, but also

by the “call of the blood” that reminds of the subjectivity that generated it as a form of reason, closes within itself its very status as an identity troubled science. To ignore economic cognition underlying on counterforts annihilates the chance of Economics to become a full-fledged science responsible for a dual issue whose solutions should consider the double perspective where it applies. Economics, the identity of which derives from the confluence between human nature and human condition, focuses on the inter-subjectivity interested in trading yield-related conditions as utilities judged as antithetic benchmarks.

Without this double-perspective foundation of causes, intents or prerequisites and effects, consequences or conclusions, Economics becomes void, turning into geometrical imagination or ideological patchwork.

The conceptual dualism underlying Economics also encompasses the fact that these assumptions *per se*, for example, should be the result of a mix of origin-related perspectives, and consequences should be explained in a binary rational-irrational fashion. For instance, assumptions should have meanings in both the conceptual horizon of human condition and that of human nature, and consequences should have meanings in both linear and stochastic order.

The manner in which economic knowledge has shaped itself throughout centuries testifies to its dual perspective character (Dinu, 2010) in the form of an antithetic substrate. The object of study of Economics is related to this double reinforced pattern: natural and artificial, subject-related and object-related, ideal and functional, conceptual and action-driven, individual and social, viable and reliable, process-related and final. It is about a cognitive balance between antithetic signifiers that render Economics the status of a science responsible for the reality extant both beyond Physics, i.e. artificial matters, and within Physics, such as random, selection risk and the uncertainty of material rationality.

It is particularly this physical extra-territoriality that makes Economics a hybrid cognitive entity, seen both as the result of rational thinking, implying measurable objects, and as the state of existence of the weightless forces of the art in attaining the target at a faster pace.

Within the universe of Economics, the origin of things in a solely human-like manner is liveliness, the single entity responsible for a ceaseless big bang. Within the universe of Economics, there are permanent beginnings, whose evolution is driven by causes in inter-subjective contexts. In Economics, the observer observes himself as a force of gravity bringing together intents (inertia) and consequences.

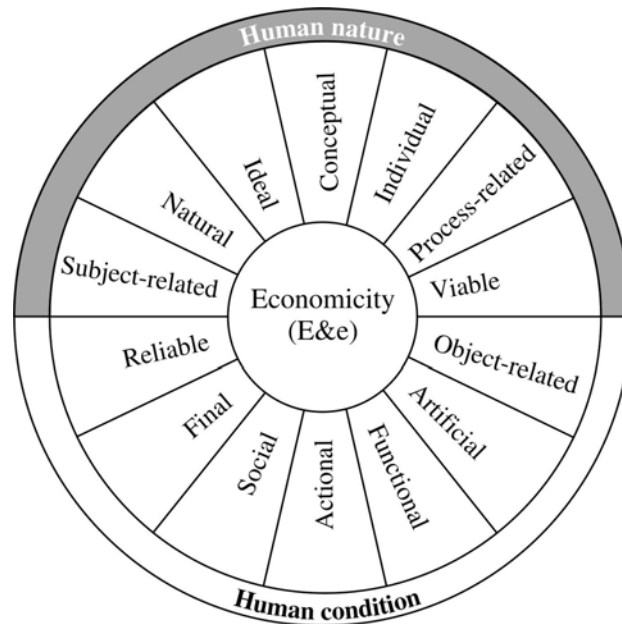


Figure 2. *Antithetic version of Economics (perimetral vision)*

Economicity occurs once at a time in both semi-spheres crystallized by substance and thinking, thus revealing its two-tier structure: subject-related and object-related, conceptual and action-driven, etc. Intermediate states have a continuous translation between the space coordinates of economicity, on the one hand, understanding-explanation-cognition and, on the other hand, labor-matter-action.

This texture of transcending significances pinpoints the breakdown of economicity vis-à-vis the other components of the global social system. Yet, above all, it shows the need to protect the field of economicity from interfering with other coordinates or takings into custody of these coordinates, such as politics.

Even the antithetic foundations of economicity that have their peers in other areas of humankind, such as the individual-social couple which in politics comes in the form of formulas to manage the adversity of individual interest and collective interest, retains in the inter-pole Economics-economy complexity the value of an indestructible complementarity between human nature and human condition. Deep down inside, economicity is organically non-ideological.

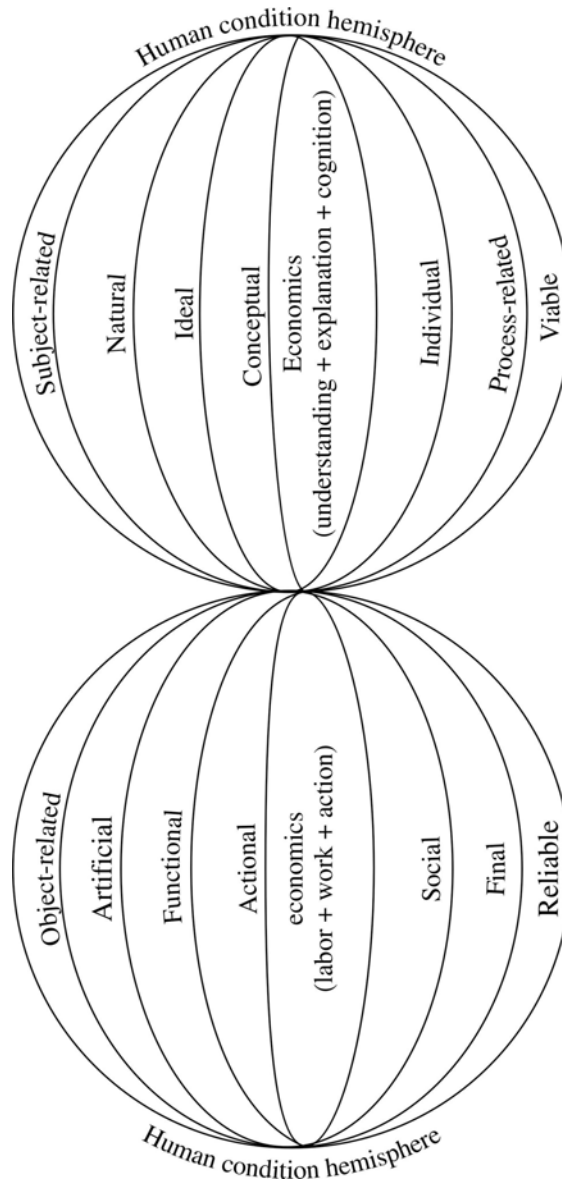


Figure 3. *Antithetic substrate of Economics (spatial vision)*

Understanding the substrate of Economics conceptualization is all the more relevant as deficits build up. The shortfalls arise directly from methodological purification attempts, as they appear now, amid the ongoing economic crisis. Fundamentalist prospects have always generated cognitive deficits manifest at times of crisis in particular. Economic crises proved to be

the natural expression of puritans' methodological options, especially those developing ideological approaches. To return to the reflection on the nature of Economics fundamentals is not only the duty of the economics researcher responsible for the fate of the science he serves, but also an emergency of avoiding the stroke looming its status as a science. As such, explaining the manner in which the meanings of antithetic fundamentals of economicity take shape becomes a principle.

Below is a description of the antithetic fundamentals of economicity and especially the challenges arising in the context of the economic crisis for the epistemic constitution of Economics.

Natural – Artificial

The distinct cognitive methods are largely absent in the economics researchers' skills.

Ever since becoming autonomous from the original theoretical body of metaphysics (which occurred, according to common knowledge, in its rationalist propensity that generated the Enlightenment breakthroughs referred to as *natural physics*), Economics bore with it, for operational purposes, the cells of the original cognitive body. In other words, it sought to rescue the benefits of the umbilical dependence within the time and the space destined to its own evolution, thus endangering the finitude of the prodigal-son-like adventure of knowledge (as the fattened calf could no longer be needed!).

This genuine epistemological dependence of Economics to the host body of *natural philosophy* where it took shape entailed, for survival, methodological transfers, from Physics in particular. They have constantly fuelled the rule of treating economicity, for instance, as the physical room of producing wealth, a novel isotropic substance being the space of yield-certified rationality. Understanding economicity as the yield-related functionality of the wealth mechanism (a kind of clock world of materialism of Economics) is the prime evidence of the transfer, and among the final ones there is the virtualization of producing value added (a structure dominated by conventions in which speculation not only dematerializes the triple dimension of human condition, but also removes it as a source of economicity). Without exaggerating, it can be proved that nearly all conceptual prospects of Economics have crystallized in the melting pot of the laws governing the physical world.

Any transposition of cognitive images from *natural philosophy* is however susceptible of inadequacy at a totally different content, including the fact that the random factor, pertaining to the essence of entities naturally endowed with sense and emotions whose behaviours are covered by Economics

as a science, fails to obey the determinist linear relationships. The intervention of conscience in the economic equation makes time a relative measure whose physical precision is thwarted by the lack of determinism of the subjective space. Moreover, the rational relation between input and output is denied by the sway of unintentional consequences on performance. Beside the measure, the elements of economicity are not homogenous, above all since they generate processes whose finality is contrary to the combined elements, as they belong to another world than the natural one.

The substantial consequence of economicity is the world of artificial things, with an ephemeral order, run by immaterial forces of subjective projections and inter-subjective compensation of individual interests, even symbolic claims. Economic rationality is manifest, on the one hand, in some kind of haziness made of immaterial complexes (originating in the order of viability) and material sets (justified by the order of reliability). On the other hand, it becomes a whole in a different universe, where things are created by conventional laws which tend, by excessive multiplication, to dislocate all that is natural, and Nature itself.

This synthesis of viable elements (belonging to life) and reliable elements (belonging to physical forces, with a material nature) turning into artificial (of a conventional origin, with geometric, unnatural features) renders economicity an ontological identity and, consequently, epistemological distinction. Its separation from the methodological prospects of Economics is doubtlessly justified both in terms of breakdown (since its conceptual universe pertains to human nature) and action (the targeted order serves the yield-related performances of human condition).

The epistemological distinction introduced by Economics (different from anthropology) refers particularly to decrypting the universe of human nature in its competition-related stances, with inter-subjective consistency, to appropriate the artificial Concrete reinforcing the pillars of human condition consisting in labor, work and action.

The state of economic rationality is a special universe where forces are amassed at a high level (meaning something completely different!), via manifestation or their conscious use in a transactional formula deriving from an exceptional function generating artificial things. Due particularly to this issue, although any natural law explaining the physical world does not become ineffective in principle, measurable influences can be ignored while configuring the explanatory model of economicity.

The difficulty of the measurement belongs to the process-like nature of economicity, not to the artificial things substantiating the final result of the state of economic rationality. The ambition of remaining in the universal rule of

measurement, which is conveyed to Economics by natural philosophy, mutilates the operational whole by removing what cannot be measured, i.e. human nature. In the general explanatory model of Economics, human nature boils down to quantity, it is viewed as a resource that is measurable (since it can be consumed) and treated conventionally as being equivalent to the material component, as part of reliability.

This equivalent relation between an animated force (human nature) and the stances of elements of human condition ensure a possible resort to mathematic methods just like in Physics, but the cognitive tragedy occurs inevitably because *reductio ad absurdum* simply annihilates the universe of economicity. The price for the abuse of cognitive analogies is so high that Economics is no longer considered a science.

In fact, Economics is a science, but different from either Physics or Mathematics. It is not a science focusing on the forces linked to the origin of phenomena such as mass, energy, light or magnetism, neither a science of abstract conventions logically built and validated.

The determinist symmetry is rational for Economics along with the cause-effect asymmetry, in the same way consistency is irrelevant in the absence of time irreversibility, homogeneity is not substantial but can be accepted as a version of the yield-related state, obviously as a nonlinear function dependent on transactions in inter-subjective contexts. Finally, the balance of process-like fundamentals is questioned by the imbalance of forces involved in the process of economicity and by the uncertain quantitative stability of the final product that should properly meet expectations within the business cycle. The state of economic rationality remains a trend via the clash of rational and irrational factors, with intertwined influences of specific dualities such as *viable – reliable*, *ideal – functional*, *processual – final*, *subject-related – object-related* a.s.o.

Adding to these is the *natural and artificial* combination in the universe of economicity, the support of cognitive autonomy and the reason behind Economics imitating the method of Physics and economics researchers daring to abandon it.

Subject-related – Object-related

The inter-subjective nature of these processes is still avoided when it comes to the determinant of economic cognition.

Frankly speaking, the process as such (as an expression of natural being) and its largely subjective contents are no preferential benchmarks of the conceptual distinction of economicity problems. Within a continuity meant to substantiate – through methodological analogy – the same scientific origin,

Economics employed the same approach as Physics (which in turn proceeded as Mathematics did) in defining its own universe as being dominated by conventional, abstract rules.

On this path the classic logical rules are resorted to, as they are solidly anchored in the habitual deductions from abstract assumptions, although in the case of Economics the algorithms of situation logics, of approximating the truth value in inter-subjective contexts would become operational. By replacing the perspectives, economic cognition earns through fraud, namely forgery and use of forgery, its right to the Fortress of Sciences, thus removing from the conceptualization equation its very specifics, i.e. the transactions-related processes, with an inter-subjective contents. In the resulting hinterland, Economics appropriates the function of a science of *the* possible grounded on geometrical assumptions, developing assertions in a purely conventional and, therefore, perfect order.

Of course, the process of imitation would not be so serious if it had not been never-ending. The perseverance of Economics in conceptualizing what is depleted by the ineffable substance of subjectivity has classified it as a subordinated science, a sort of physics of social objects, if not some kind of magic of the recipe to obtain the essence of materiality, namely wealth. It is common knowledge that, following this methodological and epistemological option, Economics is applied as a science of calculation and wealth amount. In this formula, it studies from a determinist perspective the correlation of influences between objective and object-related factors, as perceived in their temporal appearances of statistical indicators. Economics thus earns its capacity as a derivate science of phenomena and results.

The likely (in ontological terms) and likelihood (in epistemological terms) penetrated Economics both as phenomena and abstract matters, thereby substantiating the introduction of uncertainty in the resulting hazard. The relative approach resorted to in economic cognition has a bizarre nature since it is not defined in relation to the subject, which is left out of account, as if phenomena were not caused by a man's cognition and action limits.

Inconsistency is both logical and epistemological since, on the one hand, it differentiates substitutes for reality such as statistical appearances and, on the other hand, what is largely not determined by physical causes is over-objectified. Both the result-object and the indefinite object-related intent have nothing in common with economic reality, which is subjectively generated in a complex form, as an ongoing cohabitation of objects converted purposefully and of intents traded in a gradual process on the substrate of harmonized discernment.

This process, seen as an economic universe, should not remain a *no man's land* since it represents the very essence of economicity, a trade-related result of yield-related limited intents. It bound us to keep the methodology within the subject-related benchmarks of economic universe, to realize the inter-subjective causalities defining certified assertions via algorithms of contextual logics. In process-related Economics, inter-subjectivity is object-related, shaping the context of the transaction to validate the return. The subject-related feature is embedded in the object-related one, as life is contained by *the* natural.

The expression of the subject-related feature in economicity is the very human nature. The relation between the final result of economicity and the subject-related feature shape the substantial relation between human condition and human nature. The deep substrate of this relation is founded on the energy generated by human nature, materializing in labor, work and action.

If we admit this vision, we find the solution to the axiom that everything involving man is implicit in process-related terms: not only human nature, but also human condition is accessible via cognition as an implicit process. The genuine end result of economicity is human condition as a gradual fulfillment formula. However, in an old-established habit we treat human condition also through its material effects, i.e. the process state is cancelled to reduce it to what replaces the process, namely the end result, the statistical indicator. Statistical prudence of the result as the essence opens the cognition gap through appearances, a reversal of the relations between process and phenomenon in explaining economicity.

The expulsion from the economic cognition universe of anthropogenic determinants, including the inter-subjective conditionality of the rationality state, opens up the imaginative way of the possible with irrational-like weightings. The recourse to speculation, for instance, and to externalities is the result of the object-related conventional, founded on a possible derationalization or limited rationalization (*ceteris paribus!*) in Economics.

The entire history of economic knowledge is, in fact, saddled with solutions to rationality problems at a yield-related scale. They are valid in the perimeter theoretically defined by extremely restrictive assumptions. Ecological research works show, with compelling arguments, that, without exceptions, Economics certified the yield-related performance by ignoring some often huge costs left in the loss account of the natural environment. Somehow even on the verge of the state of rationality, Economics established as a universal procedure the preponderance of appropriating value added by a factor in the equation of economicity, namely capital, while the other key factor attached to the subject-related feature gets the surplus.

Minimalizing the subject-related feature until being excluded from consequences does not have, despite some visions, only ideological grounds, and in fact we speak of something totally different, i.e. an inadequate epistemological positioning of Economics in regard to its object of study which is not wealth and its distribution. Economics is a social science, belonging to inter-subjective processes ultimately resulting in wealth. Economics studies mankind in its state of rationality, it is a science of human nature behaviors given the restrictions of the human condition.

In order to elicit human nature, statistics developed no instruments, since in fact human nature cannot be rationally expressed by resorting to appearances. Human nature is neither probable, nor a statistical median. What philosophy teaches us is that ontology is befriended with the world of whole integers and that it gets restless when it is denied (in a teleological way) from bringing everything to the unit or a multiple thereof. The theory of fractals, for instance, established as the statutory law of *the* real the process-like propensity of natural towards the whole, being limited in scale by a unit, a double or a triple of a unit. Only what is conditioned by human nature in achievement degrees, similarly to fractals, namely the material stances of labor, work and action (the forms of the finality of human condition) are subject to achievement probability and statistical calculation.

Economicity is the road to finality, the pursuit of compromise between the inner expressions of the object-related feature. Whereas, centering cognition not on economicity, but on statistic kinematics of the final object, is equivalent to altering the status of social science of Economics, its conversion, if not in technology, surely in the science of commodities. The economic truth is objective insofar as inter-subjectivity becomes objective, and thereby the space of economic rationality gets filled, or not, with traded certainties. The economic truth is triple-faceted: it gets validated as a process-like finality via the object, is a yield-related function for the material component of economicity and represents the cohesive form of human nature antinomies.

Statistical phenomena appear, hence, beyond the essence of economicity. This is the truth that speaks for itself, since existence cannot be appearance or an approximation of appearance. Everything that is related to phenomena can be probabilistic, especially as an expression of phenomena via statistical indicators (i.e. approximation by approximation). Just for fun, one can say that the essence of the process can be written, while the form of the process can only be rewritten (by copying).

The economists' lack of perseverance as to their science fundamentals entails the risk of marginalizing the social function they pretend having

especially at times of crisis. In fact, this cannot be grasped as a phenomenon, neither overcome via solutions derived from statistical appearances.

Ideal – Functional⁽¹⁾

The conceptual fixation of Economics in the theory of equilibrium (as an equally ideal and functional state) does not differ from the manner in which Physics and Cosmology had remained, until a few centuries ago, captive to Aristotelian materialism and Ptolemaic sphericity respectively. Mankind has immersed its ignorance into the sufficiency of the ideal, building structures and relations in which the functional principle was only accepted if the path of *sui-generis* balancing between the demands of the authority (including the scientific one) and their tacit acceptance by the remaining majority was made possible.

Equating perfection to the attainment of the ideal form, and performance to striking a balance, pushed Economics into the obsession for growth. Its sense was understood as a progressive compensation – over large time spans – between gains and losses. Somewhat scholastically, starting from its very birth, the theory of economicity has conformed to the precepts of the universe put into motion by the mechanics of infallible cyclicity. The control of surpluses was, obviously, the attribute of the authority (in its various expressions) and it eventually ended in identifying itself to the money-managing power.

The rule of the mechanic equilibrium generating trends towards the ideal shaped Economics as a science by way of transferring methodological perspectives, especially from Physics. It is known that the rationality of the physicalist universe is partial, the idea of the primary impulse with regard to the movement of bodies being accepted as coming from outside the system. Economics founded its dynamic universe in the same manner, with finality being the trend-setting expression for the ideal equilibrium and the prime cause coming from a nebulous nature, destined to self-generate and to induce self-regulation in the functioning of the wealth-producing mechanism.

The metaphor of the invisible hand inculcates this vision. It means that Economics has constructed a mechanism by which it – invariably – gives solutions which cumulate the surpluses of wealth in favor of the part which holds the right (as being born from the ideal) to pretend for the equilibrium to be favorable to it.

The fixation of Economics in the ideal is completely transparent in this crisis when it materializes into a crisis of solutions. In fact, the perception of Economics as an explicative formula for the (short-term) fluctuations in the contribution of factors to the infallible (long-term) growth does not differ from

Newton's perspective when he had to explain why the universal clock does not stop. Cognitive tolerance allows the cohabitation of the rational and the irrational, while Economics shows excessive tolerance in its explanatory model – whose result is the equivalence between the desirable ideal and the functional possible.

The crisis of solutions originates in this very tolerant composition of desirable things and functional things, which awards Economics the quality of a self-sufficient dogma. According to a somewhat Middle-age formula, its axioms related to functionality may be regarded as assumptions that explain alternative patterns to the ideal state. This vision, which in cosmology has denied the sun the central position for about 1,500 years, denies in Economics the structuring function of man and the anthropic determinism of the functional in favor of the ideal – Olympus-like – consistency of the market. Ideality as a self-sufficiency of the mechanism of economicity plays down any solution to the real situation, to that which truly functions in an anthropic context. At most, the solution could be accepted as a working hypothesis, in order to imagine intervention as possible when covering losses, because it cannot be accepted for the ideal stance, which pretends to self-replicate its performance.

This heavenly vision on Economics tolerates the earthly competition for solutions only because it accepts it as an oblation of the anthropic ignorance on the inexpugnable altar of economic ideality. The final form of unassailable ideality was in Economics the natural right of master of economicity held by the financial market together with its first born (from its alliance with speculation), that is the banking system.

The crisis of solutions is the perverted expression of the intention for conservation and, after the recession, of the performance in redistributing the added value, the appropriation ideal being now equally divided between speculation and rationality. Any solution which would remove the absurdity of this partisan ideality is categorically rejected. This proves that reality is being disregarded, ideality being defined as opposed to functionality no matter the costs, especially the social ones. For no other reasons, the solutions for socializing losses are accepted tacitly and the solutions for settling the own surpluses are vehemently rejected.

The ideality of economicity is saved by sacrificing what runs on a rational impulse: the real economy.

Conceptual – Actional

Of all the types of conceptualizations that have been developed from Enlightenment onwards none has been as debatable as Economics. A rational explanation pertains to the strong perception of a correspondence deficit between the expectations generated by theory and the findings arising from the real life.

In fact, the conceptual economicity is not enough to devise rational benchmarks for all the fluctuations in the field of action for the substantial forces of economicity, basically those expected to occur on the precise path from assumptions to effects, as they are presumed by consistency. In a relevant unavoidable form, Economics is at loggerheads with *economy*, i.e. its conceptual order appears not to match (nor overlap with) the order of economicity as a real action.

This manner in which the meanings of rational thinking are asymmetrically arranged versus those of empirical data, trending towards a disjunctive sufficiency, originates in the attempt of assigning Economics a function deemed as the certification of its forging as a mature science: to make predictions. But forcing its entry to the Fortress of Rational Knowledge imitated the model that has steadily aroused fascination: prophetic thinking. As such, Economics developed an entire tradition of over-mundane projections, actually refining the belief that the making of economicity merely comes from the idea, as economic reality is nothing but the materialization of ideas.

It is beyond any doubt that we speak of a boldness that not always has a bad end, although not always a happy one. Anyhow, except for the economic ideas adjusting to utopias (some of them even time resistant), there is no conclusive evidence about the success. But the field of experiments had already been opened. The semi-darkness of this metaphysical inversion was penetrated, naturally, by the extremely fast vehicles of faith.

In a formula that synchronizes with the acquisitions of scientist visions, but the other way round somehow, Economics also supported the dichotomy of epistemological prospects, wandering on the path of regulatory theoretical structures and moving cautiously towards positive measures. It appears that the force of attraction of ideological beliefs led to this odd situation and the theories are adversely structured in terms of response, particularly for macroeconomic issues. The background ensured by the antinomies of societal governments, stuck in the exclusive patterns of indirect government (as suggested by monetarism) and direct government (inspired by Keynes) shaped the ideologically opposite ways pursued by Economics and the formulas underlying social experiments that marked economic action.

It must be generally found that, in case of operating with theoretical theses in practice, the state of economicity is indecisively stuck in the specifics of the two perspectives: conceptual and actional. This oddity at the level of knowledge is due to the circumstances shaping the cognitive support it resorts to: either the conceptual universe of economicity or that of solutions recommended by the shortcut of political ideology. Actually, this lack of determination of the reporting also comes from the habit of preferring the conceptual and instrumental horizon of economic policies in the real economic action. In other words, we resort to an intermediate version at the very best, although it is a deviating version from the natural acquisitions of Economics, being centered upon values and interests (not necessarily yield-related in terms of the economy) of politics.

The caesura created by tradition in the correspondence model between the conceptual hemisphere algorithms of economicity and those of its actional hemisphere is hard to pass. What makes the recovery of the substrate's economicity difficult, as an antithetical whole also comprising the conceptual-actional alignment, is the conditioned reflex of the dependence on the patterns of Political thought and action that the two forms of shaping economicity (Economics and the economy!) have created over time. So far went this manner of understanding things that Economics produces post-Keynesian ideological theories and the economy is a plot organized with the expertise of Politics.

Somehow unexpectedly, even the instrumentalization of the space of economic rationality is made with rationality gaps that the political exercise feels it has to treat with sufficiency in order to reach its targets. Economic conceptualization becomes at best the logistic warehouse of elements Politics resorts to in fuelling the power's chain reaction. This subordinated condition of Economics relative to the needs of practical action does not relieve it of the risk to be punished for being the scapegoat for the failure of Politics. This occurs in an aggravating form, because of its lack of responsibility for one's own action area. Culpability arguments also take account of the fact that Economics appears to ignore that its problems have a double form, i.e. in conceptual and actional terms, and the solutions must have in turn the substance of conceptual-actional dualism. It is clear that the blame can logically be put on the part that fails to deal correctly and directly with its problems.

The frequently invoked excuse that Economics is responsible only for the significances of the primary problems concerning the three elements of human condition (labor, work, action) does not remove the incongruences arising from the explanatory models in conceptual and actional terms. The strategic self-exile in the field of current expertise and placing Economics on the management path of conceptualization and actions in local contexts, as well as

on the critics' positions of welcoming the projection of public policies, are no evidence for assuming the specific cognitive function, but only subterfuges to conceal the epistemic failure. Of course, Economics had its heyday when, in Greek antiquity, it only used to prepare procedures responsible for household performance. Today there is no way of imagining, except for epistemic declassification, Economics as being isolated from the Agora's idea-related unrest and its manners of understanding performance.

The curse from which Economics cannot (and even should not) get away from is, on the one hand, to set limits it had to live with for three quarters of a century and, on the other hand, to settle once and for all a gold rule in its cohabitation with Politics. What we mean here is certainly to define what and how much does Economics itself pretend it resolves and especially how much does it allow Politics to expand its pretences of being a designer and manager of the actional space of economicity. The key to the success of Economics in this genuine renegotiation of convention regarding its epistemic composition is to put the antithesis between human nature and human condition at the centre of cognitive concerns and explanatory models. And this is only because animal spirits haunting human nature can no longer be left to be managed by someone else, as experience shows that Politics fuels solely their irrational propensity, being deprived of the cost-cutting body.

The fundamental antithesis between conceptual and actional reveals cognitive protocols that are compromised in the Economics-Politics relationship, a mutual mix of elements that led to the weakening of the covalent link with the anthropic substance of their worlds. The most surprising facet of Politics' intervention in economicity mechanisms is to highlight the emergency of reconstructing the manner in which knowledge is founded in what was to become social sciences, including Economics. The endeavour consists in overcoming the materialistic obsession in social sciences, the excess of validating the truths by the rule of mathematics-prone formalism and the temptation to resort to the facilities of methodological "loans" from experimental sciences in order to finance social schemes. At the same time, Politics has enough reasons to accept surrendering the abusive right over economicity; somehow it even awaits getting rid of the responsibility of having drawn on wealth as an argument for the rationalized capacity of controlling the freedoms.

The ongoing crisis is a painful and merciless testimony to the inevitable restoration of order antithetically circumscribed to the conceptual and actional specific to economicity, but also the rational sign of Economics' opportunity to revert to its basic tools, the astral hour of resuming the negative inverse links between economic thinking and action.

Individual – Social

Of all the antithetic constituents of Economics, the cognitive perspective *individual-social* has and will have the greatest potential to generate non-scientific disputes. The particular fate of the spiritual adventure of this category couple resides in the sizes of the clash, which have reached staggering heights through antinomy-based theories such as the theory of capitalism and that of socialism. It is interesting to note that in the original theoretical body of Economics the individual-social relationship ensured, in an upbeat approach, the basic structure of understanding the manner in which the regulating mechanism of economicity, i.e. the market, is shaped and operational. Somehow salutary, Economics enters the Fortress of Science in a compliant, innocent and chiefly natural way.

Unfortunately, Economics grappled with persistent disturbances of its conceptual universe at a faster pace than other non-experimental sciences, and such turbulences have gradually become so subtle that they have removed the bases and replaced the explanatory models. The most extensive and intricate negative effects were the ideological seizure of theories, the use of suggested solutions to the issues of certifying yields as non-conventional ammunition for conquering political power. As things developed in time, it appears that Economics had to grapple with all kinds of ideological assaults and what we deal with today is a terrible ideological terrorism responsible for the outset of the financial crisis and its turning into an economic crisis as well as for the unimaginable protraction of its devastating effects on the society.

So aggravating is the ideological invasion of Economics that few of those interested in the theoretical and practical issues of an economic nature are still able to discern whether they work or not in environments that can be shaped with the tools of a perverted science. The habits of appropriating as economically correct the ideas or the solutions of political ideologies are quasi-general.

This dissolution of the epistemological condition of Economics entered this irreversible course after the post-enlightenment option of managing power in the framework of representative democracy. The need has emerged ever since to multiply the sources for impacting eligibility beyond those assumed by public confidence and the natural recognition of merits. Economic science provided via wealth the strong argument of the possible substitution of every election-related criterion for the fact that the owner of the argument appeared entitled to gain confidence (standing out as the most envied prototype of the winner) and particularly for being in the best position to buy confidence. The political class based on the economic argument of power proved to be the invading army of Economics in order to increase its range of techniques needed

to hold the others under control. On this path as well, and especially on this one, Economics served Politics, thereby abandoning its scientific condition to become a Moloch referred to as Political Economy.

“Individual and social” are in fact the benchmarks for the process called “economicity”. According to the Cartesian coordinate system, individual is the abscissa of performances in the field of economic rationality and social is the ordinate (Frankly speaking, the correct representation would be that of polar multi-axes, including the other fundamental antithetic aspects of Economics such as: viable and reliable, ideal and functional, process-related and final, subject-related and object-related, natural and artificial, economic and ideological, etc.). By making an analogy, we underscore that individual and social have a rational content, including the function to measure the states of economicity, basically in correlation terms. “Individual and social” stands out as a chiefly systemic entity, shaped by the dynamics of the joint influences of both elements. Any segregation of the roles could only lead to a disintegration of the field of economic rationality.

The analogy with the unified field theory is even more relevant, with “individual and social” being for the conceptual world of Economics what “mass-energy” is to the theory of relativity. Leaving aside this epistemological principle, it is impossible to rationally understand the fundamentals of Economics or to provide a logical explanation for the inner consistency of the field of economic rationality. In fact, the Smith-type intellectual breakthrough is particularly due to the benchmarks of validating the statements on the market mechanism in the innovating individual-social interrelations. The breakdown of the world of economicity by antithetic element opens up the path of unilateralism, imbalances, adversities, namely in epistemological terms pure, parsimonious representations and, in practical terms, tribal-like organization, setbacks, and identifying the sense of life with the absurd.

Extreme solutions, solely for an antithetic element, are typical of ideological approaches. However, they became an integral part of Economics once the innovating Keynesian genius made quite a stir by labeling macroeconomics as a heal-all for the social effects triggered by the economic crisis. Macroeconomics has quickly and completely proved useful to power management as well, and even provided as a bonus the power of the possibility to extensively exert the political right to resource allocation, i.e. to rise to the occasion really capable of a cognitive revolution: to convert power to wealth. What followed is subordinated to the logics of wealth-power equivalence starting from the de-rationalized version of the antithetic individual-social foundation approached thereafter as a methodological distinction between the individual and the society, reaching an antinomy apex through the

irreconcilable contraposition individualism-socialism and a critical mass-like limit through the recent rivalry between corporate capitalism and state capitalism.

Perverting the order prospects via extreme solutions not only defies common sense as a regulatory instance for human nature and human condition, but also attacks the grounds of nature in general. Most frequently such reckless actions occur by using the language of freedom (as well as its regime) as an intermediary (including as a dictionary of dialectical symbols) between individual/individualism/individual and social/community/society. The explicit formula developed in the property right theory embraces the triple-shared breakdown of economicity (micro, macro, institutional) through abstract equivalences like property=freedom to justify the exclusivity of methodological individualism as the single principle ordering the world. People say (in the attempt to recover common language and thought): Property is power! (Obviously, in total contradiction to the Paretian legacy regarding the natural rules of property fragmentation).

The most serious distortion of the meaning and essence of economicity, achieved by replacing the fundamental antithetic social-individual feature with the explanatory model derived from the ideological assumption of *ownership is based on freedom*, establishes not only the equivalence between wealth and power, but also its decay in a conflicting prevalence order fuelled by the forms of individualism. During this stage, the generally human values are overthrown, ending up in a reality not entirely different from that induced by the obsession of highest yields after eliminating human nature from the equation and minimizing democracy-related costs by prohibiting free will.

Theorization of the elite capitalism superiority (of the corporate one, for instance) at the expense of more sensitive types of capitalism centered on the functional individual-social entity brings the developments in the global economy under the full control of ideologies and the world on a path of uniformity-creating unilateralism, which is nothing else than sublimed totalitarianism.

Reliable – Viable⁽²⁾

The ongoing crisis has revealed that for economic theory, apart from its fundamental inconsistencies, living side by side with political ideologies can only spell failure. We, the ones from the European Orient, are somewhat entitled to declare – based on our direct experience with ideology-creating contexts – that in the Economics-Politics functional relationship the winning games are as such

because... Society loses. Of course, the economy loses first, even in both its forms: as a theory (Economics) and as an activity (the economy).

What really appears to be shocking is that the loss – of consistency (in the case of Economics) and of substance (in the case of the economy) – is not related to the quality of the prevailing economic vision. Being rigorous, something such as this does not exist because, essentially, what we call dominant economic vision is proven to be the Economics-Politics mixture, in which the control function for the effects is held by Politics. Otherwise, there is no alternative reason for the economy to be considered – in spite of fundamentalist perceptions – a product which does not sell but under the brand of Politics, coming to be exactly what we believe it should not be: Political Economics.

By transposing the explanation for this knowledge in the range of meanings of the fractal theory, it could be argued that the functional entity resulting from the merger of the two instruments for the functioning of the societal is made up of one third Economics (with conceptual and actional contents) and two thirds Politics. In the projected arrangement the homothetic relations are observed regardless of either form or scale.

What is construed as a potential for bifurcation (towards either failure or win) in the mix area resides in the control of the segment (either linear, of perimeter or of volume) disputed at the confluence between the one third of Economics and the two thirds of Politics. Two situations can be noticed here: on the one hand, the case of the prevalence of the propensity to economic rationality, where the trend is for the moderation of a little over one half of the double measure of the Politics segment, thereby reducing the risk of crisis and entering an upward trend; on the other hand, the case where the expectations of Politics weigh heavier, where rationality is often defied and the one third of the confluence belonging to Economics is being altered, even in its integrity.

The state of permanent tension illustrated by the trends in the confluence area holds explanations from different perspectives, to which specific procedures of action are being attached. They indicate that the control of the wealth mechanisms matters for Economics (equivalent to one third of a viable entity) and the function for the control of power gains the upper hand in Politics (equivalent to two thirds of the resulting societal entity). The coming together of the two functions is inconsistent, because the possibility of compromise is excluded, and the result can only be one or the other. In fractal language, Economics has the function of generating the rule for covering the territory of Society with the homothetic dimension specific to the state of rationality, while Politics has the function of generating an internal structure of the Social according to the rule of fluctuating arrangements, with no internal homothecy in

the Mandelbrotian sense. And for this reason the double target is proven to be a one-way highway to failure.

The automated solution to covering the Social is the very raw failure which we experience as generalized crisis, when Politics forcefully pushes it way towards achieving its goal. It achieves, though, this counter-performance by minimizing the reliable manifestation of the specific segment of Economics. The solution is to restart the dynamics in the Economics-Politics area of confluence. For this, the function of Economics is to enlarge the space of rationality over at least half of the fractal dimension with which Politics adjoins. This means Economics has to functionalize its own segment and, at the same time, in order to achieve a viable confluence it has to control – based on socially-tested efficiency criteria – the most part of Power.

The fine tuning between the two levels of action in the area of confluence (which, obviously, is also a noise interval) pertains to the awareness to the link between the physical entities and the biological entities (between artefacts and human nature in the field of Economics and between decisions and inter-subjectivity in the spectrum of Politics). But it also pertains to the fact that the mechanisms of wealth and power put together tend to eliminate the societal goals of both Economics and Politics.

The most important issue for this explanatory model inspired by the theory of fractals is that the area of confluence between Economics and Politics has to be characterized, at some point, by a mechanism for managing the tension-riddled movements of influence. It is obvious that something like this must exist when the final goal belongs to a different level in the configuration of reality, where the *reliable* sense transcends into *viable*, because we are talking about a complex, dynamic and open system, i.e. the human society. In such systems the fracturing (not as much methodological but operational) has catastrophic consequences. Fractalization seen as a support for understanding and explaining gradually reveals both the mysterious confluence between being *reliable* and being *viable* (simultaneously and non-contradictory), as well as the influences of transforming the state of rationality by levels of substantiation, meaning one represented by the mechanism of wealth and the other represented by the organism of power.

The fractalization of the functional Economics-Politics complex demands to be understood as a perimeter where the societal entity which contextualizes the tensional trends is permanently being configured, through interpolations and extrapolations (which in the end are nothing but consensual arrangements). This eminently rational perspective protects us from compromising the reliability of yield-oriented mechanisms and from altering the viability of the societal organism. Thus, the fractalization of the Economics-Politics post-Enlightenment

super-territory distinguishes the demarcation line of the horizon of the understanding of the compromise between conflicting states in the dynamics of societal systems and, at the same time, points to the level in between whose limits the explanation is coherent and unavoidably consistent.

The *Reliable-Viable* transformational consequence of the tension-riddled dynamics in the Economics-Politics area of fractal confluence is the sole natural resource which neutralizes the spillover effects which open/close the cycles of modernity.

Processual – Final

In Economics, the object of knowledge is an intermediate issue of the essence of things, namely the phenomenon related to economic facts. For instance, economic growth is formally rendered as GDP dynamics, i.e. the direct process of expansion is superseded by a quantitative phenomenon measured in approximate terms, namely the GDP variation.

Setting perceptions into facts, somehow even beyond the phenomenon, indicates a *sui-generis* cognitive model interested in the material consequence and by no means in the path to economic facts. Herein resides the source of uncertainty in establishing rationality criteria, since they refer to final aspects, not to those shaping the conditions ensuring finitude. This is also the source of uncertainties surrounding the yield-oriented algorithms in the form of negative expectations on completion.

In addition, the cognitive image-based operation augments the appearance twice, because, despite its transcending in the final result (perceived only subsequently), growth is approached in statistic terms, as a phenomenon based on the assumption of relevance of the law of large numbers and extremely long terms in Economics. Within these benchmarks, with economic knowledge being trans-generational, it becomes absolutely non-individual, creating unacceptable inconsistencies.

It is the process which should stand alone under the magnifying glass as a potential to reach finitude. Reversing the expression of reality (its representation through finitude, not through the intermediate processuality with finitude as its consequence) complicates the understanding of Economics as a science, including its being viewed as inverted metaphysics, with facts generating solutions, and solutions (for the circumstances of the path to finitude) not ending up in economic facts. From such a perspective, the solutions concern (paradoxically) the phenomenon, i.e. the partial state, related to the appearance, seen as central tendency, and not the processual reality.

The function of finitude, deriving from original materialism and the cognition of appearances as a principle of science-like experimentalism made Economics the territory of confusing and diffusing conceptualizations. In fact, Economics appears to have insulated itself in the world of inverted assertions.

Escaping from this experience of counter-nature would involve determining economic cognition in what alters the state of the phenomenon emanated from the fact, i.e. in the processuality of the conditions on which the consequence is based. In a rational formula, one may say that Economics should overcome the replacement states of the process, in this case the perceptions in the approach to finality. Cognition conceptualizes the process, summing the limits of rationality sources. Only sporadically cognition uses the appearance of a process conception of rationality that is referred to as the phenomenon of economic growth (measured by the GDP variation).

The process reveals the kinematics of rationality sources in an inter-subjective context. The process itself is a concept of transactional inter-subjectivity related to factual finitude. Mediating between the conceptual substance of economic cognition and the factual concreteness of the GDP is made by steadily accommodating the limits of rationality sources in the context of transactional inter-subjectivity.

The process bears an economic meaning only by relying on the premise and by drawing on the substance of transactional inter-subjectivity of yield-oriented states. Insofar as economic cognition is fixed in this constitutional reality gap, not in phenomena or finalities, potentialities and certainties put together, it succeeds in freeing itself from failure or utopia. The process signifies the impending change of inter-subjectivity composition, driven by both conceptual and factual factors.

Focusing on the essence is the very function of economic cognition: to detect the process as a feature of transactional inter-subjectivity targeting yield validation. The essence appears to be accepted as an immutable state only if we go by the inverted formula of targeting the economic fact as the substance of economic cognition. It is reasonable to see the essence as achieving the process and the process-like yields, generating a movement of conceptual and factual performance limits of transactional inter-subjectivity.

Of course, such a manner of understanding the function and the algorithm of economic cognition is struck by habitude and the deposits created in the area of theoretic visions, as well as by the convenience of resorting to measurable matters in building explanatory models. Paradoxically, as economic science is expected to grow stronger, it limits its meanings to the invariant horizons of assimilated concepts. The most persistent obsession in economic cognition came from the easy handling of statistical tools and the maximum deviation

from the fashion of quantitative separation of economicity. The pressure from these extremes translated into economic cognition through the excessive resort to indicators, to cognitive prevalence by measuring the economic fact, as if Economics were a science of the final product.

The epistemic tragedy of Economics occurs when growth would be (as it should be!) separated as a process, not as a phenomenon linked to the GDP. The entire theory about economic growth takes appearances for essence, shaping a mirror image of reality, from the post-factum fluctuations in economic facts to the conditionalities of the path leading to the result, as if *they* would be the result. Even when insisting upon analyzing the conditionalities, economic cognition does not aim at emphasizing the generative qualities of the result, because evidence relates to the GDP variations, playing the major role in the analysis. One cannot speak of indirect knowledge, but simply of overlooking the process as a formula resulting in economic facts.

The lack of cognitive insistence on the algorithms of growth as a process in which things happen, as they say, on the run, on the race track where, by using up subtle energies, the fair measure of the geometry of influences pertains to human (more precisely, the projection of his/her comfort on the distribution of consequences), not to abstract substitutes, deprives the function of Economics of the conceptual support to maintain a natural balance between human nature and human condition.

Economics got used to work with appearances and conventions (following in the footsteps of cosmology, which in turn had traced geometry) in Plato's and Euclid's style.

The statistics of the result conceals the process, making Economics a science of chance, namely the chance of things by themselves, with no human presence required.

Concluding remarks

Economic science, in its fundamental instance referred to as Economics, is a complex conceptual construction of a dialethic nature, combining antithetic perspectives in a context marked by inter-subjective meanings, centered upon the transaction function of utility in a yield-oriented formula. Excluding the double methodological reporting in defining algorithms that shape the state of economic rationality, deprives Economics of its object. The unilateral approach in understanding the fundamentals empties the scientific content of Economics. For retaining the right of being a science, Economics should treat its object of study as a viable entity because it generates something reliable, as a projection of its intention with the tools of rationality and as a relational world of tensional units aimed at the same yield-oriented purpose.

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Notes

- (1) Ideas contained in this paragraph have been advanced through the editorial of the 12th issue of 2010.
- (2) Ideas contained in this paragraph have been advanced through the editorial of the 11th issue of 2010.

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Capital Budgeting: a Tax Shields' "Mirage"?

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Abstract. *The mainstream in Finance studies recognizes the impact of tax shields on capital budgeting. This study offers some evidences regarding a bias in direct investment projects valuation in the case of taking into account of the allowance of recovery of the losses recorded in the past financial exercises from future profits as long as the classical indicators (e.g., Net Present Value) are used. Also, this tax regime seems to favour the adoption of less-performer projects by less-performer companies, as long as these projects should be otherwise rejected by a performer company.*

Keywords: capital budgeting; tax shields; recovery of losses; net present value; cash flows.

JEL Code: G31.

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1. Introduction

At a macroeconomic level, taxes are acknowledged by many experts as a tool that can be used in order to have an influence on economy or even on society (Văcărel et al., 2007, Obreja Brașoveanu, Brașoveanu, 2008). However, not always this instrument achieves this goal (Dragotă, Dragotă, Țătu, Țătu, 2009).

At this moment, many countries have adopted the principle of allowing the recovery of losses from the profits supposed to be recorded in the following financial exercises. For example, in the European Union, the allowance of recovery of tax loss is stipulated in states such as: Austria, Belgium, France, Finland, Lithuania, Luxembourg, Netherlands, Romania, Spain, Sweden, United Kingdom (www.europa.eu). The main explanation for this regulation is to encourage the economic growth. A support for companies that record losses can be accepted as long as these companies will determine economic growth in the future.

The analysis of the impact of tax regulations on the corporate financial policies is a permanent presence in financial theory. However, emphasis was placed on the tax impact on financing and dividend policies, proof thereof being made by the long list of articles published in this field, initiated by Modigliani and Miller (1963) regarding financial structure, and Miller and Modigliani (1961) on the subject of dividend policy.

Concerning capital budgeting, most finance studies take into account the impact of taxes on the performance of investment projects or, more precisely, the impact of tax shields on the cash flows generated by the investments project. For example, it is recognized in this context the impact of tax shields resulting from debt, which can improve the performance of an investment project. Mainly, the basic idea behind the concept of tax shields is that some projects financed by 100% equity must be rejected (net present value⁽¹⁾, $NPV < 0$), while the same projects, but financed by a mix of equity and debt, due to tax shields, can be adopted ($NPV > 0$) (Modigliani, Miller 1963, Ross, Westerfield, Jaffe, 1999). In fact, this entire judgement is based on the idea to correct the cash flows produced by the investment project with tax shields due to indebtedness.

Similarly, it can be stated that a company can benefit from tax shields resulting from recovery of losses recorded in the previous financial years. By allowing the deduction of losses from taxable profit recorded by companies, the cash flows generated by these companies will be also affected. Regarding the

analysed investment project, this tax regulation will affect the cash flows and, also, the discount rate.

Somehow, this issue will violate one generally accepted principle in investment projects valuation, respectively to assess the project *in its individuality*, i.e. to take into account only its independent performance, and not the general performance of the company that analyse the project (Ross, Westerfield, Jaffe, 1999). However, the companies that have recorded financial losses in the previous years will be able to increase the level of their cash flows by adding the allowed recovery of financial loss. We will emphasize that this regulation promotes the adoption of relatively unproductive projects by the companies that benefit from this tax facility. Moreover, some direct investment projects that otherwise would be rejected (if they were analyzed independently, by a company that does not benefit of this facility) may become attractive for these non-profitable companies.

The main purpose of this study is to highlight the limits of the classical indicators of investment projects valuation for the companies that have the right to recover tax losses. Practically, these indicators are unable to provide accurate information necessary for taking decisions based on the valuation of direct investment projects, and have to be analysed cautiously.

The paper may be useful to decision makers involved in the analysis of investment projects, but also can provide some ideas to tax regulators. The remaining part of the study is structured as follows. In Section 2 it will be presented the case of the valuation of investment projects in the absence and in the presence of the interference given by the possibility of recovery of tax losses recorded in the previous years. Section 3 concludes the study.

2. Valuation of investment projects as long as the recovery of losses from previous years is allowed

General practice in corporate finance is to take account of fiscal issues in the estimation of the cash flows generated by the investment project. The forecast of income tax will be done based on the (expected) tax rate and on forecasted taxable profit. Regarding the determination of income tax for a negative taxable result (loss), two possibilities are accepted: a) to apply the tax rate on loss, which will produce a negative tax – or a current tax shields. In this approach, it is assumed that the investment project is part of the company's investment portfolio, so the loss will determine a lower taxable profit for the company at the present moment. Thus, the company will have to pay a lower

income tax comparative to the case in which the project would not be adopted; b) to consider the zero income tax, but to carryover the actual loss in the next years, so that the future tax profits will be lower – this is equivalent to a future tax shields. This option assumes that the investment project is considered independent of the company's activity or that the company has an investment portfolio consisting only in this project (Dragotă, Ciobanu, Obreja, Dragotă, 2003, vol. II, p. 49). In other words, the literature stresses the possibility of recovery of losses, implying the reduction in the tax payments in subsequent financial years, but also emphasizes the valuation of investment projects in its individuality.

Anyway, a financial indicator has to express something for his user. For instance, NPV has to eloquently explain if a project should be accepted or not, in accordance with the principle of “maximization of the shareholders’ wealth”, which is stipulated in the main stream of financial literature (Ross, Westerfield, Jaffe, 1999).

Although the stated purpose of corporate finance is to maximize shareholder wealth, which would translate to the exclusive adoption of projects that determine a maximum (positive, to the limit) NPV (Ross, Westerfield, Jaffe, 1999), managers can be more inclined for holding the financial resources, as a measure of discretion in decision making, prestige (achieved in contemporary organizations through access to the highest volume of money), etc. This phenomenon was highlighted even in classical papers (Cyert, March, 1963, Jensen, Meckling, 1976, Jensen, 1986). Moreover, in a more recent study, Loderer, Roth Waelchli and Joerg (2010) show that most managers of companies in the world do not mention the interest for shareholders in their statements on company goals. Regarding the investment policy of companies, this may be translated into a highest allocation of funds for financing investment projects, even these project are not so performative.

One example, extremely simplified, will express the phenomenon. Let’s consider a project that generates a number of annual cash flows (CF_t) for a period of n years (for simplicity, we assume a zero residual value). By hypothesis, in the entire study, we assume that the projects are financed entirely from equity and the rate of return required by investors is k . Project cost is I_0 . Net present value of the project is:

$$NPV = -I_0 + \sum_{t=1}^n \frac{CF_t}{(1+k)^t} \quad (1)$$

The project is acceptable if and only if $NPV > 0$, respectively:

$$\sum_{t=1}^n \frac{CF_t}{(1+k)^t} > I_0 \quad (2)$$

It may be noticed that the investment project valuation has to be done independently of the company that analyze it, given that the only key variables are the cash flows generated by the project (differences between cash inflows and cash outflows arising from the project), the rate of return required by investors and the project cost, variables determined by the expected conditions related to the project. Among these determinants it can be mentioned the payment of the income tax, calculated also on the basis of project performance. It can be stressed that this level of income tax will not be affected by the overall performance of the company, but only relates to the project performance.

If we take into account the possibility of recovery of tax losses previously recorded by the company (or even recorded simultaneously with the investment project), an artificial increase in cash flows to the company level can be induced. It is obvious that this phenomenon creates a relatively "mirage", investment projects performance appearing to be less attractive for performing companies than in the case of non-performing companies. In addition, a system based on the growth of certain expenditures can stimulate both the lack of performance in carrying costs (such an unjustified increase of them), and an alteration of performance indicators of investment projects, especially if one takes into account the agency problems present at company level.

Here, it has to be considered one important distinction between tax shields due to indebtedness and the ones due to the allowance for losses recovery. In the first case, the financial structure for financing the project is determining the tax shields. Here, the principle of direct investment project valuation in its individuality is applied. However, in the second case, an impact of losses from past projects (with no connection with the analysed project) can interfere in the project valuation, so this principle is not applied anymore.

To exemplify this phenomenon, we start from a simple numerical case, but that can be easily generalized. Let consider two companies, A and B, of equal market value, V_0 , identical in all respects. For simplicity, we assume that these two companies are non-levered for the entire period of analysis and that all their activity is quantified as a single investment project.

As such, we assume that each of these two companies adopted one single investment project. The company A has adopted a project that has produced

profit, while company B has adopted a project that has generated tax losses. The life time of these two projects was identical, and both projects are currently completing. Although market values of the two companies were originally identical, currently they are different. For simplicity, we assume that the life time of these two projects was one year. This simplification does not change the main conclusions, while what having effect is the existence/absence of tax shields. In normal economic conditions, we have to impose the condition that the tax losses to do not exceed the net assets of the company, so as not to trigger bankruptcy proceedings⁽²⁾.

Currently, company A can not benefit from the right to recover losses. Also, company B has the right to recover a tax loss of 500 monetary units (hereafter, m.u.). Each company analyzes the adoption of an investment project, with equal cost and the same levels for resulting expected cash flows. Again, for reasons of simplicity, we assume that the investment project life time is limited to one year, and the cash flow from the first year is including the residual value⁽³⁾.

The investment project requires an initial investment of 600 m.u., and the expected cash flow is 650 m.u. We consider a discount rate of project investment of 10%, both for company A and for company B⁽⁴⁾.

For the company A, the NPV is:

$$NPV^A = -I_0 + \sum_{t=1}^n \frac{CF_t}{(1+k)^t} = -600 + \frac{650}{1+0.1} = -9.09 \text{ m.u.} \quad (3)$$

For the company B, if the recovery loss is not considered, NPV will be equal, respectively:

$$NPV^B = -I_0 + \sum_{t=1}^n \frac{CF_t}{(1+k)^t} = -600 + \frac{650}{1+0.1} = -9.09 \text{ m.u.} \quad (4)$$

The analysis of the investment project shows a negative NPV for both companies. Accordingly, under the principles of assessment of investment projects, the project should be rejected by both companies.

The purpose of financial indicators is to provide useful information for management decisions, in this case regarding adopting or rejecting an investment project. In this case, because of the interference induced by allowing recovery of losses, NPV is not recommended. We stress that this does not mean

challenging the classical indicators of capital budgeting for normal circumstances of business activities, but only in these restrictive conditions.

In the case of company B, due to the influence of previous activity recovery loss, we can calculate an indicator (noted here NPV*):

$$NPV^{B*} = -I_0 + \sum_{t=1}^n \frac{CF_t + TS_t}{(1 + k \times \delta)^t} \quad (5)$$

In this equation, the cash flow from equation (4) was corrected in order to take into account the tax shield, TS_t . Also, the usual discount rate (k) has to be corrected in order to take into account the impact of tax shields. We preferred a correction factor, δ , with $\delta \in (0, 1]$, where $\delta = 1$ reflects a zero tax shield, and $\delta = 0$ reflects a 100% income tax rate. By this correction, it is taken into account the coherence between the cash flow (this one has to take into account the tax shield) and the discount rate (this one has to take into account this tax shield, too). There is a logical relationship between the cash flows and the discount rates: as long as the company can benefit from the right to reduce the taxable income, the cost of capital will decrease. We preferred this formalization instead of classical $(1 - \tau)$, where τ is the income tax rate, because loss can be recovered by profits (positive incomes) at different future moments, so the relationship between tax rate and cash flows is not stable.

For the numerical example, supposing $\delta = 0.9$, the corrected NPV is ⁽⁵⁾, ⁽⁶⁾:

$$NPV^{B*} = -I_0 + \sum_{t=1}^n \frac{CF_t + TS_t}{(1 + k \times \delta)^t} = -600 + \frac{650 + 500 \times 16\%}{1 + 0.1 \times 0.9} = 69.72 \text{ m.u.} \quad (6)$$

As long as company B benefits from a cash flow potential that can be materialized only in the case of the adoption of the project (respectively, the tax shield, TS_t), it is most likely to adopt the investment decision. It can be noticed also that, in this case, classical NPV does not offer the correct information for the management. It should also be noted that the adoption of the investment project is recommended for this company, because otherwise it would not be able to recover the losses from the previous years.

Seemingly, it can be argued that this reduction in taxable income would be negligible if the multi-periodic case will be analysed. In fact, this is not so important as long as we compare two companies, of which only one benefits by the right to recovery losses. In other words, let suppose an investor analyses an

investment project in two scenarios: (i) establish a new company; (ii) buy an old company, which has the right to recover losses. In this case, it seems to be obvious that the second choice is better.

3. Conclusions

The recovery of losses creates a relatively “mirage”. Using the classical net present value criterion, the performative companies will reject some project (less performative), but some less performative companies could accept the same projects! Furthermore, this tax regulation encourages the adoption of non-performing projects by non-performing businesses, which would be rejected if the business would be performer.

For the financial analysts, the effects of the allowance for recovery of losses have to be taken into account. These can change the normal verdict regarding recommendation for adoption or rejecting an investment project based on NPV criterion. Moreover, the classical principle of the valuation of the investment project independently by the adopting company has to be used cautiously.

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Notes

- (1) Throughout the entire study, the references to the capital budgeting decisions are based on the net present value (NPV) criterion. Of course, all these considerations can be easily generalized to any other indicator used in capital budgeting analysis – internal rate of return, modified internal rate of return, payback period, etc.
- (2) Even this condition is questionable in certain situations. For example, in Romania, some companies have recorded levels of negative equity, but are not in bankruptcy proceedings.
- (3) Normally, this assumption does not change the conclusions of the study. One can assume that the projects will be sold on the market at prices reflecting market expectations regarding the future performance of the project. As long as the market where this transaction is carried out tends towards efficiency, it will not appear significant problems. Moreover, under normal conditions, even if the market is not efficient, the best prediction made at this time for the expected resale price of the project over one year is its intrinsic value. For Romanian capital market, see tests of informational efficiency in Dragotă and Mitrică (2004), Pele and Voineagu (2008), and Dragotă, Stoian, Pele, Mitrică and Bensafta (2009).
- (4) This assumption can be considered questionable, even the projects are identical. It can be considered a different discount rate for these two projects. This difference can be explained by the higher risk expected by the investors in Company B. Indeed, the investors in Company B can anticipate a higher operational risk, due to the lower past performance of this company. Anyway, this assumption does not change the logic of the demonstration as long as the numerical result still holds even if there are used different discount rates (e.g., 10% for A and 20% for B).
- (5) In the case of a higher discount rate (let it be 20%) for the company B, if the recovery loss is not considered, NPV is:

$$NPV^B = -I_0 + \sum_{t=1}^n \frac{CF_t}{(1+k)^t} = -600 + \frac{650}{1+0.2} = -58.33 \text{ m.u.}$$

As observed, NPV for company B may be lower, plausible as this seems to present a greater risk from the investors' point of view.

For the numerical example, supposing $\delta = 0.9$, the corrected NPV is:

$$NPV^{B*} = -I_0 + \sum_{t=1}^n \frac{CF_t + TS_t}{(1+k \times \delta)^t} = -600 + \frac{650 + 500 \times 16\%}{1 + 0.2 \times 0.9} = 18.64 \text{ m.u.}$$

- (6) To highlight the impact of the tax shield given by the allowance of recoverable loss, we have considered an income tax rate of 16%, applied in some countries (e.g., in Hungary and Romania).

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Convergence of the Policies for Promoting Total Quality Management in the Public Administrations of Balkan States – European Union Member States*

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Abstract. *In the past three decades, total quality management (TQM) has been appreciated as “fundamental modality in view to improve the activity in the public and private sectors” (Boyne and Walker, 2002, p. 1). For the time being, in public administrations, we witness an extension of the policies for promoting TQM, although the experiences have not always been positive.*

The European Administrative Space (EAS) incorporates TQM, in different manners at national level, taking into consideration its recognised impact on the efficiency of public administration, one of EAS fundamental principles (Zurga, 2008, pp. 39-49). In the context of analysing EAS evolution, the administrative convergence will also comprise the convergence of TQM policies. In fact, the field literature (Hackman, Wageman, 1995) reveals, in the context of national TQM policy-making, the concepts of “Convergent validity” and “Discriminant validity”, reflecting “the degree to which the version of TQM promulgated by the founders and observed in organizational practice share a common set of assumptions and prescriptions” (Hackman, Wageman, 1995, pp. 318-319).

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By a comparative analysis on TQM policies in the national public administrations of Balkan states, EU Member States: Greece, Cyprus, Slovenia, Bulgaria and Romania, the current paper aims to reveal the level of their convergence as well as the theoretical consistency of the conceptual and practical framework for TQM assertion.

The comparative analysis will be based on a comprehensive vision on TQM, provided by Dean and Bowen (1994), Boyne and Walker (2002), namely its approach should be characterised on own principles, practices and techniques, grouped on customer focus, continuous improvement and team work (Boyne and Walker, 2002, pp. 4-5).

The tradition on promoting TQM in public administration in the above-mentioned states is relatively recent: since 1990s – Cyprus, since 1995 – Greece and Slovenia, since 2000 – Bulgaria and Romania. However, in the context of the EU membership and EAS enlargement to the Balkans, their efforts for promoting TQM in public administration are marked by concrete actions, reflecting differentiated degrees of convergence.

The current study will refer briefly to global convergence – assessed in relation to the founders' conception on TQM and comprehensively to the relative convergence – assessed by comparing the activities concerning TQM in the states under review.

Keywords: Total Quality Management Policies, Public Administration, Convergence.

JEL Code: H83.

REL Codes: 13G, 13J.

Introduction

The preoccupations for promoting total quality management (TQM) in public administrations or generally in the public sector are moreover visible, especially in the past three decades.

In the above context, TQM is appreciated as “fundamental modality in view to improve the activity in the public and private sectors” (Boyne, Walker, 2002, p. 1).

The specialists’ approaches are definitely complex and the analyses are using modern tools based on benchmarking as well as on integration and interpretation of the outcomes in the context of the processes of convergence and administrative dynamics.

For the Balkan states – EU Member States: Greece, Cyprus, Slovenia, Bulgaria and Romania – the different histories of the European integration will determine different approaches of the policies for promoting quality in national public administrations. In this view, we find significant issues since 1990s, when strategies and policies for promoting quality in the public sector, in general and in public administrations, in particular, have started to be shaped on the working agenda of public authorities.

A TQM temporal ranking reveals that those preoccupations have started in Cyprus in 1990s, in Greece and Slovenia since 1995, and in Bulgaria and Romania after 2000.

1. General analysis context of the policies and strategies for promoting quality

In general, the strategies for promoting quality in the public sector in the above-mentioned states have coincided or succeeded the strategies of public sector reform. The latter strategies have aimed “to introduce the ‘managerial’ culture and the market-based mechanisms in the public sector, to re-orient the public administration from production focus to “customer’ or citizen focus” (Borzelay, 1992), to improve “performance” of public administration and deliver better quality services to “customers” (Engel, 2003, p. 18).

Deepening the analysis, Engel (2003) refers to the fact that the actual impetus towards quality promotion, using quality management initiatives and tools has been often associated to the “paradigm of New Public Management, rooted in private sector managerialism and theory of public choice” (Hood, 1991). In fact even some governmental programmes, such as that of Clinton administration in US promoted strongly quality management in federal administration (Gore, 1996). In United Kingdom, the introduction of New

Public Management in some fields, i.e. in health, has triggered the quality policies to become “an element of public management reforms” at the end of 1980s, through the so called model “New Public Management in search of excellence” (Ferlie, et al., 1996, p. 13).

At the same time, Engel (2003) asserts that this “new” search of quality and the promotion of excellence models in businesses emphasise the development of organisational culture, staff involvement and human resource management, investment in human resources, organisational values of “learning” (Broekmate et al., 2001, p. 319).

Referring to Herbert Simon’s old school of administration and management, the above mentioned authors highlight the topic on modernisation of public administration through promotion of the new culture of quality, which “seems to be appropriate in «traditional» bureaucracies, focusing on the needs and values of public service providers and organisations” (Engel, 2003, p. 18).

At the end of last century, quality was considered a universal trend of administrative modernisation or reform, trend that, comprised both OECD countries and EU Member States. Even in the first half of 2002, a research conducted by the Spanish EU Presidency revealed that theoretically, initiatives on quality and use of quality management tools had emerged in all EU Member States. Also, the comparative research highlighted the asymmetry of the processes for externalisation and internalisation of good practices in public organisations as well as significant similarities and differences. A similar research on quality in public administrations of the EU Member States was achieved in 2005 by Slovenian EU Presidency. After 2005, relevant analyses on quality management in public administrations were accomplished by the Innovative Public Services Group (IPSG), focusing on three priority issues:

- Common Assessment Framework (CAF);
- Quality conferences;
- Studies and analyses on quality management.

In 2007, IPSG presents information on quality management in public administrations of the EU Member States, achieving a comparative analysis published in the European Public Administration Network (EUPAN).

In February 2008, Slovenia developed a wide project, analysing comparatively quality management in public administrations of the EU Member States. The study aimed at understanding the progress and actual situation of quality management in the EU Member States (Zurga, 2008, pp. 5-6).

The above research focused on two main directions:

1) comparative analysis of quality management in public administrations inside the EU, analysis that represented one of the main contributions to the 5th Quality Conference in Paris in October 2008;

2) strengthening the transparency and visibility of the current comparative analyses (improving the general analysis – first level, greater access to complementary information and/or more details – second level).

The analyses and field literature (Pollitt, Bouckaert, 1995; EIPA, 1996, Löffler, 1996, Engel, 2003, Zurga, 2008) highlight a series of differences present for the time being in the general context of quality management in public administrations. Briefly, they can be described as follows (Engel, 2003, pp. 18-19):

- in spite of a European vocabulary on quality, the directions for change and the values emphasizing quality improvement are different as regards every country and initiative;
- the attention towards quality in public administration in the framework of programmes and strategies of administrative modernization varies powerfully in every country and the quality management policies, strategies or instruments are different in the public authorities' options holding responsibilities at state level.
- the notion of quality in public administration and the objectives associated to quality promotion in the public sector have endemic characteristics and features of instability in time;
- a wide variety of quality management initiatives and tools aim either the improvement of quality of internal operations in the public organizations or the quality of services provided to citizens or customers or (often) both of them;
- although the quality “tools” promoted and used and various quality initiatives bear similar names or are identical, they do not trigger the same impact or even aim different objectives;
- significant variation of the degree of using quality management tools and techniques in various states and various governance levels in a country;
- understanding quality in public administration is powerfully influenced by several independent contextual factors referring to “administrative culture”, the role of administration and state in society etc.

Therefore, in spite of the progress in promoting quality management in public administration, similar to other European processes, we are far away from a common “European” understanding and a common approach on quality in public administration and “the research on quality is and it will remain significant for long time, differentiated mainly by its ways of accomplishment” (Engel, 2003). At the same time, the research on quality is moreover characterized by a “broad” international vocabulary of management reform (Pollitt, Bouckaert, 2000, p. 180), promoted by organizations such as OECD, World Bank or United Nations.

2. A specific issue on promoting quality policies in national public administrations of the Balkan states

Although such analysis in view to reveal the specificity of promoting quality policies in the Balkan states is not very visible, some conclusions, valid for a broad area of Central and Eastern Europe may provide valuable information for the Balkan states, integrating in the current study the five states under review.

At the same time, it is worth to emphasise the fact that the Western EU Member States have represented for the European Union and particularly for the Balkan states a catalyst for quality promotion policies. The specific method focused on externalization of policies and good practices, including the theoretical and practical substantiation of quality management.

“The low quality of public administration” as core feature of the Balkan states, associated with “uncertainty and unpredictability of the institutional context” (Brunetti et al., 1997) represented “explanatory and important factors of economic collapse and crises” (Verheijen, 2000, p. 25).

Caddy and Vintar (2002) highlight a slow and afterwards fast growth of the interest for the quality policies, fact based on three main reasons in the authors’ opinion:

- The reform processes of the state, in general, and public administration, in particular, have undergone three development stages: transformation, consolidation and modernization (Hesse, 1998). Therefore, only after the finalization of the two stages, “a differentiation of quality” (Poschl, 1996) could be perceived. At the same time, it is worth to remark the powerful influences of Western experts, international organizations and assistance programmes that have been often based on “optimum situations”, specific to other states, usually Western European states.
- The processes of negotiation for accession to the European Union have been delayed a few years, even if Copenhagen criteria had been adopted in 1993. Except Greece, the other states since 1998 have awarded attention to the development of the administrative capacity and consequently initiation and implementation of quality policies.
- Increase of the pressure exercised by citizens for improving the public services and rebuilding the trust in public administration.

To those assertions we may add the lack of empirical evidence concerning the use of management and quality assurance systems in the private sector in the states under review as well as the lack of trust in the capacity of public organizations to obtain outcomes after using quality management tools.

Also, Talbot (1999) and Gooden and McCreary (2001) have raised the issue if “the old philosophy of efficiency”, or in other words, “the improvement of quality in public organizations by tools specific for quality management derived from the private sector represents the best way for organizations in view of approaching the real citizens’ needs (not only the customers’ needs) and those of society as a whole” (Engel, 2003, p. 22).

3. Total quality management (TQM) in the context of quality policies in public administration

According to Engel (2003), TQM was used in the beginning in the private sector in view to monitor and evaluate all the activities in an organization, relevant for reaching excellent results in businesses. Addressing to all activities in an organization, TQM represents a “holistic” tool which does not especially focus only on specific activities or production processes. As above shown, in the late 1980s/beginning of 1990s, TQM was also used in the public sector. In Europe, the European Foundation for Quality Management (EFQM) promoted and developed the most spread TQM “model”.

3.1. TQM in public organizations

Boyne and Walker (2002) achieve an interesting study on evaluating the impact of TQM in public organizations. Accepted relatively recent as management tool, once with the increase of its popularity, a series of questions persist on TQM concerning the concept, components or even similarity with the theory of management (Boyne, Walker, 2002, p. 2). Making the adequate differentiation between quality and TQM, famous authors, quoted by Boyne and Walker (2002, p. 2), remark that there is no consensus on the content of TQM concept starting from the main characteristics of TQM, as promoted by Deming, Juran or Crosby.

However, Boyne and Walker (2002) assert that “it is possible to identify the key components of TQM”. Referring to TQM components, it is worth to reveal a diversity of approaches under the heading “hard techniques”, related to production and operation management and “soft techniques” which include qualitative approaches of customer focus, team work, employee’s training and involvement (Boyne, Walker, 2002, p. 4).

The above authors reveal the studies of Dean and Bowen (1994) which “provide a comprehensive vision of literature and argument that TQM approach should be characterized by its own principles, practices and techniques”. In this context, the principles identified by Dean and Bowen (1994) refer to *customer focus, continuous improvement and team work*. In the opinion of the above

authors, each principle is implemented through a set of practices (collecting information about customer, analysis of organizational processes, etc.) supported by a variety of techniques (examining the customer, events such as team building etc.) (Boyne, Walker, 2002, pp. 4-5).

Table 1 reveals a synthetic presentation of TQM components.

Table 1

TQM principles, practices and techniques			
	Customer focus	Continuous improvement	Team work
Principles	Paramount importance of providing products and services that fulfil customer needs; requires organisation-wide focus on customers.	Consistent customer satisfaction can be attained only through relentless improvement of processes that create products and services.	Customer focus and continuous improvement are best achieved by collaboration throughout an organisation as well as with customers and suppliers.
Practices	Direct customer contact. Collecting information about customer needs. Using information to design and deliver products and services.	Process analysis, re-engineering, problem solving, plan/do/check/act.	Searching measures for the benefit of all units involved in a process; setting various types of teams; Group skill training.
Techniques	Customer surveys and focus groups. Quality function deployment (translates customer information into product specifications).	Flow diagrams; Pareto analyses, statistical process control; structural diagrams.	Organisational development methods such as the nominal group techniques. Team-building methods (e.g. role clarification and group feedback).

Source: Boyne and Walker, 2002, pp. 4-5.

The above references as well as the experience on TQM use in governmental public organizations determine us, similar to Boyne and Walker (2002) to turn into account TQM definition of Dean and Bowen (1999), as pillar of our analysis.

In view to understand better the connection of TQM with public management and its reforms in the context of the enlargement of the European Administrative Space (EAS), we should reveal the fact that TQM “is obvious linked and created on the management theory”. Boyne and Walker (2002, p. 5), Spencer (1994), Dean and Bowen (1994), Grant, Shan and Krishan (1994) support also the above assertion.

In theoretical perspective it is important the demonstration of Hackman and Wageman (1995) on the “convergent and discriminant validity” of TQM.

Their arguments presented also by Boyne and Walker (2002, 5-6) reveal rather the proxy type and specific difference of TQM concept.

3.2. Convergence of the policies for promoting TQM

Referring to the convergence of the policies for promoting and implementing TQM in public administrations, this will encompass aspects of compatibility, complementarity or similarity that could be remarked in the national policies concerning the use of TQM in the reforms of national public administrations.

Their comparison with a series of general standards derived from concepts, practice and experiences at EU level will provide elements in view to determine “the global convergence” and the comparison of initiatives, mechanisms and tools promoted in the states under review will determine “the relative convergence”.

As above briefly defined, the two concepts – global convergence and relative convergence – inscribe in the general approaches of the administrative convergence as fundamental process for strengthening the European administration and enlarging the European Administrative Space.

Another perspective on the convergence of TQM policies is based on performance assessment induced by TQM in public administration. This approach, explained coherently and thoroughly by Boyne and Walker (2002), refers rather to TQM result.

The approach proposed by us will be a process assessment referring to the design, structure and content of the policies for promoting TQM.

Both approaches need empirical studies, comparative studies of TQM policies, specifically an assessment on how TQM has been made operational.

The same authors, Boyne and Walker (2002, pp. 7-9), provide a suggestive and beneficial overview for our study, identifying 19 studies concerning TQM structure and content, according to the theoretical option on TQM provided by Dean and Bowen’s (1994).

Table 2 provides a synthetic image on TQM content and structure and its correlation with performance.

Table 2

TQM content and structure			
Studies	Customer focus	Continuous improvement	Team work
Anderson, Rungtusanatham, Schroeder & Devaraj (1995), Flynn, Schroeder & Sakakibara (1995b)	Internal and external cooperation; customer satisfaction. Relations with customer; relations with provider.	Visionary leadership; process management; continuous improvement. Process management, designing the product, control, statistic feedback, support of top management.	Employee involvement. Personnel management, work attitude.
Powell (1995)	A closer relation with customer; a closer relation with provider.	Leadership and commitment; adopting and communicating TQM; open organization; mentality of zero defects; flexible manufacturing; process improvement; measurement.	Intensive training; middle management teams; problem-solving.
Youssef, Boyd & Williams (1996)	Customer focus.	Top management commitment, organizational learning; process improvement; learning.	Role of top management models; Problem-solving.
Forker, Mendez & Hershauer (1997)	Provider's quality management.	Leadership and quality policy; designing the product/service; process management; information about quality and reporting; role of Quality Department.	Relations with employer; training.
Hendricks & Singhal (1997) Easton & Jarrell (1998)	Quality Awards, Customer focus, Provider performance, relations with provider.	Process focus; systematic improvement; recognizing TQM as critical competition strategy.	Quality Awards Employee involvement and development Inter-functional management.
Forza and Filippini (1998)	TQM connection with customers, TQM connection with providers.	Quality oriented; control of the process.	Human resources.
Rungtusanatham,, Forza, Filippini & Anderson (1998)	Internal and external cooperation; customer satisfaction.	Visionary leadership; learning, process management, continuous improvement.	Employee development.
Samson & Terziovski (1999)	Customer focus.	Leadership; strategic planning, information and analysis, process management.	Personnel management.
Tan, Kannan, Handfield & Ghosh (1999)	Customer focus.	Information and analysis, role of Quality Department, leadership of top management; processes for product design.	Functional teams, learning.
Brah Woug & Rao (2000)	Customer focus.	Leadership, provider's quality management; process improvement; service design; rewards for quality improvement; order and organization.	Employee's involvement, training, empowerment.

Studies	Customer focus	Continuous improvement	Team work
Chandler & Mc Evoy (2000)	Customer friendly.	Waste, quality tools, cleaning.	Management involvement.
Kunst & Lemink (2000)	Customers.	Leadership, strategy, staff, resources, process management, social effects.	Management involvement employees.
Martinez-Lorente Dewhurst & Gallegor – Rodriguez (2000)	Relations with providers.	Organisation, designing the product; information about quality; process tools; design tools.	Relations with employees.
Douglas and Judge (2001)	Customer focus.	Management by facts; continuous improvement of the process; adopting the philosophy of quality; using TQM methods.	Involvement of top management team; Focus on TQM training.
Ho, Duffy & Shih (2001)	Provider's quality management.	Role of top management; role of Quality Department; product design; process management; reporting information about quality; provider's quality management.	Relations with employees; training.
Rahman (2001)	Customer focus.	Leadership, information and analysis; strategy and planning; processes, products and services.	People.
Sim (2001)	Customer satisfaction.	Quality at provider; statistic control of quality, methodologies for quality improvement.	Quality and team work, training.

Source: Boyne and Walker, 2002, pp. 7-9.

Table 2 will represent the pillar for understanding and organizing the comparative information in view to determine the levels of convergence for TQM policies.

4. An empirical study on the convergence of the policies for promoting TQM in Balkan states - EU Member States

4.1. Framework of analysis

The current study is based on the comparative analysis achieved and published by Zurga (2008). The information from that study has been reorganized according to the conceptual framework above described in our study.

For the Balkan states mentioned, TQM approaches will fit in the general context of quality management in public administration and, according to Zurga (2008, p. 16), they incorporate a combination of centralised and decentralised approach with top-down and bottom-up approach.

The mentioned study, achieved for the EU Member States, accomplishes a matrix containing 18 categories of information for the comparative analysis (Zurga, 2008, pp. 25-148).

From the categories of information mentioned we retained 11 categories, relevant in our opinion, for TQM in public organizations (Table 3).

Table 3

Structure of TQM policies in Balkan states

TQM principles	Customer focus	Continuous improvement	Team work
TQM elements	<ul style="list-style-type: none"> ▪ QM Policies (q11) ▪ Quality Awards (q12) ▪ Excellence Models (q13) ▪ Citizens Charters (q14) ▪ Testing Customer Satisfaction (q15) 	<ul style="list-style-type: none"> ▪ Quality Management Development (q21) ▪ Measuring the Quality in PA (q22) ▪ Sharing good practices (q23) 	<ul style="list-style-type: none"> ▪ Organizational structure for promoting quality (q31) ▪ Training for QM (q32) ▪ Quality Tools in PA Organizations (q33)

Source: The authors (processing information from Zurga, 2008).

4.2. Methodology

Related to the classification in Table 3, the comparative information provided by Zurga (2008) was processed; we introduced the codification for the issues as nominal variables, thus emphasizing a set of standards of reference for each variable, based on the general conclusions at EU level.

Related to the standards of reference, a value from the interval [1,5] is assigned to each state, representing the appreciation on the hierarchic position concerning the accomplishment of the standards of reference.

The levels of global convergence will be obtained by data statistic processing and they will be provided by Pearson correlation coefficients.

For the relative convergence, values from the interval [-1,1] will be assigned for each state and each variable, expressing the level of compatibility and similarity in TQM approaches and tools. Value 1 will express similarity in the approach specific for a variable; value 0 will express the lack of common elements, while value -1 will express incompatible activities and tools. The score obtained for each variable will represent the mean of its values through inter-states comparisons for the respective variable.

The level of relative convergence will be also provided by Pearson correlation coefficients.

4.3. Empirical analysis

4.3.1 Global convergence

Using the information from Annex 1, for every item out of the 11 items of TQM mentioned in Table 3, quantitative evaluations were formulated on the level of compatibility for the activities and tools in every state related to the general conclusions/trend at European level drawn up by Zurga (2008).

Those conclusions were considered standards of reference and accordingly the rankings in Table 4 have been achieved.

Table 4

Rankings estimated on conceiving and implementing TQM elements												
Element State	q11	q12	q13	q14	q15	q21	q22	q23	q31	q32	q33	Total
GREECE	1	2	2	2	1	4	3	2	3	3	5	28
CYPRUS	3	1	1	4	2	5	2	1	1	1	2	23
SLOVENIA	4	5	5	1	5	2	4	3	5	5	3	42
BULGARIA	5	3	3	5	4	3	5	5	4	2	1	40
ROMANIA	2	4	4	3	3	1	1	4	2	4	4	32

The evaluations in Table 4 were achieved on the basis of the information provided by Zurga (2008). Unfortunately those data were incomplete and it was necessary to use other sources, usually websites of public institutions, syntheses of EIPA, EUPAN, etc.

As shown by the final scores, the highest convergence of quality and TQM policies is present in Slovenia, followed by Bulgaria, Romania, Greece and Cyprus.

The system proposed can be improved and updated on the basis of more complete data and more rigorous criteria and standards.

4.3.2. Relative convergence

On the basis of data from Annex 2, six variables were defined, describing quantitative quantifications on the levels of compatibility of the policies for promoting TQM with the policies of the other states under review. MEAN variable evaluates the mean of the other five variables.

Table 5 presents the Pearson correlations for the variables mentioned.

Table 5

Pearson correlations for TQM policies in the Balkan states – EU Member States

		GR	CY	SI	BG	RO	MEAN
GR	Pearson Correlation	1	-.090	-.315(*)	-.138	.019	.210
	Sig. (2-tailed)		.511	.019	.314	.892	.124
	N	55	55	55	55	55	55
CY	Pearson Correlation	-.090	1	.304(*)	.188	.221	.715(**)
	Sig. (2-tailed)	.511		.024	.169	.105	.000
	N	55	55	55	55	55	55
SI	Pearson Correlation	-.315(*)	.304(*)	1	-.163	-.190	.267(*)
	Sig. (2-tailed)	.019	.024		.234	.164	.049
	N	55	55	55	55	55	55
BG	Pearson Correlation	-.138	.188	-.163	1	.298(*)	.519(**)
	Sig. (2-tailed)	.314	.169	.234		.027	.000
	N	55	55	55	55	55	55
RO	Pearson Correlation	.019	.221	-.190	.298(*)	1	.583(**)
	Sig. (2-tailed)	.892	.105	.164	.027		.000
	N	55	55	55	55	55	55
MEAN	Pearson Correlation	.210	.715(**)	.267(*)	.519(**)	.583(**)	1
	Sig. (2-tailed)	.124	.000	.049	.000	.000	
	N	55	55	55	55	55	55

* Correlation is significant at the 0.05 level (2-tailed).

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

Excepting the MEAN variable, all the other correlations are low (0.019 – 0.304) and the other correlations are negative. The general conclusion is that the policies for promoting TQM are based on various activities and tools that do not trigger the conclusion of high convergence. The most powerful correlations are between Cyprus and Slovenia (0.304), as well as between Bulgaria and Romania (0.298), both coefficients being significant at 0.05 level (2-tailed). We explain such situation as follows: membership of the two groups of states to the same wave of EU enlargement (2004, respectively 2007) as well as the European context which enables the promotion of quality and TQM policies in those four states. The case of Greece is singular, holding negative correlations [(-0.315) – (-0.090)], except the correlation with Romania, which rather signifies the lack of correlation (0.019).

If we discuss about a mean of the variables expressed through MEAN variable, we remark, as it is natural, the following order of the correlations: Cyprus (0.715), Romania (0.583), Bulgaria (0.519), Slovenia (0.267) and Greece (0.210).

5. Conclusions

The policies for promoting quality and TQM in public administrations of the Balkan states – EU Member States are quite different. The explanation for such a situation consists, on the one hand, in the different stage of accession to the EU and, on the other hand, in the late set up of a coherent, conceptual framework and good practices on promotion of quality and TQM in public administration in the end of 1990s.

In fact, the model of the European Administrative Space that provided after 2000 the standards in view to assess and monitor the progress in national public administration reforms does not contain explicit approaches on the necessity to introduce and implement quality and TQM policies in public administrations.

The initiatives on evaluating the quality and TQM policies have been expressed after 2000, as also shown in the first part of the paper, and our analysis is achieved on the basis of an initiative carried out in 2007-2008. Therefore, the period necessary for implementation and compatibility of the quality and TQM policies was insufficient.

However, the preoccupations on promoting quality and TQM policies are more visible and the efforts of the European Institute of Public Administration (EIPA) and European Foundation for Quality Management (EFQM) are more important. The instruments promoted -CAF and EFQM model- benefit in many states of distinct policies and the conferences on quality already exceeded five editions.

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Annex 1**Comparative information on promoting quality policies
in the Balkan states – EU Member States**
(processed after Zurga, 2008, pp. 25-146)**q11 QM Policies**

Several policies in the Quality Management are presented.

BULGARIA

The Strategy for Modernisation of the State Administration – from accession to integration 2003–2006 – aimed at increased efficiency, effectiveness and quality in the public sector in general – approved by the CoM in 2002.

Concept and Generic Model for Improving Administrative Services through the One-Stop Shop – pointing out the main principles and organisation of the service delivery process.

Guide for developing a Client Charter – document supporting administrations in the development of their own standards and elaboration of Client Charters.

System for Self-Assessment – an Internet-based system, developed according to the EFQM Excellence Model in 2003, which guides all administrations through the process of self-assessment (active since 2003). All administrations perform self-assessments every year and publish the results.

Methodology for Measuring Customer Satisfaction – presented in 2007 by the MSAAR under the requirements of the Ordinance for the general rules for organisation of administrative service delivery.

Ordinance on the general rules for the organisation of administrative service delivery (approved by the CoM in September 2006) – establishes the main principles of service delivery.

Law on E-Governance – adopted in May 2007 (will enter into force in June 2008). It regulates the electronic delivery of administrative services to citizens and the business sector, the processing of electronic documents within individual administrations, as well as the exchange of electronic documents between state authorities.

The Law on Access to Public Information was adopted in 2000.

The Law on Limiting Administrative Regulation and Administrative Control Over Economic Activity – adopted in 2003 and entered into force in 2004.

The Code of Conduct of Employees in State Administration was adopted in 2004 and sets the rules of conduct of employees in state administration.

The MSAAR and the Ministry of Justice jointly developed the Code of Ethics for High-level Officials. The Code was adopted with a Decision of the CoM on 23 December 2005. It aims at recognition of the principles of transparency, accountability and integrity in state administration.

In June 2006, the MSAAR elaborated the Standards of Administrative Ethics, which represent the major rules that every employee must comply with.

The Operational Programme Administrative Capacity (2007–2013) is a strategic document for the modernisation of Bulgarian state administration during the period 2007–2013. The Programme is financed by the European Social Fund (ESF) and the national budget. Its main priorities are related to good governance, human resource management, quality administrative service delivery and e-Governance development.

CYPRUS

- Employee performance management system aimed at enhancing meritocracy and transparency
- Code of Conduct
- Other policies for improving the quality of service provided to the public (e.g. One-stop-shops)

ROMANIA

Starting in 2005, all public policies/strategies issued by ministries must include quality management aspects in order to make public institutions more accountable, responsible, effective and citizen-oriented (Government Decision No. 775/2005 on public policies). The first report regarding the stage of the implementation of public policy rules is available, only in the Romanian language so far, at:

http://www.sgg.ro/docs/File/UPP/doc/raport_ian_dec2007.pdf

The package law adopted in 2006 provides the framework for developing cost and quality standards (Law No. 215/2001, revised in 2006, on local public administration; Law No. 273/2006 Law on local public finance; Framework Law No. 195/2006 on decentralisation; and Law No. 188/1999 for civil servants, amended in 2006).

SLOVENIA

Quality Policy of State Administration – “Politika kakovosti državne uprave”, 1996 (Adopted by the Slovenian Government in October 1996)

Its major components concern:

- ethical conduct of all the employees;
- partnership with citizens, national economy, friendly states and coworkers;
- establishing the conditions for social and economic development,
- harmonisation with modern European standards, norms and legislation;
- striving for implementation of the European Business Excellence model and for timely education and training;
- transparent, efficient and effective functioning within and among ministries and with administrative units;
- awareness of entrepreneurial opportunities of state administration for developing the society;

- effective and efficient use of budget resources;
- establishing the conditions for quality of life and work for all citizens of the Republic of Slovenia.

Quality Policy of Public Administration – “Politika kakovosti slovenske javne uprave”, 2003 (Adopted by the Slovenian Government in December 2003)

This document broadens the Quality Policy from the scope of state administration to the scope of public administration.

q12 Quality Awards

In the majority of cases, Member States join conferences on quality with rewarding achievements in the field of quality. In the selection procedures, countries use various models or approaches to assess applicant organisations. As the basis for assessing the State, the CAF model is used in some places (e.g. in the Czech Republic, Greece and in some countries only indirectly); elsewhere, their own quality or excellence models are used, and, in some countries, a range of several criteria is used.

BULGARIA

In June (on the occasion of State Administration Employee’s Day), the Minister of State Administration and Administrative Reform awards public institutions for their contribution to the process of modernisation of the administration.

The awards have been given since 2006. Awards have been granted in the following categories:

- “Accessible and quality administrative service delivery”
- “Best on-line services”
- “Effective human resources management”
- “Best PR practice in state administration”.

In 2003, 2004 and 2005, the Institute for Public Administration and European Integration organised several competitions and awarded good practices in the areas of administrative service delivery, e-government, transparency, etc.

GREECE

In a wider effort to promote quality, the Ministry of Interior has launched, for the first time in 2007, the “National Quality Award for Greek Public Organisations”, which aims at identifying and awarding top performers on CAF use. A number of central, regional and local government organisations have implemented the CAF and applied for the award. The three winners were:

- The Validation of Applications & Marketing Authorisation Division (*DDYEP*) of the National Organization for Medicines of Greece
- The Byzantine and Christian Museum

- The Directorate of the Organisation and Operation of Citizens' Service Centers of the Ministry of Interior.

ROMANIA

Excellence Award in Public Administration, since 2005 Romania has had several initiatives for awarding good practices within the public sector, for instance: excellence awards organised by the Romanian Leaders (7th edition in 2007), the Award for Excellence in Public Administration (3rd edition) and the awards offered by National Institute for Administration (1st edition in 2007).

The Award for Excellence in Public Administration is meant to emphasise efforts for developing the Romanian public administration system, to reward the positive initiatives of public administration specialists and important projects implemented by representatives of the local and central administration. The ceremony takes place early and is organised by the portal www.administratie.ro and by the OSC Agency (specialised in communication). <http://www.osc.ro/index.php?lang=en>

SLOVENIA

The "Good Practice" Award, since 2002; awarded at the conference: Good Practices in Slovenian Public Administration

The Business Excellence Prize of the Republic of Slovenia (PRSP0), since 2005, also for public administration organizations

q13 Excellence models

Among excellence models in public administrations in the EU, CAF and EFQM are used most. In use are also models that countries have adapted or designed themselves (for example: the Swedish Quality Model, used since 1992, INK developed by the Netherlands and also used by Belgium, and KVIK in Denmark).

BULGARIA

The use of excellence models is not widespread in the country. In the last two years, certain administrations started applying the CAF model (one regional administration, one municipal administration, the National Revenue Agency). The MSAAR organised several events and published materials in order to stimulate more administrations to apply such tools. Further activities are foreseen for 2008. A PHARE project (Twinning Light) was carried out in 2007 aimed at strengthening the capacity of the MSAAR for QM in PA (mainly in CAF) in order to provide better support to other administrations in the process of CAF implementation and validation.

ROMANIA

The Common Assessment Framework (CAF) was launched at national level in Romanian public administration in 2005 in order to increase the quality of public services. The Ministry of Interior and Administrative Reform is responsible for coordinating the use of the CAF model.

The approach to CAF implementation is as follows:

Phase 1: Training sessions on quality management – CAF for top management in targeted public institutions.

Phase 2: Training sessions on quality management – CAF for civil servants in all county councils and prefecture institutions.

Phase 3: CUPAR received and planned the requests for technical support from interested public authorities, which were sent on a *voluntary basis*

Phase 4: CUPAR's CAF team assisted the public authorities in running the exercise *on site*.

Results of CAF 2008:

CUPAR received 47 technical support requests from public administration institutions on a voluntary basis:

- 31 prefecture institutions
- 7 county councils
- 3 deconcentrated public services
- 2 municipalities
- Ministry of Economy and Finance (1 General Directorate)
- Ministry of Education, Research and Youth (3 Directorates)
- National Institute for Administration
- Central Unit for Public Administration Reform.

386 civil servants were trained in CAF and were able to disseminate the information related to it 84 high civil servants, representatives of prefectures and county councils from all 42 counties in Romania were trained on the self-assessment instrument Action plans were elaborated in the institutions based on CAF implementation.

Conclusions

The principal domains proposed for improvement are:

- Internal communication (drafting internal strategy communications, creating an intranet network, introducing integrated document management).
- Strategic planning (reviewing the multi-annual modernisation strategy).
- Employee motivation (their involvement in drafting the action plan for the institution, in drafting internal communications and the multi-annual modernization plan through working groups).
- Results measurement for both personnel and beneficiaries (established a set of indicators).
- Customer/citizen satisfaction (questionnaires were drafted in order to have a clear view on their satisfaction).

SLOVENIA

CAF was extensively introduced in Slovenia in 2002; in the beginning of 2003, the Slovene translation of the CAF was published. Since then, usage of the CAF has been increasing continuously as the CAF was defined as a strategic direction in Slovenian public administration modernisation. CAF is incorporated in different strategic documents and/or initiatives. In the *Further Development Strategy of the Slovenian Public Sector 2003–2005*, the CAF was included in the first of seven priority tasks in the area *Quality management within administration and orientation of public administration towards users*. In *Slovenia's Development Strategy (2005)*, in the action plan for 2005 and 2006 under the third development priority *An efficient and less costly state*, the CAF was proposed along with the EFQM model as a tool for systematically raising the quality of public administration services.

Furthermore, the *Reform Programme for Achieving the Lisbon Strategy Goals (2005)* states:

“Slovenia wants to achieve growth in institutional competitiveness by introducing business excellence in public administration. The objectives we wish to achieve are the introduction of a strategic planning system as a basic management tool in public administration, the introduction of management tools and the application of the Common Assessment Framework (CAF) and inclusion in the European Excellence Model (EFQM). The measures for the achievement of these objectives are: (i) adoption of regulations for quality assessment and strategic planning (2006/2007); (ii) building support (methodological support and information support) for the strategic planning system (2006/2008); (iii) management education and training.”

q14 Quality/Citizen's charters

Quality/citizen charters are widespread in the EU, being used in the majority of Member States.

BULGARIA

The development and publication of a CC has been obligatory since the end 2006, beginning of 2007. The guidelines were developed in 2002.

CYPRUS

Yes.

GREECE

Not in use.

ROMANIA

Different authorities acting at the local level (prefecture institutions) are using the Citizen's Charter concept (e.g. Bihor prefecture, <http://www.prefecturabihor.ro/>). The Romanian Government adopted a memorandum regarding "Necessary measures for improving the quality of public services", (<http://www.sgg.ro/docs/File/SGG/memo.pdf>, available in Romanian). This memorandum contains a plan for the period 2007–2008 for improving the quality of a number of specific public services: issuing passports, driving licenses, criminal records, etc. Additionally, the memorandum sets certain guidelines for general policy regarding the behaviour of public service providers towards citizens.

SLOVENIA

In Slovenia we do not have citizen charters, yet we do have defined standards for operation, communication and relations with public administration customers. These standards are part of the regulations.

q15 Testing customer satisfaction

Testing of customer satisfaction is being performed in almost all EU Member States. All these countries perform customer surveys, and some also use other tools for gaining insight into their customers' needs.

BULGARIA

In 2002, 2004, 2005 and 2006, surveys were conducted throughout the whole country (centralised). Each administration conducts (more specific) surveys itself, which has been obligatory since the end of 2006.

CYPRUS

Since the establishment of one-stop shops in 2005. Surveys are carried out to measure the level of satisfaction of the public in relation to the services provided at the one-stop-shops.

ROMANIA

We do not have standards for all public services; therefore, we test and evaluate customer satisfaction at the national level only on specific issues and projects, such as:

- MATRA 2005 Timisoara – Employment Agency

- two opinion polls in order to measure citizens' satisfaction with public services offered by civil servants and to analyse the level of depolitisation of Romanian civil servants organised by the NACS during 2005 and 2006.

SLOVENIA

Since 2001.

Yearly

The methodology for testing administrative units' customer satisfaction was developed in 2000, first as a methodological tool for those administrative units which decided to implement a quality management system according to the ISO 9000 standards. After the Government adopted the Decree on the Manner of Public Administration Bodies' Transactions with Customers in which, among other things, the obligation for testing customer satisfaction was set, this methodology has been in use in all administrative units. After the testing period in 2001, the methodology is being used on a regular yearly basis since 2002.

According to the methodology, results of the customer survey is a thorough report which is basically oriented to identification of the gap between how customers see the services they have just used in relation to their expectations; several characteristics of quality are tested in the sample and then used with a 95% likelihood for the whole population (possible customers) of the administrative unit. Results of the survey are mainly used as a basis for each administrative unit to identify areas for improvement and develop its action plan.

In 2006, the questionnaire was redesigned and simplified, yet it still based on detecting the gap between expectations and perceived quality. Comparison between administrative units for 2007:

http://www.mju.gov.si/fileadmin/mju.gov.si/pageuploads/Kakovost/Analiza_primerjav_a_med_UE_2007.xls

The following items are being compared: overall score (up to 5); difference in scores between years 2007 and 2006; 15 quality dimensions (10 for services and 5 for employees) are presented according to the traffic-light principle: green = perceived quality was better than expected, yellow = perceived and expected quality were at the same level, red = expectations of customers were higher than the perceived quality; waiting time to be served by a public employee: % of customers who did not wait to be served, % of customers who had to wait up to five minutes, the sum of both percentages and finally, the % of customers who had to wait more than five minutes to be served.

Monthly – quality barometer

In 2006, monthly customer satisfaction testing was also introduced (in May), based on a short questionnaire for customers. It aims to provide quick and short feedback information from customers and to assure responsiveness from administrative bodies.

Results (in Slovene) are published at the state portal:

<http://e-uprava.gov.si/e-uprava/javniStran.euprava?pageid=130>.

q22 Quality management development

For the present report, the Member States provided comprehensive information on national QM development, confirming that the EU Member States have different traditions for addressing quality in their public administrations.

Important lessons were learned in this respect, among others:

- A sustainable approach requires comprehensive cooperation.
- Imposing a formal model or even establishing it as a legal obligation cannot work long-term.
- Launching quality policy requires adequate support.
- Quality principles should be integrated into all government programmes.
- A national QM approach is required to contribute to the competitiveness of the national economy.

BULGARIA

The main goals pursued by quality management policy in the public sector in Bulgaria are:

- to increase efficiency and effectiveness in the public sector;
- to ensure transparency, accessibility and openness and build trust in public institutions;
- to improve the image of the public sector as employer;
- to involve all stakeholders in the improvement process and ensure the sustainability of reforms;
- to increase the satisfaction of both customers and employees.

The following strategic principles for public service delivery have been established in Bulgaria, namely to:

- treat all users fairly, honestly and courteously;
- communicate openly and provide full information;
- consult widely and promote continuous improvement;
- incorporate feedback and learn from complaints;
- encourage access to services via different channels;
- work with others to provide an improved, integrated service;
- set and publicise service standards and publish results against those standards;
- measure and publish measurements of customer satisfaction

CYPRUS

The starting year for targeted efforts in the area of quality management in public administration in Cyprus was 1993, when the decision on development and implementation of specific reform measures was taken. The main objective of this

initiative was to increase productivity and reduce operating costs in the Cyprus Public Service.

It should be mentioned that a milestone in quality management was the establishment of the Office of the Commissioner for Administration (Ombudsman) in 1991, an independent officer of the Republic who exercises control over the action or inaction of public administrative authorities.

In addition, another important milestone was the establishment of the Cyprus Academy of Public Administration (CAPA), again in 1991, which has the responsibility of contributing through training activities to the management development and modernisation of the Cyprus Public Service and, as a result, to the enhancement of quality in the Public Service. In the first five years of its operation, CAPA provided training on European Union issues in order to assist public officers in understanding EU functions, policies and practices, as well as to develop awareness of the effects of participation in the EU. In addition, the CAPA designed and developed induction courses for newly recruited public officers, as well as training programmes in skills development. Furthermore, in 1993, a decision was taken to enhance the employee performance management system in order to make it more transparent, fair and objective.

Since then several reform measures towards quality management have been introduced.

The most important goals regarding quality management in PA in our country are the following:

- to create a performance and results-oriented culture in order to enhance effectiveness and productivity (budgets are currently constructed on a pilot basis, based on performance targets; the employee performance management system is based on competencies with a view to incorporating targets in it, etc.);
- to measure customer and employee satisfaction;
- to promote strategic management and goal-setting in public service;
- to focus on initiatives that directly lead to better quality service provided to the public.

GREECE

The effort to introduce quality management in public administration started in the late 1990s through the establishment of a special Unit on Efficiency and Quality in the General Secretariat of Public Administration in the Ministry of Interior. This effort continued in the following years, and in 2004 a law was voted by the Greek Parliament (Law No. 3230/2004 providing for the establishment of a Directorate on Efficiency and Quality in the General Secretariat of Public Administration). This law provides for the establishment of a network of similar directorates in all ministries and peripheral administrations (regional government) in the country. The law also provides for the establishment of an integrated system of performance management, the introduction of quality tools (mainly CAF) and policies and a quality award for top-performing public organisations.

The details regarding the Quality Award were further elaborated by a ministerial decision in 2005, which set as an evaluation criterion the implementation of CAF by public organisations.

The main goals regarding QM in PA are: to improve the effectiveness, efficiency and quality of public organisations, to adopt a customer-citizen orientation approach in public organisations; to simplify and ease access to public administration by citizens and enterprises; to create a results-oriented administrative culture; to minimise “red tape”.

ROMANIA

Concerning civil service, we consider that 2004 was the year when certain coherent measures were undertaken by Romanian central public institutions in order to ensure and strengthen quality management.

Certain strategic documents were issued in this regard, including:

- introducing quality standards for monitoring and assessing public service and the professional activity of civil servants
- setting up a fixed number of civil servants according to the quality standards established for each public service
- establishing a strategic planning system for each public authority according to the public services offered
- establishing certain motivational schemes in order to increase the quality of public services and to stimulate innovation
- elaborating and implementing the Citizens' Charter in order to introduce and assess quality standards for public services
- implementing an assessment guide for institutional self-assessment according to CAF.

Main goals:

- reducing the bureaucracy
- citizen orientation
- professionalising civil service for increasing the quality of public services.

SLOVENIA

Intensive development in the area of quality in Slovenian public administration has been going on since 1999, when in the Ministry of the Interior, then responsible for public administration, the Quality Committee began its activity, defined as effective, citizen friendly, recognisable and responsible public administration.

In 2002, quality became one of the main pillars of Slovenian public administration reform, the main focus being on customer-friendly service, accountability of public administration bodies to the public for their results and efficient functioning, and on awareness of the role of management in it.

An additional impulse toward further development of quality was due to the formation of the Ministry of Public Administration, which occurred in December of 2004. The Ministry of Public Administration has been incorporating the demands and quality performance standards of Slovenian public administration in legislation and in all strategic documents which it prepares and/or cooperates in preparing.

The main characteristics include:

- a shift from public administration towards public management;
- quality standards and/or models as appropriate starting points for managing PA and its performance – quality standards and models have played an important role in organisation;
- the leading principles of PA: customer orientation, lower costs, efficiency etc. as incorporated in new strategies and initiatives in all areas (e.g. e-Gov strategy, RAB programme) – quality is now perceived as the other side of the same coin of PA.

Main goals: to put the customer at the centre, to improve efficiency, to reduce costs, to simplify administrative processes and to make contacts between customers and the state easier and less frequent.

q23 Measuring the quality of PA

Measuring quality in public administrations has been shown to be the least developed quality management aspect at EU level. Several Member States indicated that they do not directly measure quality in their public administrations: Cyprus, Czech Republic, Germany, Greece, Portugal, Romania and Slovak Republic.

BULGARIA

Yes, since 2003.

The quality in the PA is measured on the basis of Self-Assessment performed by all administrations according to the EFQM model. There are four stages of development – basic, developing, operational and excellent.

SLOVENIA

Since 2003.

Results published at:

CAF:

Version CAF 2002

Customer satisfaction (yearly):

Quality barometer (monthly):

Administrative unit performance:

Several reports available at:

http://www.mju.gov.si/si/zakonodaja_in_dokumenti/pomembni_dokumenti/upravne_e_note/porocila_2006/.

q23 Sharing good practices

Different channels are used for sharing good practices: quality conferences and/or awarding good practices, publications and networking. Networking, for example, is being more widely used and can be performed in different ways:

- organised by institutions or organisational units that promote quality;
- within the community of quality specialists, project leaders, administrative unit managers (France) and meetings of relevant officials (Malta);
- the inter-administrative network for quality of public services activities in Spain, and others.

BULGARIA

Sharing good practices is considered an effective tool for improvement in the public sector and is underlined in the main strategic documents of the government. The MSAAR stimulates the process by organising different events, publishing good practices on its own website and the website of the IPAEI.

ROMANIA

Seminars and roundtables on different subjects related to public administration reform (e.g. the 2007 Conference on Good Governance and Public Administration Reform). The NACS drafted a handbook of good practices with different topics related to the public administration system such as ethics of civil servants, deconcentrated public services under the subordination of the prefectures, and the transparency of public institutions in relation to citizens.

SLOVENIA

Constantly expanding. Besides the yearly Good Practices in Slovene Public Administration conferences, other ways are: networking, seminars, publications, etc.

q31 Organisational structure for promoting quality

All EU Member States have developed an organisational structure for promoting quality:

Coordination and the main responsibility for promoting quality is situated at central level, usually at the ministry in charge of public administration (interior, finance) or the prime minister's office.

In Member States where promotion of quality in public administration goes together with organisational support of national quality awards (based on the EFQM model), organisational units/councils/committees are established at government level and/or in most cases at the ministry in charge of the economy.

All Member States have established cooperation between different levels of government and institutions dealing with quality at universities, public administration institutes and private organisations.

Despite all the common characteristics of established an organisational structure for promoting quality, there are significant differences in countries' actual organisational units and the ways they cooperate with other players in the quality management area.

BULGARIA

Ministry of State Administration and Administrative Reform – leading role Council of Ministers – approves the main policy documents (legislative and strategic).

National Association of Municipalities in the Republic of Bulgaria – supports reform at the local level QM units or experts within some administrations.

Institute for Public Administration and European Integration – provides training in different areas, including quality management.

The “Club 9000” Association is a non-profit non-governmental organization (NGO) established in 1991. The Association was created in response to the necessity to speed up the harmonisation of activities related to quality management in Bulgarian organisations with internationally accepted practices embedded in the International Standards.

More info:

www.government.bg

www.mdaar.government.bg

www.namrb.org

www.ipaei.government.bg

www.club9000.org.

CYPRUS

The Public Administration and Personnel Department and the Cyprus Academy of Public Administration are responsible for promoting QM in PA. They both fall under the competence of the Ministry of Finance.

ROMANIA

Ministry of Interior and Administrative Reform: Central Unit for Public Administration Reform – CUPAR, and the National Agency for Civil Servants – NACS. Ministry of

Interior and Administrative Reform: Central Unit for Public Administration Reform – CUPAR (<http://modernizare.mira.gov.ro>) and the National Agency for Civil Servants – NACS (<http://www.anfp-map.ro/>)

CUPAR

The Central Unit for Public Administration Reform (CUPAR) is a structure within the Romanian Ministry of Interior and Administrative Reform, established in 2002 and aimed at coordinating public administration reform in Romania.

NACS

The National Agency of Civil Servants (NACS) is a central institution under the coordination of the Ministry of Interior and Administrative Reform, established in 2000 in order to ensure the management of civil service and of civil service bodies, being the main institution in charge of the Romanian Civil Service Reform.

The professionalisation of the Romanian civil service and the improvement of the quality of public services offered by civil servants is a shared responsibility between the NACS and CUPAR, as well as other central institutions.

SLOVENIA

Ministry responsible for PA: Ministry of Public Administration, since December 2004; prior to December 2004: Ministry of the Interior Quality Committee at the Ministry of Public Administration National Metrology Institution – MIRS (for EFQM)

Ministry of Public Administration

Since December 2004, Ministry of Public Administration has been in charge of the system of Public Administration, which includes QM in PA. The main reason for establishing the Ministry of Public Administration originates in the intention of the Government to join different organisational units (already operating under certain ministries or as government offices) with the common goal of improving the functioning and quality of public administration.

The mission of the Ministry is friendly and efficient public administration, and additionally: to provide public administration which will be comparable with public administrations of other EU Member States and will be – in the sense of advanced organisation, customer satisfaction and impact on public finance among the best in the EU.

Main strategic goals and directions of the Ministry of Public Administration through 2008:

- customer orientation, including customer-oriented administrative processes;
- further development of e-government and other modern mechanisms for supporting relations with external and internal customers, and for providing efficient and competitive services to individuals, civil society and the economy;
- an efficient system of public employees and a fair, transparent and holistic salary system, including all aspects of modern human resource management;

- quality and efficiency of public administration, including quality management at all decision-making levels; efficient and rational operations, with lower costs and fewer public employees in the civilian part of state administration;
- openness and transparency in the public administration system, including simple, holistic and free-of-charge access to public information, accessibility of all information on public expenditure and participation of the public in decision making.

Quality Committee

In March 1999, the Quality Committee was established at the Ministry of the Interior in order to pursue efficient, citizen-friendly, transparent and responsible state administration. The Quality Committee set the following goals:

- to improve efficiency and effectiveness
- to increase client satisfaction
- to increase employee satisfaction
- to control and manage costs
- to improve transparency
- to raise its reputation and visibility
- to gain a quality certificate for individual administrative units.

Activities of the Quality Committee are planned with a strategic view to the whole administration and have basically been oriented to administrative units, where the majority of citizens deal directly with the administration.

National Metrology Institution

The Metrology Institute of the Republic of Slovenia (MIRS) acts under the Ministry of High Education, Science and Technology, and was established in June 1991.

The Metrology Institute established and now manages the Business Excellence Prize and performs all necessary professional and administrative assignments for this programme. MIRS is an EFQM National Partner Organisation (NPO).

Permanent co-operation between the Ministry of Public Administration and MIRS:

2002/2003: Translation of the EFQM model/brochures into Slovene

2004/2005: Pilot Project of the National Quality Award for Public Administration

2006: Translation of CAF 2006 into Slovene

2007: Pilot project SOOJU.

q32 Training for QM

In almost all the Member States (25/27), training for quality management is considered not only very important but crucial for successful quality implementation. It is organised and provided in different ways.

BULGARIA

Trainings are organised by the Institute for Public Administration and European Integration of the MSAAR.

Additional training sessions were organised under different projects.

Experts from the Bulgarian PA participate in the training organised by the EIPA.

As for 2006:

Training by the IPAEI on administrative activities aimed at improvement of administrative service delivery – 1,744 employees.

Training under the Phare project on quality management systems – 150 employees trained.

CYPRUS

The CAPA organises a 4-day training programme on the CAF. Self-assessment teams are trained on the model.

Training programmes on skills development are organised by the CAPA, but not on quality management as such. However, they do have an indirect impact on quality management.

GREECE

In order to train potential or current CAF users, as well as disseminate the CAF among public servants and public organisations, the Ministry of Interior is co-organising two 5-day training programmes with the National Centre of Public Administration (training institute for public servants): in the first, the CAF is integrated into a training programme for civil servants on performance management, which includes a section on the CAF, while the second is a CAF specific seminar called “Evaluation Procedures & Efficiency”. Both programmes have as a target group employees working in central, regional and local government organisations. In 2007, 44 courses were organised as part of the two programmes, training about 1,100 public servants. In 2008, a roughly similar number of seminars will be organised.

A third training programme was run in 2007 targeted specifically for officials from the 2nd level (prefectural) of local government. This was a one-day seminar on the CAF, goal-setting and results measurement aimed at increasing awareness and boosting the use of the CAF, and goal-setting and results measurement in local government organisations. This programme is organized by the Hellenic Agency for Local Development and Local Government. As part of the programme, 9 seminars were organised, attended by 200 local government officials. In 2008, a new targeted training programme will be initiated aimed at promoting the use of CAF in a number of municipalities.

ROMANIA

In our country, several institutions provide training programmes in the field of quality in public administration: Central Unit for Public Administration Reform (Ministry of Interior and Administrative Reform), National Agency for Civil Servants, National Institute for Administration, Academy of Economic Studies, and the National School for Political and Administrative Sciences.

For example, from 10–20 March 2008, the National Civil Service Agency and SIGMA organised a joint initiative of the OECD and the European Commission, principally funded by the EC (www.sigmaweb.org), having the general objectives:

- to make participants familiar with the key elements of quality management in the public sector
- to present different instruments and frameworks to promote quality in public services and implement quality-oriented policies in the public sector.

General Topics: quality as a policy issue in the public sector performance instruments, techniques and frameworks to enhance the quality of public services, including ISO 9001, Service Charters and Balanced Scorecards assessment of the quality of governance in public service organizations.

Target Groups

- top managers and politicians at local and regional levels
- quality managers in other public agencies at local and regional levels.

SLOVENIA

Training for QM is organised by the Administration Academy of the Ministry of Public Administration, as a special PA training unit. The catalogue of the Administration Academy for 2007 listed as many as 13 different programmes on the subject of quality in administrative work:

Common Assessment Framework (CAF) for assessment of quality for public sector,

Self-assessment workshop for internal auditors based on the CAF model,

Basic course on self-assessment based on the EFQM model,

Workshop for self-assessment based on the CAF model for internal auditors (public sector),

The road to excellence with a help of the modified model CAF 2006,

A consultation meeting by internal auditors in public administration,

Managing quality – motivational lecture,

Introduction of quality ISO 9000 system – workshop on the preparation of quality manual

Training for internal Auditors,

Managing processes for the implementation of quality,

Methods and techniques for management of quality,

Quality of administrative work - mission, visions and goals,

Achievement of efficiency and effectiveness with help of measures and indicators,

It is fitting to mention that in 2002 the Quality Committee defined the content for training for quality, which is based on the necessary competences for quality, and with this in mind the Administration Academy offered a set of seminars, which are constantly updated and supplemented, with a possibility to organize tailor-made seminars on demand.

q33 Quality tools in PA organisations

Different quality tools are being used in public administrations in the EU. Among the most widely used are improvement groups/quality circles, Balanced Scorecard (BSC), Customer Relationship Management (CRM), Customer Satisfaction Management (CSM) and suggestions and complaint boxes for customers and employees. Comprehensive information is provided in the comparative review matrix on the EUPAN website www.eupan.eu.

GREECE

The Directorate of Quality and Efficiency (Ministry of Interior) has published a document providing guidelines on strategic management. Within this framework the use of BSCs by public organisations as a tool for goal-setting and performance measurement is strongly recommended and supported by the Directorate of Quality and Efficiency.

ROMANIA

CLEAR

Under a public private partnership, the NACS is implementing the CLEAR tool, which exists to help local governments and other organisations or groups at the local level to better understand public participation in their localities. It is a diagnostic tool, one which helps public bodies identify particular strengths and problems with participation in their localities and, subsequently, to consider more comprehensive strategies for enhancing public participation.

The CLEAR tool develops from a framework for understanding public participation which argues that participation is most successful where citizens:

Can do – that is, have the resources and knowledge to participate;

Like to – that is, have a sense of attachment that reinforces participation;

Enabled to – that is, are provided with the opportunity for participation;

Asked to – that is, are mobilised by official bodies or voluntary groups;

Responded to – that is, see evidence that their views have been considered.

The tool is organised around these five headings and provides a focus for individuals to explore participation in their area. This tool was developed through the Council of Europe's intergovernmental cooperation supported by a team of experts.

Industrial District as a Corporation

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Abstract. *This paper provides a comparison study of industrial districts in two European countries, Spain and Sweden, using the conceptual framework of corporation. The relevance of this approach is based on the specific qualities that the industrial districts have, including the preexisting conditions, local traditions, products and production characteristics, marketing strategies, local policies and present challenges. The findings indicate the ways in which different patterns of inter-firm relationships, organization of production and dynamics of local alliances have shaped divergent regional responses to the industrial construction.*

Keywords: industrial district, corporation, entrepreneurship, small and medium-sized enterprises (SMEs), transaction cost.

JEL Codes: D23, L14, L26, L52, O25.

REL Codes: 17B, 17C.

1. Introduction

Industrial district phenomenon has been identified as a dynamic approach to the regional economic development. Although it is not a perfect model to solve all developmental problems, there are principles of organization by industrial district which can usefully be utilized in some contexts and countries.

An industrial district as a corporation is an infrastructure for human (inter)action, which penetrates most organizations in a society thereby changes and develops them and in long run is modified by them in an ever continuing process.

This paper briefly discusses the ways in which different patterns of inter-firm relationships, organization of production and dynamics of local alliances have shaped divergent regional responses to the industrial construction in Spain and Sweden. It begins with a look at the concept of corporation and then profiles some cases from the industrial districts in both countries. It thereafter presents an analysis of those industrial districts from the corporation perspective. This paper also suggests some directions for future policies to support the dynamic growth in the industrial districts.

2. Concept of corporation

Sjostrand (1992) identifies and defines the corporation as a basic theoretically deduced institution or infrastructure (a coherent system of shared norms) for human (inter)action which reduces the fundamental uncertainty and facilitates the effective and legitimate coordination of human actions in the society. The corporation is a phenomenon which coordinates, regulates and stabilizes the human activities and simultaneously functions as a resonance for change. In this respect, most efforts of a corporation are more process oriented so that individuals participate in the change. The social and/or economic change is continuously developing and it is discretionary. This process contains the (re)constructions of cognitive structures (e.g., orders, laws, codes, rules, habits, norms, agreements and patterns) and the habits of actions embedded (and embodied) in the corporation.

Theoretically, the corporation is a deduced interaction pattern which combines a calculative rationale with a hierarchic structure. The calculative quality is principally associated with egoism and (economic) maximizing behavior in the economic analysis. Although it is not very useful to say that an individual acts purely selfishly, the need for economizing calculative rationale in impersonal, occasional and anonymous relations and exchanges, however, will be created. In calculative processes, the price contains the crucial information and the purpose of transaction is basically the exchange.

In most institutional analysis, the contract is used as a framework and the execution of that is carried out informally and in cooperation between the parties involved. Thus, the entire social context surrounding an exchange is of importance (Sjostrand, 1992). Three fundamental deficiencies in applying the idea of human interactions and exchanges as based on the contractual relations which have not been solved as yet according to Sjostrand (1992) are the problem of jurisdiction of social relations, lack of focus on dynamics and neglect of the existence of historical asymmetries (power differences).

Williamson (1979) recognizes the classical, neoclassical and relational categories of contract law in a three-way classification of contracts. He asserts that the critical dimensions for describing contractual relations are the uncertainty, frequency with which transactions recur and degree to which investments are idiosyncratic. He also describes six types of transactions to which the governance structures need to be matched. He proposes the market governance for classical contracting, trilateral governance for neoclassical contracting and transaction specific governance for relational contracting. In the last case, two types of transaction specific governance structures for intermediate production market transactions can be distinguished; namely, bilateral structure for obligational contracting and unified structure for internal organization. Nooteboom (1993) argues that Transaction Cost Economics (TCE) considers the effects of scale and scope on the costs of production, but hardly their effects on the costs of transaction. It also tends to ignore the effects of experience and learning and it has some limitations in the context of rapid innovation because it is not a dynamic theory. According to him, a transaction can be seen as an event during a process of exchange which consists of three stages; namely, contact, contract and control. Furthermore, the analysis of effects of firm size on the transaction costs indicates on the whole transaction costs are higher for smaller firm.

A hierarchy refers to the asymmetrical relationships between actors (individuals or entities) and it is characterized by the chains of relations of superiority and subordination and therefore by shifting some amounts of discretion (power) for actors in different levels.

Regarding the generality (persistence over time) of corporation, both stability and pattern maintenance are assumed in the core idea and in the definition. This macro institution, i.e. corporation, is continuously (re)produced by actors in their daily activities and interactions in the micro level. Therefore, the corporation is (re)produced through the individual actions as well as the emerging organizations in the society. Sjostrand (1992) argues that this perspective implies that an organization is thus perceived as a process, although existing structures in the corporation affect (and are affected by) the outflow.

Finally, in almost all organizations pervaded or infused by the logic of corporation, we also find both activities of (re)distribution and reciprocal relationships. Thus, according to Sjostrand (1992), the ideals manifested as rules or norms connected to the belief systems will affect the (inter)actions of individuals in the organizations as well as the friendship or other close relations.

3. Industrial districts in Spain

Spanish industries began the industrial restructuring process from a very different baseline in the midst of a global economic downturn and an internal political transformation. In this period, many sectors have restructured more out of economic necessity and cost cutting strategies from above than as a result of collective strategies from below to take advantage of new market opportunities, create alternatives to established forms of production or build on artisanal traditions or movements for local autonomy (Benton, 1992). At the first stages of restructuring, we can see the rapid growth of some new zones of industrial concentration of a large informal sector of off-the-books employment in mainly under-capitalized and not especially innovative new small firms, without the advantages of embeddedness in the supportive local communities such as the business associations and unions. The roots of these organizations among many constituencies are quite weak and have little influence over the restructuring process in small firms and in highly fragmented sectors. The political environment of transition did not favor policy supports for strengthening the industrial districts, too.

The combined effect of this institutional framework is the absence of strong leadership from local institutions to form alliances, which would underpin the emergence of dynamic industrial districts. The exceptions also reflect the wide differences in the social and political make-up of the regions in Spain.

After the recession, the industries of Spain emerged with a changed mission to improve the international competitiveness not just on lower costs, but on the ability to produce higher quality and higher fashion products. The reappearance of regional governments and political decentralization opened the opportunity for new sets of alliances to shape the regulatory context for geographically concentrated industries such as opportunities for worker mobility, technological upgrading and infrastructural improvements. Most assessments of the impact of productive decentralization on the industry have concluded that the intent has mainly been to reduce the costs (rather than to permit greater flexibility and innovation) and that the effect has essentially been to downgrade labor conditions and depress earnings (rather than to give workforce more control over the production process) (Benton, 1992).

We can identify two geographical patterns of change in Spain. First, the productive decentralization has been associated with a movement of industry away from the core and inner ring of major metropolitan areas, Madrid and Barcelona, and an expansion of an outer ring made up of a large numbers of small firms and multi-sector industrial zones. Second, many mono-sector rural- and town-based industrial concentrations have become consolidated. Benton (1992) argues that although productive decentralization has sometimes favored spatial diffusion, key industry functions such as commercial and financial services, auxiliary connections or recruitment of highly skilled workforce remained centralized in these potential industrial districts. Finally, the social and political identity of industrial districts, rather than merely their geographical setting or sector make-up, determines the direction of restructuring in these industrial districts.

The following cases present the development processes in the multi-sector industrial districts in Madrid and Catalonia as well as in the town-based mono-sector industrial districts in the Valencia and Basque regions.

3.1. Fuenlabrada in Madrid

Industrial growth in Madrid had been divided between very large-scale industrial plants, which were financed by national and international capital and small-scale industries, which served mainly the local market. Its industrial base was newer than that of Barcelona and the tradition of employers' associations of worker cooperatives was extremely weak. The industrial structure in Madrid has been evolving away from subordinate forms of subcontracting and toward a more complex structure of interdependencies among small firms located on the periphery.

The change is taking place in Madrid despite the nature of surrounding communities, which are characterized by poor housing conditions, high unemployment, dearth of services for both businesses and residents and lack of support for local development by regional and local governments. Madrid holds the largest concentration of firms in professional electronics. A small subset of firms boasted a large clientele, they owned equipment, which allowed them to produce high quality and high precision products and they were experimenting with innovative ways of organizing the production process for greater flexibility. A slightly larger number of firms were highly dependent subcontractors, which competed mainly on the basis of low cost. Most firms, however, could be placed in a middle category, which began with rudimentary equipment and family or off-the-books workforce, were struggling to establish reputation as high quality producers, to improve equipment and to train or attract more skilled workforce. For these firms, in particular, the nature of

immediate environment, dearth of local services, weak or tentative ties with other local firms and little government support seemed crucial obstacles to the continued expansion of industries.

Madrid saw a rapid growth in the number of new small firms settling in the second ring of municipalities around the city in the period after 1978. A large proportion of firms were located on the land, which was still zoned for agricultural uses or makeshift industrial parks and that often lacked even basic infrastructural improvements such as paved roads, postal service and adequate water. A high percentage of firms were metalworking and woodworking shops with a diverse mix of other industries especially printing, food processing, graphic arts and chemicals. Findings about marketing strategies status also suggested that some firms were moving quickly beyond a subordinate status of subcontractor (Benton, 1992). The competitiveness of many firms as a subcontractor still often depended more on cost cutting than on an ability to produce high quality products in a flexible manner.

Fuenlabrada boasted the largest number of industrial establishments in the region after Madrid. Humanes, a neighboring town of still more recent industrial development, shows the highest industrial employment in the region. Here as elsewhere, the pressures of recession helped the formation of new small firms, but also operated against the consolidation of stable industrial areas in which the continuity of firms could support the development of cooperation networks. Nevertheless, it is significant that out of this tumultuous environment, a segment of highly innovative and successful firms have indeed emerged. It would seem that the zone is in fact serving as a cradle for some new enterprises, which are moving in the direction of more flexible production for widening markets in spite of either the local entrepreneurial culture or the support of local community.

Possibly as a result, cooperativism in the entire region has been very weak and followed mainly as a strategy for salvaging the jobs. The social and political institutions of the towns have yet to adjust to massive influx of new residents. The unemployment rate in the zone continues to be higher than the region as a whole and more significantly the conditions for workforce also appear to be worse on average.

According to Benton (1992), the Fuenlabrada area has some of the features of a dynamic industrial district; namely, a sector of innovative small firms, growing complexity of interconnections among firms and a clear, though slow, trend toward greater cooperation among firms in at least one sector, i.e. wood furniture manufacturing. The policy changes in the regional government also appear to be sensitive to the potential of the zone to develop itself as a center for innovative industrial growth.

3.2. Valles Oriental in Catalonia

The industries of Barcelona had a long-established tradition of commercial ties to the outside of Spain and produced a wider mix of consumer and intermediate goods. A tradition of family-run and highly competitive business was also already in place as was a tradition of associations of employers. The solidarity among industry participants might be based in part on the common regional identity. The textile industry of Spain has been heavily concentrated in Catalonia (most notably Sabadell and Terrassa) since the 18th century. The long-established presence of textile industry has also generated broad participation in industry and at times a cohesive workers' movement. Finally, the industry has developed ties to other regional sectors most notably the chemical industry because of the growth of synthetic fiber production. These factors have helped establish a wide zone in and around Barcelona, which is characterized by a strong industrial tradition and pre-existing social and economic ties among industry participants.

The industrial structure in Barcelona is evolving away from subordinate forms of subcontracting toward a more complex structure of interdependencies among small firms located on the periphery. The local industrial policy has also been lacking, but employer associations have functioned to support the trend toward inter-firm cooperation. In addition, some peripheral communities have been among the leaders of the region in industrial growth.

Catalonia has emerged from the crisis period with its position as a leading industrial province firmly in place. This pattern features the relative rise of a group of intermediate regions, which tend to benefit from their lower costs in land and labor and their easy access to markets because of placement along major communication routes. This process of industrial diffusion has been accompanied by strengthening of sub-regional specialization as indicated by the relative growth of industrial investment. Finally, the region as a whole shows a substantial decline in average firm size as larger firms have been dismantled and replaced with streamlined enterprises, which engage in wider networks of subcontracting. These trends together suggest that a substantial restructuring of Catalonian industries is underway in part in reaction to new market conditions (Benton, 1992).

An existing tradition of industrial development and entrepreneurship, established community institutions, high residential value and fluid communications with other industrial zones in Barcelona appear to offer an environment much more conducive to inter-firm cooperation among a burgeoning number of small industrial enterprises. The region of Valles Oriental has experienced many of the trends described above, including the proliferation of small firms, influx of residents from Barcelona and relative

strengthening of its industry specialization in plastics and wood furniture products, metalworking, food processing and textiles. Finally, the networks of subcontracting and the relationships of cooperation among firms appear to be highly developed. Entrepreneurs clearly value the opportunity they have in Valles Oriental to work closely with both clients and suppliers. It is important to add that the dynamism displayed in Valles Oriental and other fast-growing regions in the last several years is owed at least in part to conjunctural factors. Particularly, with the entry of Spain into the European Economic Community, foreign investment has increased considerably. Foreign-financed firms may themselves take advantage of the dense network of small suppliers and subcontractors.

To summarize, Valles Oriental displays many of the characteristics of a successful industrial district; namely, a complex structure of relationships among firms, growing inter-firm cooperation and diversification and dynamism even during the worst years of industrial recession. Growth in this place in the last decade resulted from a more general pattern of productive decentralization, which drew investment away from the metropolitan core areas and the first ring of industrial centers toward the second less developed ring. This process at the same time favored the development of Small and Medium-sized Enterprises (SMEs) to allow for a diversified and flexible production.

3.3. Valencia region

The second broad pattern of industrialization in Spain, which has given rise to new industrial districts is a diffused rural-based industrial growth. The industrial growth in previously agricultural zones has tended to favor the development of communities or group of towns devoted to production in a single sector or very closely related sectors. This point can be made clear by contrasting two examples of industrial districts in the Valencia region. This Spanish region has a strong export orientation, an emphasis on light consumer manufactures, a symbiotic relationship to agriculture in the early stages of industrial growth, a spatial pattern of specialized industry concentrated in particular towns or clusters of towns and dominance of SMEs, which many of them are family business (Benton, 1992). However, key social and political conditions shape a very different environment for industrial restructuring. One such difference is the social orientation of entrepreneurs in Valencia. The success of firms has depended in large part on the capacity of sectors to imitate international style and produce a wide range of goods cheaply. To continue to compete on the markets for light consumer goods in which the region specializes, the industries would have to devote more resources to the technological upgrading, product innovation, enhancing the reputation of

Spanish design and promoting the capacity to propel fashion change rather than simply responding to it through imitation (Benton, 1992).

The industries of Valencia have reacted variably to this challenge and their responses tell us something about the viability of industrial districts as a supportive environment for this type of adjustment. We can look first at a highly dynamic and successful case, the ceramics producing region centered in a cluster of towns in the province of Castellon. The local institutions (cooperatives sponsored by the employers' association of sector) have developed to enable the growth of industry based on the diversification increasing and continual technological upgrading. In contrast, the shoe industry centered in the province of Alicante has stalled in its effort to move the production into the higher price and higher fashion markets and it is now seeing its domestic market eroding under a rising tide of imports. Rather than diminishing, the informal sector has gained certain stability in Vinalopo Valley.

Despite increasing efforts on the part of the regional government to stimulate innovation in the industry, the dominant strategy remained one of achieving flexibility through subordinate low cost subcontracting. Even though the shoe producing towns display some of the same characteristics as the ceramics producing towns of Castellon, closer analysis shows crucial differences in the way the local industry responded to the crisis. The technological differences in production in two industries have something to do with their different responses at this juncture, but the social and political conditions in two communities are ultimately more important in explaining their divergent paths.

3.4. Mondragon in Basque

The fast growth of protected domestic markets in Mondragon caused the development of cooperatives and their competitive strategy has perhaps had more in common with that of an oligopolistic firm than with the flexible adjustment of a network of SMEs (Benton, 1992). The example of Mondragon confirms the need for a strong local level institutional cooperation in the face of unresponsive or ineffective industrial policy. The case shows the benefits to be gained from inter- and intra-firm cooperation and the significance of self-governance as support for these goals. The reasons for the success of cooperatives perhaps have to be sought in the evolution of cooperatives themselves and in the internal politics of these institutions. New cooperatives provide required services and maintain an organizational structure, which links these second level organizations to the productive ventures. The second level cooperatives thus substitute themselves for the sorts of political alliances among local businesses, workers and local government leaders (Benton, 1992). This

kind of organizational structure has permitted a certain degree of flexibility in responding to the market shifts and in developing the new ventures.

However, the innovation in this area has slowed down in recent years and the members of cooperatives express considerable frustration over what they perceive to be growing tensions between the democratic governance on a broad plane and the hierarchical management in the production sphere. Resolving such tensions may prove to be crucial to the ability of cooperatives to continue to respond flexibly to the market change particularly since future growth unlike past expansion will depend on their ability to serve more demanding international market rather than a protected and growing domestic market.

4. Industrial districts in Sweden

In regard to the situation of Sweden, it is of a considerable position in the world economy. Industries of Sweden have large firms on the top and small firms as a stand. What it comprehensively lacks is medium-sized businesses. The problem for Sweden and its large firms, according to Brulin (1998), is that they have not nourished a structure of supportive SMEs. There is a lack of creative territorial energy around many large firms and the Gnosjo region is an exception. The present challenge for Sweden is to make creative territorial energy to sustain and promote its industries. One of the favorite pastimes of industrialists and economists in Sweden is to moan about the lack of a Swedish entrepreneurial culture. What has maintained the dynamism of Gnosjo has been a constant emphasis on quality, high productivity and reliability, which are married to a strong family ownership tradition. The manufacturing strength of Gnosjo has naturally spawned a supporting service sector and a welter of trading firms, but there is less evidence of entrepreneurial culture perpetuating itself through the establishment of new firms.

Apart from anything, the lack of encouragement for self-starters has led to the misshapen development of industries in Sweden. As for Gnosjo the encouraging news is that its strengths show no signs of eroding (Rock, 1995). Rock (1995) argues that entrepreneurs have been discouraged in Sweden by an onerous tax system and rigid labor market laws. Indeed entrepreneurialism has almost been sacrificed in the informal pact between the labor unions and Social Democrats. They have stressed large business and public sector rather than small business and private sector. He also says that the structure and industrial distinctiveness of Gnosjo are not exportable to other towns or regions. In contrast to him, the Gnosjo region has long served as a model for entrepreneurial skills and business success. Therefore, we focus on the Gnosjo industrial district and present more information about its development process.

4.1. Gnosjo region

The Gnosjo region is renowned for its distinctive business climate, which is referred to as spirit of Gnosjo and it is unique in Sweden. The local industries of the region in the county of Jonkoping are recognized by their small business and small-scale nature, which enable them to adapt quickly to the changing market requirements and new trends in the world. A similar industrial culture has pervaded nearby towns such as Anderstorp, Hillerstorp and Gislaved. The Gnosjo region comes top of the Swedish league table for growth alongside the Stockholm region with low unemployment rate. There is also a long tradition of cooperation and solidarity and of forming networks, which promote industrial success (Johannisson, 2002) and in turn lower transaction costs. It has a tight interaction between the social and economic lives where the specialized businesses are deeply embedded. The spirit of Gnosjo includes certain unique features, which makes it the lifeblood of the region (Johannisson, 2002, Wigren, 2003).

Karlsson and Larsson (1993) did a research about the long-run sustainability of the phenomenon of Gnosjo during the period 1980-1988. They found that the phenomenon of Gnosjo had not been as successful as expected. To sustain and improve the competitiveness of industries in the Gnosjo region in the long run, they suggested that the labor-intensive industries should be structured more in the knowledge-intensive direction. Brulin (1998) argues that bringing external partners into such a region like Gnosjo is not without any problem and proposes that external partners must not take over the process of territorial development thereby threatening to drain it of indigenously created energy.

The corporate structure of the Gnosjo region consists mainly of micro and small family-owned subcontractors primarily in the metal, plastic, wire and finishing industries. Its industries boast the production expertise and an impressive array of machinery and technological equipment. The automation and information technologies as well as the efficiency and effectiveness measures are well implemented and several firms in the region also have their own products in the global market. The level of on-the-job training and tacit knowledge is remarkably high, but the level of formal education is still low. The manufacturing, mining and quarrying industry in Gnosjo is highly labor-intensive. The trade, transport and communication sector and the health and social work sector are in the next positions.

However, the manufacturing industry in the Gnosjo region is strongly dominated by price-competing industries and the competence in each firm is not very high, but the collective competence within the fields of metal and plastic productions is quite high (Brulin, 1998). Within the tight local network in the region, a kind of mutual dependence is developed, which makes the border between competition and cooperation fluid (Karlsson, Larsson, 1993). In this region, an overall restructuring is in progress. In just a few years many family

firms were sold either to Swedish investment or venture capital firms or to foreign buyers and a number of firms also closed their factories down. The consequences of increasing external ownership of manufacturing businesses are causing changes in the economic and social lives of the region (Wigren, 2003).

In light of the ongoing restructuring trend, the demands on competitiveness and international recognition have rapidly intensified. Considering that most firms in Gnosjo are subcontractors in some form and only a small part survives based on a product of its own, there is every reason to review the potential of bringing more firms into the region, which have products of their own on the international market. Although the Industrial Development Center (a cooperative institution) and the municipality of Gnosjo are providing the necessary infrastructure, educational systems and information, there is not a mutually expressed regional strategy, which could be a guideline for public authorities to mold the infrastructure of the region.

In a traditionally strong classless society such as Gnosjo, the legal systems are highly substituted by shared ideals and genuine relationships. It reflects the stability or inertia in this society. However, legal rules of ownership and contracting are of great importance in global profit gaining and value adding business. The deeply rooted embedded formal and informal relationships based on trust (coherent system) in Gnosjo are creating a common understanding and are reducing the uncertainty in exchange and in turn the transaction costs, especially when the transactions are recurrent. The most common goals among the firms are of economic nature e.g., cost efficiency and the hierarchy in this corporation is exactly based on the power (technology, capital, information,...) of several stakeholders taking good care of their and others businesses.

5. Corporation perspective of industrial districts

To understand and compare the industrial districts in two countries, Spain and Sweden, using the conceptual framework of corporation, we distinguish and apply some specific qualities and compare the industrial districts based on these qualities. These specific qualities include the preexisting conditions, local traditions, products and production characteristics, marketing strategies, local policies and present challenges. Therefore, we discuss about the similarities and differences between these industrial districts, respectively.

5.1. Preexisting conditions

The preexisting conditions in the industrial districts are summarized in Table 1. As we can see except Fuenlabrada, some kind of nationalism helped the emergence of industrial districts in two countries. The dominance of small

and family subcontracting businesses achieving flexibility through cost cutting is apparent in all industrial districts, although in Fuenlabrada, very large-scale industrial plants are populated and there is a small subset of firms, which produce high quality and high precision innovative goods. Among these industrial districts, only Valles Oriental and Gnosjo have easy access to the markets, because of placement along major communication routes, and high residential value. We can also find the low unemployment rate (labor-intensive industry) and high tacit knowledge in Gnosjo.

Table 1

Preexisting conditions in the industrial districts

District	Quality
Fuenlabrada	<ul style="list-style-type: none"> ▪ Very large-scale industrial plants and small-scale industries ▪ A small subset of firms produce high quality and high precision goods ▪ A large number of firms were highly dependent subcontractors ▪ Poor housing conditions, high unemployment, dearth of local services
Valles Oriental	<ul style="list-style-type: none"> ▪ Entrepreneurship, family-run and highly competitive business ▪ Wide networks of subcontracting and relationships among firms especially after dismantling larger firms ▪ Solidarity based on common regional identity ▪ Lower costs in land and labor and easy access to markets because of placement along major communication routes
Valencia	<ul style="list-style-type: none"> ▪ Specialized industries concentrated in particular towns or clusters of towns ▪ Dominance of SMEs and many family businesses ▪ Achieving flexibility through subordinate low cost subcontracting
Mondragon	<ul style="list-style-type: none"> ▪ Industrial tradition in iron and locksmith industry, heaters and stoves ▪ Basque nationalism
Gnosjo	<ul style="list-style-type: none"> ▪ Self organizing industrial district ▪ Dominance of small and family (subcontracting) businesses ▪ Easy access to the markets because of placement along major communication routes (in the north of Europe) ▪ Low unemployment rate (labor-intensive industry) and high tacit knowledge

5.2. Local traditions

We summarized the local traditions in the industrial districts in Table 2. As we can see in all industrial districts except Fuenlabrada, there are social and economic ties, networking and cooperation among industry participants based on the social (commitment and trust), economic and human capitals, strong cooperatives and employers' association. It may be as a result of a forced new industrial base for Fuenlabrada. Valles Oriental has especially commercial ties to the outside of Spain and a broad participation in industry. Entrepreneurs in Valencia have a prominent social orientation like those in Valles Oriental. The creative territorial energy and collective entrepreneurship in Gnosjo are also outstanding.

Table 2

Local traditions in the industrial districts	
District	Quality
Fuenlabrada	<ul style="list-style-type: none"> ▪ New industrial base ▪ Extremely weak employers' associations of worker cooperatives ▪ Weak or tentative networks of cooperation and ties with other local firms
Valles Oriental	<ul style="list-style-type: none"> ▪ Commercial ties to the outside of Spain ▪ Broad participation in industry ▪ Social and economic ties among industry participants ▪ Associations of employers ▪ Developed cooperation and ties to regional sectors
Valencia	<ul style="list-style-type: none"> ▪ Emphasis on light consumer products manufactures ▪ Strong cooperatives sponsored by the employers' association of sector ▪ Social orientation of entrepreneurs
Mondragon	<ul style="list-style-type: none"> ▪ Development of cooperative ▪ Inter- and intra-firm cooperation ▪ Providing the required services by cooperatives ▪ Studied trust
Gnosjo	<ul style="list-style-type: none"> ▪ Social (commitment and trust), economic and human capitals ▪ Creative territorial energy and collective entrepreneurship ▪ Cooperation and networking

5.3. Products and production characteristics

The products and production characteristics of industrial districts in Spain and Sweden are summarized in Table 3.

It is obvious that all of them are specialized in consumer and intermediate goods production. Additionally, they have an impressive array of machinery and technological equipment and several different production lines so that the technological differences in production among them are apparent.

Table 03

Products and production characteristics in the industrial districts	
District	Quality
Fuenlabrada	<ul style="list-style-type: none"> ▪ Electronics, metalworking, woodworking, printing, food processing, graphic arts and chemicals ▪ A segment of highly innovative successful firms
Valles Oriental	<ul style="list-style-type: none"> ▪ A wide mix of consumer and intermediate goods, textile, woodworking, metalworking, food processing and chemicals ▪ Technology differences in production
Valencia	<ul style="list-style-type: none"> ▪ Light consumer goods, ceramics, shoes, ... ▪ Technological differences in production
Mondragon	<ul style="list-style-type: none"> ▪ Home electrical appliances and several goods ▪ Several different production lines
Gnosjo	<ul style="list-style-type: none"> ▪ Metalworking, chemicals and finishing industry ▪ Impressive array of machinery and technological equipment

5.4. Marketing strategies

The marketing strategies made by different industrial districts are summarized in Table 4. Their competitiveness almost depends more on the cost cutting strategy than producing high quality products strategy and therefore the price competition is the main factor in this respect. Gnosjo is an exception, which focuses on the quality, productivity and reliability and adapts to the changing market. Fuenlabrada is moving beyond a subordinate status of subcontractor, but in Valles Oriental a small subset of firms still have a large clientele. Although Valencia is imitating the international style, it has a strong export orientation like Valles Oriental. Finally, Mondragon is still with its protected domestic markets.

Table 4

Marketing strategies in the industrial districts	
District	Quality
Fuenlabrada	<ul style="list-style-type: none"> ▪ Moving beyond a subordinate status of subcontractor ▪ Competitiveness depends more on the cost cutting than producing high quality products
Valles Oriental	<ul style="list-style-type: none"> ▪ Competitiveness depends on the cost cutting ▪ A small subset of firms have large clientele ▪ Export orientation
Valencia	<ul style="list-style-type: none"> ▪ Strong export orientation ▪ Imitating international style and producing a wide range of goods cheaply
Mondragon	<ul style="list-style-type: none"> ▪ Protected domestic markets ▪ Export orientation
Gnosjo	<ul style="list-style-type: none"> ▪ Emphasis on quality, productivity and reliability ▪ Price competition ▪ Adapt to changing market

5.5. Local policies

Different local policies of the regional and local authorities and cooperatives in these industrial districts are summarized in Table 5. Obviously, we cannot see any strong and prominent support for local development by regional and local governments. In all industrial districts except Fuenlabrada, the cooperatives and employers' associations have made political alliances among local businesses, workers and local government leaders to provide infrastructure, educational systems, access to information, support for development of products and inter-firm cooperation. The municipality of Gnosjo helps providing the above services more than others. And finally, the cooperatives of Valencia have also done a lot of efforts to grow the industry based on the diversification increasing and continuous technological upgrading.

Table 5

Local policies in the industrial districts	
District	Quality
Fuenlabrada	▪Lack of support for local development by regional and local governments
Valles Oriental	▪Lack of local industrial policy, but support of employers' associations toward inter-firm cooperation
Valencia	▪Growth of industries based on the diversification increasing and continuous technological upgrading by cooperatives
Mondragon	▪Cooperatives have made political alliances among local businesses, workers and local government leaders
Gnosjo	▪Providing infrastructure, educational systems, information and support for development of products

5.6. Present challenges

By summarizing the present challenges of industrial districts in both countries in Table 6, the severe competition in expanding Europe and the world based on the innovation, Hi-Tech and knowledge-intensive production and flexibility to the market changes are the main future challenges for all industrial districts. For this reason, they should devote more resources to the technological upgrading and product innovation. Specifically, Fuenlabrada should do many arrangements for massive influx of new residents, high unemployment rate and bad conditions for workers on average. Valles Oriental should pay a special attention to moving away from subcontracting as well. Enhancing the reputation of Spanish design and promoting the capacity to propel fashion change as well as preventing the stability of informal sector are some considerable challenges for Valencia. Mondragon has to reduce the growing tensions between the democratic governance on a broad plane and hierarchical management in the production sphere. Finally, in Gnosjo, the succession of local industries to the next generation, increasing external ownership and deficiency of skilled workers and managers in the region should be considered more by formal and informal actors.

Table 6

Present challenges in the industrial districts	
District	Quality
Fuenlabrada	<ul style="list-style-type: none"> ▪ Massive influx of new residents ▪ High unemployment rate ▪ Bad conditions for workers on average ▪ Policy changes toward innovative industrial growth
Valles Oriental	<ul style="list-style-type: none"> ▪ Moving away from subcontracting ▪ Flexibility to the market change (internationally)
Valencia	<ul style="list-style-type: none"> ▪ Devote resources to technological upgrading and product innovation ▪ Enhancing the reputation of Spanish design and promoting the capacity to propel fashion change ▪ Preventing the stability of informal sector
Mondragon	<ul style="list-style-type: none"> ▪ Slowing down innovation ▪ Growing tensions between the democratic governance on a broad plane and hierarchical management in the production sphere ▪ Flexibility to the market change (internationally)
Gnosjo	<ul style="list-style-type: none"> ▪ Succession of local industries to the next generation ▪ Structuring toward knowledge-intensive, innovation and Hi-Tech ▪ Increasing external ownership ▪ Deficiency of skilled workers and managers

6. Conclusions

The purpose of this study is to understand and compare the industrial districts in two European countries, Spain and Sweden, using the conceptual framework of corporation. The relevance of this approach is based on the specific qualities that the industrial districts have, including the preexisting conditions, local traditions, products and production characteristics, marketing strategies, local policies and present challenges.

In Spain, the relative weakness of local level institutions and tendency of firms to substitute short term cost cutting strategies for long term collective strategies have acted as a brake on the development of industrial districts. In Sweden, the lack of entrepreneurial culture, lack of encouragement for self-starters and lack of creative territorial energy around many large firms have led to the misshapen development of industries.

There is a growing awareness among policy makers in many countries about the need to reorient the industrial policies toward support for SMEs and particular geographical concentrations of industrial growth. The effective measures will include the greater government support for local and sector associations among small firms in activities such as marketing, management training, technological assistance, credit program, support for cooperatives and

other aids, which will help firms develop and contribute to the innovation in industry. Concerning policy implications for these regions, we can propose the improvement of competitive advances by recognizing the exchange related issues, enhancing educational systems, developing the possibilities of bootstrapping and tax reduction of succession to the next generation for local family firms and embedding international firms into the local formal and informal networks.

As Benton (1992) said, the centrally or globally industrial plan is not likely to reach entrepreneurs and workers in SMEs, which comprise the largest segment of emerging industrial districts. Policy makers should explore the ways by which their actions can contribute to building a political atmosphere, which will be conducive to inter-firm cooperation, participatory and flexible organization of labor inside the firms, and to strengthening of local level alliances in support of these trends.

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Aspects of the Normalization of Managerial Accounting in Romania on a Microeconomic Level

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Abstract. *The article presents the general frame of the normalization of managerial accounting on a national level, following an incursion in its international normalization. The objectives of the normalization of managerial accounting in Romania are presented into detail, from the authors' point of view, as well as the profile and attributions of the managerial accountant as a normalizer. The article ends with the authors' conclusions related to the normalization of managerial accounting in Romania on a microeconomic level.*

Keywords: managerial accounting; normalization; principles; accounts plan; methods.

JEL Codes: M21, M41.

REL Code: 14B, 14I.

1. The general frame of international and national normalization

The international normalization of managerial accounting is done through the activity of the Committee of the Professional Business Accountants⁽¹⁾, a component of the International Federation of Expert Accountants⁽²⁾, which elaborated a series of norms related to the basic concepts of managerial accounting, aiming at the harmonization of its specific terminologies.

In Romania, the normalization of managerial accounting on a national level is regulated by OMF no. 1826/2003, where some levels concerning the organization and realization of managerial accounting by the juridical persons are approved, these being ensured by the Ministry of Finance. The stipulations of this law confer the general frame of harmonization of international normalization of some concepts of managerial accounting with the national normalization of managerial accounting in Romania, leaving it to the managerial accountant to fulfill it.

The norming of managerial accounting on a microeconomic level represents the process of elaboration and enforcing the norms, regulations and procedures specific to the organization and realization of managerial accounting. The normalization of managerial accounting on a microeconomic level is done by the harmonization of the internal methodology of managerial accounting, accepted by all its organizational subdivisions.

In a general acceptance, *managerial accounting* represents that integrated part of management that deals with the identification, presentation and interpretation of the information used to formulate strategies, take decisions, optimize the use of resources, inform the employees, protect the actives, plan and control the activities, inform the associates or other external users of information. In other words, *managerial accounting*, comprises as well *specific elements of financial (general) accounting*, as specific elements of *managerial accounting*.

Today we witness a repositioning of accounting in the ensemble of the social sciences, and in the area of the managerial sciences due to its practical role as it has become an instrument for business management, a tool of management.

Of course, the issue of bringing accounting together with the managerial sciences can be approached also through the prism of managerial accounting, which must contain *specific elements of financial accounting (general)*, and especially from the second branch of accounting, *administrative accounting*. A special place within managerial accounting must be occupied by the *administrative control*, which is responsible with the well functioning of the informational system needed in order to make decisions within an entity. Here

we must also include the internal audit, which helps the entity to reach its objectives, realizing systematic evaluations and improving the risk management, the control and administration of processes.

For instance, *managerial accounting* must supply the manager with those elements which are strictly necessary in order to make him understand the phenomena and processes that take place within the entity, to offer him the operative information on the basis of which he may be able to take pertinent decisions, to be able to foresee the repercussions of the decisions taken and in the same time to have the necessary tools to effectuate a permanent and efficient control.

The manager (an engineer, medic, architect, economist etc.) must in the same time have the necessary knowledge in order to be able to interpret the data supplied by the managerial accounting in order to help him in his managing activity. The rest of the information which is strictly specialized remains in the area of the professional accountant who operates and interprets them. He presents the manager with the consequences of the decisions taken and/or that are to be taken but also with the solutions proposed for a more efficient activity. The professional accountant must have not only new attributions and abilities, but also new responsibilities, he must not be expectative when it comes to taking decisions but on the contrary to intervene in order to critic what has been done, to be an integrant part of the collective action.

Most of the information that lay at the basis of a decision to invest within the entity are supplied by the accounting. Investors are interested by the financial position and performance of the entity (balance sheet, profit and loss account, situation of modifications of own capital, situation of the treasury fluxes, explanatory notes to annual financial situations).

Concerning *financial accounting*, the elements that a manager must know refer firstly to the *financial situations*. Due to the increase of the social role of accounting information, their production and distribution are undergoing a process of normalization.

The aim of accounting normalization is to create an even better *financial communication among the actors of a global financial market*⁽³⁾. It is estimated that accounting normalization will not reach its goal but in a context where the economic performance of entities, measured especially by the financial performance, is judged pertinently by the stock investors and useful for the financial analysts in establishing their forecasting.

The Committee for International Accounting Standards (IASB) tends to become the recognized authority on a global level as a single normalizer, a body that produces accounting norms that serve to uniform accounting practices for the same situation.

2. The normalization of managerial accounting in Romania

In our opinion, the norming and normalization of managerial accounting on a microeconomic level (Figure 1) should present some objectives like:

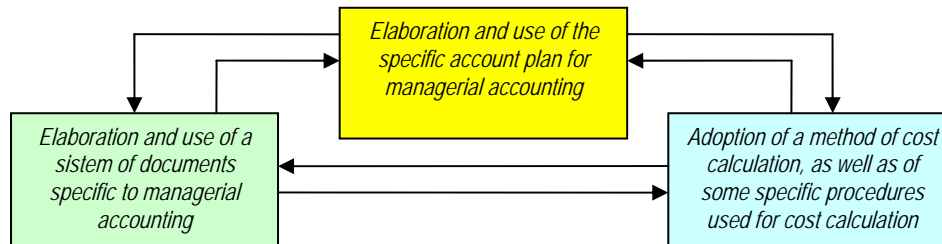


Figure 1. *The norming and normalization of managerial accounting on a microeconomic level*

1) *Elaboration and use of the account plan specific to managerial accounting.* For the organization of accounting in the Romanian practice we use the general account plan contained by the accounting regulations harmonized with the 4th Directive of the EEC, set by the Ministry of Public Finances and approved by OMFP no. 1752/2005. The duality of the Romanian accounting system means that accounting has to be organized in a double circuit: *financial accounting and managerial accounting*. The general account plan is formed of 9 account classes (8 destined to financial accounting and one destined to managerial accounting). The 9th class “managerial accounts” is used to organize and run managerial accounting, containing 10 synthetic accounts of the first degree, divided into three groups of accounts: *internal expense accounts, calculations accounts and production costs*. OMFP no. 1826/2003 mentions three distinct ways to organize managerial accounting:

- Using specific accounts (class 9 “managerial accounts”). The use of these accounts is not compulsory but optional;
- Developing accounts from the financial accounting;
- With the help of the own technical and operative accounts, without explaining the way of concretizing in the accounting practice of each of them.

Most specialists from the area of managerial accounting agree to the idea according to which in order to reach the objectives of managerial accounting one has to use an own account plan. At the basis of choosing and maintaining the system of accounts specific to managerial accounting there are a series of arguments that relate to the Romanian tradition concerning the use of the dualist system, in the time of the planned economy as well as after adapting the general

accounts plan to the French model, starting with 1994. This tradition was continued in two directions:

- *Of using accounts based on the double registration.* Most accountants used to work with an accounting system based on an account plan continued to use it due to the multiple advantages it offers and which have been mentioned previously.
- *Of using informatics programs based on the double registration.* In order to ease the work of accountants, computer scientists created software programs based on accounting registrations and not on mathematical calculation sheets like in the case of the tabular expense accounting. These computer programs have been user friendly, especially due to the huge quantity of data that can be processed with the help of computers.

The account plan specific to managerial accounting represents the *foundation* in building an accounts plan which is flexible and adaptable to every type of activity developed by the entities according to their specific. The way of constructing the managerial accounts foreseen in the general accounting plan in Romania stresses the absence of a large number of accounts groups with defined accounting roles and functions. The present accounts system offers not only the image of a total costs calculation in order to determine the product costs, but rather an expense collection on a global level.

The analytical accounts contained by the General Accounts Plan are limited under the aspect of their informational content, and that is why the Ministry of Public Finances underlines that they are not compulsory. The regulation of enforcing the accounting law in Romania stipulates the possibility that – according to the necessities of each firm and to its purpose – it is possible to introduce other accounts or to deepen on an analytical plan the necessary accounts requested by their beneficiaries. The economic content and the accounting correspondences between the accounts of the 9th class “Managerial accounts” standardized by the Romanian accounting norms satisfy only the necessities of the methods of organization of costs calculation of the total type and not so much the partial ones.

A form of presentation and use of the accounts plan specific to managerial accounting is underlined by professors Klaus Ebbeken, Ladislau Possler and Mihai Ristea in their work *The Calculation and Management of Costs*⁽⁴⁾. It considers also the calculation of the analytical result which constitutes a very important aspect in presenting the synthesis documents of managerial accounting.

2) *The elaboration and use of a system of documents specific to managerial accounting.* Concerning the elaboration and use of the system of documents specific to managerial accounting, the Ministry of Finances offers a complete liberty to entities. This way, in order to reflect expenses and the realization of costs calculation into the managerial accounting, each entity can organize its own system of documents to ensure the collection of expenses (according to bearers and expenses sectors) as well as to determine the effective cost of the obtained production.

In order to fill up the system of documents specific to managerial accounting one we must consider also the function of determination of costs and the functions of managerial accounting in order to achieve its objectives. This way the process of elaborating the system of documents, that serves the managerial accounting, implies the setting of a certain number of forms, that will have specific names and previously established purposes, concerning: the template, the way of filling up and the persons responsible with their filling up, the number of copies, their circulation and the final destinations for keeping and archiving. The goal of this system of documents aims at a performing management which can be achieved by satisfying the informational requests necessary to manage the entity and the other departments implicated in the decisional process. This way, at the level of managerial accounting we can identify three categories of documents:

a) *Justifying documents.* These are made of:

- Primary documents were there is a record, as a rule, for a single operation, in the moment of the development of the process or of the economic phenomenon (consumer note);
- Centralizing documents which cumulate as a rule several information regarding the same economic process or phenomenon. They are based on a series of documents of the same type (*expenses centralizers*) in order to facilitate their later accounting processing (fiche of ante-calculations and post-calculations).

b) *Documents of accounts and accounting processing.* Primary documents are transposed into accounts, based on the principle of the double Registration, through the means of an accounting formula, following strictly the procedures specific to the method of accounting. The accounting processing of documents is made through the means of registers (journal, inventory, Big-Book).

c) *Documents of synthesis and accounting reports* cumulate several information into a single form, which is coherent from the accounting point of view and reflects a more complex phenomenon, or an economic activity, being achieved on the basis of the other justifying documents. In this category we have the check sheet, the account of results and other situations of reporting the

deviations and performances of an entity like: situations of deviations related to bearers and sectors, their reports of analysis, budgets, calculation situations of the results according to the calculation objects (products, works, services) or to activities, informative notes or detailed reports concerning the performances achieved at the level of activity sectors or that of the realized products, the dashboard, the balanced dashboard, the comparative analysis, the cost-benefit analysis etc.

There is a multitude of documents that can be created and used on the level of managerial accounting according to the specific of the activity, of the peculiarities of each entity, but especially according to the informational necessities of the managers.

3) *The adoption of a method and of some specific procedures of cost calculation.* According to accounting regulations in Romania, the calculation of costs can be done according to one of the following methods: the global method, the phase method, the command method, the method of the standard cost, the method of variable costs, or any other method adopted by the juridical person in case according to the organizational type of production, the specific of the activity, the peculiarities of the technological process and the own necessities. In the specialized literature we may find also other methods of calculation of costs like: the method of cost calculation according to activities (Activity-Based Costing), the method of the target costing etc.

The adoption of a certain method of cost calculation is done by reaching the objectives of the entity. The applying of a certain method of cost calculation at the level of the entity implies to appeal to certain procedures of calculation like: the procedure of supplementation, the procedure of the extreme points, the procedure of rounds, the procedure of the equivalence indicators, the procedure of equivalence of the secondary product with the main product, the procedure of the rest value etc. The procedures used in managerial accounting are set according to the qualitative characteristics of the information requested by the users, as well as the peculiarities of the activity.

The organization of managerial accounting into an advertising entity implies to take into consideration the *factors that influence the organization and the principles of managerial accounting*. Among the factors that influence the organization of managerial accounting into an entity we mention:

The profile and size of the entity. Considering the size in classifying entities (big, middle-sized and small) we must approach the issue of executing the works of managerial accounting. Within large entities, the works of managerial accounting are organized by the departments of planning and accounting, situated within the production sections, but also at the entity level.

Compared to large entities, within medium and small entities all works of managerial accounting are organized by the specialized offices and departments.

The organizational structure of the entity. The general frame on which the system of managerial accounting is based is delimited by: the *production structure* and the *functional structure*. The *advantage* principle of the production structure is represented by the strict delimitation of calculations for sections, workshops, sectors etc. and allows the extraction of supplementary information necessary for the optimization of those activities. Compared to the production structure, the *functional structure* is identified and can be followed through the administrative and managing sector, finding it in the ante-calculation of costs through budgets;

The organization of the activity or of the production process. Considering that the production type represents a functional state of a production link or of that on an entity, determined by its technical and organizational characteristics, we can delimitate this way two types of production: mass production (large series) and individual production (middle and small series). Among the *advantages* offered by this type of production we may mention:

- individual production, in small and medium series ensures a high degree of flexibility of the enterprise. It allows the small costs adaption to the needs (requirements) of the consumers (customers) in order to introduce new products on the market, in a very short time.
- Mass production is characterized by a high degree of economic efficiency and profitability at the entity level.

The specific of the activity, of the technological process. Considering the type of production, from the technological point of view, we find: *simple production* and *complex production*. The main *advantage* offered by the simple production within the technology used is represented by the reduced volume of work in making the calculations for the product costs, while the main *inconvenience* offered by the complex production within the technology used is the one opposed to the simple production, that is the high volume of work in developing the documents of centralization and calculation of costs in the case of complex production.

The degree of specialization and integration. Among the other factors, the degree of specialization helps organizing the managerial accounting stressing the profile of entities and the volume of the works of determining costs on the level of entity and products. All these help to select an adequate method for the calculation of costs, appropriate with the specific, the degree of specialization of the entity. This way, we can delimitate between *specialized entities* and *unspecialized entities*.

Within specialized entities, the degree of specialization and integration presents the following *advantages*: the possibility of rapid change of the products' classification; the high degree of specialization of the machines, workers and products; it implies a much simpler and less costing calculation. Within unspecialized entities, the degree of specialization and integration presents the following *disadvantages*: difficulty in changing the classification of the products done; a lower degree of specialization of the machines, workers and products; it requires a much more complex and very expensive calculation, and the tendency is to reconversion.

The degree of mechanization, automation of production. Together with the degree of specialization and integration of the entity, the degree of mechanization and the automation of production also play an important role in the organization of the calculation of costs. This way we may distinguish entities which use a *manual process of production* (they are still present in quite big numbers, but their tendency is to be reduced following mechanization and automation as a result of the large-scale technological development) and other entities which use a *mechanized production process*: forms of organizing production in flux: automatic flux lines (of the complete or sectioned type); automatic rotor lines; conveyors; sectional conveyors; the prod-synchronous system etc.

The character of the production process. It is one of the most important factors that must be taken into consideration for the organization of cost calculation. The character of the production process makes its mark on the way of registration of future costs, considering the way of including the affected expenses to the production of goods. This way we may distinguish: *entities with continuous production* and *entities with seasonal production*.

According to the Accounting Law no. 82/1991, republished and presented in the Official Journal no. 23/12.01.2004 it is stipulated that "to ensure a real and exact content of the structure of costs the following principles will be taken into consideration:

a) *The principle of separation of expenses concerning the obtaining of goods, works, services to the expenses that are not linked to the acquisition, production or overtaking etc. of these.* This implies that at the level of the calculation objects set for each juridical person the expenses that can be attributed to those objects should be separated from the expenses occasioned by the rest of the activity. Expenses that do not participate to the obtaining of the mentioned calculation objects like: administrative expenses, sale expenses, the fix administration not allocated to the cost, financial expenses, extraordinary expenses etc., are not included into their cost.

b) *The principle of delimitating expenses in time.* It implies that the inclusion of expenses into the costs should be made in the managing period to which those expenses belong.

c) *The principle of delimitating expenses in space.* It implies the delimitation of expenses made in a certain management period according to the main processes or other expenses places that caused them, like: supply, production, administration, sell, and within the production sector, on sections, workshops, fabrication lines etc. Within the mentioned structures there can be constituted production centers, profit centers or other responsibility centers related to which the delimitation of expenses is deepened.

d) *The principle of delimitating the productive expenses from the non-productive ones.* It implies the delimitation of productive expenses, which are creating value, from the non-productive expenses.

e) *The delimitation of expenses related to the finite production of expenses concerning the production that is being executed.* This principle is valid for those productive units whose production is presented partially at the end of the management period in various stages of transformation, its quantity and value being defined from one managing period to the other”.

The correct determination of the size of production that is being executed influences not only the exactness of the size and structure of costs at the end of the management period, but also other economic and financial indicators (profit, rate of return etc.).

3. The execution of managerial accounting. The profile and attributions of the managerial accountant

According the Accounting Law no. 82 from 24th December 1991, republished, with all modifications and later completions in the Official Journal of Romania, part I, no. 454 from 18.06.2008, article 1, commercial societies, cooperative societies and the other juridical persons *must organize and execute their own accounting, respectively the financial accounting and the managerial accounting adapted to the specific of their activity.*

In large entities, the exercise of executing managerial accounting is done by the economic director, chief-accountant or other person empowered to hold this position. These persons must have an academic economic training.

Managerial accounting can be organized and executed on the basis of contracts of services in the area of accounting, closed with juridical or physical persons, authorized, according to the law, members of the Body of Expert Accountants and Authorized Accountants of Romania. The liability for the improper enforcement of accounting regulations lies with the economic

director, chief accountant or other person empowered to hold this position, together with the subordinated staff.

When the accounting is done on the basis of a service providing contract, closed with juridical or physical persons, authorized, according to the law, members of the Body of Expert Accountants and Authorized Accountants of Romania, the liability for executing the accounting lies with them, according to the law and to the contractual stipulations.

According to the new regulations, the administrator does not have the right to liability anymore for executing the financial and managerial accounting, as stipulated by the previous form from the Accounting Law no. 82/1991. Therefore, an entity must have its own accounting, internal (with an accounting department) or external (with a contract for providing accounting services).

In our opinion, the head of the department of managerial accounting must be the managerial accountant. He must be responsible for the good functioning of the informational system necessary for keeping evidence of the economic and financial operations at the level of managerial accounting which serves in the end the decision-making in an entity. The managerial accountant forms his own team with which he will ensure the good development of the works specific to managerial accounting. We present some of the attributions a managerial accountant would have:

- Active involvement in planning, achieving and perfecting the architectural system of managerial accounting;
- Drawing up the account plan specific to the managerial accounting, of the methodological norms of use (content and function of each account), of the scheme of accounting correspondences and of a monography which to contain the registration into managerial accounting of the main operations (which will consider the specific of the method of calculation selected and the corresponding calculations procedures);
- Participation in the elaboration of the set of documents specific to the managerial accounting and their adaptation according to the specific and objective of the entity;
- Ensures a permanent information, cooperation and communication among the departments involved in collecting and processing information, regardless of the hierarchical level;
- Makes available for those responsible the adequate instruments of management;
- Builds up the team he will lead and coordinate;
- Assistance in the decision-making.

In other words, if we were to draw up the profile of the managerial accountant, this would be: an active person, able to communicate and supply

rapidly reliable accounting information, to coordinate and create the necessary climate for the development of the activities specific to the managerial accounting, to cumulate multiple competencies (accounting, informatics, mathematics, statistics etc.), to contribute to the professional training and orientation of the behavior of the subordinated staff and to motivate it in order to obtain performances etc.

Conclusions

In order to ensure the success of implementation of the normalization of managerial accounting it is necessary for the three big objectives mentioned above to be achieved simultaneously. Normalization is the process that puts managerial accounting on its normal track of meeting its objectives and functions, contributing thus to the better management of resources, to the exercise of a good management for long periods of time. At a microeconomic level, the managerial accountant is the one who will have to plan, implement and manage correctly all the activity of managerial accounting, on him depending largely the exercise of an advanced management.

Notes

- (1) The Professional Accountants in Business Committee.
- (2) International Federation of Accountants.
- (3) See Ion Ionașcu, *The dynamics of modern accounting doctrines*, Economica Publishing House, Bucharest, 2003.
- (4) See K. Ebbeken, L. Possler, M. Ristea, *Calculation and cost management*, Teora Publishing House, Bucharest, 2000.

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An Analysis of the Correlation between Size and Performance of Private Pension Funds

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Abstract. *Using present performance measures, we find that inflation rate is barely covered by Romanian private pension funds strategies. The paper looks at effects of scale on performance. This issue is investigated empirically using data from Romanian private pension funds. We find results consistent with prior literature in that size, measured as total net assets, erodes performance. The highly regulated Romanian private pension environment gives rise to various interpretations for size detracting performance that do not sprout from the “asymmetric information” theory. We explain the empirical results as an effect of “perfect scaling”.*

Keywords: performance; scale; private pension market; panel data; perfect scaling.

JEL Codes: G2, G23, L2, L25.

REL Code: 11B.

1. Introduction

Still in the accumulation phase, the Romanian private pension industry ends year 2010 with approximately € 1,109.5 million in net assets, approximately 1% of GDP, with an increase of 80% compared with December 2009. Romania follows a multi-pillar system recommended by the World Bank that makes a distinction between privately managed pensions funds and optional pensions. If we also count “siblings” of same “family” fund (i.e., *ING* private managed pension fund, *ING Optim* – optional pension fund, *ING Activ* – optional pension fund) there are 9 privately managed pension funds and 13 optional pension funds. The Romanian private pension market is closely regulated by the Commission for Private Pension System Supervision (*CSSPP* hereinafter). Among other things, *CSSPP* strictly regulates the nature and limits of pension funds investments and, therefore, most of the funds are placed in secure assets as bank deposits, municipal bonds, and corporative bonds. This paper investigates how size influences the performance of a pension fund.

Theory of financial intermediation, which focuses mainly on banks, sees activities like taking deposits and issuing loans as defining the financial intermediary role. Expanding the theory of financial intermediation to pension funds activities, Davis (2000) sees pension funds as forms of institutional investors, which collect, pool and invest funds contributed by sponsors and beneficiaries to provide for the future pension entitlements of beneficiaries. Consequently, pension funds fulfill a role of financial intermediary by investing money accumulations into a variety of financial assets (e.g. corporate equities, government bonds, real estate, corporate debt, foreign instruments, and deposits).

Pension funds as financial investors could provide for various advantages such as better trade-off of risk and return through diversification and lower transaction costs (or in short economies of scale) as they trade in large volumes. In the real-world market, because of features like transaction costs and asymmetric information, pension funds benefit from declining average trading costs, fixed costs of evaluating assets, and technological advances.

Chen et al. (2004, pp. 1276-1302) explain the inverse relationship between scale and fund returns as a low liquidity implication according to which the size might affect performance much more for funds that invest in illiquid stocks. Furthermore, they hypothesize that a possible explanation for size affecting negatively the performance is related to certain organizational diseconomies. In their view, managers of larger funds⁽¹⁾ with complicated hierarchies have to follow many procedures before implementing an idea and loose valuable time in complying with all the bureaucratic requirements. For these reasons, large funds can present an inverse relation between total assets under management and performance.

Chen et al. (2004, pp. 1276-1302) findings are consistent with prior research. In a literature review, Clark (1988, pp. 16-33) identifies a pattern in the empirical studies on scale economies, consequently, that economies of scale appear to exist only at *low* levels of output (below \$ 100 million in deposits) with diseconomies of scale at *large* output levels (above \$ 100 million in deposits). Chan et al. (2009, pp. 73-96) also address the impact of size on performance and argue that mutual fund size effects are caused by transaction costs. They use a unique data base containing transactions information in order to compare the activity of large and small managers. As expected, large funds⁽³⁾ have higher transaction costs and a size that detracts from the performance of the fund.

Pollet and Wilson (2008, pp. 2941-2969) suggest that diversification is a solution to funds suffering from diminishing returns to scale. They document that large funds⁽⁴⁾ appear to be “very reluctant to diversify in response to growth but instead tend to acquire ever larger ownership shares in the companies they already own”. Furthermore, fund family has an additional effect in the rapidness of the diversification suggested as funds with many siblings diversify investments at a slower pace than the rest of the families. Instead of diversifying, family funds choose to focus funds on fewer stocks.

Yan (2008, pp. 741-768) findings are consistent with Chen et al. (2004, pp. 1276-1302) in that liquidity (measured based on bid-ask spreads) is a possible explanation for the inverse relation between fund size and fund performance. Nevertheless, these findings refer to actively managed equity mutual funds and although we can see pension funds having similar features with pension funds, due to the strict investment restrictions of *CSSPP*, we are reserved in considering any Romanian pension fund as an actively managed financial institution.

Following previous research (Chen 2004, pp. 1276-1302, Bauer 2010), we test whether there is a negative association between size, measured as total net assets, and performance for funds after a certain threshold.

The paper proceeds as follows. In Section 2 we describe the data. Section 3 includes the methodology applied and Section 4 has the empirical findings. We conclude in Section 5.

2. Data

We use publicly available *CSSPP* data base and we take all the funds that have *rates of return* available. Because June 2008 was the starting point for the Romanian private pension market and because the growth rates of unit value of funds, or so called *rates of return*, are computed for a period of 24 months, the data available for analysis spans from June 2010 to December 2010 summing up seven months of data for 17 pension funds. To handle the inconvenience of

lacking data we employ a panel data analysis as this approach increases the degrees of freedom in which variables can vary and thus, the power of the test. We obtain 118 observations.

Table 1 presents univariate descriptive statistics of our data. The statistics are based on monthly data on *TNA* (total net assets) for May 2010 – November 2010, number of funds for that same period and the means and standard deviations. In each of the months our sample includes a number of 17 pension funds with an average total net asset of € 436 millions and a standard deviation of € 39 million. This shows a wide spread in the *TNA* which becomes more evident after diving the sample into quintiles. The lowest quintile has an average *TNA* of € 1.7 million whereas the top quintile is formed of funds with an average *TNA* of € 345 millions. As the table shows, the size is skewed to the right with the fifth quintile containing funds with net assets representing more than 78% of the market. We also see a relatively steady growth in the *TNA* for the first three quintiles with a substantial difference for the fourth and fifth quintile. Consistent with prior literature (Chen et al., 2004, pp. 1276-1302, Bauer, 2010) we apply the logarithm operation so that the *LOGTNA* variable is the natural logarithm of the total net assets for each month.

Because performance is measured by net costs of the funds, the “rates of return” are obtained using net values. The *rates of return* publicized by *CSSPP* are growth rates of unit-value of funds. For determining these rates, the regulatory body takes the compounded annual growth rate of the unit value of the fund. We adjust the numbers from the *CSSPP* data base in order to obtain monthly average growth rates. Just for descriptive purposes we present the data in Euros. For accuracy, the values used in the study were in Romanian currency.

Table 1

Descriptive statistics						
Time-series averages of (monthly) cross-sectional averages and standard deviations						
Pension fund size quintile						
	Min	Mean	Median	4	Max	All funds
<i>Number of funds</i>	1	4	4	4	4	17
<i>TNA</i>	1.75	9.44	21.74	58.21	345.59	436.73
mil.Euro	[0.25]	[0.51]	[2.10]	[5.22]	[31.21]	[39.28]
<i>LOGTNA</i>	0.86	1.60	1.96	2.39	3.16	9.96
mil.Euro	[0.06]	[0.02]	[0.04]	[0.04]	[0.04]	[0.21]
<i>FUNDGRT</i>	0.0066	0.0109	0.0122	0.0135	0.0147	0.0579

This table reports summary statistics for the funds in the sample. "Number of funds" is the number of pension funds that meet our selection criteria of having “rate of return”. *TNA* is the total net assets of pension funds in million Euros. *LOGTNA* is the logarithm of *TNA*. *FUNDGRT* is the monthly growth rate of the fund’s unit value. The table presents the time-series averages of monthly cross-sectional averages and monthly cross-sectional standard deviations (shown in brackets) of fund characteristics.

3. Methodology

Our model specification is a basic one in which we look at how changes in a fund's performance are related to changes in its size. Consequently, we regress the "rate of return" of the funds by the lagged size of the funds measured as the log of total net assets under management. In their study Chen et al. (2004, pp. 1276-1302) regress market-adjusted returns (adjusted by CAPM, 3-factor model, 4-factor model) on lagged size and various fund characteristics like turnover, age, expense ratio, past-year fund inflows, and past-year returns in order to control for other characteristics than size driving the performance. Because the lack of data (for effective application of CAPM we need at least 60 months) and due to the frequency with which financial data is disclosed (i.e., sales, expenses are reported per semester) the only variables that are available on a monthly bases are the "rates of return" and the total net assets. For this reason we restrict the model to a simple regression.

$$FUNDGRT_{i,t} = \alpha_i + \beta_{i,t} LOGTNA_{i,t-1} + \varepsilon_{i,t}, \quad (1)$$

where:

$FUNDGRT_{i,t}$ is the growth rate of unit-value of the pension fund i in month t , α_i is a constant for pension fund i , $LOGTNA_{i,t-1}$ is lagged pension fund size measured as logarithm of total net assets, and $\varepsilon_{i,t}$ is a generic error term that is uncorrelated with the independent variable.

Because the data imposed restrictions mentioned above we apply panel data analysis in order to obtain more observations and increase the power of the test. Fixed effects regression allows the intercept to vary cross-sectionally as it generates a dummy variable for each cross-section; the slope parameter is constant over time and space. The null hypothesis that is tested by using the fixed effects model is if the intercepts are the same for the entire sample (i.e. same average return for all pension funds) and rejecting it shows that growth rates vary cross-sectionally across funds.

Random effects model allows the intercepts for each cross-section to vary from a "base" intercept with a random variable (cross-sectional error term). One of the advantages of the random effects model is that it does not include dummy variable for each cross-section, leading to more degrees of freedom in which the variables can vary. Consequently, the estimation is more efficient. The disadvantage is that the cross-sectional error term is assumed not to be correlated with the regression error term and with all the explanatory variables. Moreover, the random effect model is preferred when the regression model does not omit variables that are not correlated with the explanatory variable included. When the regression model includes only one explanatory variable,

bias coefficients can result from the fact that the estimator measures an increase of the dependant variable due to the explanatory variable when the case may be that the error term is causing much of the variation. As our model has as explanatory variable only the *LOGTNA* leaving out a series of unobserved omitted variables, we choose to estimate the regression coefficients using the fixed effects model. To statistically motivate our decision, we include in the results table the Hausman test statistics that measures if the random effects model would be just as good as the fixed effects one.

A disadvantage of the fixed effect method as noted by Chen et al. (2004, pp. 1276-1302) is that such an approach is subject to a regression-to-the-mean bias. They give the example of a fund with a year or two of lucky performance that experiences an increase in fund size. The issue is that, under the fixed effects, the performance regressed to the mean, leading to a spurious conclusion that an increase in fund size is associated with a decrease in fund returns. Nevertheless, giving the data issues mentioned above and relating to previous research that uses panel analysis because of data restrictions (Bauer, 2010) we further use the fixed effects model.

The strict regulations that *CSSPP* imposes on all pension funds, irrespective of being privately managed or optional, create an overall homogenous mass. Pension funds have limited possibilities in terms of investment choices. In most of the cases pension funds invest monies in government bonds, corporate equities, and deposits with an upper limit of 70%, 50% and 20% respectively. For this reason we do not make any correction for heterogeneity. As we have few months of data availability the survivorship bias is not an issue. Moreover, we do not take into account the survivorship bias because, as Blake (1993, pp. 371-403) points out, survivorship bias is less important for funds that invest mostly in bonds as bond fund performance is less variable and, consequently, fewer funds disappear in time.

Although we do not adjust for heterogeneity due to the investment strategies we make adjustment for the size of the pension funds. After sorting the data in size-quintiles for each month we see a significant spread in *TNA* variable which leads us to grouping funds in size-based-groups. This grouping results in two fund-size pension fund groups, one between € 4 and € 25 million and the other one between € 25 and € 345 million. By aggregating the funds we are trying to see if there is a negative association between size and performance and if there is one, which is the threshold for the negative association. Statistical test run over all five quintiles sustain the decision of grouping the first three quintiles in one group and the last two in another group.

4. Results

Table 2 reports the estimation results for the regression specification in equation (1) where two situations are depicted, namely, for the two size-based groups. The estimation coefficients in front of *LOGTNA* are positive and statistically significant at a significance level of 1% for the funds with total net assets between € 4 and € 25 million, whereas there are negative and statistically significant coefficients for funds with total net assets between € 25 and 345 million. The Likelihood ratio and Hausman F-statistics are presented to validate the fixed effects model. The statistics indicate that the fixed effect model is the model that should be used for this specific analysis (instead of simple pooled estimation or random fixed effects). The R^2 measure shows how much of the performance percent of variation is explained by *LOGTNA*. Given the specifics of the Romanian pension market in which regulation limits the active management impulse of pension funds managers, the high R^2 is not unusual.

Table 2

Summary statistics		
Total net assets (mil. euro)	4 - 25	25 - 345
α	-0.014***	0.028***
	[-2.55]	[5.92]
β	0.016***	-0.006***
	[4.43]	[-3.24]
<i>Observations</i>	62	56
<i>Likelihood ratio</i>	0.0000	0.0000
<i>Hausman test</i>	0.0011	0,0001
R^2	87%	85%

This table shows summary statistics for the fixed effects model for the entire sample (17 pension funds for a period of seven months). t-ratios in parentheses; *, ** and *** denote significance at the 10%, 5% and 1% levels, respectively. Also included are the number of observations, the F-statistics for the Likelihood ratio and Hausman test, and the R squared.

The regression results show that the fund's performance is inversely correlated to the assets under management for funds that have more than € 25 million under management. Although the performance (measured as growth rate of the value unit of the fund) of larger pension funds (above € 25 million) is mostly greater than the performance of the smaller funds (under € 25 million), the size affects negatively the performance of large funds. If we take the case of a large fund and assume an increase of at least € 1 million in the fund's net assets, that is 1% of the average of the fourth quintile, the decrease in the performance of next month is of 0.6 BSP per month, respectively 14.4 BSP for

two years. Conversely, an increase in size of 1% for the small funds, that is approximately € 0.2 million increase in assets, determines the performance of next month to go upwards with about 1.6 BSP per month, 38.4 BSP for two years respectively. To put the values into some perspective, the cross-sectional average growth rate for pension funds for 24 months (December 2008 – December 2010) is approximately 14%, whereas the inflation registered values of 13%. The gap of 1% between the “rate of return” of pension funds and the inflation rate can be “filled” by an increase of approximately € 119 million, causing pensions to barely cover the increase in prices. This scenario is not entirely improbable if we look at the growth rate of assets for the largest pension fund that registered an increase of € 90 millions lei in only 6 months. Therefore, any change in the performance measure translates in changes in the financial comfort of the future beneficiaries.

5. Conclusion

The empirical results are consistent with prior research (Chen 2004, pp. 1276-1302, Bauer, 2010) and show that there is a negative association between size, measured as total net assets, and performance. Specifically, the performance rises with size for funds under € 25 million in net assets and decreases with size for funds above € 25 million in net assets. Interestingly enough, this € 25 million in asset value is frequent for many privately managed pension funds (very few are under this value) whereas most of the optional pension funds have net assets under the threshold.

One explanation for size negatively affecting performance of pension funds is the level of transaction costs Chan et al. (2009, pp. 73-96). To prove this empirically, Chan et al. (2009, pp. 73-96) use an unique data base containing daily transaction information for “large” and “small” managers. The infancy of the Romanian pension market does not enable us to empirically study the argument brought on by Chan et al. (2009, pp. 73-96). We resume to mentioning the possible explanation and make suggestion for a more specialized data base for Romanian pension funds.

Pollet and Wilson (2008, pp. 2941-2969) introduce the phenomenon of *perfect scaling* under which *a manager of a \$1 billion fund will select stocks in the same way as he or she would when managing only \$10 million*. This *perfect scaling* leads to managers of large funds to *scale up* their existing investments disregarding the advantages of diversification. It appears that Romanian pension funds *scale perfectly* due to the tight regulations imposed by *CSSPP*. From the introduction of private pensions in Romania (year 2008 for private managed funds and 2007 for optional funds) until present time, few

modifications were made to the structure of the portfolios of pension funds (to be seen as secure the funds have to be invested mostly in government bonds). As expected, pension funds with different sizes can be affected differently by little diversification of assets. Further analysis on the effects of size on performance of Romanian pension funds can seek the response in fund behavior (how the money is allocated amongst bonds, shares, deposits etc.) to size growth of the fund.

Overall, the paper has several contributions. Firstly, from our knowledge, this is the first paper that looks at effects of size on performance for the Romanian pension market. Secondly, we document a negative relation between size measured as total net assets and growth rate of fund's unit values after the threshold of € 25 million. This is useful information especially for participants that disregard their choice and accept the default option when it comes to selecting a pension fund. Moreover, Romanian pension funds exhibit similarities to funds from other markets allowing regulators to see the pros and cons without a first-hand experience. This into-the-future perspective can lead to a reduction in decision mistakes in order to provide beneficiaries with the results they expect alongside the possibility of applying to the Romanian pension market analysis models that are validated on the already developed markets.

Notes

- (1) According to Chen (2004, pp. 1276-1302), large funds have an average of \$ 1,164.7 million in assets.
- (2) For Clark (1988, pp. 16-33) large financial investors are those with more than \$ 100 million in deposits.
- (3) For Chan et al. (2009, pp. 73-96) large mutual funds are those with monthly market impact costs relative to funds under management exceeding AUD 200 millions.
- (4) Pollet and Wilson (2008, pp. 2941-2969) regard large funds as those managing over 95% of the total market.

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Management of the Environmental Risk – an Economic-Social Priority

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Abstract. *The industrialization process, accelerated in the last decades of the 20th century and continued in the 21st century, determined, together with the beneficial effects manifested in the increase in quality of life, the appearance of some pollutants, especially in the areas where people live, work and entertain themselves. The risk is a situation/condition/event that, if occurs, generates an unfavorable effect both on the objectives, resources and reputation of the organization and on the successful achievement of its tasks/activities/mission. The environmental risk can manifest itself under the form of stressors (risk factors) generated by the human activity/inactivity and can generate adverse effects on the environment, and also the degradation and loss of sustainability. In order to ease the evaluation of the status/quality of the environment and facilitate the reporting and communication of the environmental performances of an organization, the present paper synthetically presents a series of environmental indicators, and also the description of the essential requirements of the voluntary environment standards in the ISO 14000 series.*

Keywords: environment; risk; management; environment indicators; environmental performance; standard.

JEL Codes: Q01, Q58.

REL Code: 15C.

1. Notions regarding the management of the risk

The AS/NZS/4360/2001 standard states that “the risk management envisions the culture, processes and structures effectively dedicated to the management of potential and adverse effects” and involves all categories of personnel, with precise responsibilities in the risk area. Realization of the risk management assumes the engagement and decisional energy of the top leadership and involvement of the employees that can identify an incident, a potential threat or an opportunity for improvement.

The generic risk management process views, according to AS/NZS 4360:2001 – Risk management. Standards Australia/ Standards New Zealand, Sydney/Wellington, 2001, the following steps:

- a) *establishing the design context for the risk factors* (determining the strategic, organizational and management context, establishing the structure, the criteria based on which the risks will be evaluated, identification of the interested/affected parties, statement of the communication and consulting policies);
- b) *identification of the potential risks* (identification, as a result of post analysis, dangers and associated consequences that can arise);
- c) *probabilistic analysis of the risks* (risk analysis, control possibilities and the effect of the control measures regarding the consequences, the probability of occurrence and the risk level estimation);
- d) *evaluation and hierarchy of the risks* (comparing the estimated risk levels, setting a hierarchy to establish the priorities, risks with reduced priority are accepted, making the subject for monitoring and revision);
- e) *concretization of the risk's effects* (implementation of a management plan, that will include considerations regarding the allocation of necessary resources and action deadlines);
- f) *communication and consultation* with the *affected/interested* parties (it will be performed in all the stages of the risk management process);
- g) *monitoring and revision* (evaluation of the performances for the risk management system).

The above presented stages are in a tight interaction.

Communication/consulting, also monitoring/revision assume activities and concepts that include the whole management process. The risk management must include communication and consulting mechanisms, both within the organization and between the organization and external parties. Both risk revision and monitoring, and the evaluation of the risk management system

performances valuation, must be permanently taken into consideration and thoroughly documented.

An example model developed and widely used is „7 Cs“, having Beer and Ziolkowski as authors, namely Beer, T., Ziolkowski, F. – „*Environmental risk assessment: An Australian perspective*“, Supervising Scientific report 102, Supervising Scientist, Canberra, Australia, 1995. (<http://www.deh.gov.au/ssd/publications/ssr/102.html>).

2. Considerations regarding the environment risk

In the most general terms, the environmental risk is the resultant of the interaction between human activity and environment.

The environmental risk can be treated starting from two assumptions, that we encounter in the papers „*Environmental risk characterisation principles*“, Proceedings of the 6th Conference on Environment and Mineral Processing, part. I, pp. 17-21, VŠB-TU Ostrava, Cehia, 27-29.06.2002, and „*Environmental risk management in mining – An overall approach*“, Proceedings of the Third International Symposium „Mining and Environmental Protection“, pp. 22-27, Belgrad-Vrdnik, Iugoslavia, 21-23.05.2001, authors Băbuț G. and Moraru R, namely the risk for environment and the risk for organization.

The risk for environment starts from the fact that the activities of an organization can generate certain forms of environmental modifications, thus inducing a potential danger.

So, the effect of human activity can have a negative impact on the flora or fauna or can generate a danger for the health and welfare of mankind. Also, the destructive effects can alter the water, air, ground resources, energy and climate are taken into consideration.

The risk for organization departs from the environment problems and include the risk of non-conformation with the existing or future legislation and criteria. In this acceptance, the losses that the organization records, as consequences of non-adequate management, costs, litigations, and difficulties to maintain the operational and development activities. The aspects regarding the working security and health can be significant from the point of view of the environmental risks too. The normative, the standards, the methodological guides dedicated to this category of problems are important in the management of environmental risk. The environmental risk management must focus on adopting decisions regarding the environment and supporting the minimization step for the uncertainty degree.

3. The management of the environmental risk

The management of risks ensures the capacity to understand the mode of running of the operations and the ability to respond to the changes of internal and external conditions. Through an adequate risk management, the expenses can be reduced, the exposure to risk can be minimized, the probability of further development of the activity can increase, the compliance with the legislation can be assured and the protection of the environment can be improved.

The environment indicator represents a key information, significant and comparable, that is based on a dataset that are values of an attribute. The attribute characterizes a property that can be measured or observed. The complex problem of valuation and monitorization of the components of the PSR (pressure-status-response) model led to approaches in elaborating systems of indicators that describe the surrounding environment.

According to the Declaration in the „Agenda 21” of the United Nations Conference on Environment and Development (Rio de Janeiro, 1992), *„it is necessary to be elaborated indicators for sustainable development to ensure solid bases in taking decisions at all levels and contribute to the self-regulation of the sustainability of the integrated development-environment systems”*.

The indicators that make the environment specific system are grouped in several categories, important being the choice of the ones specific to the concrete analysis.

Synthetically, the classification of the environment indicators is based on the use of some groups of criteria, as follows:

A) *General criteria*

a) Expressing mode for the indicators:

- Absolute indicators (consumption of resources/energy, expressed in kWh, volume of used waste water, expressed in m³, quantity of pollution emissions, expressed in kg or tons);
- Relative indicators (specific emission, expressed in kg pollution emissions/production unit, concentration of a specific pollution factor in the surface or sewer water [mg/l]; weight, in total, of the recycled waste – %);
- Derivate indicators, such as:

- Environment performance of an organization:

$$PM = a \times MPI + \beta \times OPI + \gamma \times ECI,$$

where:

MPI represents the management performance indicators;

a - weighting factor for MPI;
 OPI - operational performance indicators;
 P - weighting factor for OPI;
 ECI - indicators for the environment conditions (status, quality);
 y - weighting factor for ECI.

- Kenotic affinity index:

$$q = \frac{c}{a + b + c} \times 100,$$

where:

a - number of samples from the A species;
 b - number of samples from the B species;
 c - number of samples that include both species A and B;

- Aridity index:

$$I = \frac{P}{T + 10},$$

where:

P - yearly quantity of precipitations [mm];
 T - annual temperature (°C);

- OMS index of water pollution:

$$WPI = \frac{N \times GNP / Cap}{Q \times 10^6},$$

where:

W is the number of inhabitants of a hydrologic basin;
 GNP/Cap - Gross national product (€/capita);
 Q - average flow (m³/s);

b) The aspect expressed by the indicators:

- Physical indicators (the noise level at the limit of a precinct – dB, number of auto vehicles equipped with catalysts - pieces, the quantity of materials used per product unit kg/unit or t/unit, weight, in total, of the natural gases consumption – %);
- Economic indicators (investments for the installations that perform the reduction of SO₂ emissions, the specific investment for de-pollution at a power plant, expenses for environment protection per product unit, weight, in total, of the environment protection expenses);

- c) Sphere or level of reference of the indicators:
- Process environment indicators (PEI), such as the monthly cool water consumption at a thermal power plant with condensation groups, with open hydro-technical circuit (kg);
 - sit/emplacement/unit environment indicators, i.e. the volume of waste water, summarized from all technological processes in the emplacement, where they result (m^3);
 - Organization environment indicators (OEI): total fuel consumption (GJ/year);
 - Local environment indicators (lei), such as: total quantity of generated urban waste (t/year), total electric energy consumption for industrial purposes (MWh), traffic of particular cars (nr. of vehicles x km/person);
 - Sector environment indicators (SEI): water consumption in agriculture (m^3 /year);
 - National environment indicators (NEI): ecologic taxes on gas (lei/l), weight of Pb-less gas in total gas on market(%);
 - Regional environment indicators (REI): international transport of dangerous waste across Europe (thousands tons/year);
 - Global environment indicators (GEI): global oil consumption, global consumption of drinkable water per person etc.

B) *Organization level criteria*

- a) Application domain:
- Physical indicators (water consumption for technological purposes);
 - Business indicators (utilities-related expenses - water, natural gas, electric energy, thermal energy, gains from sales of waste);
 - Management indicators (ISO 14001 certifications or EMAS records, non-conformities recorded after the environmental audits);
 - Impact indicators (emissions of greenhouse gases - t/year);
 - Specific indicators (residual heat evacuated from the thermo-electrical centrals (CTE) in rivers/lakes- MJ/year);
- b) Area of the measured environmental performance:
- Environment policy indicators (reduction of the annual consumption of electric energy compared with the reference year – %);
 - Indicators of the environment management systems (measure the conformity of the organization with the provisions of the applicable environment law – %);

- Relative indicators of the processes, products and services (specific consumption of energy);
 - Aggregated (annual) indicators from the analysis of the eco-balance (total quantity of waste – kg);
 - Indicators for the environment status: weight, in national total, of the impact on environment produced by the material flows of the organization – %;
- c) Requirements from interested parties:
- Required indicators (quantities of waste produced, recycled, stored, capitalized, eliminated – tons per year);
 - Necessary indicators (consumption of raw materials, expressed in absolute value (kg) and in relative values (kg/P));
 - Desired indicators (weight, in total, of the emplacements where environment reports were realized);
- d) Typology of answer to questions:
- descriptive indicators (type A): emissions SO₂, NO^{*}, CO₂, powder evacuated in the atmosphere (tons/year);
 - performance indicators (type B): proportion, in total, of capitalized waste;
 - efficiency indicators (type C) – specific emissions at autovehicles;
 - total welfare indicators (type D) – lifespan of the fossil combustible reserves (years).
- e) Environmental performance of the organization, in the German vision;
- f) Environmental performance of the organization, according to ISO 14031:1999:
- Management performance indicators – MPI, that can be divided into:
 - indicators of implementation of policies and programs;
 - compliance indicators;
 - indicators of financial performance;
 - indicators of the relationships with the community.
 - Operational performance indicators – OPI:
 - indicators of materials;
 - indicators of energy;
 - indicators of services that support the activities of the organization;
 - indicators of the physical utilities and equipments;
 - indicators of supply and delivery;

- indicators of products;
- indicators of the services provided by the organization;
- indicators of waste;
- indicators of emissions.
- Environmental conditions (state, quality) indicators – ECI:
 - indicators of the air;
 - indicators of the water;
 - indicators of the soil;
 - indicators of the flora;
 - indicators of the fauna;
 - indicators of the human beings;
 - indicators of the esthetic, patrimony and culture.

C) *Criteria at the level superior to the organization*

- a) The PSR (pressure-state-response) model's conception:
 - Indicators of the pressure on the environment;
 - Indicators of the state (quality, conditions) of the environment;
 - Indicators of the society's response.
- b) The DfSR (Driving force-State-Response) model's conception:
 - Indicators of the moving force;
 - Indicators of state;
 - Indicators of response.
- c) Interaction cause-effect:
 - Sector-level indicators:
 - technical sub-system;
 - impact sub-system;
 - economic sub-system.
 - Indicators of results.
- d) Stages of the lifespan of a product/installation:
 - Indicators of design (of project);
 - Indicators of execution (buildings, montage);
 - Indicators of operation (use);
 - Indicators of maintenance;
 - Indicators of rehabilitation (modernization);
 - Indicators of disablement.

4. Reporting and communicating the environmental performances

The instruments that concretize the responses of the society at the modification of the conditions (state/quality) of the environment can be grouped into four categories, that are to respond to the multitude of requirements regarding the reporting/communication of the environmental performances, that is:

a) *Requirements that are to respond to the regulation instruments.* In compliance with the provisions of the standards, normative or other regulations, these requirements results from the necessity of the organizations to monitor and reduce the pressures (the impacts) of the activities, products and services on the environment. This information is necessary to the environment authorities too, but also to the population and other economic agents, interested, from the area, that have the right to be informed on the behavior of the organization towards the surrounding environment.

b) *Requirements that must respond to the economic instruments.* This category of requirements derives from the obligation to enforce various taxes, wages, penalties, stimulants, in order to control and reduce all forms of pollution. To respond to these requirements, the information on the environmental performance of the organization must be made available inside that, but they must reach also the interested parties, including the authorities.

c) *Requirements that must respond to the judicial instruments.* They result from the national and international regulations regarding the environment and answer to the following rights of the individual: the right to be informed on the current and perspective activity of the organization, the right to take attitude and involve in the decisions taken regarding the current and perspective activity of the organization, the right to proceed to the trigger mechanism for legal procedures and demand payment of the environmental damages.

d) *Requirements that must respond to voluntary instruments.* These requirements are among the most evident ones, being explicitly formulated in the voluntary standards of the ISO 14000 series, and also in the Environment Management and Audit Schema (EMAS).

If in ISO 14001:1996, the “environmental performance” was just outlined, ISO 14001:2004 offers it a more “palpable” definition (the measurable results of the management of the environmental aspects in an organization) and nominates it among the input data absolutely necessary for the analysis performed by the management. For any organization, the objective of the compliance with the international standard ISO 14001 is “the continuous improvement”, that is the development process of the environmental

management system to obtain the improvement of the global environmental performance, according to the environmental policy of the organization.

Form the ISO 14000 series, the ISO 14004:2004 standard is the main standard that, through descriptions, examples and options, comes to the help of the organizations that intent to implement and improve an Environment Management System (SMM), certified on the basis of the basic standard ISO 14001. The ISO 14004:2004 standard states that: “the process of establishing and analyzing the objectives and the implementation of the programs for their realization provides a systematic base for the organization to improve its environmental performance in certain areas, by maintaining its level of performance in other areas. Both the performance of the management, and the operational one can be expressed through the statement of the objectives”. In addition to ISO 14001:2004, a special attention is granted to the internal and external communication of the environmental performance, being also included recommendations on the stages of the respective processes: collecting information and performing investigations, including from the interested parties; determining the target audience and the necessities of information or dialog; selecting the information relevant to the interests of the audience; decision on the information, that is to be transmitted to the target audience; determining the appropriate methods for communication; valuating and determining, periodically, the efficiency of the communication process, being emphasized, among the information sources useful for the increase of the environmental performance, the opinions of the interested parties, including the employees, customers and suppliers.

The ISO 14031:1999 standard, through the conception of a valuation plan, usage of existing data and information, processing them and establishing the indicators, presents the mode of analysis and valuation of the environmental performance, through the benefits of reporting/communication of the environmental performance being emphasized: the adjustment of the organization at the realization of its criteria for environmental performance; the increase of the acknowledgement and dialog regarding the environmental policies of the organization, the environmental performance criteria and its relevant achievements; demonstration of the commitment of the organization and efforts for the improvement of environmental performance; supply of the mechanism necessary to respond to the preoccupations and problems regarding the environmental aspects of the organization.

Out of the ISO 14000 series, we can identify other standards that can respond to the requirements of environmental performance reporting and communication. Thus, the international standard ISO/ 14015:2001 constitutes a

guide for the achievement of “environmental valuations of emplacements and organizations”. According to the requirements of this guide, the planning of the valuation, the collection and validation of the information, their valuation and the elaboration of the report is performed by a valuator (or a team) selected by the customer. The presentation of the report can be made in written form, on electronic support or even verbally, in certain special situations. Because it is the exclusive property of the customer, the report cannot be distributed but to the parts interested established by it.

Through the international ISO 14020:2000 standard, there are established the principles that are based on the realization and use of labels and environmental declarations, they having the role to indicate the environmental aspects of a product and service under various forms: affirmation, symbol or drawing on the label of a product or package.

In the letter of this standard, “the general objective of labels and environmental declarations is to encourage the demand and supply of those products and services that affect the environment in a lesser manner, through communicating the verifiable, exact information, that do not lead to errors, regarding the environmental aspects of the products and services, this way stimulating the potential for continuous improvement of the environment”. Among other facts, the standard states that: “the labels and environmental declarations do not have to impeach the innovation that maintains or does not have the potential to improve the environmental performance”.

The international standard ISO 14040:1997 indicates the fact that the LCA (Life Cycle Assessment) can support, among others, the selection of the relevant indicators of environmental performance, including the measurement techniques. LCA is one of the management techniques that approaches the environmental aspects and the potent impact associated for products, on the trail from the acquisition of raw materials, continuing with production, use and post-use. Among the requirements regarding the communication of the results of an LCA study we can find: the results to be impartial, completely and accurately reported to the targeted audience; the type and format of the report must be defined in the stage of establishing the study domain; the conclusions, data, models, assumptions and limitations must be transparent and have sufficient details; the report would allow the results and the interpretation to be used in a manner that is consistent with the purposes and domain of study; in the situation in which the results of the LCA must be communicated to another interested part (besides the de beneficiary or elaborator of the study), a “third party report” must be prepared.

Regarding EMAS, it has included practically the requirements of the ISO 14001:2004 standard, containing, in addition, mandatory, an “initial environment analysis” and an “environmental declaration/environmental report” and has as a major objective the improvement of the environmental performance. Reaching the objective of the EMAS assumes: the design and implementation inside the organizations of an EMS; the systematic, objective and periodical valuation of the EMS's performance; the communication of information regarding the environmental performance and the keeping of a permanent dialog with the public and with other interested parties; the involvement of all the employees in the training and knowledge improvement process in the environmental protection area that would allow them to participate actively in the implementation and upkeep of the EMS. From the environmental report must evidently arise the results achieved by the organization versus the environmental objectives and targets proposed, also the requirements of continuous improvement of the environmental performance. The environmental report must be made available for the public and the interested parties.

To elaborate the environmental report, the following requirements have to take into account into view: the clear and unequivocal description of the organization, with a summary of activities, products and services realized; presentation of the environmental policy and concise description of the EMS; description of all the significant environmental aspects, both direct and indirect, and also of the impacts on the environment; description of the objectives generated and the targets in report with the significant environmental aspects and associated impacts; synthesis of the existing data on the organizational performance in relation to the general objectives and targets, also with the significant impacts (values of pollutant emissions, noise levels, quantities of waste, consumption of natural resources, energy, etc.); the data must allow the annual comparison to appreciate the environmental performance of the organization; presentation of the factors (indicators) regarding the environmental performance, including the performance to the compliance with the legal provisions, and the performance in relation to the significant impacts on the environment; mention of the name and certification number of the verification person and the validation date.

Regarding the European requirements related to reporting the environmental state, the European Environment Agenda has elaborated a guide for the preparation of the “Report regarding the state of environmental factors”

based on the PSR model, extended under the form of DPSIR (Development-economic and social; Pressure; State; Impact; Response). According to the respective model, the economic and social development exercise pressure on the environment, and therefore modifications of the environmental state occur, concretized by negative effects on the human health, availability of natural resources and biodiversity in general. The negative impact on mankind, raw materials and ecosystems, determines a response of the society, response that can manifest either against the primary causes, either on the impact and state of the environment, through a process of adaptation or restoration.

5. Conclusions

The surrounding environment and its state represents one of the major problems of mankind, and subsequently must have the permanent attention of the individual and also of the human collectivities. More efficient than the corrective approach, destined to solve the effects, it is proven to be a preventive approach on the environmental problems that envisions the elimination of the causes, involving material and financial efforts, including shorter terms, and ignoring this problem or superficially treating it may lead to disastrous results on a local, national, regional or global scale.

Recognizing the importance and efficiency of the quantification of pressures on the environment, on its state, and also of the responses of the society at the modifications of the environmental state, numerous international organisms, organizations or institutions (ONU, OCDE, UE, UNEP, CERES, Eurostat, The European Environment Agency, IAEA, etc.) develop, since many years, sustained actions to establish relevant environmental indicators a national, regional or global level, that become more complex and are integrated in sets of indicators of sustainable development.

The voluntary standards in the ISO 14 000 series (especially ISO 14001, ISO 14031 and ISO/TR 14032), also the application regulations for EMAS have an important contribution at the unification of the valuation and report conception for the environmental performance, because the approach to establish relevant environmental indicators is a dynamic and perfectible one, but is facing numerous difficulties related to the availability and correctitude of information, the common accept of the methods and procedures for determination of the indicators values, of delays or lack of reporting, which makes the organizations themselves that have implemented and certified an environmental management system to not rise yet at the level of requirements regarding the valuation and reporting of the environmental performances.

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Implications of European Directives in the Assessment of Insurance Companies

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Abstract. *The objective of this paper is to present a vision in the sphere of the problematic of assets and liabilities' evaluation that are reflected in the balance sheet of the insurance companies, inside the theory of the contingent claims, and of the marginal theory inside the insurance sphere. Our references take into consideration all the principles and evaluation norms of a company's liabilities, company operating in the life insurance domain, including the general request introduced by the IFRS. Also, we argument the fact that the making of the new IFRS standards' frame must take into consideration the accelerated globalization of the trading and the internalization of the financial markets, factors that have made pass onto the first place the necessity of a standardized financial reporting system. Because for so long the evaluating inadequacy of the assets at their fair value and the liabilities at their fair cost has persisted for so long, we underline that we find even in this a vast debate subject between the insurance companies' representatives and the IASB, especially in the second step of the IFRS4's implementation in the life insurance contract.*

Keywords: incoherent evaluation; insurance contract; risks; assets/liabilities; balance sheet.

JEL Code: M41.

REL Code: 11B, 14J.

1. Introduction

The activity of the insurance companies is, by its nature, one of the most complex; the IASB admits its importance, and in May 2002 it has decided to intervene in two steps.

The first step includes the IFRS4 in its vast means, IAS32 (the exposure and presentation of the financial instruments) and IAS39 (presenting and evaluating the financial instruments). The second step concentrates, in exchange, on the much debated subject of balance sheet liabilities' evaluation of the insurer.

The IFRS4 includes also the accounting laws applicable to the companies' insurance contracts that must present more detailed financial report regarding the insurance contracts (for example regarding the sensibilities of the profits varying with the hypothesis its stands on), the reserves for catastrophes and equality no more being admitted, used previously to absorb extraordinary losses.

The most relevant modifications refer to accounting the balance sheet items at their fair value, most of the balance sheet assets therefore being needed to be included in the balance sheet at their market value and not at their historical cost (Taliento, 2004).

2. The necessity of the IFRS implementation in the insurance contracts

The introduction of the IFRS4 produces, therefore, a strong impact not only over the accounting, but also over the management of the assets in the balance sheet of the insurance companies.

The insurers, especially the ones that operate in the life insurances' domain, hold title assets, at present this assets being highlighted in the balance sheet at their nominal value, while, according to the IAS39, most of the assets will be evaluated at their market value. In a context that is characterized by interest rate variation, the value of the assets will be subdued under variations, while the balance sheet liabilities, at least in first phase, stay essentially invariable, from here being derived the volatility of the management not only at an economical result level, determined from the new accounting standards (Chiricosta, 2004).

In order to reduce this volatility and avoid a negative evaluation on behalf of the market operators, the insurers can choose between title volume reduction, in order to be more orientated towards bonds, with the advantage to manage the assets and liabilities in a more effective way; classifying some asset as being

held to maturity, and this practice will be due to a normative that penalizes companies that sell assets classified as being held to term; reducing the exposure risk, by insuring assets on a less long term and adequate to the product's structure (Bacinello, 2001).

Unlike the damage insurers, the life policies insurers will sense more directly the IFRS being introduced; this is explained also by the nature of the balance sheet liabilities per title, which often get guarantee options.

Based on the IFRS4, some guarantee options will have to be evaluated at their market value. Companies that in the past have not taken into account these options in their taxing models are due to make the necessary adjustments.

The insurers will not only have to intensify the information with the variety of the insurance risks that the portfolio contains, but also varying with the sensibility of own assets of interest oscillation, share prices and mortality.

Realizing the new frame of the IFRS standards means taking into consideration the accelerated globalization of the trading and financial markets' internalization, which have made passed onto first place the necessity of a standardized financial reporting.

Harmonizing of the accounting practices and annual accounts' preparing systems has also been favored by international companies, lots of these aspiring in fact to be listed beyond their own national market in order to access larger markets.

IASB has evolved a normative frame, IFRS, finalized to improve the transparency and compatibility between different domains and companies. The EC has declared, on January 1st 2005, that the enterprises listed in the EU must present consolidated financial situations, by applying only one accounting standards frame, called IFRD, elaborated by the IASB. It is also stipulated a temporary exemption of two years for the companies listed either in the EU, or on a third regulated market, and for making consolidated accounts by the accounting standards recognized internationally.

3. The European accounting strategy regarding the IFRS4 standard implementation

The uniformity of the European entities' balance sheets represent for the EU one of the objectives followed in order to supply their internationalization process. This objective has determined the EC to adopt laws aimed to normative uniformity in its member countries.

Among the directives that the EC has adopted, three have especially referred to the editing of the balance sheet principles in the EU enterprises:

- the 4th directive regarding the annual capital companies' accounts (98/660/CEE);
- the 7th directive regarding the consolidated accounts, afferent to group companies (83/349/CEE);
- the 8th directive regarding the abilities of the individuals tasked with annual accounts' audition (85/253/CEE).

This represents a first tentative towards real uniformity and European balance sheet comparability, be it under the aspect of editing but also under the aspect of patrimonial items' presentation (IASB, 2003, *Exposure Draft: ED 5 Insurance contracts*).

The presented directives have codified the general principles elaborated internationally, but have not been adopted in many of the national European countries regulations. Among these principles we find: the faithful and fair frame, going concern, economical competition, non-compensating the assets with the liabilities or the income with the expense, the prevalence of the economical over the juridical, the continuity of exercise continuation, the permanence of the accounting methods, intangibility of the opening balance sheet, presenting the homogenous and comparable information.

The EC directives leave the possibility of choice between various options that can consent different accounting treatments, determining by that an incomplete harmonization. In the 508/95/CEE document, "The accounting harmonization: a new strategy in the international harmonization process", the Committee has highlighted in fact the way that the EU should act in order to consent to the wanting companies to be listed on the USA markets or other world markets to remain in the EU accounting frame.

The EC has realized in fact that the balance sheets made by the trans national European companies, according to the national law, that was based on European accounting norms, were not compatible with various accounting principles prescribed in other countries of the world from which they must obtain in order to penetrate the international accounting markets. The companies mentioned were constraint to make two series of accounts: one according to the European accounting directives and other according to the requests of the international capital market,

On an European integrated and efficient real estate market, it is necessary for a listed company to make its own balance sheet based on a single set of accounting standards. The EU did not want to make a distinct set of accounting

rules, exclusively for the European market- a choice of this type would have been incompatible with the globalization tendency of the financial markets and would have put to risk the capacity of the European companies to find their capital on third party countries' market (Mates, Hlaciuc, Grosu, 2009).

Therefore, a set of internationally recognized standards seemed to be the most adequate basis for the financial information in the EU. In the 35/00/CEE document, called "The EU strategy regarding financial information: the way to follow", the EC repeats the necessities that appear from re-giving the European entities annual financial situations comparability, based on the standards elaborated by the IASC, ensuring the guarantee of a unique, efficient and steady market.

The committee has proposed, for all the companies in the EU, listed on regulated markets, the obligation to make starting January 1st 2005 the consolidated financial situations by using the IASC standards; the member states, in exchange, have the possibility of extending this obligation also for the non-listed companies (IASB, 2004, *IFRS 4- Insurance contracts*).

The adoption of all of these has been approved in May 2001, by the directive CEE65/2001. On July 17, 2007, the Council of the Finance Ministers has proposed to the EC the introduction of these new rules and founding an adequate mechanisms regarding IAS approval. The communitarian dispositions actually want the 4th and 7th directives modified, aiming towards applying the IAS39 regarding the representation and evaluation of the financial instruments.

In June 2001, the EFRAG takes birth, with the task to assist the EC regarding the acceptability of each document in Europe and emitting commentaries about these documents, made by the IASB. On July 19th, 2002 the EC elaborates the 1606/2002 regulation, through which it is stipulated the adopting, starting 2005, of the IAS for the annual consolidated accounts afferent to the listed companies.

The obligation is valid also for the companies that are preparing to solicit the allowing for negotiation of their shares. It is also stipulated the possibility that the member states impose the application of the IAS to the companies listed in their exercise balance sheet, to the non-listed companies, but also in important divisions, such as the banking and the insurance services, independent of the fact that the companies are listed or not.

Starting July 2003, the EU has introduced the IASs by then adopted, and from that moment, the future ones - IFRS, and the SIC Interpretations. The approval has been made official by the regulation CE 1725 of September 29th 2003, obligatory in each member state.

4. The development of the IFRSs in the insurance services' division

The IAS initiative regarding the fair value dates all the way back to 1997, when the IASC has started developing a model in order to evaluate the financial instruments at their market value. In the year 2001 there has been published a "Draft Statement of Principales on Insurance Contracts"- DSOP, document evolved by a Committee made by the IASC.

This project has raised numerous debates in the insurance division, the most debated aspect being about the approach of the market value for measuring and evaluating the financial instruments and the insurance controls.

In the year 1997, the IASC has made a certain committee, the Insurance Steering Committee, with its goal to treat problems regarding insurance contracts. Taking into consideration that the initial definition presented by the committee excluded several types of insurance contracts, such as credit insurance and security plans for entities and personnel insurance, the international financial groups and the organizations of the insurance services and normative entities have strongly opposed to this proposal.

The IASC committee has been dissolved in June 2000, because of the IASB being created, to which followed the making of a new Insurance Advisory Committee. In the same time with the Insurance Project, the IASB had evolved the IAS39 and the IAS32, which treat different accounting aspects regarding financial instruments (IASB – IAS 32, IAS 39). In December 1998, the IASC had approved the IAS39 standard – Financial instruments, presentation and evaluation. This standard has formally introduced the classification of various financial instruments; in completion of the IAS39, the IAC had successively evolved the IAS2 – financial instruments – presentation, balance sheet and informing, including general presentation principles of the financial instruments, and the accent being put on particularizing the differences between various financial instruments (Mella, 2002).

The DSOP, presented by the IASB in November 2001, proposed making a standard IFRS basis for the insurance contracts. The standards contained in the DSOP had various commentaries and recommendations on behalf of the private and public sector organizations all put together in a document published in 1999.

Taking into consideration the particular situation that usually the insurance contracts are not actively negotiated, the IASB has introduced the concept of entity specific value, as an alternative to approaching the market value.

The DSOP recommends resorting to the entity specific value to all those whom the market information was not available. In July 2003, the IASB has published the so-called Exposure Draft (EDS), an orientation document for passing towards the IFRS, under which the insurers should expose the balance sheet liabilities at their market value, also the final version of the proposal being eliminated,

EDS had consented to the IASB to collect the future commentaries and recommendations came from the organizations from the private and public domain, these serving as a basis for setting the IFRS4 standards regarding the insurance contracts.

In March 2004, the IASB publishes IFRS4 – insurance contracts, but the appliance of the national accounting norms regarding insurance contracts is continued, with several modifications. It is good to remember that the IAS39 and the IASB standards refer to financial instruments held or emitted by the insurer, and the IFRS4 says that the insurer must present more detailed information regarding the insurance contracts.

5. The application sphere of the IFRS4

IFRS 4 is applied to all the insurance and re-insurance contracts (active and passive) that fulfill the definition of the insurance contract. The insurance risk supposes that at least one of these elements is random, being necessary certain conditions for the mentioned contract to be considered eligible for the re-insurance accounting, more than for deposit accounting: event checking, the moment that the event should take place and the economical impact for the insurer.

In the absence of the insurance risk, the contract is not included in the definition of an insurance contract; according to this definition, the contracts for which the insurer guarantees the payment of a sum without a possibility that an adverse event hits the insurer or other beneficiaries does not exist do not contain an insurance risk (Baione, De Angelis, 2004).

The insurance risk is different from the financial risk, which takes place when an entity assumes or transfers to another party one or more of the following risks: exchange risks, risks regarding interest rate, market risks, credit risks, or price variations.

The financial risk is practically the risk of a possible future change of one or more variables: specified interest rate, specified price of the financial instruments, specified price of the merchandise, specified exchange rate,

specified index of prices or rates, specified evaluation of client solvability or specified index regarding credit, or other variables, only in the case of non-financial variable not being specific to a contracted party.

The significance of the insurance risk must not be disclosed by the insurer over its portfolio or even him, but contract over contract. The unclassified contracts such as the insurance contracts can be reclassified if a significant variation in the insurer's treasury cash flow takes place.

If the insurer, at the date of the contract stipulation, is capable to evaluate that the probability or the actual value of a significant loss could lead to growth in time, the contract becomes classified as an insurance contract, from the beginning, even if the actual value afferent to the loss is smaller at the moment. Once classified as insurance contracts, these cannot be reclassified.

A significant part of the contracts, that are legally defined as insurance contracts, do not satisfy the current definition of the insurance contract according to the IFRS4, because to these are not applied the contractual standards regarding the insurance contracts (De Angelis, 2001).

The combination between the financial risk and the insurance risk influences therefore the classification and accounting of the contracts. Based on this definition, we can classify the life insurance contracts as follows:

- products with insurance coverage: temporary insurances, permanent health insurance;
- composite products: composite income, composite insurance;
- financial contracts: social insurance forms, investment contracts.

The Implementation Guide offers several contract models that are in the definition of the insurance contract: case of death insurance, immediate annuities, composite contracts with superior payment in case of death, investment contracts that contain participation discretionary components of the beneficiaries (Brennan, 1976).

6. Conclusions

The IAS39 imposes to any insured to separate the incorporated derived instruments that satisfy certain specified conditions in the base instrument which contains them, to evaluate the incorporated derived instruments in the fair value and identify the modifications that occur at their fair value in the profit and loss account.

Still, an insurer is not obliged to separate a derived incorporated instrument that concurs with the definition of an insurance contract.

Nevertheless, the separation and evaluation of the fair value of an incorporated derived instrument of this type is not forbidden if the accounting policies of the insurer solicit this or if the insurer modifies its accounting policies and these policies are in the sphere of the IFRS4 criteria.

The IFRS4 is a first step in defining a reference frame exclusively for making the balance sheet of the insurance companies. Applying this principle regards all the insuring contracts, the insurers not needing to follow the dispositions afferent to the systematic frame or other IAS/OFRS any more, such as the case of incorporated reference derivatives, for which are already stipulated specific evaluation norms. They cannot represent provisions if they refer to events already passed at the date of the balance sheet writing, because it would be contrary to the IAS37 standard, and it is imposed therefore to them annual auditory in order to insure adequate character to the liabilities in the balance sheet.

The modification possibilities of the accounting principles are limited, although it is allowed to introduce a principle to stipulate the non-determination of the value of certain insurer's assets, which in any case cannot be put in the balance sheet if they are not updated so that they would reflect the current market values. The liabilities in the insurer's balance sheet cannot be compensated to the insurance connected assets, and must stay in the balance sheet until they are not out or regulated.

In the end, the IFRS4 does not offer an evaluation for the passive elements connected to the insurance contracts, at their fair value, circumstance in which the risk giving an incoherent evaluation of the passive values with the active of the same company.

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