Business Administration and Business Economics

Entrepreneurship and Human Resources as Important Forces Affecting Electronic Readiness in Building the Information Society in Albania

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Abstract: Today information has become an important element without which society actors cannot achieve their goals. The term "information society" is increasingly used nowadays instead of the terms "production" or "consumption society", because of the importance and necessity of information in today's dynamic environment. In these conditions, even Albania is trying to give the proper importance and emphasis to, not just the use of information, but to the use of tools and technologies that enable efficiency in the collection, storage, processing, and distribution of data and the use information. Thus, information and communication technologies (ICT), are finding today in the Albanian society, a steadily increasing use. For the Albanian Government has established and implements the strategy is the national information and communication technologies (ICT).

Keywords: information society; ICT strategy; e-readiness

JEL Classification: G14, E21

1. Introduction

Actually, Albania, as also some other countries in the SEE group, is not subject to a consistent and systematic evaluation of e-readiness, because there is no government or non-government institution that is committed to this process. This article does not pretend to measure e-readiness in the country, but its goal is to submit existing information regarding the above aspects in Albania, as well as a description of the current state of skills and knowledge of people in using technology.

The methodology used involves collecting data through secondary sources such as Internet, various studies conducted on Albania and Eastern European countries and data collected by the respective institutions. These have helped in identifying the main problems. Further, the distribution of 100 questionnaires and its analysis has enabled the identification of the situation of ICT use by individuals and businesses in the country.

Findings show that ICTs are now used more in sectors such as governance and administration, but also education and business. They are used less in health or other sectors. Infrastructure for the use of technology should be developed further. There is still much to do, although ongoing efforts are taking place for its nationwide expansion.

On the other hand, the Albanians use ICT more for work and less for socialization and education, according to the results of the questionnaire. However features such as age, education level, or occupation, are thought to affect the benefits and use of ICT in human resources. These findings may affect the construction of appropriate strategies to increase e-readiness in our country.

Information has become an important element without which society cannot achieve its objectives. The term “information society” is increasingly used nowadays, instead of the terms “production” or “consumption society”, because of the importance and necessity of information in today's dynamic environment.

The implementation of national ICT strategy and the efforts to build the information society, in order to benefit from using ICT effectively in sectors of strategic importance to the economy, lead to the need to pursue these efforts through quantitative and qualitative indicators. One way to assess the strategy and progress of efforts to build the information society is the evaluation of the concept of electronic readiness, or e-readiness, which shows the extent to which a given society, social group or organization is aware, customized and prepared to use new information technologies and communication.

These developments has incited different world institutions in pursuing and examining the development of information and communications technology (ICT) in different world economies, and evaluated and ranked their relative digital progress. They have measured not only the availability and adoption of ICT (or “connectivity”) in different countries, but also development of the social, cultural and economic building blocks necessary for its effective use. The last attempt is to gauge the extent to which ICT and selected ICT-enabled services are being used, given that it is the use of technology which ultimately contributes to the overall economic progress of a country.

The ICT development, on the other hand requires preparation, largely in the form of investment in network infrastructure, skills and regulatory frameworks. The notion of preparation lent itself to the term "e-readiness". Since these developments, every month over 40m more people become mobile-phone users, for example, and the phones themselves are increasingly powerful data devices. The Internet—now a ubiquitous platform for commerce, entertainment and communication—has generated a thriving industry. Global monthly Internet traffic in 2010 is two-thirds higher than one year ago, according to Cisco, a network equipment provider. The capacity of the world's international optical fibber cables—which carry all this traffic—doubles every 18 months, based on estimates by Telegraphy, a telecommunications research firm. This demand is being driven by increasingly sophisticated usage of Internet-enabled services: video accounts for more than 50% of global Internet traffic today, and the data generated by Facebook, a social networking site, is estimated to surpass that of the entire world's e-mail.

The challenges ahead for countries, in our view, will be in learning how to extract the maximum economic and other benefits from the use of digital technology. In a situation when most of the world has achieved "e-readiness" to one degree or another, Albania is also trying to do its best in this regard, compared with other SEE countries. But let us begin first with the e-readiness meaning and measurements, and then learn how some of these measurements apply in Albania thus reflecting the ICT development.

2. What is e-readiness?

E-readiness was generally defined as the extent of readiness in access to network infrastructures and technologies. It can also be seen as the degree to which a society is prepared to participate in the digital economy with the underlying concept that the digital economy can help to build a better society. Regardless of a country's level of development, readiness is assessed by determining the relative standing of its society and its economy in the areas that are most critical for its participation to the networked world. So, the term e-readiness is used here to denote the degree to which a given society, social group or organization is aware of, has adjusted to and is prepared to use the new information and communication technologies. It is important to assess it in terms of defining and implementing of national development strategy. The aim is to develop awareness of the challenges and comparative advantages and deficits and to encourage development of the capacity to tackle them and to exploit the new possibilities.

However, e-Readiness can be a relative concept and it could be defined differently depending on each country's priorities and perspective. In most countries including developing countries, it goes beyond this generic definition to include various other factors. This evolves from the importance given to basic infrastructures in the eighties and nineties to more emphasis on the socio-economic dimensions of technologies today. Societies at large are increasingly empowered in decision-making processes and such achievements may not have been achieved without timely introduction and use of such technologies.

E-Readiness is about readiness in human capacities, political leadership, institutional frameworks, supportive policies, complimentary regulations, business environment, investment opportunities, and public-private partnerships in technologies. A review of recent experiences in the developing world shows that the countries which are the most successful in creating a favourable climate for the use of ICTs are those that make it a priority. Their determination to participate in the digital world is reflected by rapidly focused actions supported by superior planning and sustained by dynamic public-private partnerships. All these factors play their own corresponding roles in all countries, even in different ways. The underlying concepts on the above issues are the mutually complimentary issues of e-economy and e-society.

E-Readiness Measurement in SEE Countries

As it was said before, there are different approaches to e - Readiness assessment.

Whichever approach the country adopts, it shall be implemented systematically and used consistently in time. That is the only way it can produce useful results. With the exception of Croatia, actually none of the countries in the SEE region has systematic and consistent process of e-Readiness assessment. There are neither governmental nor non-government institutions that are dedicated to long-term assessment of country's e-Readiness. Some existing external assessments also do not provide clear picture and do not cover the region well. The overall assessment is not very encouraging but it is hard to measure exact level of e-Readiness in the region, especially changes and trends in last few years. Since the assessment of country's e-Readiness is one of the most important inputs for ICT strategy formulation and implementation, it leads us to conclusion that SEE countries need to significantly improve their ability to assess their e-Readiness status.

Since the measurement of the e-readiness requires measurements in different fields, in the following section we will treat only the human resources aspect in this regard.

3. Human Resources in Assessing ICT Development

Investments in people are essential to economic and social development. Investments in technology will impact less on reducing poverty or improving the lives of underserved communities, unless accompanied by efforts to build capacity of target populations to exploit the opportunities offered by ICT. Education and skill development are critical components of assisting individuals, communities and even across the country, to be oriented to the global information economy. Therefore they must be essential elements in any development plan. Some of the main policy principles in this regard include:

Education and digital literacy

Expanding educational opportunities and digital literacy in underserved communities is critical to broadening economic opportunities and removing barriers to digital inclusion. Although certain forms of ICTs (*e.g.*, telephones) can be and are being used effectively without widespread digital literacy, it is equally clear that digital literacy is vital to enabling users unlock the full potential of ICTs.

ICTs can also play a significant role in helping teachers expand learning opportunities. Microsoft recognizes the vital role of education in human capacity building and the contribution that ICTs can make in this area. The company supports several initiatives that focus on the specific educational needs of developing countries and has partnered with many governments and development organizations to implement these initiatives.

ICT skills development

ICT skills are vital to enabling individuals and organizations to leverage the full potential of information and communication technologies. Yet in many parts of the developing world, relatively few users have the skills to utilize ICT effectively. Fewer still have the expertise to develop ICT products or provide critical IT services. A shortage of skilled ICT workers will make organizations reluctant to invest in ICT ( ), thereby curtailing demand for domestic ICT products and services and leaving fewer opportunities for entrepreneurs and domestic ICT firms. A chronic shortage of skilled ICT workers will impair a country's competitiveness not only in the ICT sector – one of the fastest growing areas of the global economy – but in many other more traditional sectors as well. To improve skill development, policy makers should work in:

- *establishing certified training programs for:*
  - *IT professionals and developers,*
  - *Employees inside public and private sector*
  - *youth population through*
- *Strengthening business education and training and including ICTs.*

Methodology of the study

The methodology used involves collecting data through secondary sources such as Internet, various studies conducted on Albania and Eastern European countries and data collected by the respective institutions. These have helped in identifying the main problems that Albania faces inside ICT sector regarding the e-readiness level.

Secondary data helped also in identifying the state of the art in different ICT programs and curricula throughout our high education systems. It must be said that data are missing in lower levels of our education system. Since, the literature identify the digital literacy of employees in the public and private sector as an important factor for e-readiness in the country, 200 questionnaires are distributed among individuals and organizations (100 for individuals and 100 for organizations, public and private) Its analysis has enabled the identification of the situation of ICT use by individuals and businesses in the country. Although the questionnaires have covered different aspects, we will focus only in ICT use by individuals as well as in the existence of training programs inside organizations.

4. E-Readiness for Information Society in Albania

ICT sector is growing significantly in Albania, especially Internet deployment. Situation is rapidly changing from one year to the other, despite the fact that this country has the lowest telecommunication in Europe. There is a general awareness about the role of ICT between people and government; and as consequence, there are many ICT related initiatives, especially private in main urban areas. Mobile telephony has a high penetration in urban areas as an alternative solution in conditions of low penetration of fixed telephony. Despite this considerable growth of ICT deployment, there are several critical obstacles to be addressed. Some of them are related with cultural and economical conditions, for example the problem of electrical energy shortages, especially in rural areas, high poverty and lack of telecommunications infrastructure in remote areas. In addition, there is lack of data on ICT penetration and usage by different sectors and organizations. As result, it is difficult to understand the real quantitative e-Readiness of the country and the impact of many projects that are realized without coordination.

Liberalization and privatization of telecommunications in the last two years have had considerable impact in promotion of Internet usage. It is expected that adding a fourth mobile operator may decrease respective prices, while for fixed telephony services the impact of liberalization is disputable as result of de-facto monopoly of the actual incumbent operator.

An important aspect is lack of formalized information systems and data processing methodologies in management, which creates difficulties for SMEs in preparation of business planning and management.

On the other hand, another important factor that we strongly believe is having a positive effect is the ever growing number of trained technical people both in ICT and accounting/auditing services. As result, the web presence of companies is growing even if with relatively low quality.

Public administration, especially in central institutions, intensively uses computers, but this usage is mainly individual, without institutional integration. Institutional applications are missing in the majority of institutions that would make more efficient the work of administration and would pave the way for e-government applications. Almost all ministries, for example, have built institutional web sites but only few of them have dynamic content automatically reflecting their institutional activities (in most cases site updates are done manually). Education is considered as fundamental for society. However, critical problems related with the infrastructure and educational materials have negative impact on quality of teaching. Poverty of a part of population makes education of children a luxury. Government, aided by different donors, is rebuilding and re-equipping many schools, due to its e-education strategy, but its impact on real education is questionable. Full curricula for basic elements of computer use are introduced in high schools, but teaching is problematic due to lack of computers and labs.

Deployment of ICT applications in Albania is increasing contiguously, following trends characteristic for overall development of the country. There is strong commitment from donors and certain government circles to promote ICT applications, particularly with development and approval of the National Strategy for ICT Development.

5. Human Resources and Digital Literacy in Albania

Development of education and research in nineties and after was conditioned by deep political, social and economic changes that seriously impacted academic sectors. Decentralization, liberalization, opening with abroad and increasing of international collaboration, financial problems, and brain drainage, decreased collaboration with public sectors characterize this period.

ICT education started in seventies with few university courses dedicated in programming. In the eighties, the Chair of Informatics was created and full university curricula started at University of Tirana. Short and mid-term courses were developed as well. In nineties, together with liberalization, personal computers "invaded" the country and the necessity for fast widespread of knowledge on ICT was obvious. Many organizations started organizing short-term courses on basic computer skills. Considering the status of ICT in Albanian schools, the situation is improved during last years, but still it is inadequate. In June 2002, about 500 PCs are available in 400 high schools, and only 25 high schools have a computer laboratory with 10 computers each. At that time, all high schools in Tirana are equipped with a computer laboratory with 15 computers each and 24-hour Internet access, and one computer is also provided to the secretariat of the school.

Regarding the equipment of schools in all the country, the most important project was that of e-schools, 2005-2009. It aimed at providing primary and secondary schools in Albania with modern computer labs, equipped with high-speed, reliable Internet connectivity. The Program also addresses the needs and capacity of teachers to use ICT though a number of practical training courses and developed ICT curricula. On 3 December 2009, the Ministry of Education and Science celebrated the installation of computers and their connection to the internet in 2,107 schools.

Considering Internet connectivity, the majority of faculties is connected with different ISPs, but normally they do not implement in-house Internet services while using those offered by ISPs. DNS records from EDU.AL include 24 names, but only 9 institutions have web sites.

Regarding Internet in schools, the e-school project supported a cost of USD 1.05 million out of approximately USD 14.4 million of all the project. The UNDP also provided technical support that includes a plan to distribute computers and connect all schools to the Internet with Albtelecom providing the Internet connection.

Specialized training and/or certification on ICT are developing also. There is an NGO that offers Microsoft certification. Creation of Cisco Academies has lagged behind due to lack of synergy between potential stakeholders and lack of financial means. In this context, the aid from international organizations would help to overcome obstacles. Another example of certified and EU-accepted computer credentials is the Expert Certification that had been introduced in Albania with assistance of

PARSH/GTZ project. Details can be found at www.xpert-online.de.

Some important figures below show about the growth of users of Internet and mobile phones, as well as the number of graduate students in ICT curricula around the country.

Table 1. ICT users and digital literacy

YEARS	2002	2003	2004	2005	2006	2007	2008	2009
Mobile phones users (number)	370,000	800,000	1,150,000	1,259,200	1,530,000	1,769,100	2,095,000	
Internet users	2500	30000	37500	46900	58600	75000	471000	
Number of graduate students in ICT	1340	1680	1970	2136	3040	3675	2345	3987

Further data from the questionnaires will help to reflect the situation in more detail. The first group of data collected has to do with recognition and use of Information and communication technologies. Through these data are supposed to understand the level of use of individuals as well as the efforts to improve digital literacy among employees. About 73% of respondents are familiar with the term ICT, and after the explanation, about 90% of the respondents are users.

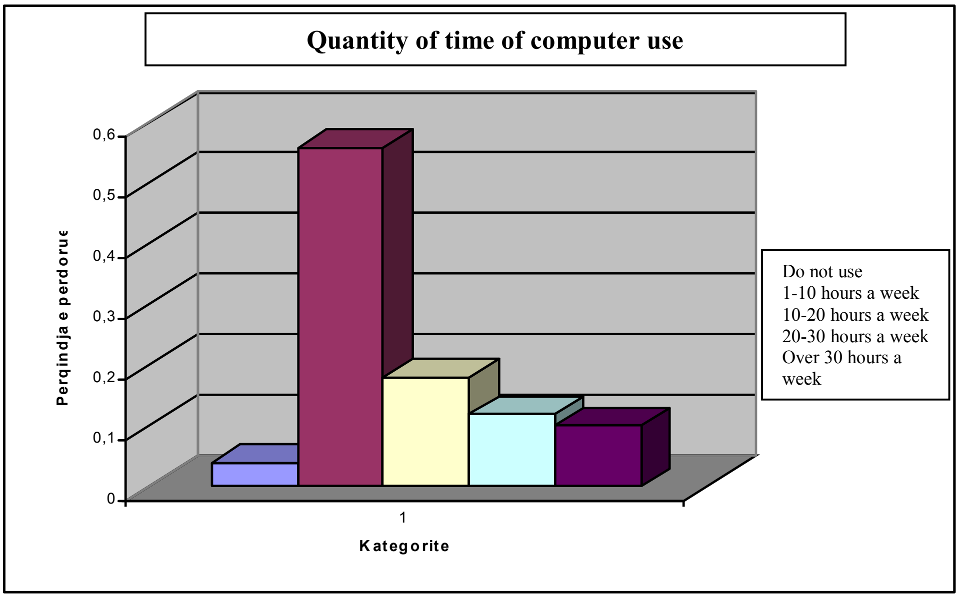
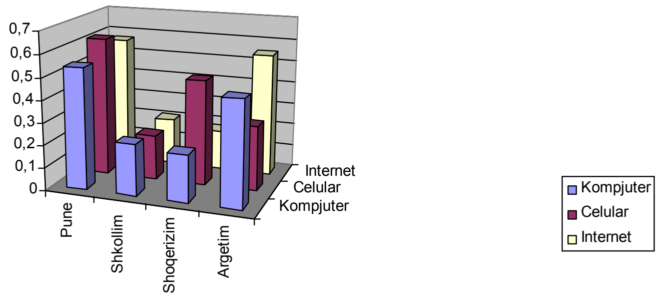


Figure 1. Time of using computers by individuals

It appears that the majority of respondents, 56% of them use the computer, but only 1-10 hours. A much lower percentage use the computer on 10 hours a day in each of the categories mentioned. It is easily seen that individual users are still in first steps in using computers.

Users also have ranked from 1 to 4 the main uses of technology, including computer, cellular phone and the Internet, as three of the main aspects of the technology used identified by exploratory research. Data show that:

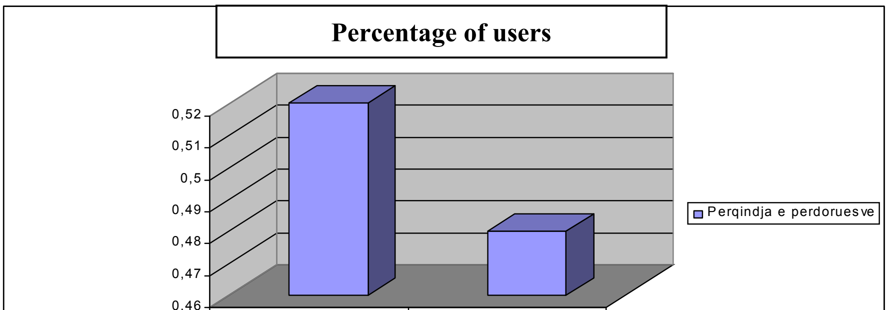
Most users use 50-60% use technology more for work estimating it in the first place, while the percentage of users that rank the three media more for entertainment or socialization is significantly lower. The figure 2 shows the percentage of respondents which rank 1 one of the usages: work, education, socialization and entertainment.



	Pune	Shkollim	Shoqerizim	Argetim
Kompjuter	0,54	0,23	0,21	0,47
Celular	0,62	0,2	0,47	0,29
Internet	0,57	0,21	0,18	0,55

Figure 2. Computer, cell-phone and Internet usage

Moreover, the degree of use and knowledge is evaluated through the list of some behaviours of individuals with regard to technology, such as their conversations with other people, their sharing experiences, their time spending etc. The goal is to identify the percentage of users who have knowledge above average and the percentage of those who are knowledgeable below average. The analysis is done through the Likert scale. So, fig 3 shows the percentage of respondents who have ranked more than the average, 3,65, for all the factors mentioned above that represent knowledge and use.



	me pak se mesatarja	me shume se mesatarja
Perqindja e perdoruesve	0,52	0,48

Figure 3. Percentage of users that use ICTs over and under the average

Beyond the actual use, digital literacy means more. Increased use will come from more education and trainings in ICT. But as it can be seen in the figures, efforts to improve in this regard are also scarce. A low percentage of organizations subject to the interviewing through their managers/owners to train employees train their employees in the field of computer science, compared to the percentage of those who do not train. These percentages are respectively 24% and 76%. Still there is room to influence the spread of knowledge which will also boost the penetration of technology in Albanian organizations.

Figure 4 indicates the level of knowledge required by employees in the organizations. Thus, only 14 percent of organizations require computer knowledge from all the employees, 44% of them require the knowledge from only a portion of employees and 42% do not have digital literacy as a necessary condition for hiring employees. These figures continue to point to the low penetration of technology in a good part of the organizations. Also, for organizations that demonstrate the demand for workers with knowledge on information technologies, we can say that only a small fraction of them require advanced knowledge, respectively 32% and 68% require only initial knowledge. This figure shows that the quality of use leaves much to be desired in terms of knowledge.

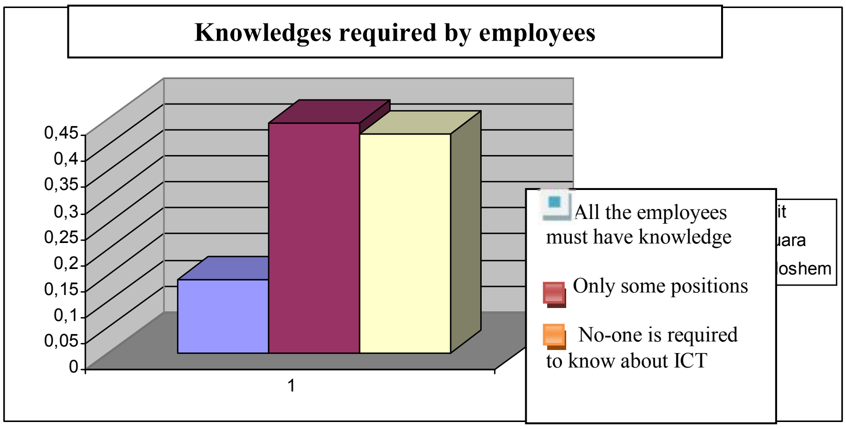


Figure 4. Percentage of organizations according to the required digital literacy to their employees

Regarding the trainings, the situation is almost the same. Only 23% of the companies offer trainings for their employees in ICT field, the rest do not think of this option as possible, even in the near future.

6. Conclusions and Recommendations

The development of ICT has been very significant in Albania. The country has seen the coming of Internet, the advent of closed networks and applications, the growing imports of computers and systems and the significant use of computers and Internet in offices. These developments are positive and are contributing towards the overall development of Albania even though some difficulties remain. E-readiness is not measured in Albania and many data are still lacking for assessing digital economy. Although different factors impact the state of the art of ICT, and a variety of indicators are necessary to measure e-readiness in a country, the human factor is one of the most important ones. Without skilled people, an economy could not benefit from all the potential of ICT. ICT awareness at both the decision-making and operational level needs encouragement. High priority should be given also to ICT training and implementation. Lack of trained manpower is yet one of the barriers for fully employment of ICT in Albania.

After evaluating a relatively poor situation in ICT use by individuals, the results are not better in organizations. Even changes have been made last years, in the equipment with computers, Internet connections and building first Information Systems, much more have to be done in regard to train people in using ICT, in the right ways in organizations.

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Specific Aspects of State Social Security Reform in Romania

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Abstract: The National pension system, in the light of major economic and financial transactions that take place today, can be challenging, through the difficulties that they create and the solutions that they offer. This paper is a comprehensive study on the public pension system in Romania facing the current global crisis, based on local case studies in an attempt to identify the main gaps and to propose viable solutions. The obtained results are based on multifactorial analysis at local level, by personal processing of relevant data, the evolving activity collected from a county pension facility that meets the characteristics of the retirement pension system nationwide.

Keywords: public pension system; employment; social security; social security budget, pension reform

JEL Classification: G23, J68

Part II

3. The Analysis of the Public Pension System Based on Indicators - A Case Study from Braila County Pension House

The Braila County is part of the economic development in the South-Eastern region of Romania, its population represents about 13%. According to the existing data in 2005, the active population (of age) in the Southeast Region was 43.7% - slightly below 45.5%, as it was the national average - and the region's employed population was 36.1%, and in Braila was 34%, also below the national average, 38.8%.[1]

These features of the South-East area, as well as the developments in the local economy are reflected in the changes of values of some indicators of the public pension system at the Braila county's level, of which the first part of this article were analyzed quantitatively and qualitatively, the number of policyholders and the main beneficiaries of state social insurance budget, the developments and correlations.

3.1. State Social Insurance Budget Execution at Local Level

In Table 14 there are presented the budget execution data for the period 2006-2010. The necessary expenditures of the state social insurance system at the level of Braila County have exceeded the revenues each year, ending the exercise with a deficit. The deficit increases from one year to another and in 2009 it exceeds the revenues. We have identified as causes the average basis on modest tax at the level of the county, the disadvantageous ratio between the number of taxpayers and the number of beneficiaries, the coverage degree continues to decrease the social insurance system in the county and the decreased collection rate (Table no. 15).

Among individual policyholders there is a large number of people who pay late or no social security contribution. If the insured under contract may have their contract terminate automatically for non-contribution six months in a row, the debts of insurance policyholders must be pursued and repossessed. In late May 2010, according to CJP Braila databases, 1309 were provided with the contract, which reported back payments totalling 284,178 lei plus accessories totalling 9968 lei, and among policyholders with insurance declaration there were 1103 debtors, with a total debit of 1,290,082 lei, plus total accessories of 922,419 lei.

Table 14. Implementation of State social insurance budget at CJP Braila in 2006-2010

lei

Indicators	Years				
	2006	2007	2008	2009	2010 (I[st] trimester)
Total revenue -, of which	**185032966**	**220522350**	**290591432**	**313560610**	**70723199**
Employer contributions, including:	124546054	145366077	191853846	197981169	47350964
- Social security contributions owed by	122604525	143566973	190301710	192810533	43844825

[1] OIR POSDRU SUD-EST Site, http://www.fsesudest.ro/Prez-Reg-SE.pdf

employers					
- State social insurance contributions owed by unemployed persons	1941529	1799104	1552136	5170636	3506139
- Contributions of policyholders	59484279	73611239	97634505	107152687	24975505
- Contributions due from policyholders	56555756	69361636	91623853	99499117	22601377
- Contributions of other policyholders	2928523	4249603	6010652	7653570	2394055
Reimbursements from social insurance contributions	0	0	0	0	-19927
Non-tax revenue	1002633	1545034	1103081	8426754	-1603270
Expenditure – total, of which:	**286894085**	**361876061**	**529739448**	**631602626**	**168270556**
Insurance and social assistance, including:	284701926	355989305	520132496	623525309	166302630
- Pensions and benefits for old age	280070781	351025109	513878599	616979430	164312892
- Social assistance in case of illness	36704	1303	0	0	0
- Social assistance for family and children	595545	44361	33950	0	0
- Aid for survivors	3998896	4918532	6219947	6545879	1989738
Personnel costs	1694050	1732363	3892743	2039544	488155
Expenditure on goods and services	493231	4093633	5602483	6189646	1536198
Capital expenditure	4878	60760	344281	0	0
Payments made in previous years and recovered in the current year	0	0	-232555	-151873	-56427
Surplus / Deficit	-101861119	-141353711	-239148016	-318042016	-97547357

Source: Annual Accounts for the implementation of state social insurance budget of the CPJ Braila

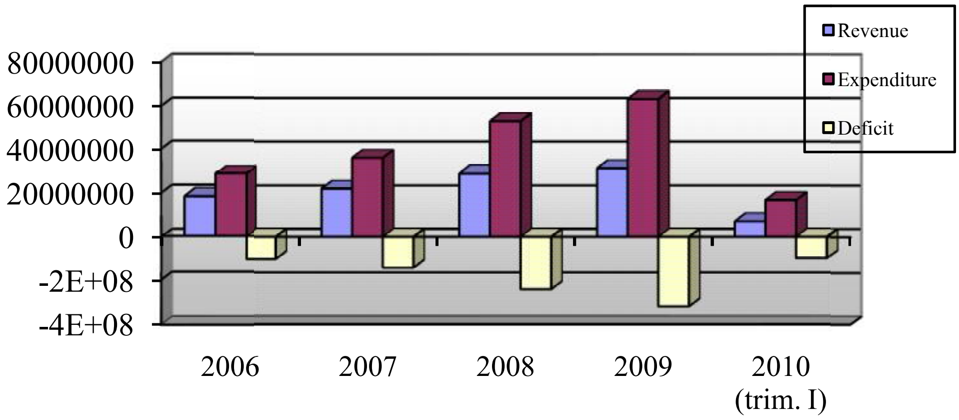

Figure 5. The evolution of revenue, expenditures and of state social security budget deficit at CJP Braila during 2006-2010

CJP Braila

Table 15. The collection degree of social insurance contributions owed by the employers and the insured

Indicator	Years				
	2006	2007	2008	2009	2010 (trim.I)
Revenues from employers under the CAS budget execution (lei)	122604525	143566973	190301710	192810533	43844825
Income owed by employees according to CAS reports (lei)	133839065	161035439	207617480	220381907	51945731
Cashing the CAS employees according to the budget execution (lei)	1941529	1799104	1552136	5170636	3506139
Revenue owed to CAS employees according to nominal records (lei)	2347213	2072506	1955023	6937756	3128622
Cashing CAS employees under budget execution (lei)	56555756	69361636	91623853	99499117	22601377
Income owed from CAS employees according to reports (lei)	63771069	78648733	102326818	112268752	26399073

Collecting degree CAS employer (%)	91,6	89,2	91,6	87,4	84,4
Collecting CAS collection unemployed (%)	82,7	86,8	79,4	74,5	112,1
Collecting CAS employee (%)	88,7	88,2	89,5	88,6	85,6

Source: C.J.P. databases Braila, own calculations

3.2. The First Developments in the Local Private Pension System

Concerning the participation of policyholders to Pillar II, we rendered in Tables 16, 17 the evolution of the number of "valid" participants, those for which transfers were made for mandatory private pensions. The number of participants per month is oscillating, whereas the contribution to the payment of Pillar II is conditioned by the presence of the insured under the nominal statements made by employers. The coverage degree of the mandatory private pension system, calculated as a percentage of the "valid" participants to Pillar II in the total number of policyholders who were registered in CJP Braila (Table 2 rd.1 + rd.6 + rd.8) is below 60%. The value of coverage degree has a modest increase from one year to another because of the new number entrants under Pillar II, by law, is annihilated by the number of people for which the contribution cannot be transferred, because it is no longer in the category of insured in the public category.

Table 16. The evolution of insured in Braila county to ensure that contributions are paid to Pillar II

Year	Months												
	January	February	March	April	May	June	July	August	September	October	November	December	Average
2008	-	-	42793	43282	43242	45036	43983	44222	44919	44788	44624	44588	44148
2009	42977	43869	43837	43802	44033	43901	43553	43672	43872	43423	43310	43024	43606
2010	42924	43335	43212	:	:	:	:	:	:	:	:	:	43157

Source: C.J.P. Databases Braila

Table 17. Evolution amounts transferred to Pillar II for policyholders in Braila County

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Year	Months											
	January	February	March	April	May	June	July	August	September	October	November	Average
2008	-	-	784458	851206	834640	919572	930541	903511	911681	1007262	981548	1062502
2009	974414	986410	1022537	975595	956727	958107	976527	959824	950572	977405	915838	681370
2010	1145641	1172452	1193706	:	:	:	:	:	:	:	:	:

Source: C.J.P. Databases Braila

Table 18. Average number of policyholders for which the contribution was paid to Pillar II according to their age

(persons)

Year	Age categories	
	up to 35 years including	over 35 years
2008	26963	17185
2009	25081	18525
2010	22892	20265

Source: C.J.P. Databases Braila for 2010, data from the first quarter

Table 19 The degree of covering Pillar II

(%) policyholders of Pillar II of the total number of insured

Year	Degree of Coverage
2008	55,4
2009	56,6
2010	57,3

Source: C.J.P. Databases Braila for 2010, data from the first quarter

3. Conclusions and Solutions having a Local and National Impact

Reforming the pensions in Romania has been a long process of transformation and optimization passing through several stages of regulation, amending and supplementing or repealing certain provisions that intended to be the foundation of a sustainable pension system, which meets the requirements of society and the EU objectives.

The state social security system at the level of the analyzed county keeps the main features of the system at national level in terms of small number of insured compared to the employed population, the lack of effective tools to bring more insurers into the system, the frequency of early retirement, maintaining their age retirement at a low level, the presence of weak labour market of people aged over

60 years, the indiscipline of employers and insured to not pay their obligations to the budget. They are the main factors determining the maintenance of a sub-unitary ratio between the number of employees and the number of retirees, considering only the pensioners that are paid from the state social insurance budget. 2005 year has brought an improvement in this report, outsourcing the benefits and shifting the task of state budget pension from the former system of farmers' social insurance. The improvement of this report continued in the years of economic growth, 2006 - 2008, before lowering again since 2009. This and the analysis of the number of taxpayers and pensioners, prove the link between economic development and improvement of input and output, and thus of the parameters of the state social insurance. The small degree of coverage of the population taken by the state social insurance system is recorded throughout the country and it has declined continuously, even in the years when employment has increased, because a large proportion of workers in categories other than employees have not paid off the obligation to ensure. Depending on further professional development, there are future potential "candidates" to the minimum income provided by social protection system. Their monitoring is impossible, since this would be done by a computer system that includes national database that does not exist at the moment.

If we relate the Romanian pension system to the 11 common objectives set by the EU Member States by adopting the open method of coordination, we can draw some conclusions about the evolution of public pension system's reform.[1]

Objective 1, *preventing the social exclusion*, means providing a decent living style for the elderly. In the period 2003 - 2006, the poverty rate of pensioners has halved. However, approximately 46.6% of the retired of state social insurance have the amount of the pension under the average gross salary per economy, where we concluded that this objective was not achieved. This situation worsened in 2010, with the measures to reduce the amount of retirement benefits, taken by the Government.[2]

Objective 2 is to *maintain the living standards after retirement, pensions, by accessing to public and/or private*. The average pension of state social insurance is located below the gross minimum wage in the economy in 2008 and slightly exceeds the amount in 2009, it is below half the average of gross wage. In late 2007, some 955,000 retired of state social insurance (20.6%), the pensions were below the minimum net wage in the economy about 3.2%, i.e. approximately 150,000 people had pensions less than half the minimum wage, in September 2008 their number doubled. The replacement rate compared with average net earnings fell to 43% in 2002 to 38% in 2007, returning to a value of approximately 44% in 2009. In the EU, it is recommended the replacement rate of 50%, currently

[1] The idea of targeting the objectives was inspired by (Fiț, 2009)
[2] M.M.F.E.S., I.N.S. (2007). Romania: Raport de evaluare a sărăciei. November 2007.

impossible to achieve in Romania because of the too high dependency ratio in the public system. (Presidential Administration, 2009) Analyzing these data, this objective cannot be fulfilled.

Objective 3, *promoting inter and intra-generational solidarity*, is also questionable, given the demographic tendencies and projections for the coming years and also the continuing increase of the foreign debt.

Objective 4, *the increase the employment rate* is still far from being achieved, if we take into account the statistical data showing the decrease in the labour force and employment rates and the rise of unemployment. There is no immediate practical solution for this situation to improve, especially in the economic crisis that we are going through which had a major impact on unemployment.

Objective 5 refers to the *extension of the active period*. In legal terms the age of retirement has been increased and it will reach 60 years for women and 65 for men by 2014. Contributory periods have also been increased to 30 years for women and 35 men. But practically, the excessive early and disability retirement, many of them believed to be illegal, determine the actual average retirement age to be below to that provided by law, according to the data of various studies is of 54-56 years to less over 60 years. According to Eurostat, Romania is the EU country where the employment rate of people aged between 55 and 64 dropped the most from 2001 to 2008. Also, the employment rate of people in that age group in 2001 decreased from an average of 48.8% in 2001 to an average of 43.1% in 2009 (average over the first three quarters) while the 35-54 years age category for the same period, employment rates ranged from 76.8% to 74.8%.[1] Given these figures, analyzed in correlation with the number of early retirements, we cannot consider this goal being achieved.

Objective 6, *insuring the financial sustainability of the pension system*, would mean in particular the improvement of the collecting degree, reducing arrears. Since 2008 the budget registered growing larger deficits and the future projections are not more optimistic, if we consider the fact that the dependency ratio of people aged over 65 is in an accelerated growth. According to World Bank studies for Romania, by 2050 the revenues for pensions will reach only 3.4% of GDP, while expenditure on pensions will reach 9.6% of GDP. The current situation and future projections do not allow considering this goal achieved.

Objective 7, *adjusting benefits and contributions in an equitable manner*. Benefits and contributions in the public system in Romania are controlled by two key parameters, pension point, and respectively, the rate of contribution, both set annually by the state social insurance budget law; their changes may be annually established or even more frequently. The contribution rate to the state social

[1] AMIGO Statistics.

insurance budget had a downward spiral during 2003-2008 and increased in two consecutive instalments in January and February 2009 and the fundamental point of retirement has gone through many inconsistencies. Both methods of correlation and substantiating these parameters and their long-term tendencies are unclear, so that this objective is uncertain.

Objective 8 relates to ensuring an adequate and solid pension system from the financial point of view. In Romania there was created a legislative framework for the operation of private pension funds. Basic rules are common with other European countries which adopted similar systems. The short period that has elapsed since the system began to operate does not allow a foundation for future projections in terms of tendencies, thus this objective can only be considered fulfilled only from the view of insuring a legal framework for the operation of private pension systems.
Objective 9 of the EU, *the creation of pension systems compatible with the requirements of flexibility and security on the labour market* can be considered fulfilled, as far as providing the legal framework for the implementation of the current European regulations.

Objective 10 regards *the revision of pension system in accordance with the requirements of equal treatment between men and women.* At this time, this target is not reached and it remains unclear whether the new pension law, which will enter into force on 1 January 2011, will introduce equal treatment between women and men regarding the retirement age.

Objective 11 relates *to the development of transparent, predictable, flexible and adaptable to new realities pension systems*, these features should lead to increased confidence in the national pension system. From an institutional viewpoint, things are relatively solved in terms of involved structures and their duties, applying the model developed in collaboration with the World Bank in all European countries that have reformed their public pension systems. Regarding the parameters, the party that interest the taxpayers and beneficiaries the most, the developments are unclear and unpredictable. So that is why not even this objective can be considered fully achieved.

As a conclusion the objectives proposed to reform the pension system in Romania have not been generally achieved, even in terms of recorded data or that of public perception. According to our analysis we can conclude that most issues arise from unbalanced financial system, between revenue and expenditure widened in the context of global financial and economic crisis, poorly managed in our country.

Few feasible opportunities to increase revenue of the state social insurance budget would be:

- an increase in social security contributions, which were used over time, exceeding the levels in most EU countries, so it is an undesirable solution;
- an increase in tax basis of the contribution, that can be achieved by: increasing the number of employees by creating jobs or by increasing wages, but both require a solid economic growth and it is not a short term result; efficient identification of persons have an obligation to ensure; attracting new categories in the system; reducing the phenomenon of “illegal labour" or "in between" (including the declaration of a wage below the real one);
- an increase of revenue collecting degree;
- a demographic policy based on increasing the birth rate.

Ways to reduce costs may include:

• stimulating activity to old age;

• raising the retirement age;

• increasing the insurance length necessary for retirement;

• harden and a more strict control on the conditions within specific categories of employment;

• reducing the conditions for early retirement;

• the introduction of equity in Romanian pension system by law, in order to prevent granting privileges from the public money, the integration of special pensions system in the public system.

Also, for a better management of the computerized record system it is useful the introduction of general computerized records in the pension system and the creation of a system of monitoring, analysis and policy in the sphere of pensions, the establishment of national databases in order to have clear evidence of people that are required to ensure, the corroboration of social security system with other systems in the field of social insurance.

State social security system aims at providing the replacement income if it occurs in people's lives the disease, disability, old age, death. But it should not be considered as the only and most important tool to fight poverty. The most effective ways in line with the EU are to stimulate employment, to increase the degree of education and training the population, in order to guarantee a decent minimum wage.

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The Role of IT in Business Process Reengineering

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Abstract: Many organizations in the world are going for Business Process Reengineering (BPR) to improve profits, to reduce costs, to improve turn around times, to improve quality or to provide better service to the customer, etc. This article discusses business process, business process reengineering, top management's role, reengineering team, process redesign, external consultant, skills required for a reengineer, communicating in the team, role of IT in business process implementation and advantages of the combination of IT and BPR in detail.

Keywords: customer; Business Process Reengineering; implementation

JEL Classification: M21; M21

1. Introduction

Business Process Reengineering (BPR) has been used widely in the industry since 1990s. Many corporations became successful in reengineering their business processes. It is mainly in the USA, the business process reengineering movement started and spread to Europe, Asia and the rest of the world. What is business process? What is business process reengineering? What are the factors, which effect business process reengineering? What is process redesign? What is the role of IT during process implementation? This article tries to answer these questions.

2. Business Process Reengineering

A business process is an activity or collection of activities, which has an effect on the customer directly or indirectly. Every organization has many processes built in their systems. Manufacturing, order processing, invoice generation, bill payment and customer service are some of the business processes of current day organizations. These processes can be reengineered.

Hammer, M. and Stanton, S.A. defined reengineering as follows in their book *The Reengineering Revolution* (1995).

"The fundamental rethinking and radical redesign of business processes to bring about dramatic improvements in performance."

According to this definition, we can expect the *dramatic* improvements as a result of our reengineering process in the business. Also the definition talks about the radical redesign of the existing business processes in the organization.

There are many steps involved in business process reengineering effort. Those steps are given in the following figure.

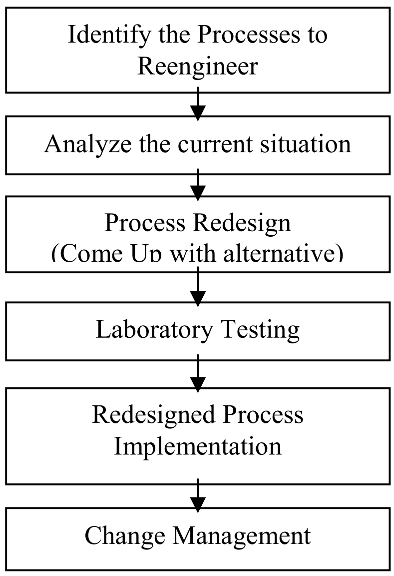

Figura 1. Steps in Business Process Reengineering

Figure 1 explains the steps involved in business process reengineering. For Business Process Reengineering, one should identify the processes in the organization to be reengineered. The outcomes expected from business process reengineering can be increase in profits, reduction in costs, improvement in quality, service or increment in turn around time, etc. There should be reengineering team assigned for this business process reengineering assignment purposes. Definitely there should be commitment from the top management such as CEO and COO for this business process reengineering purpose.

Reengineering efforts are to be supported by the senior management in the organization. The process owner and reengineering team work on reengineering of each identified processes of the organization.

During this reengineering time, the top management should be committed to the BPR efforts in the organization. Top management commitment is explained in the next paragraph.

3. Top Management Commitment

Definitely top management like CEO, COO should have commitment over these reengineering efforts. They should dedicate resources and time for reengineering efforts. First of all, top management should assess their situation and the organization's situation, and they should come up with whether they are ready for reengineering or not at this point in time. Once they are ready, the top management should identify the reengineering team. The reengineering team after situational appraisal comes up with to be reengineered processes in the organization. Identification of processes is the important step in a business process reengineering assignment.

The role of top management in reengineering efforts of the organization is very much significant and has got lot of importance. The reengineering team efforts and their role are explained in the next paragraph.

4. Reengineering Team

The top management has to identify the reengineering team. In some of the organizations, a member of senior management may head the reengineering team. The reengineering experts report to this senior management member. In some of the organizations, reengineering teams form as committees and directly report to the CEO or head of process reengineering. In some of the organizations, reengineering team consists of only external BPR consultants. Some of the organizations have VP and Director level positions for business process reengineering experts.

Reengineering team is responsible for identification of processes and redesign of the processes. The employees of the organization must be part of the process implementation stage. Next, we will see the skills required for the business process reengineer.

Skills Required for Reengineer

According to the Hammer, M. and Stanton, S.A. (1995), the business process reengineer should have the following profile.

- Process–orientation;
- Holistic Perspective;
- Creativity;
- Restlessness;
- Enthusiasm;
- Optimism;
- Persistence;
- Tact;
- Team Player;
- Communication Skills.

These skills of reengineer leads to the successful execution of business process reengineering assignments. In the next section, we will see how the BPR team communicates with the stakeholders.

5. Communicating to the Team

The Reengineer in the reengineering team should have good communication skills because he has to sell his ideas and the processes he redesigned to the outer world. That is the reengineer should communicate his work and redesigned processes to the employees of the organization for implementation purposes. This requires strong communication skills from the reengineer side. Because while communicating the designed processes to the other employees of the organization, it may face resistance to change the employees, because of various reasons. Hence the reengineer has to deal with these issues with care and diligence.

While communicating with the employees of the organization, the reengineering team should keep in mind that the communication should be clear and unambiguous. They should make their point clear to the process implementation team. Here they should take into consideration of human factors and soft issues while dealing with people. They should make it clear that the BPR is not about downsizing and layoffs or reducing head count. It is about process improvement and reducing cycle time, reducing turn around time and improving profits. This should be communicated to the employees of the organization while BPR assignment is going on. Otherwise the BPR team will face resistance from the employees.

The reengineering team should be able to respond to the employees' queries and should able to do proper transition once process reengineering is over. In the next section, we will see how to hire an external consultant for BPR assignments.

5.1. Hiring a Consultant

Usually to have a macro view of the business operations, organizations hire external management consultants for business process reengineering assignments. There are many factors, which needs to be taken care while hiring an external consultant for BPR assignments. The experience level of the consultant, domain expertise, knowledge and awareness of BPR of the consultant play vital role in selecting the consultant for BPR assignments.

Small firms may go for independent individual BPR consultants and the big firms may hire big consulting companies for business process reengineering assignments. There are examples of AT & T, American Express, Texas Instruments, and EDS, which have successfully implemented business process reengineering in their organizations. Process redesign is explained in the next section.

5.2. Process Redesign

Usually, once the reengineer studies the current processes in the organization, he comes up with the alternative ways of doing things, which result into profitability, or cost reduction, or improved quality or improved services. These new processes or redesigned process needs to be tested in the laboratory before making them public. That is the new processes needs to be tested in a simulated environment before they are implemented in the actual business situation.

There are a few companies, which failed at business process reengineering. However these companies are very less in percentage. There can be many reasons for the failure of BPR in the organizations. Many be they have not identified the processes correctly to reengineer. Or they spent most of the time on planning rather than executing. Lack of commitment from top management can be another reason for the failure of business process reengineering in the organization. Or they did not have experienced BPR consultant. Or they did not choose the right consultant. These are some of the reasons for the failure of business process reengineering in organizations.

Hence, one should study the current processes in place in the organization before going for redesigning the processes. They should identify right processes to reengineer. And then go ahead with reengineering. Then communicate the results to the employees for implementation purposes. In the next section, we will see the role of IT in business process implementation.

6. The Role of IT in Business Process Implementation

Now the IT comes into picture in the process implementation stage. For example, in case of automobile manufactures, they used to have design centres in one location and manufacturing centres in another location and marketing offices in another location. In this scenario, once the marketing executive takes the requirements from the customer, he has to send them by surface mail to the design centre. The design centre drafts are sent through surface mail to the manufacturing plant. This used to take several weeks, before the product comes out of the plant. With the advent of IT and communications technology, this is possible to roll out the product in days time in current days. The marketing executive gathers the requirements and sends them to the design centre through Internet. Then the design centre sends the designs through Internet or email to the manufacturing plant. Some of the companies even went ahead and developed distributed systems and databases using data and voice communication systems. Like this the turn around time can be reduced using information technology.

The output of process reengineering assignment becomes input to the IT implementation team. It is better to have IT experts in process implementation stage in BPR assignments. As explained in the above example, the IT is reducing the cycle time in attending to the customer requests.

Following are the advantages we get if we use IT in combination with BPR.

- Information Technology can be used to reduce the turn around time, which was taking long time using manual approaches
- Less chance for fraud
- Less chance for corruption
- More accuracy and precision assured, if the IT systems are implemented properly
- More quantity of work (reports) in less time
- Good quality of work results, services or products
- Quick communication in the team
- Faster communication with customer and other stakeholders
- Efficient progress tracking with IT tools

To get all these benefits out of IT and BPR combination, the team and employees of the organization are properly trained in IT applications and related technologies.

Once business process reengineering is over in the organization, the redesigned processes of the organization are to be implemented in the systems. There are two ways to implement them. That is either manual or automation. It is better to automate if the work is complex and needs accuracy. Payroll maintenance in organizations is an example of automation activities.

Once processes are identified to automate, the Information Technologies such as hardware, software and tools can be used in implementing the activities of processes. This part of IT implementation will be taken care by the IT project managers and project leaders. Programmers, database experts, application specialists, test engineers and quality experts are part of the information technology systems implementation. Once these IT systems are ready they will be given to the actual users and the employees of the organization. The team, which implemented the IT systems, should provide the necessary training to the users and the employees of the organization. Project management tools, database technologies, and data and voice communication technologies, networking technologies, e-commerce and web technologies can be used in implementing IT systems.

7. Conclusion

It is evident that the combination of IT and BPR results into reliable systems in the organizations. We have discussed the business process, business process reengineering, role of top management, the role of process reengineering team, and skills required for process reengineer. The factors we need to take into consideration while taking a process-reengineering consultant are also discussed. We have also discussed the advantages of the combination of IT and business process reengineering in modern day organizations. This combination is good for the benefit of customer, organization, employees and the stakeholders.

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General Considerations Regarding the Reserves and Consumption of Energetic Resources

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Abstract: The knowledge of the processes of economic and social development ensues without a doubt the study and understanding of the market mechanisms, of the market in general, in all the functions it has been known to play throughout the history in the life of peoples, but especially in that of mechanism which manages the adjustment and auto-adjustment of the economic processes. Generally speaking, the market is perceived as a meeting place, more or less abstract, where the offer of the sellers and the customers' demand meet. The first being the manifestation form of the production in the conditions of the exchange economy, the second expressing the solvent human needs accompanied by the people's capacity to buy the offered merchandise, if convenient.

Keywords: Reserves; Consumption; Energetic Resources

JEL Classification: Q00; Q51; Q57

1. Introduction

On the market there are numerous interwoven economic flows, the first one being the raw materials and energy flow, and then the merchandise and services flow. "The market- affirms M. Didier- is constructed as an ensemble of means of communication through which the sellers and buyers transmit information to each other regarding what their needs are, what prices they charge or propose in order for the transaction between them to be concluded”.

In normal conditions, the market cannot exist in the absence of competition, which actually represents its essential characteristic. Competition means confrontation, the economic rivalry between those taking part in the processes of the market. The completion must be an open, loyal confrontation. Otherwise the result could be the destruction of the market, of its mechanism, the transformation of the market into something formal.

2. The Energetic Resources Market

Competition and competitive mechanisms differ from a stage to another, from a country to another, depending on various factor and conditions:

- The number and size of the sellers and buyers;
- The product’s degree of specialization/differentiation;
- The market’s degree of transparency;
- The mobility or steadiness of prices;
- The level of economic development;
- The actual national and international political situation;
- The economic culture of the population, of different economic factors, etc.

Taking all these conditions into consideration, every producer strives to satisfy a certain amount/volume of demand in the market. Thereby the market has become the principal economic and social mechanism used in the orientation of the economic agents and the allocation of the resources in the development process.

A special type of market is the natural resources market. Its study implies a more thorough analysis based on the following factors:

- The requirements of the economic growth;
- The future potential offered by the environmental factors;
- The scientific and technologic progress and demographic evolution;
- The reduction rhythm of specific consumption, etc.

M. Didier asserts that “Natural factors are given by the universe: land, minerals, oil, space. Natural factors are not free of charge, they must be exploited. But their primary state of existence in which human beings are not included in any way, allows the conception of any industrial process and the implementation of all utilities; all these things would be impossible to achieve without natural resources.”

The analysis of the natural resources at micro and macroeconomic level has focused especially on their deficient character and, in that sense; many methodological concepts have been connected to solving the problems of the resources' allocation. Thereby, there exists a shortage of resources, on one hand, because of the rising demand in the offer-demand relationship on the market and, on the other hand, because of the layout in which these raw materials are distributed in the production process. Therefore, natural resources appear to be deficient because the production factors which are needed for the production processes are not available in an unlimited manner during the production process.

The deficient character of the natural resources on the market is slowly weakening in time with the economic development and technical progress which contributes to the economic growth. However, the spontaneous action of the demand and offer on the resources' market, with the target of maximizing profits, does not lead to the protection of natural resources or the avoidance of their rapid depletion. In that sense there are some aspects that need to be clarified:

- A better understanding of the relation which exists between the natural resources reserves and the production of raw materials and energy, and between the production of raw materials and energy and the economic development level of countries;
- The extension of commercial import-export relations in the field of energetic resources and raw materials needed for the balance of the intern demand;
- The use on a large scale of the alternative sources of energy;
- The need for a change in the energy base structure and the need for raw mineral materials.

In the conditions of the present pronounced development of the civilization, energetic has become a vital factor of the economy.

Energetic plays an essential role in the socio-economic development of countries, in the acceleration of the technical progress and in the civilization, determining economic specializations and diversification of human activities.

The energetic industry is a basic branch of the economy and covers exploration, exploitation and usage of energy sources.

In relation with the energetic industry's development is the development of all the other branches of an economy, and most times the energetic industry outruns the other branches.

The level of industrialization and the living standard are usually connected to the energy consumption.

As a consequence of the society's development, the production and usage of energy are rising at an alarming pace. Therefore, during the Energy World Conference from 1989 it has been concluded that until 2020 the energy consumption will rise with 75%.

The resources used in the energetic industry are both exhaustible and inexhaustible. The consumption of the exhaustible resources must be exploited and used attentively, because the opportunities offered by the earth for the future are limited.

The resources which are found at the basic level of the energetic industry can be divided into the following 2 categories:

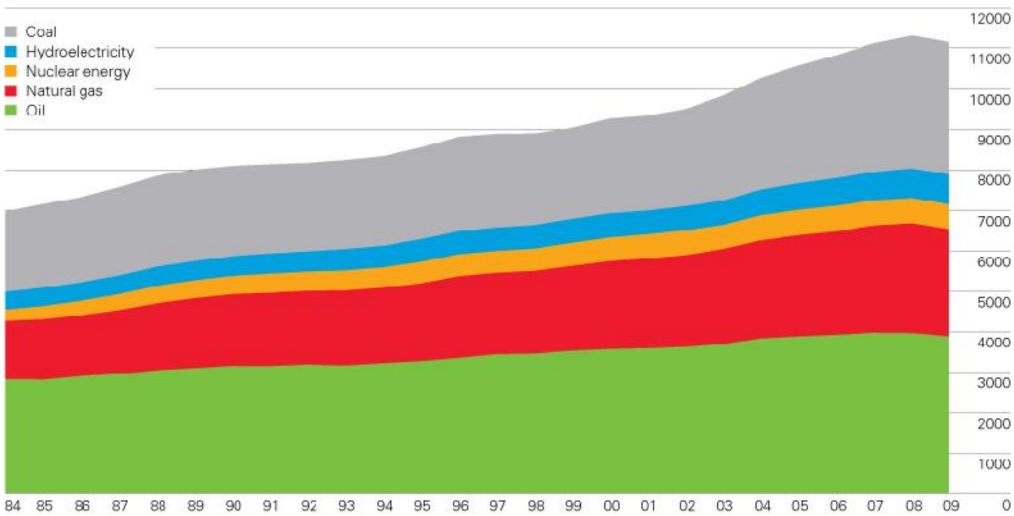
- Conventional resources – wood, coal, oil, natural gas, nuclear fuel, running water, etc.
- Unconventional resources – solar energy, geothermal energy, ocean's energy, biomass, etc.

In the energetic balance, the exhaustible resources still have an important role, some because they are the result of natural processes which happened at a geological time scale, others like wood because they are renewable. Unfortunately today's abusive rhythm of exploitation may outrun the biological rhythm of regeneration.

Changes in the world energetic equilibrium mirror the general trends of development in the energetic industry, but how these trends manifest themselves can vary from region to region, from country to country. The energetic balance of each country has its specificity, determined by the degree of economic development and the access to different energetic resources.

World consumption

Million tones oil equivalent



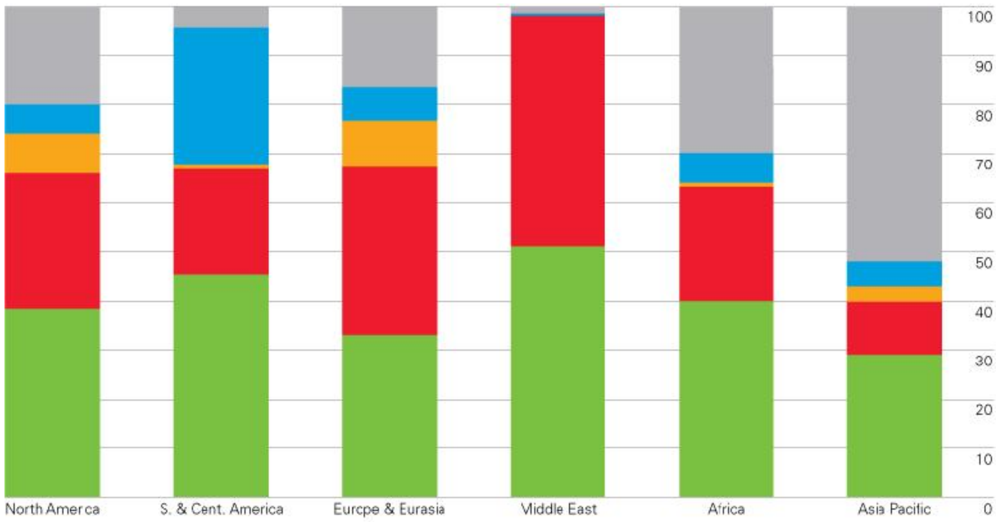
Source: BP Statistical Review of World Energy

World primary energy consumption fell by 1.1% in 2009, the first decline since 1982. Consumption was weaker than average in all regions. While oil remains the leading fuel (accounting for 34.8% of global primary energy consumption), it continues to lose market share. Coal's share of global energy consumption was the highest since 1970.

The oil crisis also triggered by the immoderate consumption of hydrocarbons determined the need for a re-analysis of the production-consumption relationship, entailed a more thorough examination of the nuclear resources, the energetic unconventional resources and the integration of these resources in as big a percentage as possible in the energetic balance.

Regional consumption pattern 2009

Percentage



Source: BP Statistical Review

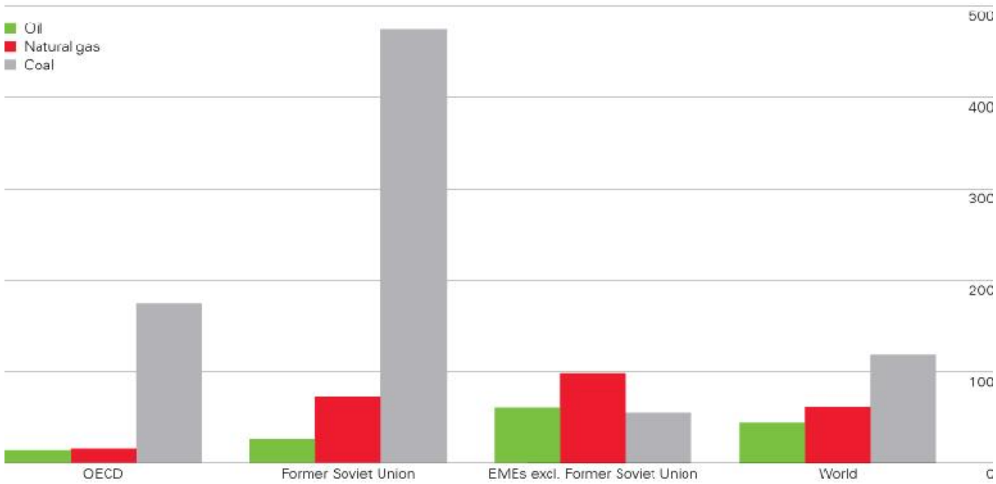
Oil remains the world's dominant fuel, although it has lost market share over the past decade- globally and in every region. Natural gas has the leading market share in Europe and Eurasia, while coal is the dominant fuel in Asia Pacific. Regionally, oil and natural gas have the highest market shares in the Middle East; coal in Asia Pacific; and nuclear and hydro in Europe and Eurasia.

This stacked column bar chart shows percentage energy type composition of global regions. The regions represented North America, South and Central America, Europe and Eurasia, Middle East, Africa and Asia Pacific, each show the prevalence of most used energy types.

Oil comprises between 29% (Asia Pacific) and 51% (Middle East) of fuel across each region with natural gas the second most used fuel with highest usage in the Middle East 48% and the lowest in the Asia Pacific with 11%. Asia Pacific has the highest consumption of coal with 52% of its consumption. South & Central America are the largest consumers of hydroelectricity with 28% and Europe & Eurasia are the largest consumers of nuclear energy with 10%.

Fossil fuel reserves-to-production (R/P) ratios at end 2009

Years



Source: BP Statistical Review

While coal remains the world's most abundant fossil fuel, with an R/P ratio of 119 years, proved reserves of oil and natural gas increased in 2009 and have tended to rise over time. OECD countries account for less than 10% of global proved reserves for oil and natural gas, but 42.6% of proved coal reserves.

This bar chart shows fossil fuel ratios at the end of 2009 in years for the OECD, Former Soviet Union (FSU), Emerging Market Economies (EME's) exclusive of the FSU and the world. In all areas except EME's coal has the highest R/P ratio. For the OECD coal's R/P ratio is 173.7 years, gas 14.8 years, oil 13.5 years. In the FSU the coal R/P ratio is 473.5 years, gas 72.4 years and oil 26.2 years. For EME's the gas R/P ratio is 97.6 years, coal 55.9 years and oil 60.2 years. For the world, coal's R/P ratio is 119 years, gas 60.6 years and oil 44.4 years.

3. Conclusions

In conclusion, it can be stated that the market of natural resources can be characterized by:

- Limited number of producers (sellers), number that varies from one type of resource to another or because of the uneven distribution of natural resources, fact that underlines a comparative advantage in the international relationships for the countries that own energetic reserves;
- Because of the uneven natural potential of countries, the market of natural resources shows the features of a monopolistic one (or oligopolistic), with all the advantages and disadvantages this type of market can present: the establishment of the extraction rhythms, the alignment of prices, the restriction of exported quantities, etc.
- The offer in the case of natural resources is limited while the demand is greater, especially from the number of buyers' point of view.
- Depending on the level of development of each country the following situations are possible: the intern demand can be greater than the offer, in which case the import of energetic resources or raw materials is necessary; the intern demand is smaller than the offer (in the case of underdeveloped countries that have large reserves of resources), a fact that determines the export of energetic and mineral resources, etc.

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Romanian Health Care Reform in the Context of Economic Crisis

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Abstract: The effects of financial crisis are strongly felt in Romania, which already face with a significant slowdown in economic growth or even economic recession. The current and international situation remains still difficult, and requires high budget constraints. Under these conditions, the health system in Romania has become one of the most inefficient in Europe, mainly characterized by lack of transparency in the allocation of funds and inefficiency in resource use. The lack of clear and coherent criteria to evaluate the performance of health institutions results in a difficult implementation of efficient managerial systems to reward the efficient manager.

Keywords: health systems; health economics; public management; financing

JEL Classification: A12; I10; I18

1 "Chronic" Problems of Health in Romania

Romanian health system continues to rely on hospital care as the primary method of intervention, Romania registered one of the highest rates of hospitalization from the European Union and one of the highest in the world. The access to medicines, especially for disadvantaged groups remains a perpetual problem for patients, drugs offset depletion in the early days of the month came to be regarded as a quasi-normal situation, as happens at many hospitals and otherwise. In this context it is not surprising that although the financial efforts of the Romanian state have increased considerably in 2004-2008, the feeling of deprivation in the system continues to persist and to worsen (Vlădescu, 2008).

Romanian health-care system is vulnerable through lack of transparency, monitoring and control of expenditure incurred. Funding continues to be inappropriate and be used in an inefficient way, the health financing system in Romania remains low in a European context, especially taking into account the long period of “chronic” under-financing and lack of investment in health. Besides under-financing, we can speak about arbitrary use of resources: allocation of resources between different regions, between different types of health services, between different health care institutions is inefficient and inequitable. Cost-efficiency studies are missing or are not used for resource allocation; the allocation process is not transparent, clear criteria are missing or not constantly used. (Vlădescu, 2008)

Romania's health system is one of the most inefficient in Europe and is characterized mainly by lack of transparency in the allocation of funds and inefficiency in resource use. The management, an area crucial to the effectiveness of hospital care can be succinctly characterized by confusion and inconsistency of all health ministers since 1989 which have claimed this area as a priority, but, in their final mandate, the situation was practically unchanged. Hospital management is often characterized by confusion and incoherence. The legislation does not provide the hospital managers with the required power or authority to organize and manage resources efficiently. The managerial deficiencies, adding frequently to deficient funding, conduct to the situation when hospitals confront with stock-outs of consumables or even medicines and request patients to bring their own items that they need. The extremely low role attributed to local authorities in hospital administration explains the low support that local authorities provide in their turn; the local funds are extremely low in the hospitals total budget (Vlădescu, 2010).

Experience gained by the public managers in developed countries, the results and satisfying the public interest by considering the economic and managerial criteria is clear evidence that performance-based management is the perfect option for the public system in Romania. The health system in our country, does not apply any of the criteria based on performance management. Economic criteria, social and managerial base that should be efficiency, effectiveness, performance, actually results in a single overriding concept - economy (in the sense of inexpensive) - saving all resources regardless of consequences. Reducing at the tolerable limit of expenditure in the health system generates serious consequences: lack of medicines and sanitary materials needed to operation and to provide medical services, limiting or even banning of investments of any kind, limiting employment even whether health unit needs staff, prohibiting any increase in wages or salary supplements granted for outstanding results. Thus, a manager of public health institutions (such as tertiary credit holder) cannot exercise its powers, cannot make decisions for the purposes of performance; he is limited to execute decisions of the primary credit holders and to maintain public activity as constant as possible from existing resources.

2 The Current State of the Romanian Health System

The recent deterioration of performances in Romanian health system is due to underfunding and lack of consistent reforms, but also by the opaque and unexpected decisions of medicines pricing, higher taxation and distorted allocation of funds. These are the conclusions drawn by numerous statistical studies of companies in health economics research, nationally and internationally.

The most representative indicator of health systems is the Euro Health Consumer Index. EHCI has become a standard measurement of health systems in Europe, which include 33 countries and 38 healthcare performance sub-indicators divided into six key areas: "Patient rights and access to information", "E-health", "Waiting times for regular treatment", "Outcomes", "Range and reach of services" and "Access to pharmaceuticals". First published in 2005, the Index is a compilation from public statistics, polls and independent research conducted by the founders - analysis company "Health Consumer Powerhouse" in Brussels.

We witness with concern at the rapid deterioration of the Romanian health system performance, a phenomenon which culminated in 2009 with Romania's demotion on the penultimate place: according to 2009 report, the annual benchmarking of health systems in Europe has ranked Romania at penultimate place of 33 European countries. Romania cannot boast even with basic rights of patients or E-health, slightly improved categories; and about the results cannot even speak. The only country worse than Romania is ranked Bulgaria, the two new EU Member States, and it is surpassed by Albania, Croatia and Macedonia[1]. "*Romania has, unfortunately, poor scores in most areas of health*" says Dr. Arne Björnberg, Research Director of EHCI. "*It appears that informal payments from patients are still expected a serious problem and an obstacle to achieving a health system based on fairness"*. The ranking for 2009 emphasizes that winning states (Netherlands, Denmark, Iceland) are beginning to use information health and choice to involve patients in decision making, building a bottom-up process to improve performance. At the bottom of the league is a group of countries (Latvia, Romania, Bulgaria) blocked the old health system, hierarchical and lacking transparency. This difference poses a challenge for the principles of fairness and solidarity of the European Union.

We believe that the main cause for which our country has come in this situation is insufficient and inefficient allocation of financial resources for health. After nine years of continuous growth, the budget allocation for health has declined sharply since 2009 to an alarming percentage of only 3.2% of GDP, which is half the

[1] Health Consumer Powerhouse, Euro Health Consumer Index 2009 Report, available on site - http://www.healthpowerhouse.com/files/Report%20EHCI%202009%20091005%20final%20with%20cover.pdf

European minimum level and is so far from the European average of 8 %, and the government target set at 6%.

An analysis of health and pharmaceutical policy in Romania, conducted by the Romanian Academic Society (SAR) in November 2009 entitled "*Is Health Falling into a Coma?"*[1] reveals that the Romanian health budget in 2009 fell by almost 20% over last year and the budget 2010 is 25% lower than 2009. The result analysis shows that the Romanian system of public health is really underfinanced, beyond any other discussions, taking occidental standards into account (where 8-10% of GDP is allotted to health field) and the fact that our health indicators are much worse than other European countries, not only from EU. Theoretically, the Romanian health system has been developed as an occidental type, and the citizen's expectations follow the same track; or, it is impossible to make it work with third world country level of resources. For instance, in 2007 we used to spend under $ 500 PPP (purchasing price parity) - the least per capita for health out of all of Europe, except for Albania, to Norway ranked first with over $ 4.500 PPP (see Fig. 1).

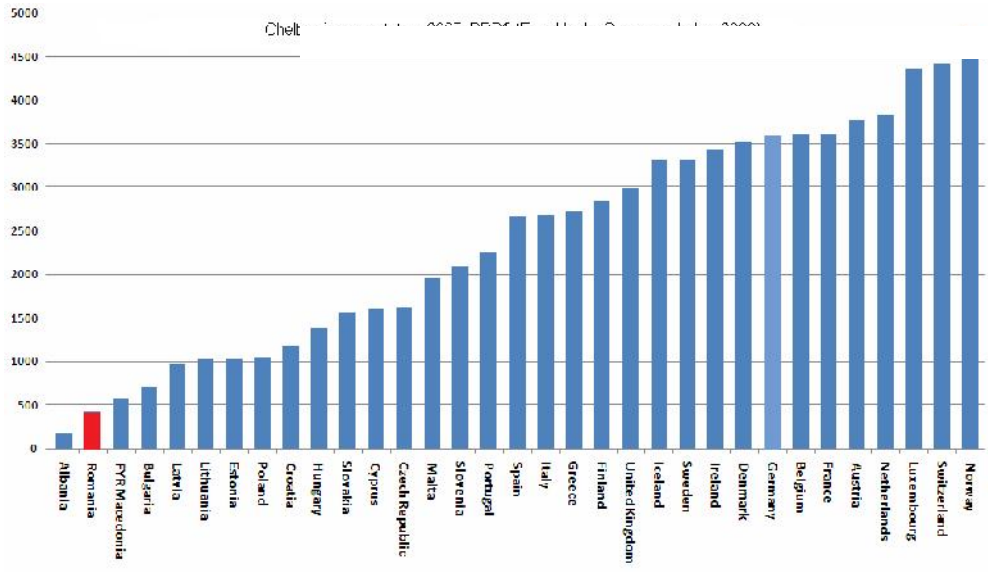

Figure 1. Total health costs in 2007, $ at PPP

Source: The Romanian Academic Society (SAR) in November 2009

[1] http://www.sar.org.ro/art/publicatii_sar/policy_briefs/intra_sanatatea_romaneasca_in_coma_-412-ro.html

3 Models for Financing and Providing Health Services

Until the advent of Law no. 145/1997 on health insurance, the health care system was centrally coordinated by the Ministry of Health through county health departments, consisting of a network of hospitals, clinics, dispensaries and other health care facilities. In addition, there were a number of hospitals, institutes and highly specialized national centres directly under the Ministry of Health, and parallel medical networks subordinated to the Ministry of Transport, Ministry of National Defence, Ministry of Interior, Ministry of Labour and Social Affairs and the Romanian Intelligence Service, which provide medical services and were responsible for health care for a particular category of people[1].

In the period 1990-1998, we used a two-tier system of the type of state budget financing, additional financing - health fund (GO no. 22/1992) and external financing - loans from World Bank (Law no. 79/1991), Phare funds and donations. The beginning of health reform involved the reorganization of health care financing system and health services. Organisational principles of the health system was significantly improved, by the free access to medical services, medical care paid for, national coverage, the transfer of responsibilities - county health departments, the Romanian College of Physicians, free choice of doctor, the emergence of the concept of family physician and emergence of the private sector.

In July 1997, Romania introduced a new health insurance system by Law no. 145 on health insurance, based on a modified version of the Bismarck-type insurance model, with compulsory health insurance based on the principle of solidarity and operating under a decentralized system. It entered into force on January 1, 1999 but there was a transition period in 1998 when the county health departments and the Ministry of Health has administered insurance funds. Accordingly, from 1 January 1999, according to the law, health insurance houses worked as a autonomous public institutions. Among the novelties introduced by Law 145/1997 on health insurance, first act which introduced the social health insurance principles, include:

- mandatory coverage of the population in a unitary system of social protection;
- free choice of doctor, health-care unit and health insurance house;
- provide a defined package of health services;
- funding through contributions and state subsidies;
- financial balance;
- decentralized operation;
- solidarity and subsidiarity in the collection and use of funds;
- fairness and accessibility in providing medical services.

[1] *National Health Insurance House (Romania), http://www.cnas.ro/despre-noi/scurt-istoric*

Since 2002, Law no. 145 on health insurance was repealed by GEO no. 150/2002 regarding the organization and functioning of health insurance system. Only in 2006 the health insurance system begins to prepare for substantial changes: the start of health reform in Romania - *the health, as a major objective social interest* - was given by Law no. 95/2006 on healthcare reform.

In all developed countries, insurance and health promotion is the responsibility of the state through its authorities. In Romania, taking several years ago policy decision of profound and sustainable change of health system, namely health care reform, it must be translated into practice, with the ultimate goal of population health improvement. In his "personal vision", Prof. Dr. Armean Petru establishes the main objectives of health reform in Romania:

- *general accessibility to health services;*
- *equity in service delivery, depending on the needs and expectations population;*
- *quality health care;*
- *increased efficiency in public spending;*
- *allocation of resources at national and regional levels*.

To achieve its goals, health policy must be uniform and multisectoral integrated, with the following strategic priorities (Armean, April 2010):

- health promotion and disease prevention;
- development of health care services;
- development of rural healthcare and for the elderly;
- development of social services and preventive medical care;
- reducing avoidable deaths, given the fact that in Romania, 15% of the deaths fall into this category, but currently are not avoided;
- influence major risk factors for health.

Health insurance is a key objective of a health system. Achieving a high level of health and equal distribution of healthcare services is an important goal of it. Each country's health system must involve respect for the individual (privacy and autonomy) and the orientation of the patient through responsive and quality amenities, so to meet people's expectations (Bârliba & Siniţchi 2008).

Health systems are defined by the dominant mode of funding, and those used in Europe are:

- ➢ The national health service - Beveridge type;
- ➢ The system of compulsory social health insurance - Bismarck type;
- ➢ The centralized system of health insurance - Semashko type;
- ➢ The private health insurance system.

A comparative analysis of the characteristics, operation, advantages and disadvantages of international health insurance systems is presented in the table. 1, in an adaptation of Bârliba & Siniţchi, 2008. It is noted in the comparative study, that world states grants priority for their health services, to one or other of the objective, depending on strategy, economic, social and ideological factors, and sacrificing other qualities of the system: either be granted universal and equal access to a specific package of medical services, either be more pronounced freedom is exercised options for beneficiaries and providers, either becomes paramount efficient use of available resources and limited. If, for example, they choose for a high freedom of choice of the beneficiaries, then the costs will be high and there is a restriction of accessibility to health services because not all patients can incur high costs. This system which stresses freedom of choice is common in the U.S., where, although the state is investing enormous health (14% of GDP, as opposed to 3.2 ÷ 4% in Romania), there are over 35 million citizens who do not have insurance and not receiving medical services (Doboş, 2006). U.S. health system is the most expensive in the world, but also the least efficient among the six major industrialized countries, said economists, authors of a study published by the Institute for Independent Studies "Commonwealth Fund". (Davis, Schoen, & Schoenbaum, May 2007) The study compares the health systems in Australia, Canada, Germany, New Zealand, UK and USA. "*U.S. health experts often assert that the U.S. system is best in the world without scientific evidence to that effect /.../ Americans looks at their mirror image, without including international comparison*" says the study's authors. In terms of quality, access, efficiency, equity and the results, the American health care system ranks last in every time between the six countries. Germany is ranked first place for access and quality health care, while Great Britain is also the first place to the criteria of equity in medical access and effectiveness of health-care.

Another type is the British model, there is increased access to health care, fairness, but accompanied by a limitation of options and of freedom choice (Tomescu, 2009). In contrast, the British system is the least expensive in the EU, but options are limited and there are long lists of waiting. Over one million patients are on waiting lists for various interventions (Vlădescu, 2004). The growth in health spending is remarkably moderate compared with trends observed in most Member States. The level of funding of UK health care, subjected to a rigorous central budgetary control, is still subject to further public and political debate. The criticism is powered especially by the scarce resources for secondary care, which appears as one of the main causes of long waiting lists in hospitals. The problem of waiting lists explains the relatively mediocre level of satisfaction with their British health system. With rare exceptions, the system works correctly for serious illnesses or emergencies, but less well for minor ailments (CNPV, 2009).

Concluding our analysis, we can say that health is considered a social right in Europe, to which all citizens should have access, unlike the U.S., where health is an individual item for which you must pay high costs.

In our country, has created a system of financing medical care consisting of public and private resources, based on equal opportunities for health services and ensuring equity in the issue of payments for services rendered. The health system in Romania is a modified revision of German Bismarck model - with compulsory health insurance based on the principle of solidarity and operating under a decentralized system - with influences from Semashko and Beveridge. The changes in recent years, in the medical services, did not solve the problems, the system at present is one hybrid, calling into question some health policy decisions on their long-term effectiveness. Following the operation of this hybrid system, some experts in the field was not considered necessary to pass the Romanian to health insurance system (Doboş, 2005). One of the reasons invoked by decision makers change was that the structure before 1989 was associated with centralized communist regime. But discontent and expectations were diffuse and they were not related to operating one way or another, but, obviously, by the poor quality of health services and doctors complaints were related to low wages and difficult working conditions in terms of lack of sanitary materials, facilities and utilities. Switching to the new financial scheme created, it seems, a new "mammoth" administrative, annual consumption of significant additional financial resources (Doboş, 2008). An example is the National Health Insurance House with 235 employees and 42 county homes with an average of 50 persons/house, whose administrative efficiency reported costs is questionable.

Switching to the new system was done without a very clear analysis of the implications of various European models in the Romanian context, in the immediate time period '89 when Romania did not have trained too many specialists in the field of healthcare management or health policy. The precarious financial resources allocated to health sector in the period 1990-2007, continued weak investment trend in the health system of the last decades in Romania. This led to lack endowment of public hospitals, with modern medical equipment and utilities performance and providing of low wage to staff in the system, compared with their status. This was reflected directly on the quality of health care enjoyed by the population. Perception of medical staff on working conditions offered by the system and its social status, combined with dissatisfaction with the low wages, legitimizes according to medical staff, demanding extra payments for the provision of medical care. This limits poor population access to services, which demanding, in turn, as required, or rooted, the additional payment (Tomescu, 2009).

Unfortunately, current economic and financial crisis, the lack of real reforms and several years of underfunding have destroyed the Romanian health system. The powerful social character of the Romanian health allows for broad segments of the population to be included in the insurance system, without financial contribution from the person or another state body. Paradoxically, by the contributions of nearly 5 million payers, benefits, at least in theory - for free or compensated - about 21 million policyholders - potential patients. Thus, wife, husband or parents without their own income, who are dependents by a medical insured person, may have all the facilities it offers health insurance, as co-insured. Uninsured persons receive a minimum package of health services that includes medical-surgical emergencies to stabilize the patient, screening of potential endemic-epidemic diseases, family planning services. There are also certain categories of people without income or with incomes below the gross minimum wage for the country, receiving medical services without payment of contribution[1]: all children up to age 18, young people from 18 years up to age 26 years, if they are pupils or students, other categories of persons who receive gratuities by virtue of specific laws (revolutionaries, politically persecuted, war veterans, disabled persons, ill patients included in national health programs), people in leave for temporary incapacity to work following a work accident or occupational disease and persons in parental leave up to the age of 2 years, pregnant and postpartum women, pensioners for pension income up to the limit on income subject to tax, unemployed, detainees and remand prisoners, monarchical staff of recognized religions, etc.

In addition, the NHIH policy in Romania is only populist: it says gratuities everywhere, but financial limitation of these gratuities is the responsibility of medical providers (hospitals, pharmacies, medical offices, etc.) through the ceiling of compensated prescriptions / physician, the ceiling of number of admissions / hospital, the ceiling of drugs netted / pharmacy, the ceiling of number of medical tests / medical analysis laboratory (Păduraru, Radu & Pereţianu, 2000). Given the limited financial resources, therefore, have been found other ways, to limiting the number of services and hence, the costs: access to specialized services, generally more expensive, is permitted only with referral from general practitioners; laboratory investigations are allowed only correlated with diagnosis and can only be prescribed by some doctors, prescriptions compensated and free drugs are limited in number and value of drugs prescribed per prescription, etc. (Tomescu, 2009).

4 Conclusions

In light of the globalization trend, but amid the general crisis faced by most national health systems, we can say that radical reform measures are needed. In Romania it is necessary to develop a strategy based on four principles: equity, quality, accountability and focusing on patients / citizens, the principles which in fact were in varying degrees, assumed and accepted by all governments after 1990,

[1] Article 213 of Law no. 95 of 14 April 2006 on health care reform.

while being consistent with all agreements and documents to which Romania is a signatory.

It is crucial to look at expenditure on health, not only in the form of cost increases, but as an investment that will bring us future benefits - that social and economic value resulting from investment in health. Given these considerations, and current financial situation, it is necessary a continue and predictable growing of financial resources allocated to health, including the generalization of multi-annual budgets, which can lead to recovery the imbalances caused by decades of previous underfunding, compared with the rest of EU member countries. In the medium term, the gradual increase of the GDP allocated to health resources, through the multiannual budgetary cycles, should arrive by 2012 to 6% of GDP.

For increase the funds available, it should be rethought the current system of health contributions. It can consider using a method similar to that of private pensions: small percentages of the compulsory individual contribution to be redirected to a private health insurance system, along with a tax incentive scheme for those amounts.

It is also necessary to develop a system of allocating health resources based on transparent criteria and medical records. The essence of the health system must be level of service provided and not the level of funding. Therefore, the organization and financing should be made so as to ensure that funds are used in the most efficient way, to enable the provision of quality health services and appropriate patient needs. In other words, the level of funding is not only important but also, especially, how these resources are used. In allocating resources among different types of services should be considered especially those services that can contribute most, to reducing illness and decreasing avoidable death rate, with an emphasis on the allocation to primary care and preventive services and to promote health; it is vital to freeing up hospital care, intensive consuming financial resources.

On the other hand, currently, payment of most health services provided in the health sector in Romania do not take into account the performance of medical act, particularly at the level where occur most medical services (hospitals, for example). Both doctors and other medical staff are paid by salaries that take little account of the quantity and quality of medical services performed. These deficiencies should be eliminated by introducing and supporting payment mechanisms based only on efficiency and quality of medical act, and by stimulating and developing public-private partnerships, privatizations and private management in the public system.

Finally, the solution already put in place since August 2010 - organizational and decisional decentralization - is a solution for the Romanian health system reorganization. Recent events - decentralization (hospitals are subordinated to local authorities), liquidation of arrears in hospitals and for compensated and free drugs -

will lead to more efficient hospitals to stabilize the health system and will have a positive impact on environmental business in health. This will only happen if there will be a major change in the decision-making and accountability mechanisms so that decision can be taken as close to where they are provided and used health services. In this way, ensure a better match to the health needs of the population, along with direct accountability to those who take decisions in the community.

Table 1. Comparative Analysis of International Health Systems

Insurance system	Application	Features and operation mode	Advantages	Disadvantages
BEVERIDGE	• Denmark • Finland • Iceland • Norway • Sweden • Greece • Italy • Portugal • Spain • England	• source of funding through taxes, general tax (public budget) • government-controlled, government is the payer of health services • there is a private sector • access to services for all citizens • broad coverage of the population with health services • leadership by state authorities • use the role of "filter" principle-family doctors, elected freely by patients • physicians are salaried or paid by the number of patients enrolled on their lists (per capitation) • it is engaged a co-payment of part of the cost of medical services • budget (as total revenue) is split, divided by destinations, according to criteria of social importance (as education, health, defense, public order)	• positive impact on health • ensure universal coverage of population • a high degree of social equity • relatively un-onerous (not unbearable by population) • payment for services performed after administration of therapeutic act • risk groups have priority	• long waiting lists of payment for therapeutic acts and for certain categories of diseases and patients • medical staff has no incentive • high dose of bureaucracy
BISMARCK	• Austria • France • Netherlands • Germany • Belgium • Romania	• source of funding is contributions to health, which are binding on the employer and the employee • contributions are equal to a percentage set by law, but this reflected different at taxpayers in relation with real income received • share of the institution and the employee's participation is dependent on the executive policy and economic potential (additional resources) • insurance contributions are collected and managed by Health House, an independent institution of government, that select models of health service delivery, payment models, contracts with hospitals, clinics, surgeries • health policies are set by the executive with the Ministry of Health and Insurance Houses • broad coverage, but not total (remaining uninsured persons who do not work) • contracts with healthcare providers based on tax per service, tax per prestation, tax per case solved	• relatively high medical performance • funds transferred, custom stable • visible cash flows on the components of the system • making effective and appropriate service delivery • health programs consistent with the public policy • Insurance House has an operational independence in relation to the executive • combining "good risks" to "bad risks" • health services allocated according to needs • remove tests • supports the rights of policyholders	• high administrative costs (the largest in Europe) • generates a high induced consum, with the possibility of emergence phenomena 'perverse', such as moral risk (in a service whose price is zero, demand always exceeds supply) or "adverse selection" (expensive groups insurance are denied due to expensive high volume of consumption or the high cost of services) • health services are for the insured persons and for disadvantaged groups • cost control for medical services, with a difficult execution
SEMASKO	• countries that had a centralized economic system in Central and Eastern Europe	• source of funding: taxes, general tax, which forms the state budget • the state has a monopoly on health services, which are its property • the controlling of the sales process - purchasing of medical services is the territorial level through centralized planning and execution in stages • medical employed staff (civil servants) • people's access to health services is generally free and seems erroneously (in the sense that is not paid by patient) • there is no private sector • medical staff do not obtain additional data through work	• general access to medical services	• lack of initiative and competition • doctors become public servants • reduced impact on health status • quality of treatment act is affected by insufficient funding (underfunded and ineffective) • competition is absent, so this system is underperformant

Insurance system	Application	Features and operation mode	Advantages	Disadvantages
PRIVATE	• USA - functional priority • Europe - voluntary, 20% of health insurance	• the patient, through the private insurance model, selects the institution, the service quality and includes a financial relationship patient - doctor • disadvantaged categories are covered by special programs	• emphasizes the freedom of options • high medical performance • efficient and quality services • cover all categories of medical services (proportional with insurance)	• health is an individual good for which must pay high costs • those with high risks of illness will be excluded from the system • those with presumptive risks will have input (adverse selection)

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General Consideration on Legal Tax Evasion *vs*. Tax Fraud

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Abstract: The article is a brief overview of tax evasion as a complex social and economic phenomenon, of utmost importance, that today's states confront with; its consequences seek to limit as much as possible, by legal and fiscal means, the eradication, which, at this point, is virtually impossible. Tax evasion can be analysed from two points of view, the legal and the illegal aspect of the phenomenon or the fiscal fraud. The "fiscal paradises" had a very important role in the last years' activity.

Keywords: tax evasion; fiscal paradises; eradication; international tax system

JEL Classification: K49; K34

1. The Evolution and the Situation of the International Tax System

Globalization means the union of different national economies within a unique economic world. This appears as a result of the increasing investment and commercial flux, of increasing the mobility of labour and fast increase of technological changes. Dereglementation of financial markets, reducing the investment and commercial barriers, as well as the decreasing costs for communication and transport, impulse these tendencies.

Even if the expression „international tax system" is not proper, because there is no inter/supranational institution to take care of the way the international tax authorities administrate the specific aspects of taxing their own taxing basis, we will be using this syntax, in order to identify the sum of the world's tax systems and the multitude of relations which appear between them notable, or less notable for the public.

In today's economic environment the high tax level is difficult to maintain. As the economic integration expands, the individuals and the companies gain more liberty to take advantage of foreign economic opportunities, this increasing the sensibility regarding the taxing level of the investments or localization decisions. Higher levels of taxation cause great economic losses in terms of capital mobility, and the international tax competition becomes more and more harsh, while the mobility of labour and capital increases.

In the last years, most of the developed countries had as goal the tax reformation in order to ensure themselves that their economies remain attractive for foreign investments. In the industrialized countries of the Organization for Development and Economic Cooperation (OCDE), the medium tax per income (the maximal quotation) decreased with 20% since 1980, and the medium tax per profit (the national maximal quotation) decreased with 6% only in the last 6 years. (Edwards & Rugi, 2002, p. 1)

2. The Beginning and the Evolution of the Modern Taxing Systems

The modern era started with a wave of reactions against taxing, which generated discontent when the growing costs of the war imposed rising taxes all around Europe, part of these actions had no success – as in Austria and Ireland – and others became historical turning points. The American war of independence was marked by the fight against customs taxes and contraband. In France, taxing was the one to put into light the conflict between the social classes, during the 1789 revolution, revolution marked by the customs robbery, burning the tax registers and the lower classes declaration that all the existing taxes are null and void.

The development of capitalism and liberal democracy did not mean the end of taxing, the first capitalist states reached the conclusion that taxes are necessary, but their mandatory character was in contradiction with the idea of free exchange. From that moment the taxation was a reason of greater discontent. For example, the Poujadist Movement in France in the 50's started in a village of the region Lot, as a protest against a preceptor's visit and represented a refusal of the all farmers and of the merchandisers to accept the taxes of a bureaucratic state, which they understood as being an ally with the tendency of lack of personality – in the historical conditions of the great stores and business birth, as well as of the great financial structures. This social movement concentrated on taxes, because they represent a pure expression of the absolute power of the state. (Mulgan&Murray, 1993, p. 3)

So, even in the most permissive democracies, the tension appeared surrounding the taxes legitimacy. The political intrigues surrounding this legitimacy, the way the revolts were led and the new compromises that were made, ensured the essence of the taxes' history.

Geoff Muigan and Robin Murray identify two historical transition moments. The first moment took place between the end of the XVIIIth and the beginning of the XIXth century, replaced an absolutist regime, with a capitalist one. In the absolutism, the taxes were paid, especially by the merchandisers and the poor. The nobles, and the church, the rich class of the cities were, largely, free of taxes, excepting periods of war. The economists and politicians of that time campaign against the privileges, arguing that every citizen should pay taxes, internal taxes should be lowered and income accumulation should be made from rents and fortune. With few exceptions, this was the program of the ministry of finance and of persons with economic views, but there was needed the revolution in France – and the fear of its spreading abroad – in order for this program to spread all around Europe.

The new order was characterized by five features: the end of privileges and feudal obligations, tax increase on the prime necessity goods (for example: salt) and increasing the addiction on the taxes on the liquor and tobacco, the opening towards the taxation of rents and fortunes, increasing the centralization of the public finance and of the decision or the national treasury expenditures, as well as subordination of the fiscal administration and of the public finances to the parliamentary control, through budget.

The second crucial moment took place in 1890, as an answer to the sudden expansion of public expenditure to the increase of working class movement. This implied the passing from a unique tax to progressive taxes, centred on a new role of the income tax. In Great Britain of the 17th and 19th century, as most of the states, the direct taxes were the bigger percentage from the collected taxes. The first income tax was temporary applied in 1799 and became permanent in 1842, but its efficiency was modest.

In other countries, things evolved a little faster than in Great Britain: the income tax was introduced in Sweden in 1861, in Italy in 1864, in Japan in 1867, and in many federal German states at the beginning of the 19th century. The progressivity principle was adopted by the conservative Prussia – in 1891, in liberal Belgium – in 1893, and in democratic America – in 1894 (before being declare unconstitutional by the Supreme Court).

Until the beginning of the First World War, the direct progressive taxes became standard.

In the 70's in the countries members of OCDE, the income tax and the contributions at the social insurance represented the majority of the income from taxes, and in many countries represented 2/3 of all the taxes. The countries, where industrialization was born later – Ireland, Spain, Portugal, Greece - quickly adopted the meaning of the income tax, and its importance in the total taxes.

3. Fiscal Paradises

The fiscal paradises play a key- role in the increase of capital movement and making new complex networks of transactions and interactions between states, multinational companies, very rich personas and simple individuals. In the last five years the controversial term fiscal paradise became financial offshore.

The fiscal paradises are territories that offer fiscal advantages to the offshore companies existing in those jurisdictions. If we make reference to the fiscal part of the strategy, favourable taxation may be realized only when the company that works in offshore regime is registered in a fiscal paradise. The offshore working regime is given by the development of the companies' affairs outside the territory of registration. This means that a company that works „offshore" may benefit from great advantages regarding its foreign operations, but may be treated (and taxed) as a resident company for the businesses developed within the jurisdiction of registration.

At the beginning of the 80's, the French Ministry of Finance asked for documentation paperwork over the fiscal paradises, materialized in the Gordon Report – published in 1983. According to the Gordon Report, „the fiscal paradise is any country which is considered as such and wants to be this way". The definitions given to the fiscal paradises are not entirely satisfying, we may propose the conceptual view belonging to Roger Brunet: „ It is called fiscal paradise a territory in which physical persons or firms have the sensation that are less taxed than somewhere else".

The existence of such fiscal alternatives became known in the international business right after the First World War. Since then, these special entities developed all over the world, being into a continuous evolution. In the actual economic context, characterized by an unseen rapidity of changes, becomes more and more difficult for a businessman to choose the most appropriate fiscal paradise.

Since 1980 the number of the offshore zones doubled, reaching from 30 to almost 60 territories. Many of them are territories dependent of the British crown, or ex British colonies, being in general within the area of influence of the great occidental financial powers.

The activities developed in these areas allow the increase of capital profit, but they have also powerful economical, political and social consequences upon other zones persons, inside some circles, the offshore zones are considered to be a threat to the global financial system because they allow a more flexible way of making the financial situations (because of the relaxed regulation), and the offshore banks are more vulnerable than the others in front of rate exchange risk and insolvability. (Errico & Musalem, 1994, p. 4)

Some experts say that the offshore zones undermined the national governments (sabotaging the intention of taxing the physical/juridical persons), stimulated money laundry and weakened the power of international organisms which supervises the fiscal system.

It is estimated that the accumulated value of the gains from taxing obtained by the almost 70 offshore jurisdictions in the world is approximately 200 billion/year. (Diamond, 2003, p. 93)

4. Legal Tax Evasion vs. Fiscal Fraud

4.1. „Legal" Tax Evasion.

The migration abroad of the tax payers in order to decrease taxes has two ways of approach. One of them characterizes a tax payer who intends to break the fiscal rules of the residence country, using the discretion of the fiscal paradises and the logistic difficulties found outside the country by the fiscal investigators. These transactions hidden in offshore are elements taxable by the fisc, but the people pay taxes hope that their inspectors will never be the truth. This is called fiscal fraud. Another approach regards a person who pays taxes, who, in a very intelligent way, uses all the existing inadvertences and breaches in the national fiscal system in order to legally decrease his fiscal obligations, this being called legal tax evasion.

We present as follows a classification of the transactions made in offshore areas:

1. The transactions without fiscal impact are transactions which have no impact over the paid tax in the residence state. For example, a bank could open a branch in a fiscal paradise in order to avoid the national bank's request regarding the making of the legal reserves. Another company could use a branch registered in a fiscal paradise to avoid the currency control imposed by the country where it makes business. A fiscal paradise may be used to reduce the expropriation risks which come along with business developed in most third world countries.

2. Transactions with fiscal impact, but in accordance with the law – some examples are:

- using the convenience pavilions in order to obtain fiscal benefits (avoiding direct and indirect taxes over the international naval activities);

- intra-group loan operations (which delay the taxes over the interests from the loans);
- transactions between the branches of different companies (created to avoid AVT and to make some transactions which takes advantage of the law's breaches).

3. Aggressive fiscal planning operations – these are transactions made to reduce the fiscal duties by "forcing" the vulnerable sections in the law. An example could be the foundation of a new company of services in a fiscal paradise to furnish services to another branch of the same company localized in a third country. A method used at large scale by the multinational companies is represented by the usage of transfer prices, consisting of distorting evaluation of some international transactions in the purpose of total/partial transfer in a fiscal paradise of the obtained profits in the high fiscal areas.

4. Fiscal fraud – is represented by actions of those who try by fraud by avoiding fiscal duties. This might generate, by the simple omission, to declare the obtained income or by trying to create fiscal deduction in excess.

Fiscal fraud may be, at its turn, divided into two categories:

- legal income tax evasion;
- illegal income tax evasion (ex. drugs traffic).

4.2. „Illegal" Tax Evasion (Fiscal Fraud)

Illegal tax evasion (fiscal fraud) refers to breaking directly the law, having as basis the international element, by making false transactions using firms with „ghost" character. Fiscal fraud means the infringement of the fiscal order, deliberately, in order to avoid taxation, correlated (most of the times) with inexact, incomplete information transmission, having the role to give to the author fiscal advantages.

As far as the „illegal" tax evasion is concerned, it may have the following forms:

1. developing activities generating undeclared income, unregistered and untaxed, by declaring lower income, or avoiding declaring some unit's income;
2. double fiscal evidences held by the contributor intending to hide the real income, and making fake declarations, falsifying the balance sheet, in order to falsify the results;
3. inclusion in the costs of some fake salary rights, this method having as main disadvantages the registration of the taxes as the firm's obligation towards the state;

4. Diminishing the WATT collected using the collecting actions with a fake character, not having as basis documents legally made for this purpose;
5. Foundation of new „ghost" firms(usually on foreign citizens names, very difficult to identify) which are used as a „curtain" to illegal commercial operations, the firms mentioned above not functioning at the mentioned centre (fake, most of the times) and being an important „provider" of illegal fiscal documents;
6. Transit commerce or temporary import doesn't impose custom tax payment, this offering the possibility of seal violation at the entrance custom point, selling the products on the countries' territory, and afterwards simulating their exit from the country.

The contraband, in its classic form, practiced at the customs points by introducing inside a country illegally of products as coffee, cigarettes, etc, facts that imply escaping from paying taxes (custom taxes, WATT).

In the most used way, the fiscal evasion is seen as a way of avoiding the fiscal laws, based on three action directions: promoting some fiscal favourable regimes based on numerous exonerations, fiscal facilities having as role to guide the contributor to tax evasion; applying some fiscal reglementation containing many gaps which interpretation may generate the phenomenon of tax evasion; not developing the operation which generates the taxing act, behaviour justified by an excessive fiscality, case in which the marginal rate of taxation becomes overwhelming, and the contributor prefers not to provide a supplementary working unit. Some economic phenomenon may transit from the illegal to legal area, depending on the options and decisions at political level. Practically, the operation of making a barrier between the „tolerated" tax evasion and tax fraud is not certain, and it's based on legal interpretation and law solutions.

5. Conclusions

The phenomenon of fighting against the forms of tax evasion has an increasing effect, usually, when the named ones to make the fiscal and fiscal control procedures, have established very diverse ways and means, realistic and efficient, well known being the fact that these forms of manifestation may have unexpected aspects. Neglecting the control of the tax evasion may lead to increasing the phenomenon until it gets to fiscal fraud or organized economical-financial crime. As well, the negative consequences of this phenomenon reflect upon the local and central budgetary balance, upon the stability of the national economies. In order to prevent and reduce the phenomenon of tax evasion we appreciate that the following factors should be taken into consideration:

- the systems of informing and assistance for the contributors' development, by specialized centres, organized within the territorial financial administrations;
- eliminating the overlaps of competences in the control actions, establishing, clearly, own objectives specific for each control organism;
- professional control activity, by perfecting the professional training and periodical examination of the personnel;
- establishing unique normative and procedures for each control activity;
- continuous perfecting of the f- in order to eliminate the present imperfections, as well as the fiscal procedure code - to ensure an equivalence between the contributors and the state's fiscal control organs;
- fiscality relaxation, specially at the level of fiscal obligations coming from salaries, taking into consideration the compulsions imposed by the international organisms regarding the drastic limitation of budgetary deficit;
- increasing the efficient collecting of taxation obligations.

Excessive taxation is the main reason for increasing the tax evasion, this, may be more than any other economic phenomenon, has a auto regenerative feature, meaning that, some firms avoidance of paying taxes leads inevitably to an increase of taxation, which, determines the „slipping" of more firms from the transparent economic zones to dark economy zones. In most cases this fact represents an affect of conservation instinct, a diminishing of the taxation basis taking place. The state authority must understand that only applying some drastic corrective measures cannot only by itself generate miraculous results in fighting against fiscal evasion, they must be sustained by removing the causes that generated it.

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Hotel Classification Systems: A Comparison of International Case Studies

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Abstract: Over the last few decades we have witnessed an increasing interest of scholars and especially operators in service quality in the lodging business. Firstly, it is important to observe that the diverseness of the hospitality industry also affects the classification of hotel quality. We can actually find many programmes, classifications and seals of quality promoted by public authorities and private companies that create confusion in the consumer perceptions of hotel quality. Moreover, new electronic distribution channels and their ratings are becoming a new way to gather information about a hotel and its quality. Secondly, a point that can cause complications is that different countries and regions can choose differing approaches depending on the features of the classification (number of levels, symbols used, etc.) and the nature of the programme (public, private). Considering these assumptions and the recent changes in the Italian hotel classification system, this paper aims to analyse the situation in Italy, underlining both its positive and negative aspects and comparing it with other European and North American cases. Based on a review of literature and tourism laws as well as personal interviews with public authorities and exponents of the private sectors, we were able to identify critical issues and trends in hotel classification systems. The comparison of case studies shows a heterogeneous situation. Points in common are the scale and the symbol used but, if we analyse the requirements of each category, we discover very different circumstances, also sometimes in the same country. A future European classification system could be possible only after a standardization of minimum requirements and criteria at a national level. In this situation brands and online consumers' feedbacks become even more considered by the customers in the hospitality industry.

Keywords: hotel classification; hotel quality; hospitality industry

JEL Classification: L80; L84; L83

1. Introduction

In the service sector, a customer's perception of service quality is the result of the comparison between expectations and experiences (Grönroos, 2000; Zeithaml et al., 2006). Research demonstrates that customer satisfaction is not linked to a specific quality category, but depends on the hotel's ability to meet customer expectations (Lopez Fernández et al., 2004). Even if research on this topic is scarce, a few studies demonstrate that the classification category in the hotel sector is an indicator of price rather than quality (Israeli and Uriely, 2000; Israeli, 2002, Danziger et al., 2004). From the customer point of view, price and stars category may be factors determining expectations (Israeli, 2002; Danziger et al. 2006). Therefore, when a customer pays a high price to go to a hotel of a high category is more demanding, has higher expectations and then his quality appraisal and satisfaction are influenced (Lopez Fernández and Serrano Bedia, 2005; Fernandez Barcalà et al., 2009; Davutyan, 2007). Moreover, hotel classification is generally producer-driven rather than customer-driven (Briggs et al., 2007).

What does it mean to be a 3 or 4-star hotel? How are these signs interpreted by consumers? And especially, can we reach a common understanding of these signs from an international point of view?

Reviewing case studies, literature and laws, and personal interviews with public authorities and exponents of the private sectors helped us to identify similarities, important characteristics and trends in hotel classification systems.

To start with, let us briefly describe the complexity of hotel quality programmes, which is influenced by the diverseness of the hotel sector in terms of supply and demand (Kotler et al., 2010). We can actually find many programmes, classifications and seals of quality promoted by public authorities and private companies that may create confusion regarding consumer perception of hotel quality. Different countries and regions can choose different approaches depending on the features of the classification system (number of levels, symbol used, etc.) and the nature of the programme (public, private). Moreover, new electronic distribution channels and their ratings have become a new way to gather information about a hotel and its quality.

One method of evaluating hotel quality is the creation of a ranking based on specific criteria and on the assignment of a symbol that certifies a quality category. The symbol and the scale used can vary from one country to another but the most commonly used are the star and the diamond, with a scale of 1 to 5. This kind of hotel quality classification is the main topic of this paper and will be analysed in depth in the following paragraphs.

We can find other associations that use a ranking system which assigns symbols to assure quality. For example, travel guides usually give customers information about the price and other general hotel features. The Forbes Travel Guide in the United States, for example, evaluates hotels using a star classification system. More than 550 criteria are verified by a mystery inspector who assigns a number of stars from 1 to 5. In Italy, the Touring Club Italiano, an association aimed at promoting and developing tourism, assigns stars to hotels on the basis of a 6-category scheme (from the “no star” level to the 5-star luxury level).

Another way to determine a hotel’s level of quality is to verify if the organization has received a quality award such as the Malcolm Baldrige National Quality Award

(MBNQA), the Six Sigma Award in the United States, or the European Foundation for Quality Management Award (EFQM) in Europe, adopted also in Italy with the name of Premio Ospitalità Italiana. These programmes are based on the Total Quality Management (TQM) approach and the main objectives are to reach excellence within a specific sector and to increase customer satisfaction (Zhu and Scheuermann, 1999; Fisher et al., 2001; Kujala and Lillrank, 2004; Williams and Buswell, 2003). However, these awards are not so developed in the hospitality industry (Soriano, 1999).

We also find quality certifications based on the adoption of the ISO 9000 standards introduced by the International Organization for Standardization (ISO) in 1987. A model of quality assurance is proposed to rationalize quality issues in contractual business-to-business relations, and establish a quality system (Barnes, 1998; Conti, 1999; Zhu and Scheuermann, 1999; Tsekouras et al., 2002; van der Wiele, 2002; van der Wiele et al., 2006).

Moreover, we can consider hotel branding an important element that communicates a certain level of quality to the customer, create value and guest loyalty (O'Neill and Mattila, 2010). Even if today brand is not yet one of the most considered attribute in the customer purchasing process (Akan, 1995; Callan and Bowman, 2000; Yesawich, Pepperdine, Brown & Russel, 2004), the situation is changing due to the development of leading brands competition in the same location. This phenomenon will increase the importance and influence of brands on the travellers purchasing behaviour (Deloitte, 2006; O'Cass and Grace, 2004). Hotel chains, small hotel groups and hotel associations develop their brands based on quality management systems studied specifically for the organization. Quality standards, service procedures for the staff and inspection procedures are defined in order to offer the same level of service in different hotel locations, thereby achieving a higher level of customer satisfaction. Examples of such hotel chains include Hilton, Holiday Inn, Novotel but we can also find groups that develop brands that are not linked to a specific hotel chain but ensure the level of quality. One example is Leading Hotels of the World, a seal of quality for single-unit hotels and for properties belonging to hotel groups such as Fairmont, Kempinski, Baglioni, etc.

Lastly, a large number of travel websites, especially new electronic distribution channels, propose ratings. Sometimes they simply quote the official rating of the country or organization; in other cases, they develop their own seals of quality based on customer feedback.

In such a complex situation, a hotel can be classified differently by various programmes at the same time. Therefore, there are cases in which the same hotel earns 5 stars in one programme, but only 4 in another. This is the case for some Ritz Carlton hotels in the United States.

2. Research Methodology

A qualitative research was conducted based on different steps. The first step was the review of relevant research and literature about the topic of hotel classification systems. In particular, academic articles and reports of international organizations on tourism trends were consulted.

The second step was the selection of case studies following a purposeful sampling that allows the researcher to choose cases presenting information richness and relevance for the research (Patton, 2002; Altinay and Paraskevas, 2008). In particular, 7 case studies was chosen: 5 European (Italy, France, Germany, Spain, UK) and 2 non-European (USA, Canada).

Information was collected by means of:

- review of national laws and regulation (public/private) on hotel classification in the countries analysed;
- personal interviews to exponents of the private or the public association managing the programs (USA, Canada, Italy, UK);
- online interviews to exponents of the private or the public association managing the programs (France, Germany, Spain).

The third step consisted in the elaboration of interview structure and contents. The model used has been that of a previous research conducted by International Hotel & Restaurant Association (IH&RA) and World Tourism Organization (WTO) in 2004 on the topic of Hotel classification in Europe. We concentrated on the hotel business excluding motel, apartments, B&B, etc. investigating the following points:

1. the presence of an official classification system in the country;
2. the level of classification (national/regional);
3. the nature of the program (private/public);
4. the identification of the organization that manage the program;
5. the type of standards (hard/soft);
6. the program orientation (producer/consumer);
7. the applicability of classification (voluntary/mandatory);
8. the presence, types and frequency of controls.

Internet rating was studied by the comparison of different case studies of main online travel agencies and social networks on the net. A personal interview with general managers of 4 international hotel chains allows us to select the most used operators: Booking, Expedia, Lastminute, Orbitz, Travelocity, and TripAdvisor.

The study was undertaken between April and September 2009.

3. Hotel Quality Classification

In Europe, hotels are usually ranked on a scale of 1 to 5 stars, with five stars being the highest rating possible. In Australia and Canada, a 5-star scale is used, sometimes using half star-increments. In the United States, hotels are generally ranked on a scale of 1 to 5 stars by the Forbes Travel Guide while the American Automobile Association (AAA) still uses the diamond on a scale of 1 to 5.

Star ratings in Europe are determined by local government agencies or independent organizations, and they vary greatly from country to country. In some cases, there are nationwide government-run systems (France, Portugal), other times the management is assigned to each Regional Government which has its own legislation (Italy, Spain); otherwise, they can be managed by the combined action of private and public organizations (United Kingdom). Sometimes the programmes are compulsory (Italy), while in other cases they are voluntary and managed exclusively by private associations (Germany).

So far, no international classification has been adopted, even though several attempts to unify the classification system have been made. New research and projects are developing to try to create a single standard, but the diverseness of the hospitality sector and the large number of existing programmes for quality makes this plan very difficult to put into place (IH&RA-WTO, 2004).

At present, the trend is the development of plans to align these different systems of various nations. An example is the new star rating system recently endorsed by the Italian government (2009), which sets minimum national standards that hotels must meet within the Italian territory. A case of success of this tendency is the Nordic-Baltic Classification that consists of six northern European countries (Denmark, Sweden, Iceland, Estonia, Latvia and Lithuania) which all agree on minimum quality standards for the hotel star rating system.

3.1 The Italian Rating System

Italian hotel classification is a compulsory system managed by public authorities. The method was adopted in 1983 when the General Policy Law for Tourism was enacted and provides a quality evaluation of hotel organizations by awarding each of them from 1 to 5 stars. More stars indicate a higher quality level.

The new law of 2001 (Law n.135/2001) and the subsequent decree of September 2002 (D.P.C.M. 09/13/2002) assigned the task of defining minimum standards to regional governments through combined activity. As a consequence, each region set their own standards without reciprocal coordination resulting in the creation of 21 different programmes.

The recent Decree enacted in 2008 (D.P.C.M. 10/21/2008) strives to overcome these differences by setting national and common minimum quality standards for all Italian hotel organizations. The new regulation is now being developed, and a tourist board within the regions was set up to discuss the operational details of the law's application.

Until now, rating assignments have been based on two different methods: the minimum score and the minimum requirements. The first is used by a group of regions that scores each service offered (for example the room service counts for 10 points, the private bathroom 30 points, the TV in each room counts for 5 points, etc.) and establishes a minimum number of points that the hotel has to reach for each category:

- 30 points for 1 star-level;
- 80 points for 2 star-level;
- 128 points for 3 star-level;
- 187 points for 4 star-level;
- 240 points for 5 star-level.

The second method goes beyond the concept of "minimum score" and is based on minimum requirements and more detailed standards.

The new tourism decree supports the method used by the second group of regions and, as we saw earlier, sets some minimum requirements that the hotels must fulfil to belong to a particular category.

What has changed? Considering that they are still a work in progress, the minimum requirements have been increased compared to the previous law. More details have been added, not only for the lowest category (1-star), but also for the highest levels.

The Italian case can be compared with some other similar European cases that use the star hotel rating system. The next section provides a brief description of some of these cases.

3.2. Other European Hotel Rating System Cases

In this section, we will discuss and compare the cases of France, Spain, the United Kingdom and Germany.

The French rating system is the oldest in the European Union, dating back to 1942. The relevant legislation is constituted by the decree law of 13 June 1966 and 14 February 1985. In 2009, a new regulation was introduced in order to meet the need to compete internationally. The previous system consisted of 6 levels: 0-star, 1-star, 2-star, 3-star, 4-star and 4-star luxury. By maintaining this system, people travelling around the world could have difficulty comparing the French hotel levels of quality with those of other countries. As a consequence, the 4-star luxury category was turned into 5 stars to increase the competitiveness of French hotel operators, and reduce possible consumer confusion.

Moreover, the upgrade in the structure of the programme includes a revision of the minimum standards in a more customer-oriented approach, although they are still predominantly linked to structural and technical aspects that are easier to evaluate (SYNORCA, 2006).

All hotels are registered and classified by the Government through the regional prefectures. Inspections for the first classification and for periodic assessments of the quality level offered are conducted by external organizations.

The Spanish hotel classification system is very similar to the Italian one. There is no national classification system for hotels; each Regional Government has its own legislation, but in practice, the differences between regions are minimal because they were able to coordinate themselves. The classification system is compulsory and regulated by the Royal Decree 1634/83, which provides minimum standards and other technical requirements that the hotels have to fulfil regarding security systems, pricing policies (for example maximum service prices must be visibly displayed in the lobby and a pricelist must be visibly displayed in the rooms), number of categories, types of accommodation facilities, star-category display, etc. (Confederación Espagnola de Hoteles y Alojamiento Turisticos, www.hotelsterne.de).

The categories go from 1 to 5 stars and each Regional Government is responsible for monitoring the standards through annual inspections.

Prior to 2006, the British Classification System was very similar to the Spanish and Italian ones, namely because hotel quality evaluation and inspection were the responsibility of the regional authorities of England, Wales, Scotland and Northern Ireland. In 2006, the national government in collaboration with VisitBritain, VisitScotland and the Wales Tourist Board, developed a nationwide system called the National Standards of Quality Assurance.

The stars are assigned based on a score expressed as percentage. Each category corresponds to a given percentage range: 30-46% (1 star); 47-54% (2 stars); 55-69% (3 stars), 70-84% (4 stars) and 85-100% (5 stars). In determining the hotel's category of membership, three aspects are considered: the minimum requirements, the overall percentage score and the main quality standards particularly regarding cleanliness, service, bedrooms, bathrooms and food quality. Each of these aspects is rated on a scale of five percent levels ranging from acceptable to excellent. The hotel has to satisfy at least three of the key areas, meeting or exceeding the standards of the specific category and the other two can be no more than one level below. For example, if a hotel wants to reach the 4-star category, it needs a percentage score between 70 and 84% (VisitEngland, 2009).

The requirements for each category are very detailed and more customer-oriented than in the past. In addition to the key requirements, hotels have to respect the basic standards for safety, security, maintenance and physical conditions, cleanliness, hospitality, services, guest access, and business hours.

The classification system is voluntary but strongly recommended by VisitBritain. The fact that only classified hotels are promoted on the association's website is a strong incentive to participate.

Professional inspectors perform annual assessments for VisitBritain, VisitScotland and VisitWales. Since 2009, a mystery guest overnight stay is used to evaluate all hotels, regardless of their star ratings.

The German hotel classification "Deutsche Hotelklassifizierung" was developed by the German Hotel and Restaurant Association (DEHOGA) in 1996 with the support of various tourist organizations throughout the country. The programme was welcomed by the industry's operators, who had long expressed the need for regulation. Following the last update in 2005, the classification system consisted of 280 criteria.

The system is voluntary and based on minimum criteria and weighing points for each category. The assessment is based exclusively on objective criteria (conditions and maintenance of the structure, furnishings, services, etc.) to facilitate the evaluation and to avoid the subjectivity of the inspector's evaluation (www.hotelsterne.de).

The scale, as in other European cases, is of 1 to 5. After the first inspection, assessment is repeated every three years.

3.3. The United States and Canada

In 1977, the American Automobile Association (AAA) developed the quality rating system that certifies the level of quality of a large number of hotels in the United States and Canada.

The programme is divided into 5 levels (1 diamond being the lowest and 5 diamonds being the highest) and represents a combination of the overall quality, the range of facilities, and the level of hospitality offered. The programme is voluntary and the hotels that wish to participate must apply for admission and wait for a first inspection, paying a non-refundable $150 application fee.

AAA Tourist Information Development is the division responsible for the direct management of the rating process. Its main activities are the assessment of travel information regarding classified hotels, monitoring members' needs and expectations. Inspectors visit the properties to check the level of quality offered, assigning and adjusting ratings.

The acceptance process includes the following steps. The first part aims at verifying the hotel's request and decides if the inspection can proceed. The criteria used to decide this are: location, type of structure (newly built/renovated), degree of cleanliness and comfort, facilities, price. The property tour establishes whether or not the hotel meets the standards of a specific diamond category by analysing its curb side appeal, exterior, and other factors pertaining to the basic foundation of the establishment. If the inspector is satisfied, the owner or general manager is contacted for a brief interview and the visit continues in order to evaluate the rest of the hotel. During the meeting, the property representative has the opportunity to inform AAA about any future plans for improvement and about the hotel's strengths and weaknesses. After that, a rating is assigned by AAA in each of the following categories:

- cleanliness and upkeep of the structure;
- management and staff;
- exterior, grounds, and public areas;
- guest room décor, ambiance, and amenities;
- bathrooms;
- guest services (if applicable).

Table 1 gives an example of the diamond rating requirements for the outside area of the hotel (building structure, parking, etc.).

At the end of this process, the hotel is assigned a number of diamonds (from 1 to 5). A general description of each level is shown in Table 2.

Table 1 AAA Diamond Requirements for external area

Exterior	One diamond	Two diamond	Three diamond	Four diamond	Five diamond
Curbside Appeal	The combination of all exterior elements provides basic, unadorned curbside appeal	The combination of all exterior elements provides a modestly enhanced, good curbside appeal	The combination of obvious design enhancements and all exterior elements provides a very good level of curbside appeal	The combination of all exterior elements provides an impressive, well-integrated, and excellent level of curbside appeal	The combination of all exterior elements provides a stunning, unique and outstanding level of curbside appeal
Landscaping	Basic, simple variety of landscaping	Good variety of landscaping	Very good variety of landscaping with noticeable enhancement to layout and design	Excellent variety of landscaping professionally planned and manicured	Extensive variety of landscaping with meticulous attention to detail in placement and care
Building's structure and design	Basic building structure and design	Good building structure and design	Contemporary or classic building structure with noticeable design element enhancements	Impressive architectural features well integrated into the surrounding area	Stunning and unique architectural features
Parking	Varied parking surfaces; illumination is adequate	Paved/marked parking areas; lighting is from several sources providing good illumination; drive- through covered entry	**2 plus** Lighting is well-positioned and provides very good overall illumination; porte-cochere	**3 plus** Lighting fixtures reflect characteristics of the design of the property; evidence of added security exists; excellent overall illumination	**N/A** -Valet parking is expected

Source: American Automobile Association (AAA) 2008. *Approval requirements & Diamond rating guidelines. Lodging.*

Table 2 AAA Diamond Rating Levels

LEVEL	DECRIPTION
	(a) Properties appeal to the budget-minded traveller (b) Essential, no-frills accommodations (c) Basic comfort, cleanliness and hospitality requirements
	(d) Properties appeal to the traveller seeking more than basic accommodations (e) Modest enhancements to the overall physical attributes, design elements and amenities of the facility, typically at a moderate price
	(f) Properties appeal to the traveller with comprehensive needs (g) Properties are multifaceted with a distinguished style, including marked upgrades in the quality of physical attributes, amenities and level of comfort provided
	(h) Properties are upscale in all areas (i) More refined and stylish accommodation (physical attributes, amenities) (j) High degree of hospitality, service and attention to detail
	(k) Luxury and sophisticated properties (l) First class accommodations (physical attributes, amenities) (m) Meticulous service exceeding guest expectations (n) Impeccable standards of excellence (o) Many personalized services and amenities

Source: American Automobile Association (AAA) 2008. Approval requirements & Diamond rating guidelines. Lodging.

For the higher categories (4 and 5 diamonds), standards relating to the functional quality are also requested. Requirements are set for reservations (table 3), arrival, check-in, bell, evening housekeeping, wake-up calls, room service, check-out, departure, and concierge.

The standards are checked every year through proper inspection conducted by the AAA staff.

4. A Comparison of the Rating Systems

We can compare European case studies to understand their similarities and differences. All the systems analysed evaluate hotel quality, assigning a category (from 1 to 5) to hotel organizations that fulfil several minimum quality standards requirements. Even countries that had a different scale have modified the structure of their programmes over the last few years, making them more uniform. France, for example, has recently changed its system, renaming the 4-star lux category 5 stars, like most other European countries. This is an advantage for both customers, who can better compare hotel services within Europe, and for France, which increases its competitiveness.

An analysis of the situation in Europe reveals many additional differences.

Sometimes the programme is national and is managed by the central government, other times, it is administered by regional governments, private organizations or a combination of the two. The system can be voluntary or compulsory and generally national schemes are voluntary. Almost all of the cases are mainly producer-oriented and present hard standards. Only in the case of United Kingdom and in part of France we notice a new approach that considers the importance of service standards. Moreover, controls procedures are not always systematic and in two cases (Italy and Germany) they are not so frequent. Table 4 shows the general hotel rating features of the systems analysed.

Table 3 Service requirements for reservation service

Service level		Reservation Services
5D	**4D**	Accepted 24 hours, either at property or through a central reservation system
X	X	Operator answers phone promptly within three rings
X	X	Operator provides a warm and sincere greeting
X	X	Reservationist thanks caller for contacting the property
X	X	Reservationist provides an introduction
X	X	Reservationist asks for caller's name
X	-	Reservationist addresses caller by name prior to closing
X	-	Reservationist anticipates caller's needs or offers a personalized recommendation
X	X	Reservationist provides rate structure and room availability
X	X	Reservationist provides an overview of facilities and services
X	-	Reservationist exhibits competent knowledge of all associated facilities and hours of operation
X	X	Reservationist collects registration information
X	X	Reservationist explains deposit and cancellation policies

X	X	Reservationist explains unusual payment options
X	X	Reservationist reviews reservation request
X	-	Reservationist exhibits a sincere desire and compliance to all guest requests
X	X	Reservationist provides confirmation number or contact's name
X	-	Reservationist is efficient yet unhurried and sensitive to the manner of the guest
X	X	Reservationist provides a warm and sincere thank you to guest for calling
X	-	Operator addresses guest by name during closing
X	X	The guest feels well-served
X	-	Property offers follow-up reservation confirmation to guest in advance of arrival

Source: American Automobile Association (AAA) 2008. Approval requirements & Diamond rating guidelines. Lodging.

Table 4 General features of the European programmes

	Italy	*France*	*Spain*	*United Kingdom*	*Germany*
Level of classification: National (N)/Regional (R)	R	N	R	N	N
Nature of the program: Private (PR)/Public (PU)	PU	PU	PU	PU/PR	PR
Type of standards: Hard (H)/Soft (S)	H	H	H	H/S	H
Applicability of classification Voluntary (V)/Mandatory (M)	M	V	M	V	V
Frequency of controls: Once a year (1); every 3 years (3); every 5 years; not specified (NS)	5*	NS**	1	1	3

Source: our elaborations

*Other controls will be provided in case of specific complaints
**Periodic control

All programmes include minimum requirements that the hotel has to meet to be part of a certain category. Some countries have more detailed basic standards (Germany, the United Kingdom) while others allow the hotel operator or regional governments to develop more flexible standards, giving only a few guidelines (Spain). Italy was in the same situation as Spain, but with the new decree and the improvement of basic standards the country is gradually moving towards other systems.

Then, if we analyse the minimum requirements we can find other differences:

- not all countries specify a minimum number of rooms. Only France and Italy specify a minimum of seven rooms to obtain a star. Moreover, France's requirements vary from level to level (7 rooms for 1 and 2 stars and 10 rooms for the other categories);
- the size of the room varies from country to country but all consider this standard very important. France and Italy have created two main groups: one for 1, 2 and 3 stars, and another for higher categories (4-5 stars). Spain and Germany have differing size requirements for each category. In particular, Germany is the country that has the widest range of measurements: from 12 m^2 for 1-star double rooms to 26 m^2 for the same kind of room in the highest category. The United Kingdom only gives a set room measurement for the 1-star level;
- the presence of a private bathroom in the room is another very complex issue. First of all, when analysing the hotel rating schemes, it is important to understand the kind of bathroom: bathroom with only a washbasin, bathroom with bath or shower, bathroom with toilet. Obviously, there is a great difference and this is one of the aspects most considered by customers during the booking process. For example, in Germany, the first two categories may have rooms with full, private bathrooms while, in other places, it is necessary to book at least a 3-star hotel;
- the staff's knowledge of languages is another critical point. Sometimes this standard is not only clearly indicated with the number of languages, but also the specific languages (generally English). Only Italy and France state this standard for each category.

Even though this analysis only considers a few examples, it is clear that a tourist organizing a trip around Europe could have some problems because of the different standards of the quality categories from one country to another. Choosing the same star category in different countries does not always guarantee the same level of service. Possible unpleasant experiences can increase the tourist's risk perception for future bookings and generate negative word-of-mouth.

In comparison to the European rating system, the American-Canadian one is based on another symbol, the diamond. The structure, even in this case, is the same (1 to 5-levels) but we find standards based more on service aspects, especially for 4 and 5-diamond categories. The system is voluntary and managed by a private organization.

5. Internet Rating

The booking behaviour of the tourist has increasingly changed with the development of new technologies. Many tourism services are now bought on the net using electronic distribution systems: flights, hotel stays, car rentals, etc.

(Deloitte, 2006; PhoCusWright, 2010). These booking engines, in order to capture hotel guests' interest and loyalty, generally offer ratings to help consumers find hotels that meet their requirements. A report of Nielsen (2010) discovers that online reviews in purchasing travel services play a key role even if other studies confirm the importance of traditional word-of-mouth that is generally considered more reliable (Marketing NPV, 2006).

What are the main criteria of these rating schemes? Each website has its own classification system based on different requirements that do not necessarily coincide with the official one of the country in which the hotel is located. The result is that the rating indicated near the name of the hotel is sometimes inconsistent with government ratings, where existing, or private ones (AAA diamonds, Forbes, etc.). In comparing hotel prices or availability on different web portals, we discover, in fact, that the category can change from one website to another and the reason is unclear. This uncertainty perceived by the customer influences the booking process, increasing the effort necessary in researching hotels. Ratings, websites, ambiguous criteria and guests' comments sometimes create even more confusion and frustration, because appropriate information is not always given about a category's standards (Mitchell et al. 1999; Matzler et al., 2005). Moreover, sometimes the situation is further complicated by the use of the same symbol employed by other official rating schemes. Customers often ask themselves: "is this the country's official rating or the website's?".

We will try to better understand the basic criteria used by comparing 5 web portals. They present in all cases a double rating system: one for the category and one for customer comments. For example Travelocity classifies hotels with stars that show the category and smiley faces that represent the travel reviews rating. Generally, the evaluation process of online travel agencies in order to define the category is based on comparing different sources of information: the official ratings, guests' comments, inspection reports, etc. Orbitz, for example, establishes a rating through the analysis of industry classification systems (AAA and Michelin Travel Guide), personal evaluations by the Orbitz hotel team and customer feedback. Expedia relates the rating of regional and national public authorities (where existing) and, if the evaluation differs, it shows the website's rating, giving more details about the category. In the case of Travelocity, star ratings appear for hotels that have not been rated by AAA.

The result is an incongruous description of categories from different websites. For example, Expedia is more focused on services offered (restaurants, housekeeping, etc.) and gives details about amenities while Orbitz and Travelocity focus on the location, style, design and staff courtesy and concern.

Travelocity measures customer satisfaction with smiley faces that are a result of the overall evaluation of the following topics: room quality, cleanliness, activities, meeting room, location, security and safety, staff service, bed comfort, value for money, fitness, facilities, dining, and pool. The customer is asked to give a score from 1 (terrible) to 5 (excellent).

The most well-known website that collects tourists' comments is TripAdvisor. Here it is not possible to book a hotel, but the website is linked with major booking engines. TripAdvisor usually shows the official rating of the hotel in its country and its own category (coloured bullets) on a scale from 1 to 5. The guests are asked to provide information about overall satisfaction, cleanliness, location, rooms, services, meeting centre, etc. Then other information is also requested as to the purpose of the stay, the intention to return, etc.

In order to protect hotel industry against manipulation and unfair evaluation it is important to have a sort of filter for comments, but not all websites provide one. Generally, booking portals develop tools to check the reliability of comments while social networks do not have any kind of selection. This issue is widely discussed in the sector, especially in terms of reliability of comments, unclear selection and filtering methods that sometimes do not exist at all, the website's lack of responsibility in cases of libel and the poor consideration of the hotel companies as customers and partners. In particular, HOTREC (Hotels, Restaurants and Cafés in Europe) fixes 10 principles to regulate hotel reviews: editorial controls, prevention of manipulation, quality assurance, no anonymous reviews, guaranteed minimum number of reviews, harmonization of rating scales, right of reply, legal certainty, up-to-date data, indication of the official star classification (HOTREC, 2007).

In conclusion, internet rating confirms the general problems identified in previous pages and further complicates the situation by adding new interpretations and symbols. The advantages for the customer include the possibility to easily compare hotels, and obtain more information than in the past, thanks to pictures (Jeong et al., 2004) and customer comments that become key elements. However, the subjectivity of hotel quality evaluation influences customer comments. When you read a customer comment, how can you be sure that the needs and expectations are the same? Often people in the same family disagree on the quality of a film, a book, etc. In this case it could be helpful to have some information about who is writing the review. TripAdvisor provides this information by segmenting the feedback into 5 groups: business, couples, family, friend getaway, solo travel.

The development of web portals as a way to gather information about the hotel and handle bookings can represent both an opportunity and a threat for hotel companies (Briggs et al., 2007; Lee and Hu, 2004). Customer feedback and evaluation of customer satisfaction become interesting management tools to consider along with other traditional means and the hotel's visibility increases. On the other hand, the company is more exposed to competition and possible negative comments create negative word-of-mouth that could influence new customers.

6. Criticism of Hotel Quality Classification

After having analysed the main classification systems used in Europe and North America, we make some observations. In particular, the comparative examination of various classification systems shows some common limitations in all the cases considered:

- the diverseness of the supply among regions and among countries especially for the intermediate categories (3-4-star). The 5-star level is the only category that has a certain uniformity from an international point of view;
- sometimes there is a lack of correspondence between the hotel ranking and the service offered, based on customer expectations. Star classification points out the price level of hotels but does not necessary meet consumer expectations as reported in previous research (Lopez Fernández and Serrano Bedia, 2004; Israeli, 2002; Danziger et al., 2004);
- more attention to quantitative and technical elements (room size, bars and restaurants equipment, etc.) rather than service aspects that are more difficult to measure and quantify (IH&RA-WTO, 2004; Briggs et al., 2007);
- cases of new categories which are not regulated by official systems. For example, 6 and 7-star hotels. The two most famous cases in the world are the 7-star Burj Al Arab Dubai and the Town House Galleria in Milan. This is more frequent in countries where the rating system is voluntary but we also have an example in Italy where regions sometimes develop their own categories (for example the Region of Trentino Alto Adige with the 4-star superior hotels).

If we only consider the Italian rating system, we can highlight some other critical issues concerning both the tourism law and the recent decree. First of all, the frequency of inspection is particularly low (every 5 years) compared to other European countries (every year or every 3 years). This is a point to clarify, perhaps with the future development of the new regulation. The new decree suggests that regions check standards more frequently but it remains the prerogative of regional authorities. Furthermore, some restrictions on the room size (1-star double room min. 14 m^2 also in the new standardization project) and the features of public areas interfere with the development of low-cost hotel chains in Italy. In the past, for example, Travelodge and Formule 1 could not enter the Italian sector for these reasons, which are used by Italian hotels as an entry barrier. This is a serious threat to country's international competitiveness.

In conclusion, we can identify some issues related to the new Italian hotel quality classification decree. Firstly, some critical points of the tourism law were not resolved (excessive focus on technical quality and entry barriers for low-cost hotel chains). Secondly, the new minimum structural requirements only apply to new hotels and to those being renovated, which received approval before the decree: this reduces the incentive for existing companies to conform to the new standards. Thirdly, the operational details of the programme are not clearly defined (for example frequency and type of inspections, figures involved, etc.).

7. Trends and Conclusions

From the analysis of the various hotel quality programmes and the discussion of the problematic points it is possible to identify some trends and ongoing developments.

First we mentioned that there is sometimes a gap between the level of quality that consumers expect from a hotel of a certain category and the service that they actually receive. The hotel companies should therefore work harder at understanding customer expectations in order to provide service that effectively meets their needs, rather than simply conforming to the standards of its category. To this end, international hotel chains are developing their own management programmes that generally exceed the minimum standards set by the regulations of the countries in which they are located (for example, stars). Hotel guests rely on well-known brands because they know what to expect and their perceived risk in choosing the hotel decreases (O'Neill and Xiao 2006; O'Neill and Mattila, 2010). This is true of The Leading Hotels of the World or Hilton for the upscale and luxury category but also of Formule 1, Ibis, Motel 6 for the budget and economy category, to mention a few.

Moreover, we can identify two different approaches depending on the public or private nature of the programme that confirm previous research conducted by IH&RA and WTO (2004). Public authorities are generally less customer-oriented and the focus is mainly on regulating the sector or increasing its international competitiveness. The standards remain in effect for years before being updated. On the other hand, private operators (or a mixed management of public and private organizations) are much more interested in responding to needs and expectations of the demand. Although most programmes are still focused on quantitative aspects of hotel services, recent updates to the classification systems show greater interest in standards linked to functional quality (United Kingdom, United States). The courtesy and empathy of staff are more frequently checked. This also means more subjective inspections and so the training and professionalism of staff become very important.

With the development of new technologies and new tourism intermediaries on the web, tourists can consult a new hotel classification system based directly on other customers' experiences and satisfaction. Customers consider these new tools more reliable than other existing classification systems promoted by public and private associations, because they reflect real experiences with the service (Verma and Smith, 2010). Two kinds of problems may arise: certain online travel agencies (such as Priceline or Hotwire) have an ambiguous system (opaque) where buyers can only see the price and quality level of the hotel, but the name is not provided. In this case, the customer cannot compare prices to specific hotels or brands (Kotler et al., 2010; Anderson and Radium, 2010). In other cases, even when the name of the hotel and brand are present, very different comments about one hotel can create confusion. This can be the result of different interests, reasons for travel, etc. In this case, operators are attempting to provide profiles of the customers commenting to make their interpretation simpler.

Attempts by international agencies (WTO, European Union) to set up some form of international classification for the hotel industry crop up periodically, but so far no international standards have been approved. Some associations that initially worked together on this project, such as the International Hotel and Restaurant Association (IH&RA), believe it to be unfeasible. In fact, the creation of standards at an international level is a very long and difficult process. To be effective, any future international programme must still consider the cultural differences that effect the services offered by various countries and operators.

It is therefore more realistic to establish minimum international standards on safety, hygiene, etc. Even in this case, we find many different regulations in different countries (for example, the ban on smoking in public establishments is not extended to Europe as a whole).

The definition of European minimum requirements should be a step process. First of all countries should continue the present trend of standardizing internal criteria and quality standards at a national level, especially where there are strong differences among regions and, than, it could be possible to proceed with the European harmonization.

8. Implications for Further Research

Starting from the previous remarks, additional research needs to be undertaken in online word-of-mouth and online customer reviews studying their impact on customer expectations and behaviour. A comparative study of various online travel agencies and social networks ratings could be interesting. Moreover, further quantitative research is necessary to confirm conclusions achieved. In particular, it could be interesting to investigate the consumer purchase process comprehending the importance of each variable and the influence on customer behaviour.

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Financial Institutions and Services

The Impact of Foreign Banks Presence on the Performance of Domestic Banks in Kosovo during the Period 2001-2007

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Abstract: The purpose of this study is to empirically research the impacts of the foreign bank's presence on the performance of domestic banking sector in Kosovo. The research data on foreign and domestic banking are quarterly time seri data gathered by the Central Bank for the period 2001-2007. By using the compatible data on seven commercial banks, we introduce how the net interest margin, non interest margin, overhead cost, tax paid, and profitability differ between the foreign and domestic banks. We find that the foreign banks have higher net interest margin and profit than the domestic banks. The research outcome indicates that the presence of foreign banks had a negative and statistically significant impact on the net interest margin and loan loss provision of domestic banks, but positively related to the non-interest income, overhead cost and profitability of domestic banks, but we did not find any statistically significant values. The general conclusion is that the presence of foreign banks has not influenced on the increase of competitiveness.

Keywords: foreign banks; domestic banks; performance

JEL Classification: G21; G24

1. Introduction

As the foreign banks entered in the transition countries from year 1990, following the liberalization of financial markets, such process took place in Kosovo after the same year, as a consequence of ethnical conflicts in former Yugoslavia. In most of the transition countries, the liberalization process was the main topic of discussions between policymakers and academics concerning the benefits and costs of the entry of foreign banks in the economies of respective countries. Unfortunately, such a discussion was never made in Kosovo due to the inexistence of the Banking Sector and other financial institution therein. As of year 2000, the Kosovo financial sector has therefore been open and liberalized enabling thus a free-from-obstacles entry of foreign banks in the Kosovo's banking market. However, what most of the authors agree upon is that financial markets were liberalized and obstacles were removed for the purpose of benefiting from the entry of foreign financial institutions, which aim to foster competitiveness and increase efficiency.

This paper aims to contribute to the literature by providing empirical evidence on the impacts that the foreign banks presence has on the performance of Kosovo banking sector. In doing this, we use the OLS regression model in order to test a number of research hypotheses.

In addition, this paper differs from other studies made in transition countries in many aspects:

Firstly, the banking sector of Kosovo was re-established upon foreign banks entry at the time when no domestic-owned bank operated in the Kosovo banking sector. Thus, the share of foreign banks in the total of assets was 100% in 2000. Later on, five domestic-owned banks and one foreign-owned bank were established in 2001.

Secondly, given that the Kosovo banking sector, which can be considered as liberalized in terms of regulatory perspective, has no control on the interest rates, it has no program on direct loan and no control on capital account either.

Getting to assess the impacts of the foreign banks presence in the banking market, it is necessary to research the differences between the performance of domestic banks and foreign banks. Although the number of foreign banks entered was increased since year 2000, few studies have been made to assess the comparative performance of foreign and domestic banks. Besides, no econometric analyses have been made to study the impacts of the foreign banks entry.

The paper is organized as follows: firstly an overview of the banking sector development and foreign banks entry process is given, and then a description of literature, research hypotheses, data and methodology, estimation results, and conclusions are presented.

2. Overview of Kosovo banking sector

2.1. Development of Kosovo Banking Sector and entry of foreign banks

The reconstruction of economic and financial system was embedded in the building of new relevant institutions started after the conflict of 1999. The establishment of a new banking system based on market principles was a very important element of the reconstruction. The Kosovo financial and banking system did not exist before the conflict of 1999, thus Kosovo established the financial system from the very beginning. Following year 1999, Kosovo was administered by the United Nations Organizations. International and local authorities were committed to establish a banking sector in compliance with international standards as well as to create a more adequate environment for attracting foreign capital in the banking sector. The establishment of the Banking and Payments Authority of Kosovo in 1999, which was then transformed into the Central Bank of the Republic of Kosovo in 2008, was a direct outcome of these efforts. The basis of two tier banking system was established.

The Central Bank of Kosovo is the highest authority within the financial sector, which operates as a Regulatory and Oversight Authority for the commercial banks and other financial institutions. In the framework of the financial system, the commercial banks are the most important financial intermediaries in Kosovo by 90.9 % of the total of assets in the financial system at end of 2007 and by 90.8 % in 2008. They are almost the only source of financing because the non-banking financial institutions are not developed and their role as intermediary institutions in channelling the financial savings on investments is insignificant. This indicates that the Kosovo's economy, particularly the small and medium enterprises (SME), is highly depending on the commercial banks. The money and capital market, as segments of financial market, does not exist. The lack of the financial market and the not long developed banking system make the financing of many SME investment projects very difficult.

As in many transition countries, the banking sector is dominated by institutions owing foreign capital. The structure of Kosovo banking sector has changed over these years. No bank operated in Kosovo during 1999. Therefore all commercial banking operations were carried out by the Banking and Payment Authority of Kosovo.

In January 2000 the first bank called Micro Enterprise Bank (MEB) was established, which in November 2003 was transformed into ProCredit Bank. In November 2001 the American Bank of Kosovo (ABK), another foreign-owned bank, was established, which in July 2003 was bought by the Raiffeisen Bank of Kosovo (RBKO).

Over year 2001, other five domestic-owned banks were established. Thus, the number of commercial banks amounted to seven.

This banking sector structure remained unchanged as of the end of year 2007. By the beginning of year 2008 a Slovenian Bank, called Nova Ljubljanska Banka (NLB), bought 50.1% of the Kasabank's (KSB) shares, which together with the 25.1% of shares owned by another Slovenian Bank, Factor Bank Ljubljana, increased the foreign capital share of KSB to 75.2%.

Moreover, NLB became a shareholder of Banka e Re e Kosovës (BRK), by buying 87.0% of its shares. This process continued afterwards with the merging of KSB and BRK in one single bank, the NLB Prishtina, in January 2008.

In addition, two other banks, the Banka Kombëtare Tregtare (BKT) from Albania and Komercijalna Banka (BK) from Serbia were licensed. Another foreign bank, the Turk Ekonomi Bankasi (TEB), was licensed by the Central Bank of Kosovo, according to the Central Bank of Kosovo Report 2007.

In 2008, the banking market was dominated by the foreign banks in terms of both number of banks and the share in the total of banking sector means. Hence, we may count seven foreign-owned banks and two domestic-owned banks. The foreign banks assets share in the total of banking sector's assets was 91.0%, whilst their share in the total of banking sector's means was 90.9% in 2007.

3. Literature Overview

Many studies have been made to research the impacts of foreign banks presence in the domestic banking sector. These studies may be classified in two groups: the one that elaborates the impacts across countries and the one focused on the impacts of foreign banks entry in particular countries. Studies, made in both many countries and a particular one, indicate that the foreign banks presence in the domestic banking sector has influenced on the increase of competitiveness in the banking sector, which simultaneously stimulates the domestic banks to enhance their efficiency, thus influencing on the performance of domestic banking sector.

Claessens, Demirgüç-Kunt, and Huizinga (2001) have, by using the banks level data for 80 developed and developing countries over the period 1988-1995, researched the impact that the foreign banks entry has on the net interest margin, profitability, non-interest incomes, overhead expenses, and on loan loss provision. They ascertained that the increase of foreign banks presence has been followed by a decrease in the profitability, non-interest incomes, and overhead expenses of domestic banks. In addition, the results have not shown a significant impact on the net interest margin and loan loss provision. These results indicate that the foreign banks entry has positive impact on the banking sector efficiency.

Hermes and Lensink (2001) have further developed the analysis of Claessens at al (2001) by using the banks level accounting data from 990 commercial banks in 48 countries for the period 1990 – 1996. They researched the impact of foreign banks entry in the domestic banking market of less developed countries (LDCs) and found results that contradict the ones of Claessens et al (2001). According to them, the presence of foreign banks drives to the increase of revenues, profit, and costs. They also indicated that the foreign banks entry may have a different impact on the domestic bank market of developed and less developed countries.

Hermes and Lensink (2004) explained the relation between the performance of foreign banks presence and domestic banks by taking into account the level of financial system's development. They used the data from 982 banks in 48 countries between year 1990 and 1996. They proved that when the financial development level is low, the foreign banks presence induces the increase in cost and profit margin of domestic banks, whilst when the financial development level is high; it induces a fall in costs and profit margin of domestic banks.

In addition, Hermes and Lensink researched in (2004) the short-term impacts of foreign banks presence in the domestic banking operations by taking into account the economic development level. This study was conducted by using the data of Beck, Demirguc-Kunt and Levine (2000) and Bank Scope. This paper includes 3.967 samplings between years 1990 and 1996. They show that, in short term, the foreign banks presence is associated with the increase of expenses and interest rate spread of domestic banks at lower level of economic development. Meanwhile, at higher levels of economic development, the results obtained appear to be somehow contradictory because the finding from studies conducted show that the foreign banks presence is either associated with a fall of cost, profit, and interest spread rate or has no impact on these bank variables.

There are conducted more studies which are focused within one country. Denizer (2000) analysed the impact of foreign banks presence on domestic banks in Turkey. He empirically arguments that as the foreign banks entered the banking market of Turkey, the net interest margin, return of assets, and overhead expenses of domestic banks fell. These results support the idea that the foreign banks put pressure on domestic banks in Turkey in terms of competitiveness.

Unite and Sullivan (2001) analysed the impacts of foreign banks entry in the domestic banking sector of Philippine during the 1990-1998 period. They show that the foreign banks presence is associated with the reduction in difference of interest rate and profit of banks, but only for those domestic banks that are affiliated to a family business group.

Zajc (2002) analysed the impacts of foreign banks entry in the domestic banking sector of transition countries (Chezk Republic, Estonia, Hungary, Poland, Slovakia, and Slovenia) during the 2001 – 2007 period. He has find that the foreign banks entry reduces the non-interest revenues and profit, and simultaneously increases the cost of Central and Eastern European domestic banks.

Janek Uiboupin 2004 analysed the short-term impacts of foreign banks entry on the performance of domestic banks of Central and Eastern European countries. He used the data from 219 banks of ten countries. He showed that the foreign banks entry has a negative impact on domestic banks incomes from interest-earning assets, non-interest incomes, and profitability. The foreign banks entry may also increase the overhead cost of domestic banks at a shorter term.

4. Hypotheses

The hypotheses of this study are based on the theoretical and empirical literature. The studies show that the foreign banks presence influences on the net interest margin, non-interest incomes, overhead cost, profitability and loan loss provision of domestic banks by having an impact on the competitiveness and efficiency of domestic banks. The increase in competitiveness caused by the foreign banks presence in the domestic banking sector makes the domestic banks pay higher deposits interests in order to avoid their market share and at the same time, makes them to apply lower interest rates on loans. Given that the interest income is decreased and interest expenses increased, the foreign banks presence is associated with the falling of net interest margin. The net interest margin is the difference between the interest income generated by loans and interest expenses in deposits.

This reduction in the distinction between interest differences is an important indicator of competitiveness, because the banking sector becomes more competitive when the loan interest rates are expected to be reduced, whereas the deposits interest rate is expected to increase. Denizer (2000), Unite and Sullivan (2001), and Uiboupin (2004) have found an inverse relation between the foreign banks presence and net interest margin, while Claessens, et al. (2001) has not found any significant relation.

In addition, we assume the increase of competitiveness in Kosovo's banking market upon the increase of foreign banks presence.

H1. The increase of foreign banks presence has an impact on the reduction of net interest margin of domestic banks.

The reduction of net interest margin of domestic banks due to the increase of competition as a result of higher foreign banks presence makes the domestic banks to search for other sources of interests incomes from non-loans operations. We assume that the domestic banks will try to increase the non-interest income in order to compensate the fall of interest margin. However, if the foreign banks provide services with better prices than the domestic banks, it is expected that the non-interest income will be reduced as a result of the increase of competitiveness by foreign banks. Although the generation of profit from non-loan operations happens in short terms, it has a long term results.

H2. The increase of foreign banks presence has a positive or negative impact on non-interest income of domestic banks.

The foreign banks presence may have a positive or negative impact on the overhead cost of domestic banks. The foreign banks may have a lower cost than domestic banks; therefore the domestic banks should strive to reduce the cost in order to be competitive with foreign banks. The studies conducted by Claessens, et al. (1889), Unite and Sullivan (2001), Bayraktar and Wang (2005) have shown a negative relation between the foreign banks presence and overhead cost. This is however a short term impact. In addition, it could be that the presence of foreign banks and the cost of domestic banks be connected in a positive fashion. The domestic banks are obliged to make new investments in order to be able to compete with foreign banks which own a more advance banking technology and more qualified staff. Therefore, this causes the increase of cost in a short-term period. The studies conducted by Hermes and Lensink (2001, 2004a, 2004b); Uiboupin (2004); Micco, et al, (2004) show a positive relation between the foreign banks presence and overhead cost.

H3. The increase of foreign banks presence impacts the overhead expenditure of domestic banks

The foreign banks entry is usually expected to have a positive impact on the banking market competitiveness, and for this reason, it is also expected to have a negative impact on the domestic banks profitability. A number of studies conducted by Denizer, (2000), Claessens, et al,(2001), Unite and Sullivan, (2001) and Uiboupin, (2004), show a negative relation between the foreign banks presence and domestic banks profitability. Therefore, the following hypothesis has been also elaborated herein in order to evidence the impact of foreign banks presence on the domestic banks profitability in Kosovo.

H4. The increase of foreign banks presence has a negative impact on the domestic banks profitability.

The effect of foreign banks entry on the loan loss provision of domestic banks might have a positive or negative impact on the quality of loans. The increase of loan loss provisions may be based on the affirmation that the domestic banks are obliged to attract clients having lesser loan capacities due to the increase of competitiveness resulting from the foreign banks entry. Claessens, Demirgüç-Kunt, and Huizinga (2001), Uiboupin (2004), Bayraktar and Wang (2005 have proved that the increase of foreign banks presence may encourage the domestic banks to have clients with relatively lower loan-return capacities, thus increasing the banks risk.

On the other hand, the foreign banks presence may have an impact on the reduction of loan loss provisions of domestic banks, given that domestic banks pay particular attention to the loans that they give in order to avoid the loss due to increase of competitiveness.

H5. The foreign banks presence has a positive or negative impact on loan loss of domestic banks

5. Data

We will use the quarterly data including the period 2001: Q1-2007: Q4 in the empirical analysis of foreign banks presence in the banking sector of Kosovo. The data used in this paper are drawn from the Central Banks of Kosovo and contain records from the balance sheet and income statements of seven commercial banks, out of which, two are foreign-owned banks. This study does not include a domestic bank due to lack of quarterly data and to its bankruptcy at the beginning of year 2006. Banks are defined as foreign if at least 50% of their shares are foreign-owned. According to Cleassens, there are two ways to measure the foreign banks entry ratio. The first way is to compute the assets share of foreign banks as share of total of the banking sector assets. This measuring is more adequate if the foreign banks have an impact on the price and profitability of domestic banks only when they get to the considerable size.

The second way of measuring is the number of foreign banks as share of total number of banks in the banking sector. Classens et al (2001) says that this measuring is adequate if the number of foreign and domestic banks determines the competition criteria.

Table 1 shows the share of foreign banks average assets in the total of banking sector assets, which is almost 70 percent. The foreign banks share in assets was quite higher than their share in the total number of banks. Therefore, we may conclude that the foreign have a higher share in the Kosovo banking market.

Table 1. Structure of assets by ownership, (in percent)

Ownership	***2000***	***2001***	***2002***	***2003***	***2004***	***2005***	***2006***	***2007***	***2008***
Domestic Banks	-	*27%*	*26%*	*36%*	*37%*	*33%*	*28%*	*9.1 %*	*10%*
Foreign Banks	*100%*	*74%*	*74%*	*64%*	*63%*	*67%*	*72%*	*90 %*	*90%*

Source: author's calculation

Table 2 shows the foreign banks share in the total number of banks. The number of foreign banks has remained the same until 2007.

Table 2. The Kosovo Banks' ownership structure (number of banks)

Ownership	***2000***	***2001***	***2002***	***2003***	***2004***	***2005***	***2006***	***2007***	***2008***
Domestic Banks	-	*5*	*5*	*5*	*5*	*5*	*4*	*2*	*2*
Foreign Banks	*2*	*2*	*2*	*2*	*2*	*2*	*2*	*7*	*7*

Source: Central Bank of Kosovo http://www.bqk-kos.org

We have used the in this paper the accounting data in order to elaborate how foreign banks differ from domestic banks in terms of net interest margin, non-interest income, profitability, paid tax, overhead cost, and loan loss provision. Like the renowned economists Dermirguc - Kunt and Huizinga (1999), we use simple accounting identity which includes:

NIM + NII/TA + PBT /TA + OE /TA + LLP/TA

NIM = Net interest margin

NII = Non-interest income

PBT = Profit before tax

OE = Overhead expenses

LLP = Loan loss provisions

We use two variables to measure the banks incomes: The net interest margin (NIM) and non-interest income over the total of assets. The net interest margin presents the interest income generated by loans operations, while the non-interest income presents all other sources of incomes generated by non-loans activities such as fees and commissions.

Secondly, the profitability of banks is characterized by the profit before tax over the total of assets. Whereas, the overhead cost representing the banks operations costs are measured with two variables; the overhead expenses and the loan loss provisions over the total of assets.

Based on the data presented in the Table 3, we may notice the average value of performance indicators of foreign banks and domestic banks for the 2001 – 2007 periods.

Table 3. Performance indicators of Domestic vs Foreign banks 2001 2007

(Average, in percent)

Ownership	Net margin / ta	Non-Int. income / ta	Overhead / ta	Tax / ta	Loan. Loss prov/ta	Net profit / ta
Domestic Banks	4.77%	3.41%	4.92%	0.23%	2.14%	0.95%
Foreign Banks	5.44%	2.0%	4.39%	0.51%	0.72%	1.89%

Source: author's calculation

In general, the foreign banks generate a higher net interest margin and profitability than domestic banks, whilst the domestic banks had higher non-interest income, overhead expenses, and loan loss provisions than the domestic banks.

According to Classens et al 2001, the high net interest margin of foreign banks in comparison to the domestic banks of developing countries reflects the market conditions of the hosting country wherein the foreign banks operate. For example, in the developing countries, the foreign banks may have higher net interest margin than the domestic banks because they may be released form restriction rules, and they do not operate on non-commercial criteria as many state-owned banks operate and apply modern banking practices which mostly evaluate the disadvantages of their information.

6. Empirical Model

The aim of this study is to measure the impact of foreign banks presence on domestic banks. To that respect the empirical model used here has been mainly derived from Claessens et al. (2000) but adapted to this study in order to reflect the objectives which are twofold:

1. Estimate the impact of foreign bank presence (i.e. passive presence) on domestic banks; this is achieved by using as a dependent variable the ratio measuring the foreign banks' share over the total shares of the banking sector.
2. Estimate the impact of foreign bank performance (i.e. active presence) on domestic banks performance; this is done by using as dependent variables performance ratios which are described below.

One of our main targets is to determine the relationship between domestic banks' performance indicators and foreign bank entry, first independent variable introduced is the asset share of foreign banks.

As such the model used is as follows:

$y_i^d = \alpha + \beta x_i^f + \varepsilon_i$ g

Where y_i^d is the dependent variable representing the performance of domestic (d) bank (i) and x_i^f is the independent variable representing the performance of foreign (f) bank (i). The variables used here for measuring banks' performance are the following:

- First dependent variable is net interest margin to total assets;
- The second dependent variable is the ratio of non-interest income to total assets;
- Third dependent variable is ratio of before tax profit in total assets;
- Fourth dependent variable is ratio of overhead costs to total assets;
- The last dependent variable is the ratio of loan loss reserves to total assets.

The parameters will be estimated using OLS regression technique in SAS by way of R^2 maximization

7. Result of the Empirical Analysis

The results generated by the foreign banks presence and domestic banks performance for the 2001-2007 periods are shown in Tables 4 to 8. We have presented the result on each of five variables of domestic banks' performance, including the net interest margin, non – interest income, profitability, overhead cost, and net loan loss provision over the foreign banks' share as an independent variable.

The result presented in Table 4 shows that the foreign banks presence has a negative and statistically significant impact on the net interest margin of domestic banks. Since the foreign banks presence is negatively related to the net interest margin, we may conclude that the foreign banks presence had an impact on the reduction of net interest margin of domestic banks.

The SAS System

The REG Procedure

Dependent variable: Net interest Margine / total assets of Domestic banks

R-Square = 0.7625

Table 4 (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.15594	0.04640	0.00055295	11.30	0.0028
Foreign_share / total assete	**-0.09354**	**0.03045**	**0.00046193**	**9.44**	**0.0056****
Equity / ta_Boreign banks	0.00344	0.23298	1.066081E-8	0.00	0.9884
NII / ta_Foreign banks	0.86382	0.23118	0.00068346	13.96	0.0011
CustFunding / ta_Foreign banks	-0.10003	0.04347	0.00025917	5.29	0.0312
Overhead_Expenditures / ta_Foreign banks	0.81130	0.78844	0.00005183	1.06	0.3147

Source: author's calculation

Note:

*Significant at 10 per cent level;

**Significant at 5 per cent level;

***Significant at 1 per cent level.

The SAS System

The REG Procedure

Dependent variable: Non interest income / total assets of Domestic banks

R-Square = 0.7080

The results of testing the second hypothesis concerning the impact of foreign banks presence on non-interest income of domestic banks are presented in Table 5. We find that the foreign banks presence is positively related to the non-interest income of domestic banks, but we did not find any statistically significant values.A potential reason for this positive sign could be the case when domestic banks, due to the fall of interest income, started to focus their activities in generating noninterest income by establishing branches and sub-branches throughout the country.

Table 5. (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.02275	0.04479	0.00001176	0.26	0.6166
Foreign_share / total asete	**0.00277**	**0.02939**	**4.063243E-7**	**0.01**	**0.9257**
Equity / ta_Foreign banks	0.51015	0.22489	0.00023472	5.15	0.0335
NII / ta _Foreign banks	1.32291	0.22316	0.00160	35.14	<.0001
CustFunding / ta_Foreign banks	-0.04518	0.04196	0.00005288	1.16	0.2933
Overhead_Expenditures / ta_Foreign banks	-0.37064	0.76106	0.00001082	0.24	0.6311

Source: author's calculation

Note:

*Significant at 10 per cent level;

**Significant at 5 per cent level;

*** Significant at 1 per cent level

The SAS System

The REG Procedure

Dependent variable: Profit before tax / total assets of Domestic banks

R-Square = 0.7669

The results of testing the third hypothesis concerning the impact of foreign banks presence on profitability of domestic banks are presented in Table 6. We find that the foreign banks presence is positively related to the increase of profitability of domestic banks, but we did not find any statistically significant values. Our interpretation on this result is that the foreign bank presence is not associated with a higher competition in domestic banking system. Classens 2001 finds that by keeping other factors unchanged, the high profits reflect a lack of competitiveness, whilst the higher cost of expenditures may reflect less management efficiency and a poor organizational structure.

Table 6 (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.01950	0.02466	0.00000865	0.63	0.4374
Foreign_share_total assete	**0.01640**	**0.01618**	**0.00001420**	**1.03**	**0.3218**
Equity_ta_Foreign banks	0.61592	0.12382	0.00034214	24.74	<.0001
NII_ta_Foreign banks	0.52142	0.12287	0.00024902	18.01	0.0003
CustFunding_ta_Foreign banks	-0.05245	0.02310	0.00007126	5.15	0.0333
Overhead_Expenditures_ta_Foreign banks	-1.18029	0.41903	0.00010970	7.93	0.0100

Source: author's calculation

Note: *Significant at 10 per cent level;

**Significant at 5 per cent level;

*** Significant at 1 per cent level

The SAS System

The REG Procedure

Dependent variable: Overhead cost / total assets of Domestic banks

R-Square = 0.1946

The results of testing the fourth hypothesis concerning the impact of foreign banks presence on overhead expenses are presented in Table 7. We find that the foreign banks presence is positively related to the overhead expenses, but we did not find any statistically significant values. This increase of overhead costs of domestic banks results from the expenses incurred in operations, such as purchase of new equipments, training of employees, etc. Hermes and Lesnik 2002 find that the increase of foreign banks presence increases the cost of domestic banks. Zajc 2002 finds that the foreign banks entry increases the cost of domestic banks in Central and Eastern Europe countries.

Table 7 (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.01002	0.02623	0.00000228	0.15	0.7062
Foreign_share_total assets	**0.00532**	**0.01722**	**0.00000149**	**0.10**	**0.7603**
Equity / ta_Foreign banks	0.12834	0.13173	0.00001485	0.95	0.3405
Non-interest income / ta _Foreign banks	0.26836	0.13071	0.00006596	4.22	0.0521
Customer Funding / ta_Foreign banks	-0.00879	0.02458	0.00000200	0.13	0.7239
Overhead_Expenditures / ta_Foreign banks	-0.26712	0.44579	0.00000562	0.36	0.5551

Source: author's calculation

Note:
*Significant at 10 per cent level;
**Significant at 5 per cent level;
***Significant at 1 per cent level

The SAS System

The REG Procedure

Dependent variable: Loan loss provision/ total assets of Domestic banks

R-Square = 0.5831

The results of testing the hypothesis concerning the impact of foreign banks presence on loan loss provisions are presented in Table 8. We find that the foreign banks presence has a negative impact on the loan loss provisions of domestic banks. A potential reason for this negative sign could be the case when the foreign banks presence influenced on the domestic banks to be more prudent in issuing loans. Claessnes et al 2001 finds that as foreign bank share increases, the loan loss provisions fall.

Table 8 (Number of observation is 30)

Variable	Parameter Estimate	Standard Error	Type II SS	F Value	Pr > F
Intercept	0.08524	0.04336	0.00016520	3.86	0.0621
Foreign_share_total assets	**-0.10679**	**0.02846**	**0.00060204**	**14.08**	**0.0011*****
Equity / ta_Foreign banks	-0.55194	0.21771	0.00027475	6.43	0.0189
Non-interest income / ta _Foreign banks	-0.27979	0.21604	0.00007170	1.68	0.2087
Customer Funding / ta_Foreign banks	0.01591	0.04062	0.00000656	0.15	0.6990
Overhead_Expenditures / ta_Foreign banks	2.17778	0.73678	0.00037348	8.74	0.0073

Source: author's calculation

Note:

*Significant at 10 per cent level;

**Significant at 5 per cent level;

***Significant at 1 per cent level.

8. Conclusion

In this paper, we have empirically analysed the impact of foreign banks entry on the domestic banks of Kosovo, by using the quarterly time seri data on seven commercial banks for the period 2001 -2007. The Kosovo banking system has considerably changed over these years of its operation. The foreign banks have played a very important role on the development of modern banking sector in Kosovo, because they assisted the reestablishment of banking sector by contributing in the improvement of quality and quantity of Financial Services.

The empirical results show that the foreign banks presence had a negative impact on the interest rate spreads and provision of domestic banks. Whereas, the foreign banks presence in Kosovo did not have a significant impact on the profitability and non-interest income of domestic banks in Kosovo.

The overall conclusion from this empirical analysis is that the foreign banks presence in Kosovo has not increased the competitiveness in the banking sector

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The Short Life of the Bank of Ethiopia

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Abstract: The Bank of Abyssinia, established in 1905, was given a 50-years concession by the Emperor Menelek II. This institution was engaged in issuing notes as well as in any kind of commercial banking business. Haile Sellassie, after acceding to the throne in 1930, could not accept that the country's issuing bank was a foreign-owned share company and decided for nationalization. The change was implemented, however, in a soft way, providing an adequate compensation to shareholders, and in agreement with the main foreign shareholder, the National Bank of Egypt. The Bank of Abyssinia went, therefore, into liquidation and a new institution, the Bank of Ethiopia, was established in 1931. The new bank, although under full Government control, retained management, staff, premises and clients of the ceased financial institution. Italian occupation of the country, in 1936, brought the liquidation of the Bank of Ethiopia.

Keywords: African Banking History; Ethiopian Banking; Bank of Ethiopia

JEL Classification: G 21; G 33; N 27

1. Introduction

Most of the contemporary qualified economic literature emphasizes the relevance of financial innovations, embodied both in financial institutions and in financial technologies, in promoting and speeding up economic development. Basic changes and convenient arrangements conducive to economic development were brought up in Ethiopia also in the financial sector during the first decades of XX century. Ethiopian banking history, in fact, goes as far back as 1905, when the first bank, the Bank of Abyssinia was established in the country. The second relevant event was the nationalisation of issuing banking decided by Haile Sellassie with the establishment of the Bank of Ethiopia. The third event was Italian colonization in 1936, when, following liquidation of the Bank of Ethiopia, a broad banking network, extended to encompass all Italian possessions in the Horn of Africa and closely linked with the metropolitan financial system, was set up.

The paper concentrates on the period of the banking history of Ethiopia (1930–1936), marked by significant changes in the institutional features of this industry in the country. The remainder of the paper is organised as follows. Section 2 gives a necessary background by summarizing the main phases for the implementation of the Bank of Abyssinia’s project. Section 3 deals with the first step adopted in the path for the crucial institutional financial innovation: the liquidation of the previous bank. Section 4 reports on the establishment of the Bank of Ethiopia and evaluates the results achieved by this institution during its short life. Section 5 concludes with the liquidation of this bank enforced by Italian authorities in 1936.

2. The project for an Ethiopian bank implemented by Menelek II

Emperor Menelek II wanted to establish a bank in the country, at that time called Abyssinia (Sellassié, 1932). For understandable motives of national pride he gave preference to a financial institution at least formally independent rather than to a much easier solution represented by opening a branch office of an expatriate bank. The Emperor contacted envoys from a number of European countries asking all of them for assistance in carrying out the project for a bank (Caselli & Mauri, 1986). While political and financial aspects of the project were being discussed in some European continental countries, the prompt British answer reached Addis Ababa. London was ready to provide assistance in this venture and felt it was best to entrust the task to the National Bank of Egypt, a private bank, under British control registered in Egypt as a limited company (Mauri, 1997).

An agreement was reached and, on March 11th, a convention for establishing the bank was signed in Addis Ababa by the two parties: the Emperor of Ethiopia and the National Bank of Egypt.[1] The new bank was established in Cairo as a joint-stock company according to the Egyptian commercial law at the end of May 1905. The statute was drawn up bearing in mind all the clauses contained in the Convention of Addis Ababa. The share capital of Bank of Abyssinia was set at pound sterling 500,000, divided into 5-pound shares. Of this authorized capital a 25 per cent was to be paid-in at the time of the constitution. Cairo was chosen for the registered office of the institution and consequently as the forum for Board of Directors' and Shareholders' meetings.

The statute called for the adoption of the pound sterling as the unit of account of the Bank of Abyssinia, even though most bank transactions would be carried out, as usual in Ethiopia, in Maria Theresa's thalers. This feature was not to have unimportant consequences for the Bank management, since the money of account

[1] The convention, known as “Charter for the Bank of Abyssinia”, drawn in a twin-language text (English and Amharic), had provisions which covered the main features to be conferred to the Bank and listed some privileges guaranteed to this institution by the Ethiopian government for 50 years (Mauri, 1967).

was on gold standard, while the specie normally used for payments in Ethiopia was based on silver standard. The Governor of National Bank of Egypt was to be the Board's ex-officio Chairman; he was to be a voting member as were the Governor of Bank of Abyssinia (Vice Chairman of the Board) and an additional eight ordinary members. The latter were to be nominated by the Shareholders' meeting; at least three of them were to be chosen among Board members of the Egyptian bank and two among Ethiopian notables.[1]

The 100,000 shares of Bank of Abyssinia were assigned as follows: 50,000 shares to an Anglo-Egyptian Group, 25,000 shares each to an Italian Group and a French Group. However all the shares were to be placed in a common account administered by National Bank of Egypt, which had pledged to take up 29,000 shares for itself and for the eight directors; parallel pledges were made by the French and Italian groups for 13,000 shares each. In order to offer the remaining 45,000 shares for public subscription, a banking syndicate, located in Paris at the headquarters of the Société Générale de Credit Industriel et Commercial, was formed, in which British banking group held 50 per cent and French and Italian groups 25 per cent each. Placing of Bank of Abyssinia shares, as expected, had a considerable success. In fact, 610,000 shares, i.e. more than thirteen times the total amount offered, were subscribed (Mauri, 1997).

The opening ceremony for the Addis Ababa head office of Bank of Abyssinia was held on February 15th, 1906 in the presence of the Emperor and his retinue of court dignitaries and diplomatic envoys (Pollera, 1926). From the beginning of its activity Bank of Abyssinia made conscious efforts to build up its administrative organization and lay out a network of branches in the country.

The management of Bank of Abyssinia from the very start of the Bank's operations continued Menelek's cause of spreading the use of national currency throughout the country.[2] Efforts were made to establish confidence on the exchangeability of the notes issued by the Bank and to familiarize the public with its services (Duggar, 1967). The widening of the monetary area of the Ethiopian economy was a chief objective strongly pursued, although with differing ends, both by the Government and the Bank of Abyssinia: the former aimed at the country's progress, the latter at gaining the confidence of the public for the expansion of its notes. It could be thought that the Bank could have full control of the money supply in Ethiopia, given that it minted coins for the State, issued notes under monopoly and was the only depository institution in the country. In truth the Bank's powers were greatly

[1] Thanks to the casting vote of the Board Chairman, the control over the bank was guaranteed to the British even in the unlikely event of a coalition among all other Board members, European and Ethiopian. (Mauri. 1967). According to Schaefer (1992) "from 1906 to 1909 the bank acted as a tool of British imperialism".

[2] Lowering interest rates was also one of the targets pursued by Menelek II in contemplating the establishment of a bank in the country (Schaefer, 1992).

limited, since national specie and bank notes had a very narrow circulation, which did not reach, in most instances, beyond the major urban centres. At the same time, the Maria Theresa silver thaler, a full value commodity money, was in use everywhere not only in Ethiopia but also in the countries of the Red Sea Littoral (Tschoegl, 2001). Coming back to the issue of notes by Bank of Abyssinia, it has to be underlined that these notes had to be fully covered by silver coins. Last, no reserve requirements were asked on deposits, but disappointedly for the Bank, current accounts held only a marginal position among the kinds of money used for payments in the country. Bank notes and bank deposits, in fact, are to be regarded as interchangeable forms of bank liability for payments, but their use depends on public's choices.

Because of the country's backwardness, which made transfer of money quite difficult and expensive, large cash balances in specie were needed in branches. It is not therefore too surprising to find out that earning assets represented less than half of the Bank's total assets. In part loans and investments were made in Egypt, primarily during the Bank's early years. The usual lending of Bank of Abyssinia in Egypt was made by advances on securities, a type of transaction unknown in Ethiopia, where guaranteed loans, overdraft facilities and advances on goods, often stored in warehouses, were granted.

Since the first days of this venture a great part of bank credit was channelled to financing international trade. In particular, the Bank was involved on the one hand in financing the collection and export of the primary commodities, such as coffee and on the other in financing distribution of imports of consumer goods. Investments in British Government bonds were also important, as a second line reserve. Deposit operations were not as successful as had been hoped. In particular, the inflow of savings deposits was scarce because of a number of factors such as the modest branch network, the low level of per capita income, the early stage of monetary development of the country (very low monetisation ratio of the economy), the lack of confidence on the part of the public and the unattractive interest rate offered to depositors. Current account deposits recorded better levels, since they were used by foreign businessmen and rich Ethiopian clients more accustomed to banking services and to the use of drawing cheques. The Bank of Abyssinia drew in considerable proceeds from exchange operations and imported huge quantities of Maria Theresa thalers, which were placed in the domestic market. Transfer of funds within the country was also a good source of revenue, but international transfers were even more profitable for the Bank.

A glance at Bank of Abyssinia series of Profit and loss statements and an investigation of performance determinants reveals considerable variability of results due both to business climate changes (connected chiefly with Ethiopian exports) and fluctuations in the price of silver and, consequently, in the exchange rate Ethiopian thaler / pound sterling. Losses were recorded during the first years of operation, but starting from 1909, profits are recorded. However caution dissuaded directors from paying dividends until 1918 in order to recover preceding losses registered in the take-off stage and because of uncertainties during the war period. For two years after dividends to shareholders were paid until a three-year slump of the Ethiopian economy (1921-1923). Payment of dividends recommenced in 1924 and continued without interruptions until 1930 (Mauri, 1967). At the end of 1930 the total amount of notes in circulation was 1,740,000 thalers (evaluated £. 88,549 12 s. 4.d in the Balance Sheet of Bank of Abyssinia) fully covered in the assets side by an equivalent amount of silver coins. Cash on hand in specie was almost £. 164 thousand and overall deposits more than £. 250 thousand.

3. The Liquidation of Bank of Abyssinia

When Zawditu, whose sole qualification, according to prominent Ethiopian historians (Bahru Zewde, 1991), was her birth, as the daughter of Menelek II, was proclamed Empress, Tafari Makonnen was designated regent of the empire and heir to the throne. Ras Makonnen had an impressive lineage and an extraordinary talent. He was open to foreign culture and very ambitious: since the beginning it was clear his climb to the throne. This goal was attained only after the death of Empress Zawditu, in 1930. The coronation of Ras Tafari Makonnen, under the style of Haile Sellassie, brought, once again after Menelek II, an outstanding personality to rule Ethiopia.

Haile Sellassie continued Menelek's policy aiming at independence, modernization and progress of the country. He had once been a member of the Board of Directors of Bank of Abyssinia and, following this line, gave priority to the reform of the Ethiopian monetary and banking system. Managers of the Bank, in a context of an “anti-foreign” movement, were blamed by a public opinion grown around the court in Addis Ababa (Schaefer, 1992) to have preconceptions about the conduct of banking business, which were the result of their cultural background. These criticisms were not unfounded, but it should be underlined that these foreign bankers brought in banking business good standards of integrity and incorruptibility. The people’s criticisms did not influence, nevertheless, the Emperor’s decisions on this matter and the managers of the Bank were not dismissed. In conclusion we can state today the opinion that Bank of Abyssinia had been of undeniable utility to the Ethiopian economy, but in 30’s times and views had changed and the Emperor thought that it was no longer possible for Ethiopian government to accept the fact that the only issuing bank operating in the country was owned and controlled by foreigners. He wanted a purely Ethiopian institution (Konczacki, 1962). Without delay Haile Sellassie made his decision known to the National Bank of Egypt and, since the Egyptian bank was not particularly reluctant to withdraw from Ethiopia, provided an adequate compensation, negotiations began in Cairo for Bank of Abyssinia liquidation.

The legitimate and long standing Ethiopian aspiration of creating a truly national bank of issue did not necessarily imply the liquidation of the existing Bank of Abyssinia. It would have been sufficient to cancel the Abyssinian bank's privileges of issuing currency, of banking monopoly and of exclusive right to act as fiscal agent for the Government. At the same time, a new financial institution, an Ethiopian state bank, could have been created. Nevertheless, both parties' interests laid in liquidating Bank of Abyssinia. On the one hand, National Bank of Egypt was not so much interested to continue doing business in the country under the less favourable conditions brought about by the change in the political setting and, on the other hand, the Ethiopian Government strongly wanted to make use of the existing organization (assets, liabilities, management, personnel and premises) of the Bank of Abyssinia in order to speed up implementation of the project for the establishment of a State bank. The solution of liquidation of the Bank of Abyssinia, in fact, would make possible to establish the new bank without delay.[1] Negotiations were concluded on April 16th, 1930 with an agreement calling for (Zervos, 1936):

a) revocation of concession and privileges granted to the Bank of Abyssinia in the 1905 convention;
b) the winding up of the Egyptian joint-stock company "Bank of Abyssinia";
c) liquidation of Bank of Abyssinia through conveyance en bloc of its assets and its liabilities to the Ethiopian Government;
d) payment by the Ethiopian Government of a sum of 40,000 pounds to Bank of Abyssinia shareholders as a compensation for terminating the concession nearly 25 years before it was scheduled to end and for the Bank's goodwill.

In accordance with agreed conditions, the Ethiopian Government paid up to shareholders a total of £ 203,807. 7 s. 6 d. in instalments until July 1931. This amount was calculated by summing up the adjusted book value of Bank of Abyssinia, the above mentioned compensation of 40,000 pounds for terminating in advance the concession and the interest (at a rate of 6% per annum) on the debt of the Ethiopian Government from the end of 1930 to July 16th, 1931, the day on which the last instalment was paid. An important agreement was signed with the Ethiopian authorities on July 13th, 1932 regarding the notes issued by Bank of Abyssinia. The liquidators transferred to the new Ethiopian bank the specie reserves in Maria Theresa silver thalers, which covered issues of notes by the Abyssinian bank depositing them in a specific account entitled “Trustee for Redemption of Bank of Abyssinia in voluntary liquidation notes”. The new bank

[1] Three liquidators were appointed: Sir Bertrand Hornsby, governor of the National Bank of Egypt, J.C. Sidley from Cairo and C.S. Collier, governor of the Bank of Abyssinia. Later, on request of the Ethiopian government, Hornsby was replaced by Mr. Johan Crawford from Cairo (Schaefer, 1992).

agreed to provide the conversion service for these notes free of charge (possibly by means of replacement with its own notes) and to make, as a guarantee, a deposit in South Australia 5% bonds with an overall face value of 5,000 pounds with National Bank of Egypt in Cairo. The guarantee deposit was to be freed gradually as Bank of Abyssinia notes were redeemed by the new Ethiopian bank and destroyed under the control of the Egyptian consulate in Addis Ababa.

4. The Bank of Ethiopia

The new bank was chartered as Bank of Ethiopia by the Imperial Decree issued on August 29th, 1931 and this act represented the first banking law ever passed in the country (Pellegrineschi, 1936). A regime of ex-ante authorization for banking industry was established and this provision was justified by attributing the qualification of public interest to banking operations.

The Bank of Ethiopia was set up as a joint-stock company, with an authorised capital of £ 750,000 divided into 30,000 shares of 25 pounds each. Private Citizens were supposed to become shareholders since two different needs had to be met. On the one hand, given the important functions assigned to the Bank of Ethiopia, the Government was to have full control over the Bank's management. On the other hand private contribution to the share capital could have made Government contribution less burdensome. The two objectives were not irreconcilable and it was deemed that the best solution would be to differentiate shares into two classes. Class A shares, 18,000 in number, would have been meant for the Government, while class B shares, 12,000 in number, would have been placed by public subscription. The two above-mentioned classes would have enjoyed equal rights, the only relevant difference lying in the appointment of the Bank's directors. The holders of the two classes of shares would have met separately: holders of class A shares (i.e. Government) to appoint six members of the Board and holders of class B shares to appoint the remaining four members. This formula would have ensured the Government's control over the Bank even with a minority stake in the equity capital. At the time of constitution, only half of the share capital, however, was paid up. At the closing of subscriptions, a total of 18,877 shares of the 30,000 offered had been subscribed. The results did not come up to expectations as the public showed no interest in the operation. In particular, the subscription failed to attract foreign capital that had greatly contributed to the success of the Bank of Abyssinia stock subscription. The Ethiopian Government held 18,003 shares, nearly 95.4 per cent of the company capital, and another 874 shares were in the hands of the public. The paid-up capital of Bank of Ethiopia turned out to be £ 235,692 10 s. 0 d. instead of the expected £ 375,000. The sum paid by the Government included the purchase price paid to the shareholders of Bank of

Abyssinia because of its contribution in kind by conferring the assets and liabilities of the liquidated bank.[1]

Bank of Ethiopia notes, according to the Imperial Decree, were to be fully covered by reserves including: minted and ingot gold, foreign currencies (provided they were payable in gold), bank bills and acceptances in gold currency, Ethiopian and foreign short-dated government bonds and other assets of a similar nature. The various assets backing notes were not however perfectly fungible and ceilings had been established for some types of reserve-assets. The Bank of Ethiopia was made the depository of public funds and was to provide other normal banking services, as fiscal agent, to the Government.

The institution began operations in November 1931 retaining the Governor Mr. Collier (a Canadian banker), appointed chief executive, and taking over management, staff and premises of the ceased Bank of Abyssinia (Deguefe, 1965). Since only the name of the institution had changed, most of the public were unaware of the event, which nevertheless represented a very important step on the way toward the county's emancipation (Pankhurst, 1963). Bank of Ethiopia however came into being with a more favourable position than Bank of Abyssinia. Relations with Ethiopian authorities were in fact much smoother than they had been for the former bank since all Bank of Ethiopia Board members were appointed by the Government itself. The powers of the Board of Directors were wide-ranging, encompassing also the main aspects of monetary management in the country. The Board was entrusted with fixing borrowing and lending rates applied by the Bank. Bank notes coverage in specie was only partial and not full as for Bank of Abyssinia. Eventually Bank of Ethiopia could have been considered a central bank, since, besides enjoying the sole right of note issue and acting as financial agent of the Government, it was providing refinancing facilities to other financial intermediaries. The Bank of Ethiopia gained, since its establishment the full central banking status and may be placed, therefore, among the first indigenous central banks set up in the whole of Africa (Ahooja, 1965).

The Bank of Ethiopia in its ability to pursue an independent monetary policy and a credit supply policy could foster the economic development of the country. The Bank however was run conservatively on the one hand because had to face a number of constraints and on the other hand because the management, taken over from Bank of Abyssinia, preferred to keep on with the customary cautious policy of the previous bank. The pound sterling was maintained as unit of account even though in transactions with customers the use of Maria Theresa's silver thalers prevailed by far. The branch network took over by the Bank of Abyssinia was

[1] According to Schaefer (1992), many deposit accounts were unclaimed and could have been distributed to the Bank of Abyssinia's shareholders. However the Bank was involved in enquiring on depositors and their heirs.

extended and encompassed the transit office in Djibouti and 6 branch-offices: Debre Tabor, Dessie, Dire Dawa, Gambela, Gore, Harar. Efforts to spread the use of national currency throughout the country were eventually unsuccessful, but it should be mentioned that the main causes, which prevented the achievement of this ambitious goal were external and out of control of the Bank. It was decided to replace the silver standard of Bank of Abyssinia (full coverage of notes circulation in silver coins) with a gold exchange standard system, based on British pound sterling, even though only silver coins were circulating in the country. Frequent and sharp fluctuations in the value of silver (high volatility of prices in the past experience) had suggested to abandon the silver standard and to adopt a monetary system based on gold; therefore minted silver was to be allowed to continue circulating, but only as token money. There was no circulation of minted gold and the new Ethiopian golden thaler was in fact to be only a virtual monetary unit.

Just less than a month after the Imperial decree was promulgated, an international crisis of the gold standard occurred. Bank of Ethiopia had to adapt to the new situation while its notes were covered by minted silver (Maria Theresa thalers) and foreign currency. Maria Theresa thalers served to maintain internal convertibility and thus to permit continued contacts with a domestic economy dominated by the Austrian silver coins as well as the settlement of trade balance's with a number of neighbouring countries. Conditioned by its political and economic international ties, Ethiopia sought to remain linked to British sterling even after this currency interrupted convertibility into gold on September 21st, 1931. The dual reserve system of Bank of Ethiopia, due to the desire to link simultaneously the Ethiopian monetary unit to pound sterling and to silver, while silver prices underwent considerable fluctuations, was a cause of serious problems for the Bank. In facing these disturbances the Ethiopian bank tried to stabilize the silver thaler / pound sterling exchange rate. In other words efforts of Bank of Ethiopia were directed to neutralize effects on the domestic market of fluctuations of silver prices on the London market. This policy caused a growth of smuggling on the borders of the country, mainly during periods marked by maximum divergence between the market price of silver and the Bank's official price (Bertone, 1936). The Bank of Ethiopia made efforts to pursue the objective of increasing the use of national currency in the country and to enlarge its sphere of influence on the economy. Another objective of the Bank's monetary policy was to avoid disturbances due to seasonal movements.

Attempts were made in the first place to safeguard what little progress had been achieved by Bank of Abyssinia. The new bank notes therefore had format, languages and appearance similar to that of the previous ones. Issue of notes, under the new legislation, began in May 1932 in the following denominations: 5, 10, 50, 100 and 500 Eth. thalers. In June 1933 notes in 2 Eth. thalers denomination were also issued (Zervos, 1936). As the new notes were issued the Bank of Abyssinia old notes were withdrawn from circulation. At the end of 1933 nearly 94% of the outstanding circulation of Bank of Abyssinia notes had been redeemed. While the note substitution went on smoothly, it proved much harder job to expand the circulation of paper money to other segments of domestic economy. Curiously enough, in some instances Bank of Ethiopia notes seem to have been accepted only at discounted value (Farago, 1935). Table 1 shows the circulation of notes issued by Bank of Ethiopia, figures refer to the end of month. The table indicates that he overall circulation of Bank of Abyssinia notes had been surpassed in October 1932, but reveals a standstill the following year. The peak was reached in February 1935 and from the following month began to shrink owing to impending war. The table enlightens another interesting phenomenon still visible in Ethiopia today: the seasonal fluctuations of money supply due to exports which usually make an inflow of foreign currency during the first quarter of the year, creating monetary base.

Table 1. Outstanding Notes of Bank of Ethiopia

End-of-Month Circulation (*unit: Eth. thalers*)

Month	**Year**			
	1932	*1933*	*1934*	*1935*
January	-	2,282,680	2,336,531	2, 989,977
February	-	2,459,305	2,541,601	3,143,080
March	-	2,519,270	2,530,424	2,374,173
April	-	2,358,320	2,625,174	2,709,780
May	123,905	2,148,920	2,708,029	2,401,797
June	976,580	2,127,145	2,728,366	2,306,276
July	1,287,395	2,108,520	2,800,274	2,439,442
August	1,327,155	2,194,560	2,785,261	2,001,235
September	1,616,425	2,155,630	2,859,505	1,925,300
October	1,858,500	2,209,479	2,591,692	1,658,243
November	1,839,305	2,288,418	2,791,465	1,741,746
December	2,065,135	2,121,632	2,890,620	1,804,322

Source: Bank of Ethiopia, Annual Reports

In order to evaluate correctly the results achieved by Bank of Ethiopia in developing bank notes circulation in the country it is necessary to take into consideration the circulation of foreign-minted silver coins during the same period of time. At this point it should be added that monetary reform also involved token coins by establishing a decimal based fractional currency system of nickel and bronze coins, fully backed by Maria Theresa thalers in the Bank's vaults. The official figures on the stock of money within the country, at that time, show slightly less than 6.4 million thalers, made up approximately as follows: bank notes 44 per cent, token coins 11 per cent, bank checking deposits 45 per cent. Alongside this official money supply circulated theoretically a mass of full value commodity money (i.e. Maria Theresa silver thalers) estimated at 40 - 50 million pieces.

The Bank of Ethiopia co-existed with other financial institutions, each catering to the needs of different types of customers and with little overlap of functions. The Bank was engaged in collecting deposits in domestic currency as well as in a number of foreign currencies. There were no provisions for reserve requirements in respect to this liability similarly as it were with the Bank of Abyssinia. Demand deposits, chiefly made up with public funds, were not interest bearing and savings deposits accounted for one fifth of total deposits. Savings passbooks earned a modest rate, which did not reflect market conditions. This fact, together with a lack of a savings promotion campaigns, explains the unsatisfactory growth rate of deposit balances.

Earning assets were limited by the need to keep high idle cash balances in branch offices. Investment portfolio held Ethiopian and foreign Government bonds and bills. In addition the above mentioned South Australia 5% bonds were deposited as security for notes redemption with National Bank of Egypt. In lending operations a very important role had discounting of international and national bills and promissory notes. Advances on securities and merchandise, whose term almost never exceeded six months, were also granted. Merchandise was stored in the Bank's warehouses while precious metals were held in the Bank's vaults. An interest rate of 8 -10% was applied to these transactions. In addition Bank of Ethiopia granted loans to Ethiopian individuals covered by personal guarantees. Mortgage loans developed at a very modest rate. In conclusion it is undeniable that lending by the Ethiopian bank during the first years of operations was excessively prudent and that this institution did not take full advantage of its leading position to implement a lending policy conducive to speeding up economic development. However the judgement should not be too severe because of the short life of this institution. In fact the Italian invasion of Ethiopia interrupted the take off of this bank.

5. Conclusion

The Italian authorities, after the fall of Addis Ababa in their hands, on May 5th, 1936, initially allowed normal activities of Bank of Ethiopia to be continued because some time was needed to make decisions on the Bank's future. They were faced in fact with two alternatives equally viable, but each tied to different views on the target structure of the banking system of the Horn of Africa. On the one hand there was the opportunity of keeping the Bank alive, changing its ownership (class A registered shares being transferred from the Ethiopian Government to the Italian Government), name, management and, partially, staff. This line of action, which had been successfully followed dealing with Société Nationale d'Ethiopie, nonetheless entailed the adoption of an autonomous stance in the monetary and credit field which had not been taken in the past in the former colonies of Eritrea and Somalia, but which did not lack prominent supporters among Italian economists. On the other hand the view calling for a complete integration of Ethiopia as well as other Italian possessions in East Africa into the metropolitan monetary and banking system necessarily implied the liquidation of the Bank of Ethiopia. The second alternative, mainly based on political issues of the Fascist regime, finally prevailed.[1]

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[1] Following the liquidation decree issued by the Italian colonial government, a litigation arose before the English courts, where effect was given to the Italian decree on the basis that Great Britain had recognised Italy as being in *de facto* control of the conquered country; see "Bank of Ethiopia v. National Bank of Egypt and Liguori", *The American Journal of International Law,* 1937.

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Analysis of Budget and Fiscal Policy and its Implications in Terms of Integration into the European Union

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Abstract: Our paper's aim is to review the main fiscal and budgetary measures taken by the Romanian government in the pre EU era and its effects. Many of them were imposed by the European aquis, but other was just proper for the economic national and international context.

Keywords: fiscal; budget; policy; integration; tax

JEL Classification: H72; H61; E63

1. Introduction

Fiscal policy in the period 2002-2007 had as main objective the integration of Romania into the European Union, and actions would be undertaken to achieve the objective have been included in the first variant of the pre-accession economic program in 2001. Ministry of Public Finance Strategy developed in 2001 for the period 2002-2006 which included the priority objectives for Romania's accession to the EU including in the fiscal budget. From this perspective, financial policy, including fiscal policy had directed that "contribute to stimulating savings and investment and to meet the rigors of macroeconomic stability." (Văcărel, 2004, p. 123) Government priorities include control of the consolidated budget deficit, fiscal and quasi-fiscal deficit reduction, increased revenue collected to the budget, harmonization of tax legislation with EU norms, increasing the effectiveness of tax administration, transparency in public spending.

The fiscal policy objectives outlined in the Convergence Program from 1 January 2007, specified that the government's fiscal policy is designed to support the objectives of convergence, the budget deficit at a prudent level by stimulating improved collection rates, by increasing efficiency and accountability in public spending of resources and promoting measures to broaden the tax base in order to enhance public revenues in a sustainable manner. Medium-term efforts of the

Government and headed by "creating conditions conducive for maintaining long-term sustainability of public finances, including the costs of launching the second pillar pension, which means primarily adjusting to the consequences of public budgets aging population."

In general, discretionary public spending are made possible when a country has the "fiscal space (space tax), in other words, the difference between peak current public expenditure and government expenditure which can be done without harm to the fiscal and budgetary solvency, in other words, without affecting current and future ability to pay its debts[1]. Indicators that can appreciate the "fiscal space" are represented by public debt to GDP, external debt to GDP ratio, budget deficit as a percentage of GDP. Fiscal space can be created without creating new debts by improving efficiency of public spending, increase revenue and mobilized additional financial aid (grants). Maintaining fiscal budget solvents is one of budget and fiscal policy issues. Another relates to macroeconomic stability. Capacity increases public spending while maintaining macroeconomic stability was supposed to "macroeconomic space" (macroeconomic space)[2]. High rates of inflation limit the ability of fiscal and budgetary expansion.

In addition to changes in the overall budget, had been changed and its components, revenue and public expenditure, which have been redesigned according to international classifications and specific classifications of the European Union and International Monetary Fund.

2. Analysis of Budgetary Resources Procurement Policy and its Implications in Terms of Integration into the European Union

Fiscal resources to purchase the policy had an important role in the launching of accession, accession and EU integration, therefore, negotiations with the Union in the chapter on taxation was opened in October 2001 and provisionally closed in June 2003 and then reopened and provisionally closed in November 2004. The main objective of the EC Treaty establishing the common market with characteristics similar to a domestic market requires that the Member States in the field of indirect taxes (mainly on VAT and excise) and direct taxes (with particular reference to corporate tax and taxes capital).

Procurement policy measures on fiscal resources, seen as part of budget and fiscal policy, which were considered during this period had implications for the idea of reforming the tax system in fiscal easing the situation in Romania, to encourage cell production, saving , especially consumption and private investment. The table below presents the situation of saving and investment from the private sector:

[1] 2009 World Development Indicators, p. 199.
[2] Idem.

Table 1 Balance saving (S) and investment (I) on in Romania, 2003-2007 (% of GDP)

Indicator	**2003**	**2004**	**2005**	**2006**	**2007**
Private Savings	14.9	13.7	11.9	13.5	14.4
Private Investment	18.5	21.0	20.0	23.3	26.0

Source: Romania: Selected Issues, IMF Country Report No. 08/210, July 2008, 2008 International Monetary Fund, p. 6

Thus, the above table, we see an improvement in private investment as a percentage of GDP, due to fiscal policy decisions (particularly the reduction of taxation, but also the efficiency of administering the tax system in terms of taxes simplify them) that have generated increasing disposable income of private agents, who finances the investment objectives oriented, with strong social and economic effects. In this sense, the measure allowed the introduction of a flat increase in the volume of private investment from 20% in 2005 to 26% of GDP in 2007. 2005 was the year after that and allowed a recovery of private savings, which until then had seen a downward trend, as a percentage of gross domestic product.

Table 2. Evolution of public revenues from the consolidated budget in Romania, 2002-2008

(mil lei)

Explanations	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Total revenue	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Taxes	93.1	94.0	94.3	94.1	90.5	90.6	86.6
Indirect taxes	37.8	40.8	40.3	42.8	36.9	36.2	34.3
Direct taxes (including contributions)	55.3	53.2	53.9	51.3	48.7	51.3	51.5
Social security contributions	36.1	32.8	31.7	32.5	30.8	30.6	29.4
Other current revenue	6.6	5.6	5.0	5.1	6.8	6.4	10.0
Capital Revenue	0.2	0.3	0.5	0.5	0.9	0.7	0.6

Source: Romania: Selected Issues and Statistical Appendix, IMF Country Report No. 06/169, May 2006, p. 88, Romanian Statistical Yearbook data processing, 2007 (for 2006-2008) and general government budget execution in 2006, 2007, 2008, source: Ministry of Public Finance

Romania's total revenues during 2002-2008 originated in a ratio greater than 50% of taxes (without taking into account social security contributions) and over 90% of taxes and contributions. Collection of a social nature also has an important place among categories of sources of public revenue, representing over 30% of the total revenue accruing to the Exchequer. Capital revenues are less significant for fiscal policy, which is nearly a percentage of total revenue raised from the public budget. Evolution of current income, other than tax is positive, reaching 10% of total budgetary resources.

A breakdown of tax revenue in Romania is required and is shown in the table below:

Table 3. Evolution of tax revenue in Romania, 2002-2007

% total

Explanations	2002	2003	2004	2005	2006	2007
Receipts from taxes, fees and contributions	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
I. Receipts from taxes	**61.0**	**64.8**	**65.2**	**64.0**	**64.6**	**64.5**
Taxes on production and imports	**40.8**	**43.6**	**42.3**	**45.3**	**43.7**	**41.8**
A. Taxes on production	38.6	41.4	40.6	43.5	41.7	39.0
1. VAT	24.9	25.6	24.1	28.3	27.2	26.9
2. Import duties	2.3	2.5	3.7	3.3	3.2	0.3
3.Accize	9.2	12.3	11.7	10.8	10.0	10.1
B. Other charges, of which	2.2	2.1	1.7	1.7	2.0	2.8
a. Taxes on land and buildings	1.0	1.1	1.0	1.0	1.1	1.3
b. Taxes on international transactions	0.2	0.2	0.2	0.2	0.2	<0.1
c. Taxes on pollution	<0.1	<0.1	<0.1	<0.1	<0.1	0.7
Taxes on income, wealth	**20.2**	**21.3**	**22.9**	**18.7**	**20.9**	**22.7**
Taxes on income, of which:	18.8	20.2	21.9	17.7	19.9	21.6
Income Tax individuals	9.4	10.0	10.2	8.0	9.8	11.0
Tax on income / profit businesses – Corporate tax	9.2	10.0	11.4	9.5	9.7	10.4
Other current taxes	1.4	1.1	1.0	0.9	1.0	1.1
II. Proceeds from social contributions	**39.0**	**35.2**	**34.8**	**36.0**	**35.4**	**35.5**
Actual social contributions (state social insurance contribution, contribution to	37.7	33.8	33.2	33.9	33.5	33.3

the Fund for payment of the unemployment, the Fund contribution for single health insurance)						
Social contributions-Employer	22.7	22.0	21.3	22.4	21.6	21.0
Social Contributions - Employee	14.7	10.9	10.7	10.5	11.7	11.3
Imputed social contributions (pensions for military)	1.3	1.4	1.6	2.1	1.9	2.3

Source: Adapted from Eurostat statistics, http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/main_tables

The table above shows the detail of tax revenues accruing to the general consolidated budget in 2002-2007. In this respect, it becomes a social tax reduction, both the employer, from 37% in 2002 to 33% in 2007 which allowed for boosting employment and supporting the production and the employee, from 14.7% in 2002 to 11.3 % in 2007, which has had positive effects on the propensity to work of employees. In addition, there is a reduction of income earned by employees and entrepreneurs representing about 4 percent boost private savings for investments and to support the growing national economy is in full swing, even if the receipts from taxes on income and Profits increased as a final step, but in 2005 there is a significant reduction as a result of bringing the flat tax system that resulted in a collapse of revenues collected initially, followed, as economic theory supports an expansion of earned income.

As regards direct taxes, Romania did not meet in terms of integration, imposing conditions to mergers, divisions and assets transfer and exchange of securities between companies belonging to Member States.

From 1 July 2002 new legislation came into force on the profit tax[1] has brought progress on the harmonization of national legislation with the acquis communautaire, which was intended to simplify existing legislative support at the time, is a series eliminating normative acts related accumulated over time in repeated changes and additions. This regulation brought the new accelerated depreciation, increased the tax rate of profit generated by export activity to 12.5%, all with respect to export activity, the tax rate was applied the income generated by export activity has increased from 25% in 2004 and was virtually under the same regime that was governed by the profit generated by activities undertaken in the country. These changes have increased the tax efficiency of this type of tax and its neutrality.

Fiscal policy at the time of introduction of the flat tax of 16% of the profits made by traders bet on an easing of the tax burden. Thus, we created an environment attractive to Romanian and foreign investors have been paved to reduce the shadow

[1] Income Tax Law no. 414 of June 26, 2002, published in Official Monitor no. 456 of June 27, 2002.

economy, whose layers are pretty consistent, and the issue of collection of public financial resources to meet the needs of the public who provided it was considered resolved, both within the statutory reinstatement of taxable economic activities by and through measures to broaden the tax base, an action that has restricted visibility and reap revenue without throwing the government on various charges inhibit economic year itself. Also regulations were not consistent EU legislation had reconsidered, forgoing some of them are full, more are being redesigned to be folded so that the acquis communautaire became legal support us in 2007 before the end had to be incorporated in our legislation nr.2003/96/EC Directive restructuring the Community framework for taxation of energy products and electricity, nr.86/560/EEC Directive on the harmonization of Member States relating to turnover taxes, nr.90/434/EEC Directive on the common tax regime applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (as consolidated with Directive 19/2005), Directive nr.90/435/EEC the common tax regime applicable to parent companies and subsidiaries of different Member States (as consolidated with Directive 2,003,123) nr.2002/94/EC Directive laying down detailed rules for implementing certain provisions of Directive 76/308/EEC Council on mutual assistance for the recovery of claims on certain levies, duties, taxes and other measures, etc. Another aspect of procurement policy to fiscal resources is the taxation of individuals, in this case, the system adopted by the government had measures in the forefront of broadening the tax base by including the income tax more types of income and incentives to generate positive activities, such as those relating to the deductible expenses that have been extended for housing rehabilitation activities or to pay their insurance premiums or contribute to a private insurance health.

Regarding personal income, for example Peter was true following the 2004 scale of assessment for monthly income from wages and pensions:

Table 4. Imposing scale monthly wage and pension income, 2004

Monthly taxable income (ROL)		Monthly Income tax (ROL)	
		Fixed amount	Marginal rate
until	2.400.000	-	18%
2.400.001 –	5.800.000	432.000	23%
5.800.001 –	9.300.000	1.214.000	28%
5.800.001 –	9.300.000	2.194.000	34%
over	13.000.000	3.452.000	40%

Source: Ministry of Public Order, nr.1848 of 22 December 2003 setting monthly tax scale of salaries and pensions for the fiscal year 2004, published in Official Gazette No. 4 of 6 January 2004

The scale of tax was amended in late 2004, replacing the 5 allowances into remote composed of three levels, namely: 14, 26 and 38, which would have effect in 2005. This measure aimed at reducing the tax on disposable income and positive effects on consumption and saving process of individuals. But it took time to have effect as a result of changes in fiscal and budgetary plan next year.

Table 5. Evolution of tax revenue on salaries and income from the consolidated budget in 2002-2008

% Of total general government budget resources

Explanations	2002	2003	2004	2005	2006	2007	2008
Wage and income tax	9.3	9.4	10.1	7.8	9.1	11.3	11.2

Source: Romania: Selected Issues and Statistical Appendix, IMF Country Report No. 06/169, May 2006, p. 88, Romanian Statistical Yearbook data processing, 2007 (for 2006-2008) and general government budget execution in 2006, 2007, 2008, source: Ministry of Public Finance

From the table above would impact the product so far to change income tax rates and wages at the end of the year 2004 so that in 2005 the volume of resources collected on this pathway was reduced by almost two percentage points in total resources general government.

Then, in 2005 we opted to management to simplify tax, flat tax was introduced that brought a clarity and transparency in fiscal operations of our country. This flat is a first step by the government at that time sustain growth, resulting in additional revenue to the budget of its existence, and not least, changes in taxpayer behaviour, changes that we have presented explaining the evolution of saving table and private sector investment. In this regard, since January 1, 2006, under legislation adopted for income earned by non-resident individuals, the rate of 16%, excluding income from gambling, for which the tax rate remains 20%, thereby unifying the tax rates applied to non-residents increased from 10% and 15% to 16%, except for gaming where the share remains constant. In this way nr.2003/48/EC transposed Directive on taxation of savings income in the form of interest payments.

3. Conclusion

Reduce income taxes on individuals and businesses helping to stimulate investment and consumption support. Flat tax has been applied in Europe for the first time in Estonia (1991), followed by Latvia (1994), Lithuania (1994), Russia (2001), Serbia (2003), Ukraine (2003), Slovakia (2004) Georgia (2004) and Romania (2005). Some analysts are not great supporters of the tax reduction as a factor for economic recovery, however, is quite clearly that tax cuts issue for individuals and companies, funds can be spent on consumer goods, new investments can be made or new jobs and may even attract foreign investment, while the host country tax rates is less than the mother country.

The introduction of flat tax was intended to spur investment and create new jobs, and on the other hand to reduce workers in the underground economy (estimated that the measure has so far about the situation. 150,000 workers) and reducing the burden of tax administration act.

"The main purpose of the budget and fiscal reform in this period was to simplify the tax system, increase predictability and improve incentives for work and business. [1]

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***Convergence Program, 2006-2009, Romanian Government, January 2007.

[1] Convergence Program, 2006-2009, Romanian Government, January 2007.

Miscellaneous

Two Methods of Determination of an Acquisition Program in Integer Numbers

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Abstract: This paper solves the problem of maximization of the total utility in integer numbers, using first the analysis of integer cases and after with the linear programming in integer numbers.

Keywords: utility; maximization; Simplex; Gomory

JEL Classification: C65; C81; C82

1. Introduction

In the process of acquisition of goods, the first principal problem is those of maximizing the utility under a budget constraint. Let therefore two goods A and B with corresponding prices p_A and p_B and the total budget for acquisition V. The utility function is U: $\mathbf{R}_+^2 \to \mathbf{R}$, $(x,y) \to U(x,y)$ where x and y are the quantities of A and B respectively. The classical conditions for maximizing the utility are:

$$\begin{cases} \max U(x,y) \\ p_A x + p_B y \le V \\ x, y \ge 0 \end{cases}$$

It is shown that, if the goods are perfectly divisible, the extreme of U is reached on the straight line: $p_A x + p_B y = V$.

The question which arises is those related to the indivisibility of A and B. Before to formulate the new problem, let suppose that the prices p_A, p_B and the budget V are integers. This is not a forced assumption because after a multiply with a convenient factor this supposition becomes true.

The problem is therefore:

$$\begin{cases} \max U(x,y) \\ p_A x + p_B y \le V \\ x, y \in \mathbf{N} \end{cases}$$

For example, let consider the problem of acquision where $p_A=11$, $p_B=10$, $V=184$ and the utility function is one of Cobb-Douglas type: $U(x,y)=x^{0,37}y^{0,63}$. The classical solution is: x=6.189 and y=11.592 with the maximal utility $U_t=9.190$. At a first sight, we can take the round values: $x_1=6$ and $y_1=12$ with $U_{t1}=8,243$. But the necessary budget is $V_1=11\cdot6+10\cdot12= 186>V$ therefore the combination is not good. Another allocation is find on integer values of x and y, that is: $x_2=6$ and $y_2=11$ with $U_{t2}=8,790$ and $V_2=11\cdot6+10\cdot11=176<V$.

In what follows, we shall see that neither this solution is acceptable.

2. The Allocation of an Integer Number of Goods in order to Maximize the Total Utility

Let $R=\{(x,y)\mid x,y\ge0, p_Ax+p_By\le V\}$ the budget region and $R_{\mathbf{N}}=R\cap\mathbf{N}\times\mathbf{N}$ the restriction of R to all pairs of positive integer coordinates.

Because $p_Ax+p_By\le V$ we have: $x\le\frac{V}{p_A}$ and $y\le\frac{V}{p_B}$ therefore $(x,y)\in R_{\mathbf{N}}$ implies that: $x\in\left[0,\left[\frac{V}{p_A}\right]\right]\cap\mathbf{N}$ (*where [a] is the greatest integer less than a*) and $y\in\left[0,\left[\frac{V}{p_B}\right]\right]\cap\mathbf{N}$.

For a value $k\in\mathbf{N}$ such that $0\le k\le\left[\frac{V}{p_A}\right]$, we find that $y\le\left[\frac{V-kp_A}{p_B}\right]$.

Let now $y\le\left[\frac{V-kp_A}{p_B}\right]$ such that $y+1\le\left[\frac{V-kp_A}{p_B}\right]$. Because the utility is an increasing function with respect to x and y we shall have $U(x,y+1)>U(x,y)$ therefore $(x,y+1)$ will be preferred to (x,y).

After these considerations we have the answer for the problem. We must compute all the values $U\left(k,\left[\frac{V-kp_A}{p_B}\right]\right)$, $0\le k\le\left[\frac{V}{p_A}\right]$ and choose the greatest.

Example For the problem presented in introduction, we shall obtain the best solution: x=4, y=14, U_t=8,807 and V=184 which differ essentially from the above.

3. The Simplex Algorithm for the Allocation of an Integer Number of Goods

Let a consumer which has a budget V of acquisition of two goods A and B. The corresponding prices of A and B are p_A and p_B respectively. The utility function is U: $\mathbf{R}_+^2 \to \mathbf{R}$, $(x,y)\to U(x,y)$ where x and y are the quantities of A and B respectively. Let also the marginal utilities $U_{mA}=\frac{\partial U}{\partial x}$ and $U_{mB}=\frac{\partial U}{\partial y}$ which generate for each integer value k of x and p of y the corresponding values $u_{Ak}=\frac{\partial U}{\partial x}(k)$ and $u_{Bp}=\frac{\partial U}{\partial y}(p)$ respectively. Let note also a – the number of goods A and b – the number of goods B taking into account in a consumer's plan.

Because the total utility is the sum of the marginal utilities, we shall search the maximum of the function: $U_t=\sum_{i=1}^{a} u_{Ai} + \sum_{j=1}^{b} u_{Bj}$.

Let note: $x_{Ai} = \begin{cases} 1 \text{ if the i - th dose from the good A is used} \\ 0 \text{ if the i - th dose from the good A is not used} \end{cases}$

and also for B: $x_{Bi} = \begin{cases} 1 \text{ if the i - th dose from the good B is used} \\ 0 \text{ if the i - th dose from the good B is not used} \end{cases}$

Because the impossibility of using the (i-1)-th dose involved the existence's impossibility of the i-th dose, we shall put the condition that: $x_{Ai}, x_{Bi} \in \mathbf{N}$, $0 \le x_{Ai} \le x_{Ai-1}$, $0 \le x_{Bi} \le x_{Bi-1}$ for i>1.

We have also: $\sum_{i=1}^{\left[\frac{V}{p_A}\right]} p_A x_{Ai} + \sum_{j=1}^{\left[\frac{V}{p_B}\right]} p_B x_{Bj} \le V$.

The problem consists in the determination of x_{Ai}, x_{Bi} such that $\max\left(\sum_{i=1}^{\left[\frac{V}{p_A}\right]} u_{Ai} x_{Ai} + \sum_{j=1}^{\left[\frac{V}{p_B}\right]} u_{Bj} x_{Bj}\right)$.

The problem is therefore:

$$(1)\qquad \begin{cases} \max\left(\sum_{i=1}^{\left[\frac{V}{p_A}\right]} u_{Ai}x_{Ai} + \sum_{j=1}^{\left[\frac{V}{p_B}\right]} u_{Bj}x_{Bj}\right) \\ \sum_{i=1}^{\left[\frac{V}{p_A}\right]} p_A x_{Ai} + \sum_{j=1}^{\left[\frac{V}{p_B}\right]} p_B x_{Bj} \le V \\ x_{Ai} \le x_{Ai-1}, x_{Bj} \le x_{Bj-1} \\ x_{Ai} \le 1, x_{Bj} \le 1 \\ x_{Ai} \ge 0, x_{Bj} \ge 0 \end{cases}$$

Finally we shall have: a= $\sum_{i=1}^{\left[\frac{V}{p_A}\right]} x_{Ai}$ and b= $\sum_{j=1}^{\left[\frac{V}{p_B}\right]} x_{Bj}$.

Because the problem (1) is in integer numbers, we shall apply the algorithm of Gomory.

After the solving of (1), using the Simplex algorithm, we shall have two cases:

Case 1

If $\overline{x}_{Ai}, \overline{x}_{Bj} \in \mathbf{N}$, i=$\overline{1,\left[\frac{V}{p_A}\right]}$, j=$\overline{1,\left[\frac{V}{p_B}\right]}$ the problem is completely solved.

Case 2

For the simplicity, let note the good A with the index 1 and B with 2.

If $\exists\, \overline{x}_{kp} \notin \mathbf{N}$**,** the variable $\overline{x}_{kp}$ is obvious in the basis.

In this case, let note y_{kpts} the element of the Simplex table at the intersection of x_{kp}-row with x_{ts}-column. In order to simplify the notations, let: $v_{kpts}=\{y_{kpts}\}\in[0,1)$, $v_{kp}=\{\overline{x}_{kp}\}\in[0,1)$ the fractional part of these quantities, $B=\{(g,h) \mid x_{gh}$ is a basis variable$\}$ and $S=\{(t,s) \mid x_{ts}$ is not a basis variable$\}$.

We have now, from: $x_{gh} = \overline{x}_{gh} - \sum_{(t,s)\in S} y_{ghts}x_{ts}$ $\forall (g,h)\in B$:

$$(2)\qquad x_{kp} = \overline{x}_{kp} - \sum_{(t,s)\in S} y_{kpts}x_{ts} = \left[\overline{x}_{kp}\right] + v_{kp} - \sum_{(t,s)\in S}\left[y_{kpts}\right]x_{ts} - \sum_{(t,s)\in S} v_{kpts}x_{ts}$$

We can write (2) also in the form:

$$(3) \qquad x_{kp} - \left[\overline{x}_{kp}\right] + \sum_{(t,s)\in S}\left[y_{kpts}\right]x_{ts} = v_{kp} - \sum_{(t,s)\in S} v_{kpts}x_{ts}$$

In order that the problem has integer solution it therefore necessary and sufficient that: $x_{kp} - \left[\overline{x}_{kp}\right] + \sum_{(t,s)\in S}\left[y_{kpts}\right]x_{ts} \in \mathbf{Z}$ or, in other words: $v_{kp} - \sum_{(t,s)\in S} v_{kpts}x_{ts} \in \mathbf{Z}$.

Let now:

$$(4) \qquad v = v_{kp} - \sum_{(t,s)\in S} v_{kpts}x_{ts}$$

from where:

$$(5) \qquad \sum_{(t,s)\in S} v_{kpts}x_{ts} = v_{kp} - v,\ v \in \mathbf{Z}$$

From the hypothesis, v_{kpts}, $v_{kp} \in [0,1)$ and $\sum_{(t,s)\in S} v_{kpts}x_{ts} \geq 0$ from the positive character of variables.

We have now three cases:

Case 2.1.

If $v>0$ we have $v \in \mathbf{N}^*$ therefore $0 \leq \sum_{(t,s)\in S} v_{kpts}x_{ts} = v_{kp} - v$. From this: $v_{kp} \geq v \geq 1$ – contradiction with the choice of v_{kp}.

Case 2.2.

If $v=0$ we have that $\sum_{(t,s)\in S} v_{kpts}x_{ts} = v_{kp} \geq v_{kp}$.

Case 2.3.

If $v<0$ we have from the condition that v is integer: $v \leq -1$ which implies: $-v \geq 1$. Finally: $\sum_{(t,s)\in S} v_{kpts}x_{ts} = v_{kp} - v \geq v_{kp} + 1 > v_{kp} > 0$.

From these cases, we have that the condition to be integer for x_{kp} is: $\sum_{(t,s)\in S} v_{kpts}x_{ts} \geq v_{kp}$.

After all these considerations, making the notation: $y = \sum_{(t,s)\in S} v_{kpts}x_{ts} - v_{kp}$ we shall obtain the new problem:

$$
(6) \quad \begin{cases}
\max\left(\sum_{i=1}^{\left[\frac{V}{p_A}\right]} u_{Ai}x_{Ai} + \sum_{j=1}^{\left[\frac{V}{p_B}\right]} u_{Bj}x_{Bj} \right) \\
\sum_{i=1}^{\left[\frac{V}{p_A}\right]} p_A x_{Ai} + \sum_{j=1}^{\left[\frac{V}{p_B}\right]} p_B x_{Bj} \le V \\
y - \sum_{(t,s)\in S} v_{kpts}x_{ts} = -v_{kp} \\
x_{Ai} \le x_{Ai-1}, x_{Bj} \le x_{Bj-1} \\
x_{Ai} \le 1, x_{Bj} \le 1 \\
x_{Ai} \ge 0, x_{Bj} \ge 0
\end{cases}
$$

If the problem (6) will has at finally an integer solution the problem will be completely solved. If not, we shall resume the upper steps.

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Economic, Political and Military Aspects in the Application of the Armistice Agreement in Romania on September 12, 1944

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Abstract: The years 1943-1944 were the turning point in the carrying of the Second World War, the United Nations' troops managing to take the strategic initiative on the front due to significant human and material resources at stake. The services brought to the Allied cause cost Romanian state significant material reserves, not to mention the number of lost lives among the Romanian Army. The calculations showed that Romanian's economic effort after August 1944 amounted to $ 1.5 billion (1938) allocated only for the implementation of the Convention's provisions and 1.2 billion dollars for the war effort. The real costs of Romania's participation in the anti Hitlerite war placed Romania on a respectable fourth place in the hierarchy of states participating in the war against Germany, before France, Yugoslavia and Australia.

Keywords: Romania; Economic; Political; Military Aspects

JEL Classification: Y4; Y70

The years 1943-1944 were the turning point in the carrying of the Second World War, the United Nations' troops managing to take the strategic initiative on the front due to significant human and material resources at stake. The political and military disaster that Romania was heading to would impose the need of reorienting its foreign policy, aiming at the country's swift removal from the war and the signing of the armistice. (Baciu, 1996, pp. 103-104)

Considerable deterioration of the military situation on the eastern front, materialized in the Red Army's sustained offensive, would strengthen the ties between the leaders of political parties and would achieve the "united opposition" seeking through various diplomatic channels, to obtain favourable conditions for Romania in order to sign the armistice. The opposition's diplomatic action had the support of King Michael, but the initiatives for signing the peace were conducted simultaneously by the regime from Bucharest as well, which, through direct negotiations with the Allies had the same political purposes. In March, the Soviet troops had already reached in some sectors Nistru's bank line, thus making the Romanian authorities to be increasingly concerned with the possibility of transforming Romania in a theatre of war, the attitude expressing faithfully the fears both of civilians and of the political class.

Romania's international political position in the first days after the coup d'état on 23 August and the turning of weapons against Germany, was that of an "independent state fighting a war against its former allies, (Deletant, 1997, p. 40) but now on the side of his former enemies, having a part of its territory militarily occupied. The Soviet Army would find in Bucharest an independent government, able and willing to sign an armistice, having as main advantages the neutralization of the German troops and the liberation of an important part of the national territory[1]. (Quinlan, 1995, pp. 98-99) If somehow the Soviets had other plans[2] for Romania,[3] (Şperlea, 1997, p. 47) they would be confused with the action of King Michael, who had managed to change the course of events by arresting the Marshall. The intention of the new Romanian authorities was to sign the agreement with the United Nations as soon as possible in order to avoid having the whole country under the Red Army's military control and occupation. Raised to power in pretty exceptional circumstances, the new government led by General Sănătescu would proceed the swift initiation of the process for signing the armistice with the United Nations (the Soviets having the priority) by sending to Moscow, on 28 August a delegation empowered to do so. The delay of negotiations due to the Soviet Union Commissioner for Foreign Affairs, Vyacheslav Molotov, and also that with respect to signing the Armistice Agreement would further complicate Romania's political and military situation at the date for signing the Convention, thus being put *de facto* and *de jure* under the occupation of an enemy army[4].

Romania's new political orientation, announced by the royal proclamation would enjoy nation's total adhesion because, the natural consequence of this new situation, was giving the opportunity "to liberate the land of our Transylvania from foreign occupation." (România, marele sacrificat al celui de al doilea război

[1] The war communiqués of the Red Army evoked the battles for the liberation of certain regions, even of the capital, taking hold of the entire merit, although these had been already liberated by the Romanian troops. Admittedly, after the liberation of Paris by the Anglo-American allies, on the western front, the Soviets were looking to impress at their turn with "the liberation of Bucharest".

[2] The scenario for seizing control of the state from Central and South –Eastern Europe would be conceived and unfolded almost identically, the countries liberated by the Soviet Army, would have to "bear" the communist parties raised to power, extensively supported by the Soviet Union.

[3] The formation of volunteers units, the unabating activity of the Russian group of the Communist Party and the bringing of the volunteers unit "Tudor Vladimirescu", were sufficient clues revealing the true intentions of the Soviets. These took the Soviet Union by surprise, which had to use the longer road to get to dug-out and to respect the terms of the Armistice Agreement. (Duţu, Dobre, & Leonida, 2000, pp. 198-201).

[4] The English had agreed with the Soviets upon holding the prerogatives of the Armistice with Romania since May 1944 receiving this way the "affairs from Greece", thus the delay with respect to signing the Armistice by the Russians was followed by an extremely simple calculation having in view the post war situation. To the discussions on various topics and expressed on the diplomatic channels of the Romanian Government and of the opposition emissaries till 23 August there were also included technical aspects, the Romanian delegation left for Moscow signing the Armistice with a curious delay on 12 September, 1944. (Baciu, 1996).

mondial. Documente, 1994, pp. 251-252) The Armistice Convention concluded between Romania, on one hand, and the United Nations, on the other hand, was not in the opinion of many Romanian politicians, the most eagerly expected document by the Romanian authorities and opposition during the secret negotiations in Cairo, Ankara or Stockholm. The formula of "unconditional surrender", adopted on 24 January 1943 in Casablanca would have the role of preparing the governments at war with the United Nations on the treatment and conditions their countries would be subject to, irrespective of the causes determining the output of their struggle. For Romania, the conditions of surrender were, among others, demobilization and disarmament, reparations etc., all these being imposed by the Big Three and "designed" primarily for assuring security and further continuation of the war against Germany, goals considered to have significant political implications." (23 august 1944. Documente, vol 1, pp. 66-70)

Romania's taking part with the Allied and Associated Powers was conditioned by the signing of the Armistice on 12 September 1944, fact which would primarily involve long term economic and political costs for the Romanian state, the Convention representing at the same time the basis of discussions for the future Peace Treaty from Paris in 1946. Containing a preamble, 20 articles and 6 annexes comprising the areas of order, politics, army, economics, finance and administration, (Mureşan & Mureşan, 2003) the Convention Act would highly contribute to the diminishing of Romania's potential, this being written and interpreted very hostile to Romania. The basis of economic stipulations which Romania must have met was the article 11 of the Armistice Agreement. According to this, the Romanian side was obliged to pay 300 million dollars as war indemnity in products, the rates being spaced out on six calendar years with the statement that if the payment schedule was not respected there could be taken up penalties of 5% from the remaining balance for every month of delay. (România, marele sacrificat al celui de al doilea război mondial. Documente, 1994, pp. 312) The Annex D of the agreement would impose explicit clarifications with respect to the U.S.' dollar parity, meaning $ 35 per ounce of gold right from the day of the signing act.

Equally, the other articles of the Armistice Agreement called on a significant budgetary effort for the Romanian State. Thus, although Romania's participation was recognized in the anti-Nazi war, starting from 24 August 1944, however, the Article no. 3, mentioned that Romania would provide the Soviet and Allied forces with the entire contest...... on its expense. (România, marele sacrificat al celui de al doilea război mondial. Documente, 1994, pp. 311-312) "For the proper functioning of the armistice, there was stipulated the founding of an Allied Control Commission in accordance with the Chapter no.18 which "would take upon itself the regulation and control of the execution till the conclusion of peace.....". The activity of this institution would deeply damage the Romanian state due to interferences in the internal administration and unfavourable interpretation of the

Armistice'provisions. (Şandru, 2007, pp. 137-142) Given this circumstance, the Romanian authorities would be obliged to establish the Romanian Commission for the Application of the Armistice, a new institution entitled to fully cooperate with the Allied authorities (Soviet). Its president, I Cristu, would constantly inform the Romanian authorities about the abuses of the Allied (Soviet) Commission of Control with respect to the execution of obligations deriving from the Armistice Agreement. (Şandru, 2007, p. 150)

The evaluations of the Soviet party started from pretty erroneous calculations which had in view Great Romania's potential before the World War I and which ciphered the state's annual income at about 2 billion dollars. In the new context, given the loss of one third of the national territory, the endurance of a substantial economic war effort (about 1 billion U.S. dollars by August 1944) and the rendering to its neighbors of 6 million people, the state's revenues had been estimated, at about $ 600 million, (România, marele sacrificat al celui de al doilea război mondial. Documente, 1994, pp. 308) but they had also been forecast to a decrease fact which later on was proven out by the internal official evaluations[1]. (Constantinescu, 2000, p. 93) It should be emphasized that the simultaneous fulfillment of all obligations imposed by the Convention was quite difficult because the infrastructure and entire economic potential had to be put at the service of the Red Army, with respect to the front necessities and what was superfluous these were allocated to the Romanian army and eventually to fulfil the economic obligations the Convention. (Constantinescu, 2000, p. 83)

The Armistice signed between Romania and the United Nations on 12 September 1944 would represent the overall framework for the unfolding of Romania's military campaign against Germany and its satellites. The implementation of its terms was the responsibility of the Allied (Soviet) Commission of control, which according to the agreements of the Big Three would throw Romania into the arms of the Soviet Union. Its representatives' brutal interference would highly affect the internal political events disturbing at the same time the state's budget through massive withdrawals of goods seized on the basis of the Armistice Agreement.

No less important would be in the future the economic costs of war held against Germany, the date of August 23, 1944 finding Romania's economy controlled by German capital, the German debts owed to the Romanian state being calculated at 1.5 billion German marks. The mobilization of a large military contingent would weaken Romania's industrial production, bound to maintain the same levels of production this time with substantial efforts. Furthermore, the economic transition would channel important financial and economic resources which were normally intended for other purposes, the maintenance of the Romanian troops requiring

[1] According to a study conducted by the Ministry of Foreign Affairs, the values of the state's revenues were estimated in 1945 at 537 millions $.

significant costs. (Constantinescu, 2000, p. 66) The allied bombing, carried out mostly on the vitally important economic centres, would cause considerable losses to the Romanian economy, especially to the oil industry there simultaneously occurring a large number of casualties. Among indirect deficits caused to the Romanian economy there are to be mentioned, first and foremost, non-equivalent exchanges of currency between the two countries, the German mark artificially increasing against the Romanian leu, thus resulting in an unjustified price increase for products imported from Germany in comparison with the Romanian exported goods (Constantinescu, 2000) and an increased purchasing power of German soldiers as well who "depleted" the Romanian market of certain products by artificially increasing their price.

The maintenance of the German troops on the Romanian territory, the payment system, the deductions resulting from transport and communication activities would be other "hot spots" of the collaboration with the Third Reich in the anti-Soviet war. While the German military units and import-export companies were making supplies with minimum costs for first necessity products, the goods imported from Germany were absolutely irrelevant to the Romanian market's needs, these being sold at inflated prices. Romania's complex situation internationally made it extremely vulnerable to the claims of its German ally who was fully aware of the groundless adverse reactions of such economic cooperation with the Romanian side. All these reasons, shading the Romanian-German cooperation, resulted from the fact that, once having accepted to participate in the military campaign from the east, the Romanian authorities had missed "small details of the cooperation", although Romania's legal situation was similar to an independent and sovereign state fighting against a common enemy.

The royal decision for achieving the volta-face as soon as possible was a real general surprise for the international diplomatic circles, this being mainly motivated by the need to avoid transforming the country into a theatre of war, fact which would have had one of the most unfortunate consequences on the civil population and on the economy as well. The act itself was a very good short term initiative; however, the deriving consequences would be harmful in terms of domestic and international policy. The benefits brought to the Allied cause were huge, somehow inversely proportional- some critics say - to those acquired by Romania. Without neglecting the importance of regaining North Transylvania, one can say that the price paid by the Romanian side was unfairly high, great sacrifices being made, both on the front and on the inside for the years that had come.

Although Romania's economic war effort, estimated to the enormous amount of 1,200,000,000 dollars (acc. to the currency in 1938), had situated it on the fourth place in the hierarchy of the United Nations fighting against Germany, its justly deserve co-belligerent status would be denied for political reasons known only to the Great Powers. Of all the states which were are in a situation somehow similar to that of Romania's, none of them made the military or economic effort at the same scale as Romania did in defeating the Nazi war machine[1].

Though fluctuant, due to the Romanian-Soviet military protocol signed on 26 October, the Romanian military manpower engaged in the theatre of operations would be placed permanently over the minima imposed by the Armistice Convention. Furthermore, Romania's contribution was total[2], the authorities and the population making considerable efforts for supporting the military campaign of the Romanian troops. No military organization, troops or any other type of associations or military units continued fighting against the United Nations after the turning over of weapons against Germany on 23 August. For instance, Italy contributed with 100,000 supporters to the cause of the United Nations, while five infantry divisions and two aviation squadrons continued fighting in Northern Italy on Germany's side. In the case of Hungary, there were 10 divisions, Bulgaria - a pro-fascist division, Yugoslavia - three divisions, nine brigades plus a guard division and one of cavalry In France, the number of allies who continued fighting was amounted to that of a fast and divisions, and in Poland, about 20 to 25,000 soldiers[3]. The Memorandum submitted by Romania at the Peace Conference from Paris, recalled, in addition to the military and economic war effort made directly by our country, the amount of the obligations fulfilled by 1 July 1945, on the basis of Article no. 3 of the Convention, this being numbered to 77 billion lei (currency from1938).

The services brought to the Allied cause cost Romanian state significant material reserves, not to mention the number of lost lives among the Romanian Army. The calculations showed that Romanian's economic effort after August 1944 amounted to $ 1.5 billion (1938) allocated only for the implementation of the Convention's provisions and 1.2 billion dollars for the war effort[4]. (Mureşan & Mureşan, 2003, pp. 358)The real costs of Romania's participation in the anti Hitlerite war placed Romania on a respectable fourth place in the hierarchy of states participating in the war against Germany, before France, Yugoslavia and Australia.

[1] A.N.I.C.B., Fund of Royal House, file no. 21/1945, f 1-12.

[2] Ministry of National Defence Archives fund 948, file no.177, passim.

[3] Idem, file 151, f 105-110.

[4] To these sums there are also added approximately 1 billion $ spent on the campaign in August 1944.

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