ROMANIAN ECONOMIC AND BUSINESS REVIEW

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CONTENTS

TYPES OF SHARES

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Abstract:

This article focuses on equity instruments. There are presented the characteristics of ordinary and preference shares. There are described the types and characteristics of preference shares such as: cumulative preference shares, participating preference shares, convertible preference shares, callable preference shares and redeemable preference shares. Treasury shares are also described. The accounting records are based on IAS 32 Financial Instruments: Presentation. There are presented the conditions when a puttable instrument is classified either as equity or as financial liabilities under IFRS.

Keywords: equity instrument, ordinary shares, common stock, dividends, preference shares, cumulative preference shares, treasury shares, par value, outstanding capital, authorized capital, puttable instrument

JEL: G32 – Financing Policy; Financial Risk and Risk Management; Capital and Ownership Structure; Goodwill; H32 - Firm M41 – Accounting.

"An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all its liabilities, liabilities, where liabilities are defined as the present obligations of the entity arising from past events, the settlement of which are expected to result in an outflow from the entity of resources embodying economic benefits (i.e., an outflow of cash or other assets of the entity)" (Barry J. Epstein and Eva K. Jermakowicz, 2010, page 820).

The shares (named also stocks in U.S.A.) of an entity may be divided into two major types: ordinary shares or equity shares (named also common stock in U.S.A.) and preference or preferred shares (preferred stock in U.S.A.) Both may be split into smaller classes of shares. Owners of shares are referred to as shareholders or stockholders. Ordinary shares and preference shares have different rights.

Generally, ownership stock conveys the next four rights to shareholders:
a) sharing of profits and losses from the present year and/or and previous years;
b) voting rights;
c) liquidation rights; and
d) the opportunity to purchase additional shares if issued its class.

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The holders of preference shares (preference shareholders) have the right to receive income – as dividends -before any holders of ordinary shares (ordinary shareholders). In other words the dividends for preference shares must be paid before the dividends for ordinary shares (Sunil Parameswaran, 2011, page 119).

"Preferences as to assets exist when the preferred shares have a stipulated liquidation value. If a corporation were to liquidate, these preferred holders would be paid a specific amount before the common shareholders would have a right to participate in any of the proceeds. In practice, preferred shares are more likely to have preferences as to earnings than as to assets" (Barry J. Epstein and Nadira M. Saafir, 2010, page 332).

The same rule must be applied also if the entity is liquidated. The proceeds of sale of all assets of the entity are distributed- first - to the creditors and -second - to shareholders of the entity. Creditors of the entity are paid first and all that remains is distributed to the shareholders. When the proceeds are distributed between owners' entity, preference shareholders are given preference over ordinary shareholders. We can say that preference shareholders have an advantage over the ordinary shareholders because the preference shareholders receive the liquidation value of their shares before any distribution to the ordinary shareholders. This makes ordinary shares riskier than debt or preference shares.

A) Ordinary shares (common stock, equity shares)

Ordinary shares are a type of financial claim issued by the firm to investors. In return for their investment, the shareholders are conferred with ownership rights. An entity must have at least one shareholder. Generally there is no restriction regarding the maximum number of shareholders of an entity. Also there is no restriction on the total number of shares that may be issued by an entity. At the moment when an entity is incorporated, a specific number of shares will be authorized for issue. The value of these shares is named authorized capital of the entity. Sometimes not the entire authorized capital is raised immediately due to the fact that a portion of authorized capital can be held for issue at a later date. The outstanding capital represents the value of the shares that are currently held by the investors (Sunil Parameswaran, 2011, page 97).

Ordinary shares have a par value (named also stated value or nominal value or face value). Often the issue price of a share is different than par value. The difference between issue price and par value of a share is named: share premium or additional paid-in capital, if the issue price is higher than par value, or discount share when the issue price is less than par value. The ordinary share does not have a maturity date (Barry J. Epstein and Nadira M. Saafir,2010, page 333; Sunil Parameswaran, 2011, page 99).

When ordinary shares are issued it should be considered five matters:
a) accounting for par value share;
b) accounting for no-par value share;

c) accounting for shares issued in combination with other securities;
d) accounting for shares issued in noncash transactions; and
e) accounting for costs of issuing shares.

An entity may have more than one class of ordinary shares. Each class (Class A, Class B, Class C, and so on) may have different rights to earnings or voting. Generally there is no limit concerning the number of different classes of ordinary shares which may be issued by an entity.

Puttable/Non-puttable ordinary shares (puttable/non - puttable common stock)

Under IAS 32, as a general definition, a puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset. It can also be automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder ((Barry J. Epstein and Eva K. Jermakowicz, 2010, page 182). So we can say that puttable ordinary shares are ordinary shares that give the investors- unlike non – puttable ordinary shares - the right /option to put the shares back to the issuer for a predetermined price usually for a limited stipulated time period.

B) Preference shares (preferred shares, preferred stock)

An entity may chose to issue preference shares. Like ordinary shares, preference shares also represent equity because they are financial claims that confer ownership rights on the shareholders. Unlike ordinary shares, this kind of shares has certain associated privileges. Preference shareholders have a claim on income, assets and liquidation value (if the entity is liquidated) ahead of that of ordinary shareholders. Also, current dividends due on the preference shares must be paid before any dividends for the year can be declared for ordinary shareholders. In case of liquidation of the entity, the proceeds of sale of the assets are distributed in the following order: creditors and bondholders, preference shareholders and ordinary shareholders. With other words we can say that preference shareholders are owners who have certain rights superior to those of common shareholders. Unlike ordinary shareholders, preference shareholders usually do not have voting rights. Unlike creditors or bondholders, preference shareholders do not have a legal claim to receive the dividend and they cannot force the entity into bankruptcy for failure to pay the dividends. Generally the dividend for a preference share is fixed   (Barry J. Epstein and Nadira M. Saafir, 2010, page 332; Sunil Parameswaran, 2011, page 120)

Like in the case of ordinary shares, an entity may issue different classes of preference shares. Each class of preference shares may have different dividends rates and rights. The ordinary shares- as mentioned before - are never issued with a

maturity date but the preference share may be issued with or without a maturity date. The preference shares issued without a maturity date is named perpetual preferred stock or perpetual preference **(http://www.investopedia.com/terms/p/perpetual-preferred-stock.asp).**

The preference shares can be divided in the following categories: (i) callable / non-callable, (ii) cumulative / noncumulative, (iii) convertible / nonconvertible, and (iv) participating / non-participating.

B1) Callable/ Noncallable preference shares (redeemable / nonredeemable preference shares or Callable/ Noncallable preferred stock)

This kind of preference share gives the issuer the **right** to buy the shares from the holders at a predetermined price after a defined date. If the entity wants to buy back the issued shares, it must to exercise the call option and to pay the predetermined price, also named as call price. "Thus, callable preferred shares, which are redeemable at the issuer's option, and convertible preferred shares, which are redeemable at the holder's option, are not mandatorily redeemable shares" (Barry J. Epstein and Nadira M. Saafir, 2010, page 254). In other words the issuer can prematurely recalled or retired such preference share, if the established price is paid, unlike the plain vanilla preference shares, which are noncallable. This kind of share presents an advantage for the issuer and, in the same time, a disadvantage for the investor.

The redeemable preference shares confer to the issuer, by exercising the call option, the possibility of decreasing the cost of capital if interest rates decline or if it can issue the shares at a lower dividend rate at a later date. From the investor point of view, if the issuer decided to call the preference shares, this will be faced with the prospect of reinvesting the proceeds at a lower dividend or interest rate (Sunil Parameswaran, 2011, page 120 – 121)

There are cases when the issuer is **obliged** to redeem the shares at the option of the holders or at a determinate moment in the future according to the mutual agreement between the issuer and shareholders.

B2) Cumulative / Noncumulative preference shares (cumulative/ noncumulative preferred stock)

In the case of cumulative preference shares, any unpaid dividend in one year must be paid next year or years before any other dividend for noncumulative preference shares is paid and before any ordinary shares dividend is paid. In other word, if a preference share dividend is cumulative, than any unpaid dividend in one period is carried – over year to year – till it is paid. If the dividend for noncumulative preference shares is not paid in one period, than the dividend is lost and it is not paid in other future period.

"Cumulative preference dividends in arrears. If an entity has preferred share outstanding, and does not pay cumulative dividends on the preference shares annually when due, it will be required by statute to pay these arrearages in later years, before any distributions can be made on common (ordinary) shares. When there are several series of preferred shares, the individual share indentures will spell out the relative preference order, so that, for example, senior preferred series may be paid dividends even though junior preferred shares has several years' arrearages. Although practice varies, most preference shares are cumulative in nature. Preference shares that do not have this feature are called noncumulative preference shares" (Barry J. Epstein and Eva K. Jermakowicz, 2010, page 824).

B3) Convertible/Nonconvertible preference shares (convertible/ nonconvertible preferred stock)

This kind of preference share gives the investor the right to convert the preference shares- usually anytime after a predetermined date - into ordinary shares a predetermined rate of exchange. The most convertible preference shares are exchanged at the request of the investor but, there are situations, when an entity can issue mandatory convertible preference shares. This kind of preference share compels the issuer to convert them into a fixed number of ordinary shares within a specific period of time.

The mandatory convertible preference shares present advantages for both parties (issuer and investor). From the issuer's point of view, these mandatory preference shares are attractive because the issuer is released from the obligation to pay preference dividend but instead it is forced to convert them into ordinary shares. From the investors 'point of view, mandatory convertible preference share offer the right to convert – only within specific period – these shares into ordinary shares (Sunil Parameswaran, 2011, page 121)

B4) Participating/Nonparticipating preference shares (Participating/ Nonparticipating preferred shares)

The investor, who holds a participating preference share, has the right to receive a share of the entity's earnings according to predetermined conditions. This share of earnings is either in addition to a stated preference dividend or varies according to the ordinary share dividend. The additional dividend paid to preference shareholders is commonly structured to be paid only if the amount of dividends that ordinary shareholders receive exceeds a specified per-share amount. The most preference shares are nonparticipating in nature. "In exchange for the preferences, the preferred shareholders' other rights or privileges often are limited. For instance, the right to vote may be restricted to common shareholders.

The most important right denied to the preferred shareholders, however, is the right to participate without limitation in the earnings of the corporation. Thus, if

the corporation has exceedingly large earnings for a particular period, most of these earnings would accrue to the benefit of the common shareholders. This statement is true even if the preferred stock is participating (a fairly uncommon feature) because participating preferred stock usually has some upper limitation placed on the extent of participation" (Barry J. Epstein and Nadira M. Saafir, 2010, page 332).

Usually all the shares issued by an entity are hold by sundry investors (corporations, entities or individuals) which are different than the issuer. However there are situations when the issuer holds its own shares by repurchasing them from the investors. These kinds of shares held by the issuer are named treasury shares or treasury stock.

C) Treasury shares (Treasury stock)

Treasury shares are represented by the entity's shares that were at one point in time issued to the public but they have been reacquired or bought back by the entity. Treasury shares are also the shares that have never been issued to the public in the first place. These shares are kept by the entity in their own treasury. Treasury shares have no voting rights and are not included in share outstanding calculations (such as earnings per shares or profit per share). A buyback program will increase the earnings per share.

"Treasury stock. Shares of a corporation that have been repurchased by the corporation. This stock has no voting rights and receives no cash dividends. Some states do not recognize treasury stock. In such cases, reacquired shares are treated as having been retired" (Barry J. Epstein and Nadira M. Saafir, 2010, page 332).

Often the issuer buys its own share in order to avoid a potential takeover. The buyback of the own shares may represent an advantage for the management of the issuer and a disadvantage for the rest of the shareholders. By reducing the shares in circulation, the management of the issuer can obtain a better control. In some situations, by reducing the shares in circulation, the share's market price may increase. These shares are not eligible to receive cash dividends. These shares are held by the issuer in their treasury and can be subsequently reissued to the investors or employees (Sunil Parameswaran, 2011, page 107).

D) Issued stocks / shares are always a component of Stockholders' Equity/ Shareholders' Equity?

An entity which issues a financial instrument has to classify - at initial recognition - the issued financial instrument as either a financial liability or as equity according to the substance of the contractual agreement and the definitions of a financial liability and equity mentioned bellow. IAS 32 Financial Instruments: Presentation does not look to the legal form of financial instruments. Instead, it focuses on the financial instruments' contractual obligations. There are situations when financial instruments (e.g puttable shares) as may have the legal form of equity but, under IAS 32, to be classified as liabilities.

Classification of an instrument as liability or equity

Equity is the residual interest in the assets of an entity after deducting all its liabilities. A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. A financial liability is „any liability that is:

1. A contractual obligation to deliver cash or another financial asset to another entity

2. A contractual obligation to exchange financial instruments with another entity under conditions that are potentially unfavorable

3. A contract that will or may be settled in the entity's own equity instruments and is a nonderivative for which it is or may be obligateed to deliver a variable number of its own equity instruments

4. A contract that will or may be settled in the entity's own equity instruments and is a derivative that will or may be settled other than by an exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments (which excludes puttable financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation— classified as equity, and instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments)" (2010 Interpretation and Application of International Financial Reporting Standards, Barry J. Epstein and Eva K. Jermakowicz, Published by John Wiley & Sons, Inc., Hoboken, New Jersey, page. 191)

Any contract that evidences a residual interest in the assets of an entity after deducting all its liabilities is an **equity instrument**. "An obligation to issue an equity instrument is not a financial liability because it results in an increase in equity and cannot result in a loss to the entity" (Hennie van Greuning, 2009, page 532).

A puttable instrument can be presented, under revised IAS 32, either as a financial liability or equity. The puttable financial instruments that impose on the issuer an obligation to deliver a pro-rata share of net assets of the entity only on liquidation are equity, and thus should not be presented as liabilities.

Under revised IAS 32, puttable financial instruments are now to be presented as equity if and only if all of the following criteria are met:

1. The instrument entitles the holder to a pro rata share of the entity's net assets on liquidation;

2. The instrument is part of a class of instruments that is subordinate to all other classes of instruments;
3. The instruments is in the class of instruments that is the most subordinate and all instruments in that class have identical features;
4. The instrument has no other characteristics, except the put future, that would meet the definition of a financial liability; and

The total expected cash flows attributable to the instrument over its life are based substantially on either: (i) profit or loss, (ii) the change in the recognized net assets, or (iii) the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of the instrument itself);

5. The issuer must have no other financial instrument or contract that has (a) total cash flows based substantially on the profit or loss, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract) and (b) the effect of substantially restricting or fixing the residual return to the puttable instrument holders.

Shares that are puttable at fair value, but which are not the most subordinate class of instrument issued, must still be classified as liabilities. The appropriate classification is determined by the entity at the point of initial recognition. The issuer must consider all terms and conditions agreed between itself and the investors who hold the instruments of the issuer. The issuer has to distinguish between those cases in which it is forced, under the agreement, to deliver cash or other financial assets and those in which it has the discretion over paying out cash or other financial assets.

Instruments That Will or May Be Settled in Own Equity

Contracts that will or may be settled in the entity's own equity instruments are classified as equity instruments of the entity if they (Abbas Ali Mirza et. al, 2011, page 228):

1) Are non-derivative contracts and will be settled by issuance of a fixed number of the entity's own equity instruments
2) Are derivative contracts and will be settled by the exchange of a fixed number of the entity's own equity instruments and a fixed amount of cash

Due to the fact that such instruments are classified as own equity, any consideration received for such an instrument is added directly to equity and any consideration paid is deducted directly from equity. Changes in fair value of such instruments are not recognized.

Option is a contract that gives the investor (option holder) the right, but not the obligation, to acquire (call option) from or sell (put option) to the option seller (option writer) a certain quantity of an underlying security or commodity, at a specified price (the strike price) and up to a specified date (the expiration date).

If a financial instrument requires the issuer to repurchase its own issued equity instruments for cash or other financial assets, there is a financial liability for the present value of the repurchase price (redemption amount). The liability is recognized by reclassifying the amount of the liability from equity. If it is classified as a financial liability measured at amortized cost, the difference between the repurchase price and the present value of the repurchase price is amortized to profit or loss as an adjustment to interest expense using the effective interest rate method.

E) Examples

Example 1) Entity ABC issues 1,000 ordinary shares of its CU20 par value each share. Each share was sold for an exercise price of CU22. Shareholders are entitled to a pro rata share of any dividends or other distributions of the entity. The issuer has the right to decide whether or not to pay dividends.

The issuer does not have a contractual obligation to deliver cash or another financial asset to the shareholders. Therefore these ordinary shares should be classified as equity.

Total proceeds for selling the shares	22,000
Value of share capital - ordinary shares	20,000
Additional paid in capital in excess of par	2,000

Dr Cash (financial asset)	22,000	
Cr Share capital (equity)		20,000
Cr Share premium (equity)		2,000

Example 2) Entity ABC issues two types of shares: 2,000 ordinary shares with no par value but, instead, with a stated value of CU1 and 600 redeemable preference shares at CU10 par value. The shares are redeemable at the option of the issuer. The preference shares are noncumulative. All issued shares were sold at an exercise price of CU32 for ordinary shares and CU55 for preference shares.

The issuer has the right to redeem the shares. The issuer has no obligation to redeem the shares and consequently there is no obligation to deliver cash or other financial asset. So, these preference shares are classified as equity. Also, the issuer has no obligation for paying dividends and consequently they are not liabilities.

	Ordinary shares	Preference shares	Total
Value of share capital	2,000	6,000	8.000
Additional paid in capital in excess of par	62,000	27,000	89.000
Total proceeds for selling the shares	64,000	33,000	97.000

Dr Cash (financial asset)   64,000
    Cr Share capital (equity)- ordinary shares   2,000
        Cr Share premium (equity) – ordinary   62,000
        shares

Dr Cash (financial asset)   33,000
    Cr Share capital (equity)- preference   6,000
    shares
      Cr Share premium (equity) –   27,000
      preference shares

Example 3)   Entity ABC issues at 01/04/2012 a number of 1,000 mandatory redeemable preference shares at par of CU50 per share with a 7 per cent fixed dividend on the par value payable annually (assume that 7 per cent is the market rate of interest for this type of instrument).The preference shares are cumulative.

    The issuer has a contractual obligation to deliver - at the time of redemption - cash or another financial asset to the share holders for the preference shares. The preference shares are classified as financial liabilities due to the fact that the issuer cannot avoid the redemption of the shares. Because the dividend payments are not at the discretion of the issuer, it could not avoid paying those dividends and consequently they are liabilities.

   Dr Cash (financial asset)   50,000
     Cr Preference shares (Liability)   50,000

   Recognition of financial liabilities for the accumulated dividends at the end of the year: Number of months: 9 months; Value of dividends: 9/12 x 7% x 50,000 = CU2, 625

   Dr Finance costs (profit or loss)   2,625
       Cr Preference shares dividends   2,625
       (financial liability)

Example 4) Entity ABC issues two types of shares: 1,000 ordinary share and 1,000 redeemable preference shares. The issuer will redeem the preference shares at the option of the shareholders. The preference shares are noncumulative.

There is a contractual obligation to deliver cash exists to buy back the shares at the request of the shareholders. That present obligation is a liability. According to the contractual agreement the issuer cannot avoid redeeming the shares. Because the dividend payments are at the discretion of the issuer, it could avoid paying those dividends and consequently they are not liabilities.

Note: If the preference shares are cumulative that the issuer has the obligation that, any unpaid dividends in one year, to be paid next year or years before any other dividends for noncumulative preference shares and/or before any ordinary shares dividends are paid. These dividends have to be recognized as liabilities at the end of the year.

Example 5) Entity ABC issues - during 2010 - 5,000 convertible preference shares of CU90 par value. The exercise price for these shares was CU155. One preference share can be convertible into three ordinary shares (par value of an ordinary share is CU35). The preference shares will be convertible within 2 years from the date of issue. At the end of 2012, all the issued preference shares were converted.

The issuer has no obligation for delivery cash or other financial asset. The shares are classified as equity. The treatment of convertible preferred shares at its issuance is no different from that of nonconvertible preferred shares.

Total proceeds of selling the preference shares	775,000
Value of share capital - preference shares	450,000
Additional paid in capital in excess of par	325,000

At the date of issue:

Dr Cash (financial asset)	775,000	
Cr Share capital (equity)- preference shares		450,000
Cr Share premium (equity)- preference shares		325,000

Number of ordinary shares issued is 5,000 x 3 = 15,000 ordinary shares
Value of issued ordinary shares: CU525, 000 (15,000 ordinary shares x CU35)
Total proceeds of selling the preference shares: CU775, 000
Additional paid in capital in excess of par: CU250, 000

At the date of converting:

Dr Share capital (equity) - preference shares	450.000	
Dr Share premium (equity) -preference shares	325.000	
Cr Share capital (equity)-ordinary share		525000
Cr Share premium (equity)-ordinary share		250.000

Example 6)   During 2012, the entity ABC reacquired 20,000 of its CU1 par value ordinary shares. The price paid by the entity is CU12 per each share. In March, 2012 the entity sold 15,000 of treasury shares in exchange for CU10 per each share. In June, 2012 the entity sold the remaining treasury shares in exchange for 7CU per each share. At the end of 2011 statement of financial position included the following:

Share capital – ordinary shares (100,000 shares x CU1/share): 100, 000
Share premium – ordinary shares: 50,000
Retained earnings: 80,000

Treasury shares are not recognized as a financial asset of the entity regardless of the reason for which they are reacquired. An entity shall deduct from equity the fair value of the consideration given for the treasury shares. The entity shall not recognize a gain or loss in profit or loss on the purchase, sale, issue or cancellation of treasury shares.The amount paid for the reacquired ordinary shares is: CU240, 000. The accounting entry at the date of acquisition is:

Dr Treasury shares	240,000	
Cr Cash		240,000

Proceeds for selling 15,000 treasury shares at CU10 per share are CU150, 000. The entry is:

Dr Cash (financial asset)	150,000	
Dr Share premium – ordinary shares	30,000	
Cr Treasury shares		180,000

Proceeds for selling 5,000 treasury shares at CU7 per share are CU35, 000. The entry is:

Dr Cash	35,000	
Dr Share premium – ordinary shares	20,000	
Dr Retained earnings	5,000	
Cr Treasury shares		60,000

Example 7) The entity ABC issues a (written) call option or warrant that gives the holder the right to purchase 10,000 shares for a CU10. The proceeds from issuing the call option is CU80,000.

Dr Cash (financial asset)   80,000
              Cr Option reserve (equity)   80,000

Example 8)   A purchased call option that gives the entity ABC the right to repurchase 10,000 shares for CU5. If the price for purchasing the call option is CU20,000 the accounting entry is:

Dr Option reserve (equity)   20,000
              Cr Cash (financial asset)   20,000

Example 9) On January 1, 2012, Entity ABC enters into a forward contract that requires the entity to repurchase 1,000 shares for CU70, 000 on December 31, 2012. No consideration is paid or received at inception of the contract. The market interest rate is 12%.

> The entity must to recognize a financial liability at the present value of the repurchase price.
> The present value is 70, 000 / (1+12%) = CU62, 500
> At January 01:

Dr Treasury shares   62,500
              Cr Forward contracts (liability)   62,500

> On December 31, 2012 entity has to recognize the amortization in accordance with the effective interest method and to settle the contract:

Dr   Finance costs (profit or loss)   7,500
              Cr Forward contracts (liability)   7,500

Dr   Forward contracts (liability)   70,000
              Cr Cash (financial asset)   70,000

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WHAT CAUSES WHAT? AVIATION DEMAND AND ECONOMIC GROWTH IN ROMANIA: COINTEGRATION ESTIMATION AND CAUSALITY ANALYSIS

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Abstract:

This paper is empirically analyses the aviation-led growth hypothesis for Romania by testing causality between aviation and economic growth. We resort to econometric tests such as unit root tests and test of cointegration purposed by Johansen (1988). Fully Modified OLS, Dynamic OLS and Conical Cointegration Regression are used to estimate the cointegration equation for time span of 1970 to 2012. Empirical results reveal the existence of cointegration between aviation demand and economic growth. Graphic methods such as Cholesky impulse response function (both accumulated and non-accumulated) and variance decomposition have also been applied to render the analysis rigorous. The positive contribution of aviation demand to economic growth is similar in all three estimation techniques of cointegration equation. Finally Granger causality test is also applied to find the direction of causal relationship. Findings help in chalking out the importance of aviation industry in economic growth for Romania.

Keywords:

Aviation, Economic Growth, Unit Root Tests, Fully Modified Ordinary Least Square (FMOLS), Dynamic Ordinary Least Square (DOLS), Conical Cointegration Regression (CCR), Aviation Multiplier.

JEL Classification: L93; O40; C22.

1. Introduction

Role of transportation has been pivotal in transporting human beings (services) and goods since historic times. Economic activities, both from production (supply) and consumption (demand) side depend on transportation. This paper analyses 'aviation/air transportation' as covariate in association with economic growth. Recent work on this issue has shown positive effects of aviation on economic growth of a

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country. Nearly no heed has been paid to the empirical analysis of the relationship between economic growth and aviation of Romania. This creates the justification of this research. Focus of this research is to explore the causal relationship between aviation and economic growth in Romania. To measure aviation, we used 'passengers carried by air transport' (PAX). While for incorporating economic growth, GDP in constant local currency unit is used. For statistical analysis, this paper resorts to econometric tests such as unit root tests (ADF and Phillips Perron) and test of cointegration purposed by Johansen (1988). The time span covered by the study is 1970 to 2012. This paper scrutinizes the relationship between aviation and economic growth by applying the Johansen cointegration approach for the long-run and the standard error correction method (ECM) for the short-run. This paper contributes to the existing methodology in Marazzo et al. (2010) and borrows from Mehmood & Kiani (2013) by using FMOLS, DOLS and CCR to estimate cointegrating equations. Estimation of cointegration equations is becoming a popular practice. For recent application of FMOLS, see Mehmood, et al., (2012).

2. Literature review

Empirical work on aviation-led economic growth is still in its infancy. Oxford Economics (2011), enumerated different channels via which aviation sector of Romania generates economic benefits and supports macroeconomic growth. Analysis of basic macroeconomic indicators show that aviation sector contributes 0.7% of Romanian GDP and 54,000 jobs (0.6%) of the Romanian labor force. Including tourism sector contribution, GDP augments to 0.9% and job creation increases to 78,000 jobs (or 0.9% of the labor force). Approximately, 50% customers of Romanian airlines are Romanian residents. They carry almost 50% of passengers and freight. All such statistical findings reveal that such income and revenue generation creates multiplier effect to the Romanian economy.

To our knowledge no further instances of research on Romanian aviation exist.

While modern research on aviation in relation to economy includes David and Scott (2005) that state aviation has a significant impact on world trade as explorers have discovered trade routes and the technology of transport have improved. The pioneering research on aviation-growth nexus is conducted by Marazzo et al. (2010). They empirically tested the relationship between aviation demand and GDP for Brazil. They used passenger-kilometer as a proxy of aviation demand and found a long-run equilibrium between the two variables using bi-variate Vector Autoregressive Model. Their findings reveal strong positive causality from GDP to aviation demand but relatively weaker causality other way around. Robustness tests were applied through Hodrick and Prescott filter to capture the cyclical components of the series and the results withstood these robustness tests. Their interpretation of the positive causality indicates the existence of multiplier effect. Mehmood & Kiani (2013) empirically examine the aviation-led growth hypothesis for Pakistan by testing causality between aviation and economic growth using unit root tests and cointegration tests. Using the data from 1973 to 2012, they innovated the work of Marazzo et al. (2010) by used Fully Modified OLS and Dynamic OLS

for the estimation of cointegration equation. Estimations reveal that positive contribution of aviation demand to economy is more prominent as compared to that of economic growth to aviation demand. They found similar positive contribution of aviation demand to economic growth is similar in both FMOLS and DOLS. To do this much-needed research for Romania aviation, this paper aims at analyzing the aviation-growth nexus for Romania. Specific testable proposition is as follows:

P$_A$: *There exists a causal relationship between Aviation Demand and Economic Growth in Romania.*

For scrutinizing this proposition, data dimensions and sources are explained. Moreover, the econometric methodology is explained as follows:

3. Data and Methodology

Borrowing from Marazzo et al., (2010) and Mehmood & Kiani (2013), the demand for aviation is represented by 'air transport, passengers carried' and economic growth by GDP is used in local currency (in constant terms). Data for these variables is taken from World Development Indicators (WDI). For Romania data on passengers carried and GDP is available from 1970 to 2012. The time span allows us to use 43 observations for our time series analysis. EViews Standard Version 7.2 is used for all estimations. Before conducting the inferential analysis, line chart is furnished.

4. Description of Variables

Economic growth is proxied by GDP (Current LCU), while demand for aviation is proxied by 'passengers carried by air transport' (PAX). The line charts of GDP (current LCU) and passengers carried by air transport are plotted against time in years. Both of these shows trend and intercepts. This information will be helpful in conducting the stationarity tests.

Figure 1. Line Chart of LGDP and LPAX
(Natural logged forms for GDP and PAX)
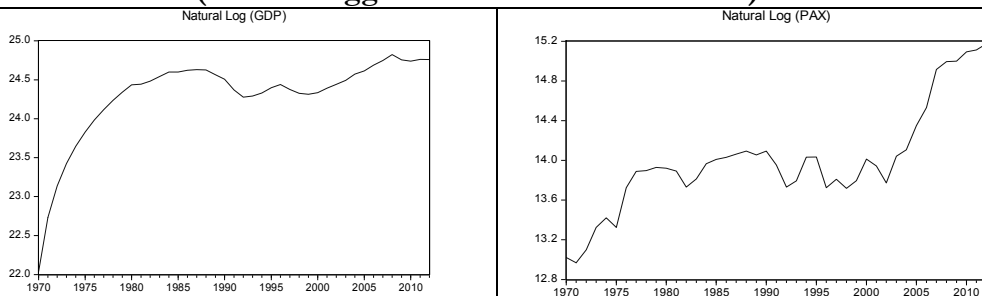
Note: Line charts of LGDP and LPAX are plotted that show an intercept (constant) and trend (slope).

5. Inferential Analysis

5.1. Stationarity Tests
Both stationarity tests, Augmented Dickey Fuller (ADF) and Phillip Peron (PP), are applied with the assumptions that LGDP and LPAX in their logarithmic form reveal intercept and trend. Both variables are stationary at first level using ADF and PP tests. So LGDP and LPAX variables are stationary at I(1). Such is tabulated in table 1.

5.2. Augmented Dickey Fuller Test
For scrutinizing non-stationarity in a time series Augmented Dickey–Fuller test (ADF) test was purposed by Dickey and Fuller (1979). In order to check if the series carry one unit root, the ADF test presents the following specification:

$$\Delta Y_t = \alpha + \beta T + \varphi Y_{t-1} + \sum_{i=1}^{p} \Delta Y_{t-i} + \varepsilon_t \qquad (1)$$

where Y_t and ΔY_t are respectively the level and the first difference of the series, T is the time trend variable, and α, β, φ, ψ are parameters to be estimated. The p lagged difference terms are added in order to remove serial correlation in the residuals.

The null hypothesis is H_0: $\varphi \neq 0$ and the alternative hypothesis is H_1: $\varphi \neq 0$. ε_t is the error term presenting zero mean and constant variance. First order integrated series can present stationary linear combinations (I(0)). In these cases, we say variables are cointegrated. It means there is a long-run equilibrium linking the series, generating a kind of coordinated movement over time. In order to assess the existence of cointegration between I(1) series, Engle and Granger (1987) proposed a regression between two non-stationary variables (Y_t, X_t) to check the error term integration order. If the error term is stationary one can assume the existence of cointegration.[4] Thus:

$$Y_t = \alpha + \beta X_t + \mu_t \qquad (2)$$

is an equation of cointegration if μ_t is stationary. This condition can be evaluated through the ADF test. A more recent approach is provided by Johansen and Juselius (1990). They suggested an alternative method which has been applied under the following specification:

$$\Delta Y_t = \Pi Y_{t-1} + \sum_{i=1}^{p-1} \Gamma_i \Delta Y_{t-1} + \beta X_t + \varepsilon_t \qquad (3)$$

Where $\sum_{i=1}^{p} A_i - I, \Gamma_i = -\sum_{j=i+1}^{p} A_j$, Y_t is a vector of k non-stationary (I(1)) variables, X_t is a vector of d deterministic variables and ε_t is a vector of random terms (zero mean and finite variance). The number of cointegration relations is represented by the rank of P coefficient matrix. The Johansen method relies on

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[4] For more see Bouzid (2012).

estimating the P matrix in an unrestricted form and testing whether it is possible to reject the imposed restrictions when reducing the rank of P. The maximum likelihood test, which checks the hypothesis of a maximum number of r cointegration vectors, is called the trace test. It should be highlighted that variables under cointegration analysis should present the same integration order. If one concludes that cointegration exists in (3), then there is at least one stationary variable that may be included in the model. This representation is known as Error Correction Model (ECM), specified as follows:

$$\Delta Y_t = \lambda + \sum_{i=1}^{m} \alpha_i \Delta Y_{t-i} + \sum_{j=1}^{n} \beta_j \Delta X_{t-j} + \phi Z_{t-1} + \varepsilon_t \qquad (4)$$

Where λ is the constant term, α, β, φ are coefficients, m and n are the required number of lags to make the error term ε_t a white noise and Z_{t-1} is the cointegration vector ($Z_{t-1} = Y_{t-1} - \delta X_{t-1}$), where δ is a parameter to be estimated). In this case, Z_{t-1} works as an error correction term (ECT). The ECT provides valuable information about the short run dynamics between Y and X. In Eq. (4), all the terms are I(0).

5.3. Phillip Perron Test

Phillips and Perron (1988) propose an alternative (nonparametric) method of controlling for serial correlation when testing for a unit root. The PP method estimates the non-augmented DF test equation $[\Delta y_t = \alpha y_{t-1} + x_t' \delta + \varepsilon_t]$ and modifies the t-ratio of the α coefficient so that serial correlation does not affect the asymptotic distribution of the test statistic. The PP test is based on the statistic:

$$\tilde{t}_\alpha = t_\alpha \left(\frac{r_0}{f_0}\right)^{1/2} - \frac{T(f_0 - r_0)(se(\hat{\alpha}))}{2 f_0^{1/2} s} \qquad (5)$$

Where $\hat{\alpha}$ is the estimate, and t_α the t-ratio of α, $se(\hat{\alpha})$ is coefficient standard error, and s is the standard error of the test regression. In addition, is a consistent estimate of the error variance in equation (1) (calculated as $(T - k)s^2/T$, where k is the number of regressors). The remaining term, f_0, is an estimator of the residual spectrum at frequency zero.

Table 1. ADF and PP Tests

Using constant and trend	Stationarity	Variables	t-Statistic	Prob. Value
I	II	III	IV	V
Augmented Dickey Fuller (ADF)	At level	LGDP	-2.1120	0.5240
		LPAX	-0.4676	0.8874
	At first difference	ΔLGDP	-5.6629	0.0002
		ΔLPAX	-5.6409	0.0000
Phillips & Perron (PP)	At level	LGDP	1.6897	0.9761
		LPAX	-1.3954	0.8479
	At first difference	ΔLGDP	-6.0826	0.0000
		ΔLPAX	-5.5793	0.0002

Notes: (i) t-statistics estimates listed in column IV.

(ii) ADF and PP tests of LGDP & LPAX show stationarity at 1st difference with significance at all levels (1%, 5% & 10%).

Johansen cointegration test is applied on the variables of concern and mathematically this is expressed in equation (6) and (7):

$$\Delta LPC_t = \alpha_1 + \sum_i \alpha_{11}(i)\Delta LPC_{t-i} + \sum_i \alpha_{12}(i)\Delta LGDP_{t-i} + \beta_1 Z_{t-1} + e_{1t} \qquad (6)$$

$$\Delta LGDP_t = \alpha_2 + \sum_i \alpha_{21}(i)\Delta LPC_{t-i} + \sum_i \alpha_{22}(i)\Delta LGDP_{t-i} + \beta_2 Z_{t-1} + e_{2t} \qquad (7)$$

Here $\Delta LPAX_{t-i}$ and $\Delta LGDP_{t-i}$ are the lagged differences which seize the short term disturbances; e_{1t} and e_{2t} are the serially uncorrelated error terms and Z_{t-1} is the error correction (EC) term, which is obtained from the cointegration relation identified and measures the magnitude of past disequilibrium.

Table 2. Johansen-Juselius Likelihood Cointegration Tests

Null	Alternative	Statistic (LGDP & LPAX)	Critical Value (95%)
I	II	III	IV
Maximal eigenvalue test			
$\gamma = 0$	$\gamma = 1$	18.4682	14.2646
Trace test			
$\gamma = 0$	$\gamma \geq 1$	18.6699	15.4947

Notes: (i) Values of Maximal eigenvalue test and Trace tests.

(ii) Optimum lag length is '2' in this case which is selected using the SIC and AIC.

Maximal eigenvalue test and Trace tests reveal the existence of one cointegrating vector. Cointegration is evidenced, using which estimation of cointegrating equations is conducted in the next step.

5.4. Vector Error Correction Model

The model is a first order VEC (Vector Error Correction) model representing short run dynamics and is shown in equation (6) & (7). The lag length was found to be '2' which is established on the basis of SI and AI criteria. Based on column 1 of table 2, the cointegration vector confirms the expected positive relationship between aviation demand and economic growth.

5.5. Impulse Response Function

The intensity of responsiveness to shocks among variables is assessed through impulse-response function (IRF) analysis.[5] Shocks are defined as one standard deviation in the innovations. The effect is also transmitted to other endogenous

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[5] The condition of ceteris paribus holds.

variables through the VECM dynamic structure. IRF tracks the effect of shocks on each innovation over all endogenous variables in the system. If innovations are simultaneously uncorrelated, IRF can be directly interpreted. The ith innovation ε_t is just a shock on the ith endogenous variable Y_t. Since, innovations are usually correlated, Cholesky decomposition is applied for making inference about IRF. This tool makes the innovations become orthogonal (uncorrelated).

Figure 2 (panel 2(a) and 2(b)) give IRF plot for a 10-period-horizon in yearly and accumulated patterns. Response of LPAX is positive and strong to a shock in LGDP. Maximum impact takes place till sixth year (t + 6) as seen in graph. After 6th year the reponse becomes stable LGDP also shows a sharp response to an innovation in LPAX till 2nd year and them becomes stable. These results are similar to intuitive results in Marazzo et al. (2010) in which authors refers strong response of GDP to shock in aviation demand as 'aviation multiplier effect'. An additional finding is the opposite strong response of aviation demand to shock in GDP. In this case, Romanian economy is affected by an abrupt increase in aviation demand in a strong way. Similarly, aviation demand reacts readily and significantly to a shock on economic growth. In terms of comparison of responsiveness, it is found that:

Response of LPAX to innovation in LGDP > Response of LGDP to innovation in LPAX

In panel 2(c) and 2(d), the responses over time are accumulated to analyze the long-run effects of the shocks. On completion of ten periods, aviation demand has increase by 94.0%. While a shock on LPAX raises the GDP by 22% after ten periods. This comparison of accumulated responses can be put in an inequality as done above:

Accumulated Response of LPAX to LGDP > Accumulated Response of LGDP to LPAX

Both inequalities reinforce that responsiveness, both yearly and accumulated, of aviation demand is greater than that of GDP.

5.6. Forecasting Error Variance Decomposition (FEVD)

It provides the proportion of a series forecasting error variance due to shocks on itself and shocks on other variables in a system. Panel 2(e) and 2(f) depict that approximately 35% of LPAX forecasting error variance can be attributed to LGDP, whereas only 15% of LGDP forecasting error variance can be assigned to LPAX. Significant part of LPAX forecasting error variance explained by LGDP is in lines with IRF analysis furnished above. In comparative terms:

Variance of LPAX due to LGDP > Variance of LGDP due to LPAX.

Yuan et al. (2007) terms FEVD as an out-of-sample causality test.

Figure 2. Matrix for ECM, Impulse Response Function and Variance Decomposition

2 (a)	2 (b)

Response of LPAX to LGDP

Response of LGDP to LPAX

2 (c)	2 (d)

Accumulated Response of LPAX to LGDP

Accumulated Response of LGDP to LPAX

2 (e)	2 (f)

Percent LPAX variance due to LGDP

Percent LGDP variance due to LPAX
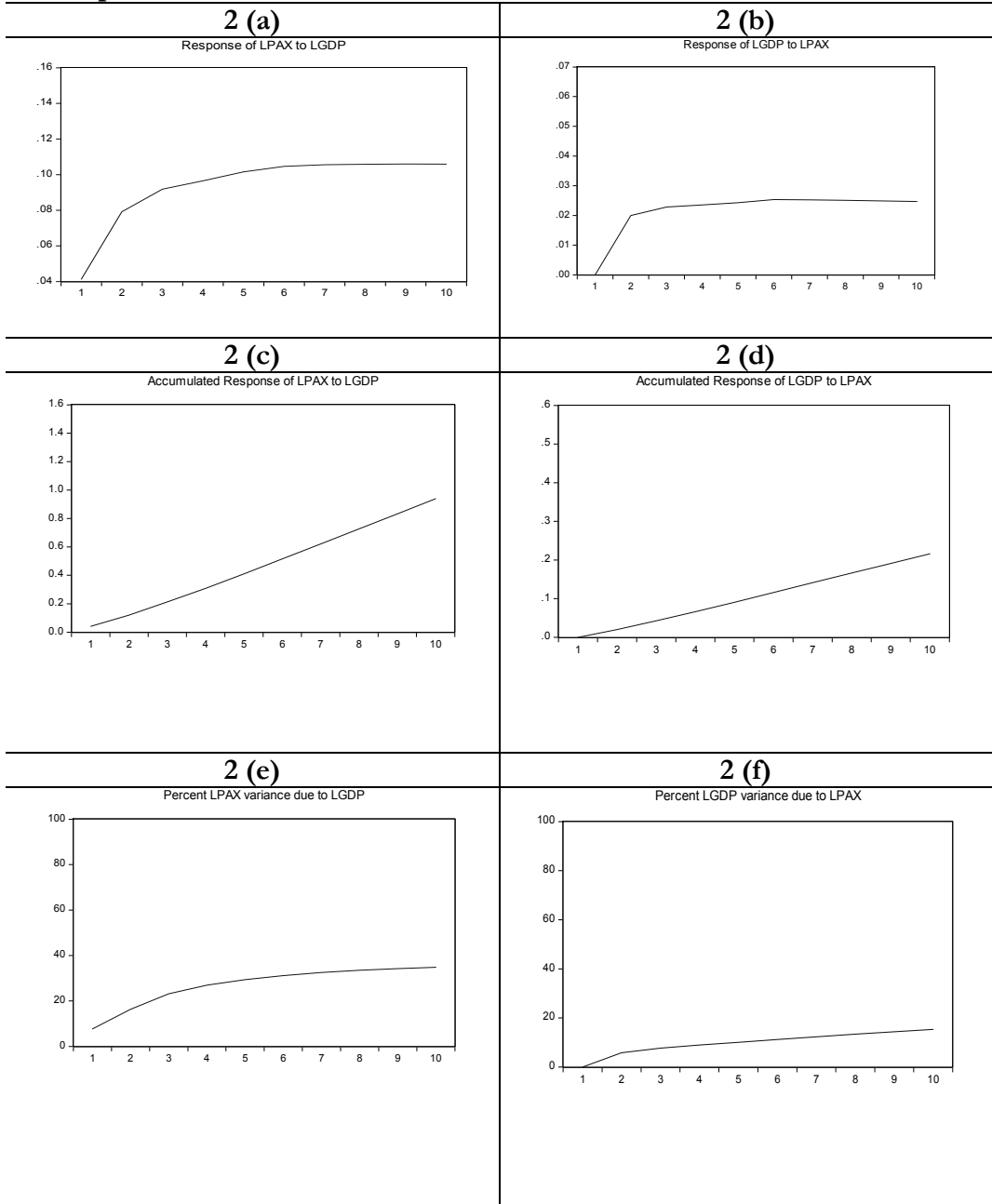
Cointegrating equation is estimated using recently developed econometric methodologies, namely: fully modified ordinary least squares (FMOLS) of Phillips and Hansen (1990), dynamic ordinary least squares (DOLS) technique of Stock and

Watson (1993) and Conical Cointegration Regression (CCR) of Park (1992). These methodologies provide a check for the robustness of results and have the ability to produce reliable estimates in small sample sizes.

5.7. Fully Modified Ordinary Least Squares (FMOLS)

On the basis of VAR model results, cointegrating regression is estimated. In a situation, where the series are cointegrated at first difference 'I(1)', Fully modified ordinary least squares (FMOLS) is suitable for estimation. FMOLS is attributed to Phillips and Hansen (1990) to provide optimal estimates of cointegrating regressions. FMOLS modifies least squares to explicate serial correlation effects and for the endogeneity in the regressors that arise from the existence of a cointegrating relationship.[6]

$$X_t = \hat{\Gamma}'_{21} D_{1t} + \hat{\Gamma}'_{21} D_{1t} + \hat{\epsilon}_t \tag{8}$$

or directly from the difference regressions

$$\Delta X_t = \hat{\Gamma}'_{21} \Delta D_{1t} + \hat{\Gamma}'_{21} \Delta D_{1t} + \hat{v}_t \tag{9}$$

Let $\hat{\Omega}$ and $\hat{\Lambda}$ be the long-run covariance matrices computed using the residuals $\hat{v}_t = (\hat{v}_{1t}, \hat{v}_{2t}')'$. Then we may define the modified data

$$y_t^* = y_t - \hat{\omega}_{12} \hat{\Omega}_{22}^{-1} \hat{v}_2 \tag{10}$$

An estimated bias correction term

$$\hat{\lambda}_{12}^* = \hat{\lambda}_{12} - \hat{\omega}_{12} \hat{\Omega}_{22}^{-1} \hat{\lambda}_{22} \tag{11}$$

The FMOLS estimator is given by

$$\hat{\theta} = \begin{bmatrix} \hat{\beta} \\ \hat{\gamma}_1 \end{bmatrix} = \left(\sum_{t=1}^{T} Z_t Z_t' \right)^{-1} \left(\sum_{t=1}^{T} Z_t y_t^* - T \begin{bmatrix} \hat{\lambda}_{12}^* ' \\ 0 \end{bmatrix} \right) \tag{12}$$

Where $Z_t = (X_t', D_t')'$. The key to FMOLS estimation is the construction of long-run covariance matrix estimators $\hat{\Omega}$ and $\hat{\Lambda}$. Before describing the options available for computing $\hat{\Omega}$ and $\hat{\Lambda}$, it will be useful to define the scalar estimator

$$\hat{\omega}_{1.2} = \hat{\omega}_{11} - \hat{\omega}_{12} \hat{\Omega}_{22}^{-1} \hat{\omega}_{21} \tag{13}$$

Which may be interpreted as the estimated long-run variance of v_{1t} conditional on v_{2t}. We may, if desired, apply a degree-of-freedom correction to $\hat{\omega}_{1.2}$.

5.8. Dynamic Ordinary Least Square (DOLS)

Dynamic Ordinary Least Squares (DOLS) is attributed to Saikkonen (1992) and Stock & Watson (1993). DOLS is a simple approach to constructing an asymptotically efficient estimator that eliminates the feedback in the cointegrating system. Technically speaking, DOLS involves augmenting the cointegrating regression with lags and leads of so that the resulting cointegrating equation error term is orthogonal to the entire history of the stochastic regressor innovations:

$$y_t = X_t'\beta + D_{1t}'\gamma_1 + \sum_{j=-q}^{r} \Delta X_{t+j}' \delta + v_{1t} \tag{14}$$

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[6] See Phillips and Hansen (1990), Hansen (1995) and Saher (2011) for details.

Under the assumption that adding **q** lags and **r** leads of the differenced regressors soaks up all of the long-run correlation between $\mathbf{v_{1t}}$ and $\mathbf{v_{2t}}$, least-squares estimates of $\theta = (\beta', \gamma')'$ have the same asymptotic distribution as those obtained from FMOLS and Conical Cointegration Regression (CCR).

An estimator of the asymptotic variance matrix of $\hat{\theta}$ may be computed by computing the usual OLS coefficient covariance, but replacing the usual estimator for the residual variance of v_{1t} with an estimator of the long-run variance of the residuals. Alternately, you could compute a robust HAC estimator of the coefficient covariance matrix.

5.9. Conical Cointegration Regression (CCR)

The CCR estimator is based on a transformation of the variables in the cointegrating regression that removes the second-order bias of the OLS estimator in the general case. The long-run covariance matrix can be written as:

$$\Omega = \lim_{n \to \infty} \frac{1}{n} E \left(\sum_{t=1}^{n} u_t\right)\left(\sum_{t=1}^{n} u_t\right)' = \begin{bmatrix} \Omega_{11} & \Omega_{12} \\ \Omega_{21} & \Omega_{22} \end{bmatrix} \tag{15}$$

The matrix Ω can be represented as the following sum:

$$\Omega = \Sigma + \Gamma + \Gamma' \tag{16}$$

where

$$\Sigma = \lim_{n \to \infty} \frac{1}{n} \sum_{t=1}^{n} E(u_t u_t') \tag{17}$$

$$\Gamma = \lim_{n \to \infty} \frac{1}{n} \sum_{k=1}^{n-1} \sum_{t=k+1}^{n} E(u_t u_{t-k}') \tag{18}$$

$$\Lambda = \Sigma + \Gamma = (\Lambda_1, \Lambda_2) = \begin{bmatrix} \Lambda_{11} & \Lambda_{12} \\ \Lambda_{21} & \Lambda_{22} \end{bmatrix} \tag{19}$$

The transformed series is obtained as:

$$y_{2t}^* = y_{2t} - (\Sigma^{-1}\Lambda_2)' u_t \tag{20}$$

$$y_{1t}^* = y_{1t} - \left(\Sigma^{-1}\Lambda_2\beta + \left(0, \Omega_{12}\Omega_{22}^{-1}\right)\right)' u_t \tag{21}$$

The canonical cointegration regression takes the following form:

$$y_{1t}^* = \beta' y_{2t}^* + u_{1t}^* \tag{22}$$

where

$$u_{1t}^* = u_{1t} - \Omega_{12}\Omega_{22}^{-1} u_{2t} \tag{23}$$

Therefore, in this context the OLS estimator of (22) is asymptotically equivalent to the ML estimator. The reason is that the transformation of the variables eliminates asymptotically the endogeneity caused by the long-run correlation of y_{1t} and y_{2t}. In addition (23) shows how the transformation of the variables eradicates the asymptotic bias due to the possible cross correlation between u_{1t} and u_{2t}.

5.10. Comparison of the Cointegration Regression Estimates

Estimates of the three estimates techniques are summarized in the table 3:

Table 3. Comparison of the Cointegration Regression Estimates

Technique	Const.	Coefficient	t-statistics	S.E.	Adj. R^2	Long-Run Variance	Remarks on Relationship
FMOLS	14.0820	0.7343	5.0259	0.1461	0.2559	0.2310	positive & significant
DOLS	14.8236	0.6852	5.5402	0.1237	0.6718	0.1131	positive & significant
CCR	13.9089	0.7464	4.9859	0.1497	0.2620	0.2311	positive & significant

Note: All the constants and coefficient estimates are significant at 1%, indicated by [***].

Results of all three estimation techniques (FMOLS, DOLS & CCR) for cointegrating regression show a positive relationship between LGDP and LPAX. However, DOLS has increased explanatory power of LPAX while the adjusted R^2 is highest using CCR. Our major concern, however, is to find the nature of relationship between LGDP and LPAX, that is found to be positive and significant using all three cointegration equation estimation techniques.

Table 4: Granger Causality Test Results

Null Hypothesis	F-Statistic
LGDP does not Granger Cause LPAX	0.9414
LPAX does not Granger Cause LGDP	3.2598[**]

Note: [**] show statistical significance at 5%.

Results of Granger causality, in table 4, show that GDP does not have the tendency to boost the number of passengers carried (PAX) by aviation sector. While, PAX Granger-causes GDP. Increasing number of carried passengers contribute substantially to economic activity and increase GDP. Such is in lines with graphical evidence of 'aviation multiplier effect' in section 5.5 of this paper.

6. Conclusions

This paper investigated the cointegration, reaction to shocks and causality relationships between demand for aviation and economic growth in Romania. The results of this paper imply that aviation and economic growth are cointegrated in the long run and the relationship holds in the short run as well. LPAX reacts positively and strongly to a shock on LGDP. The maximum impact occurs after six years (t + 6) while LGDP also shows a substantial and quick positive reaction till second period and then sustained effect in coming years. This can be translated into a multiplier effect. Our innovation into the empirical analysis of estimation of cointegrating

vector using FMOLS, DOLS and CCR corroborate the findings in Marazzo et al. (2010) and Mehmood & Kiani (2013).

The positive relationship can be attributed to direct and indirect effects of aviation. Direct effects include transportation of labour force (implicitly of services) and goods. Indirect benefits include benefits that accrue to other industries through backward and forward linkages of aviation industry. This gives further impetus to economic activity and hence growth. In the case of Romania, aviation industry should get policy attention to play its further ameliorated role in determining economic growth. Formal incentives should be given to aviation industry to increase its macroeconomic contribution. The scope of research on aviation can be extended by using cross country analysis.

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CONSIDERATIONS REGARDING THE DISTRIBUTION OF INDUSTRIAL GOODS

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Abstract:

The industrial goods market should be approached primarily from a practical standpoint; hence, we must mention that a company addresses distinct categories of economic agents.

The distribution process must meet the appropriate conditions of achieving products in accordance with the requirements of the businesses operating on the market, taking into account the nature of products, consumption structure, the presence of competing units, the structure of media outlets, the specific situation of the development of production and marketing at certain times.

Distribution management includes all economic activities and industrial organization aimed at transferring goods from the producer to the user, by means of specialized units, logistics and personnel. Thus, it must be kept in mind that distribution management has two components: economic distribution (distribution channels) and physical distribution (logistics).

Regardless of the number and variety of businesses participating in the distribution of an industrial product, the interests that dominate their activity, a decisive say in the development of strategic decision regarding the orientation of distribution lies with the producing company, however, not ruling out the possibility of other strategic views among the other participants in order to achieve a complete flow of goods.

1. Conceptual aspects of the industrial goods market

The industrial goods market is the place for trade and economic relations between the selling and / or buying, it is practically the confrontation manifestation of supply and demand, which then translates into acts of sale at a certain price level, established by negotiation.

The industrial goods market should be approached primarily from a practical standpoint. Hence, a company addresses different categories of traders. The following figure shows the main types of markets that a firm that offers goods for industrial use addresses its offer to.
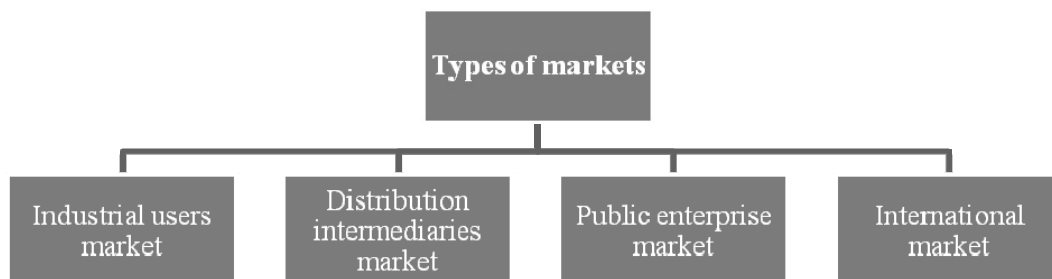
Figure no. 1
Types of markets addressed by a company providing industrial goods

The delimitation of the industrial market requires the consideration of a range of specific issues, among which the most important are the following:

~ Industrial consumption, the number, class and the importance of possible customer businesses;

~ Type and methods of production of consuming enterprises;

~ Manufacturing criterion and possible means of modernizing the technological process;

~ Raw materials used;

~ Type of products produced;

~ Supply practices;

~ Storage policy;

~ Planning projections;

~ Logistic conditions;

~ Structure of products forming the merchandise offer.

Compared with individual consumption goods market, the intermediary consumption market has a number of distinctive features:

● the number of buyers in this market is limited;

● there is a certain dependence of the industrial market on the general investment policy of the state;

● every purchase is conducted based on performance, with the objective of scheduling some goods or materials to ensure the smooth conduct of certain activities;

● within this market there is a diffusion of responsibility for purchasing, purchase decisions and actions representing the result of a collective decision

for which the technical and production departments, investment sectors, supply department, legal department, etc. are responsible.

2. Features concerning the distribution of industrial goods

Through distribution, the company's economic activity is completed, as it recovers the resources invested in the product in cash, and obtains a certain profit margin.

The distribution policy of industrial goods ensures, on the one hand, the supply of goods made by a producer to the final user, and on the other hand, the creation of all the conditions necessary to facilitate users to find products in accessible places, in appropriate time, in sufficient quantity and of appropriate quality.

The distribution process must meet the conditions of producing the appropiate goods, in accordance with the given market conditions, by taking into account the nature of products, consumption structure, the presence of competing units on the market, the structure of media outlets, the specific situation of the development of production and marketing at certain times.

Directing the goods, their physical movement is preceded, accompanied or followed by a series of flows that bind together participants from the entire distribution process[1]:

- *the promotional flow* includes promotional messages about the product and its use addressed to intermediaries, buyers and other stakeholders, in order to sell;
- *the negotiation flow* includes all talks taking place between the manufacturer and the intermediary (as purchaser), aimed at an agreement between the two in relation to routes that the goods will travel, technical and economic changes that they will bear, responsibilities and deadlines that must be met;
- *the orders flow*-transfer of intentions of purchase from intermediaries or users to the producers;
- *the funding flow-* refers to the attraction of the necessary funds for purchase;
- *the payments flow-* the transfer of the amounts representing the value of orders from buyers to sellers;
- *the transfer of ownership flow* from producer to purchaser is accomplished through sales and purchase agreements;
- *the commercial risk flow* refers to risk taking on traded goods during their movement within the distribution channel;
- the *information flow* refers to the bidirectional movement of information, records, statistics on the size, structure, methods of distribution-related activities and economic - financial results.

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[1] Ph. Kotler, *Managementul Marketingului*, Teora Publishing House, Bucharest, 1999, pp 663 – 664 (adapted and added)

The promotional flow

The negotiation flow

The orders flow

The funding flow

The payments flow

The transfer of ownership flow

The commercial risk flow

The information flow
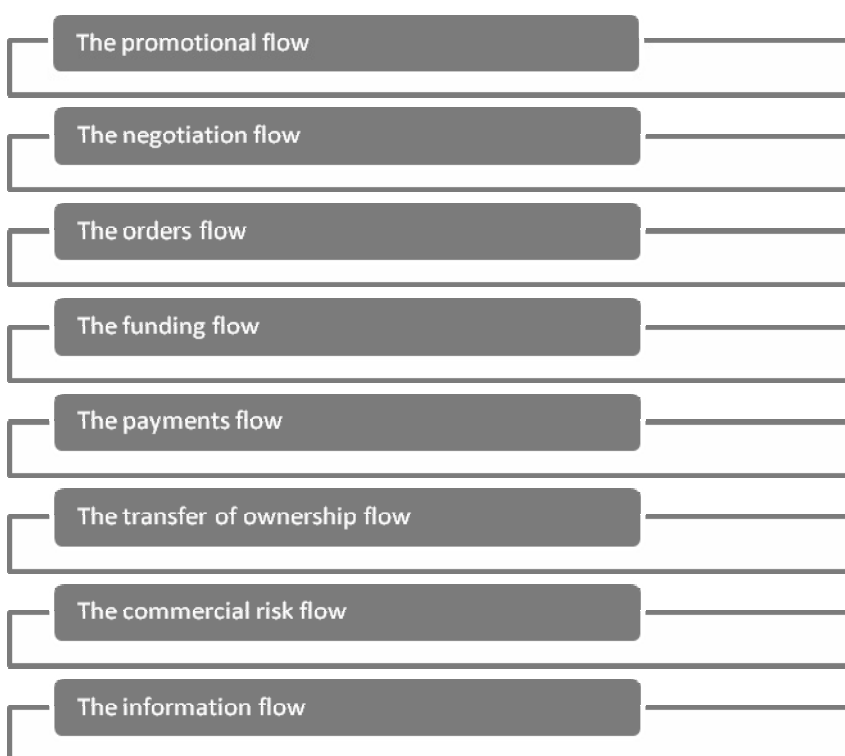
Figure no.2
Distribution channel flows

Distribution management includes all economic and industrial organization activities aimed at transferring the industrial goods from the producer to the user, by means of specialized units, logistics and personnel. Thus, we must keep in mind that distribution management has two components: economic distribution (distribution channels) and physical distribution (logistics).

An appropriate distribution management must meet several requirements such as: setting specific objectives in line with the company's strategic objectives, as well as with the other elements of the marketing mix, anticipating the emergence of factors or events that may hinder objectives, planning and organizing specific activities that operate under speific market conditions, establishing the optimal distribution strategy, but also be able to determine when it should be changed, obtaining useful information on the efficiency and effectiveness of distribution channels.

2.1 Distribution of economic industrial goods

Distribution channels are groups of interdependent organizations involved in making a product or service available for use or consumption. The distribution channel includes the combination of entities and activities through which it carries out acts of sale - purchase. The channel is composed of a chain of links through which the goods pass successively, changing their place, their owner and sometimes their physical appearance. The distribution channel includes on the one hand the manufacturer (entry point) and the consumer (exit point) on the other.

The distribution network is a strategic combination of channels useful for an efficient distribution circuit. The concept of distribution channel refers to the organizational and institutional aspects of the products' path, from their production by the manufacturer and up to the target consumer, with all its nodes, designating groups of independent organizations involved in bringing said products to the consumers or users for consumption. The distribution channel should be considered as a set of intermediaries performing various functions in the transformation of a product from the producer to the final consumer.
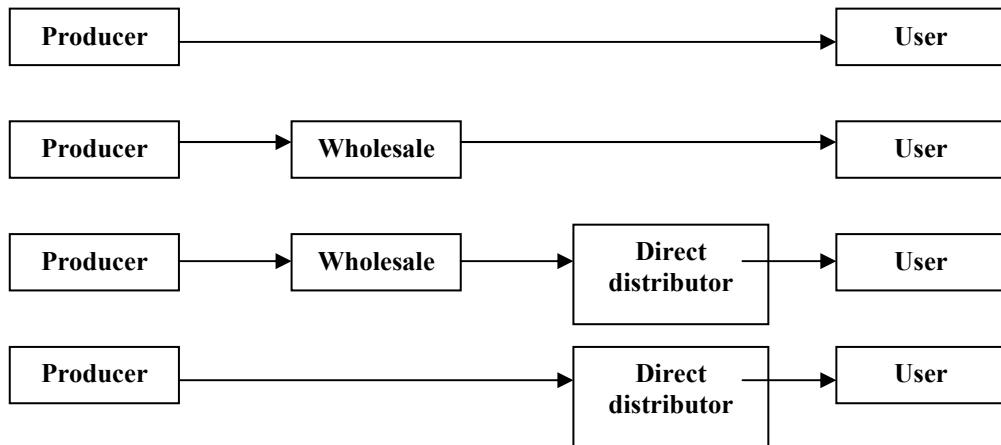
Figure no. 3
The main distribution channels of industrial products

Regarding the specific parameters that can be considered in decision making on establishing various distribution channels, it should be noted that they may be numerous and very diverse, given the complexity of the problems companies face on the market. Among them, the main issues concern:
- the intermediate categories that can be employed within each market area;
- the specificity and structure of rights and obligations that can be negotiated with various potential partners;

- a possibility of realization of the channel in accordance with the product intended to be highlighted through marketing channel;
- the reciprocal nature in providing product-specific flows, the adaptability of businesses providing services to the requirements of the marketing channel;
- the size of distribution channels in certain areas of the market;
- the quality and level of professionalism of the staff of intermediary companies;
- the sales forces of companies in the distribution system on certain markets;
- specific cooperation systems.

2.2 Logistics of industrial goods

Physical distribution represents a complex of responsibilities regarding the movement of raw materials, semi-finished and finished products and the development of an optimal transport route. It considers the moving and efficient handling of the company's goods and services, traded through established channels, from producing businesses to user units.

In industrial marketing, physical distribution includes organizing and managing all the supply operations and movement of raw materials from the source, to the end of the manufacturing line, to the final users.

Establishing the policies for distribution and therefore each logistic system is achieved through:

- market requirement analysis in the context of which the company operates;
- studying current methods of distribution, the costs involved and the size of the product flow in the channels used;
- researching possibilities of alternative of multiple distribution systems;
- comparative evaluation of various alternatives studied and choosing the best one based on forecasted costs and investments required by each alternative.

According to recent works in the field, specialists consider logistics itself as a complex process of operational activities to assure the achievement of customer satisfaction[2].

The American Marketing Association defines physical distribution as "the movement and handling of goods from where they are produced to where they are consumed or used." Philip Kotler believes that the main objective of logistics is bringing the products to the right place, at the right time, and at the lowest cost.

The contents of the logistics system are given by a series of activities taking place within its chain, and can be divided into the following components[3]:

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[2] K.N. Gourdin: *Global Logistics Management: a competitive Advantage for the 21th Century*, Blackwell Publishing, Molden, 2006, p. 2

[3] * * * : *The Boot Leg, Trafic World* Magazine, July 19, 2004, p. 15, quoted by D. Patriche in *Tratat de Management Comercial*, Universitară Publishing House, Bucharest, 2007 (adapted).

- study of customers;
- management of product structure and assortment;
- transportation;
- storage and handling;
- packaging;
- information process;
- estimating market demand in different areas;
- production planning;
- procurement;
- location and strategic placement of warehouses.

Studying the customers requires, on the one hand the analysis of some aspects of their needs manifested through production planning, and on the other hand the analysis of complaints regarding the quality of products, and some suggestions for their improvement.

Management of product structure and assortment refers to the management of our product portfolio. An important issue is the structure of supply, so it is always adapted to new technologies and requirements.

Transportation is the most important component of logistics, but also one that has the largest share in its cost structure. Transportation management raises a number of issues: the use of adequate transportation, the conditions in which the product is delivered, duration, goods and means of transportation insurance, the existence of one's own fleet of vehicles or means of rent, the amount of goods transported.

Storage and handling have a particularly important role. Storage aims to offer efficient storage management so as to ensure a rhythmic rotation of merchandise under such terms that the selling process is unhindered. Manipulation involves handling storage spaces so that products are not affected in terms of quality, and space is effectively harnessed.

Packaging refers both to protection of the products that are transported or stored, and ease and rationalization of storage, handling, transportation and warehousing. In recent years, its focus has been on the use of packaging so that it doesn't pose negative effects on the environment, specifically being biodegradable and recyclable.

Information involves providing a permanent link between all stakeholders in the logistics system so that no gaps exist (uncontrolled pauses) in activity development. Information is facilitated by the development of computer technology, which allows sending and receiving messages in a very short time. To this end,

various online marketing techniques are used by companies in order to pursue their goals and sustain their overall strategy[4].

Estimating demand considers buying intentions analysis of actual and potential customers and providing the required goods in adequate time and space.

Production planning is considered by many authors as an independent activity, but its relationship with logistics is regarded as a recipient of information from the field of use of the said industrial goods. Depending on feedback received, production specialists will determine the necessary materials and supplies, and also new specifications for the products.

Procurement refers to the acquisition of raw materials, subassemblies, etc., in order to obtain final products. This activity has a direct impact on both the costs and the quality of products.

The location and strategic placement of warehouses are made according to the existing infrastructure and supply needs. In considering this, flawless customer service is necessary in terms of opportunities - time, place, quantity, assortment and price structures - and, secondly, minimizing business costs.

The main preoccupations of distribution policy when it comes to physical distribution can be summarized as follows:

~ Establishing he system for the internal circulation of products;

~ Locating the inventory and determining the storage systems for various products;

~ Providing permanent control system over stock size and structure;

~ Establishing the order processing technology;

~ Choosing adequate transportation within the distribution circuit.

3. Strategic features of industrial goods distribution

Regardless of the number and variety of businesses participating in the distribution of an industrial product, the interests that dominate their work, a decisive say in the development of strategic decision regarding the orientation of distribution lies with the producing company. However, there is the possibility of strategic views among other participants in achieving a complete flow of goods.

The issues regarding the process of distribution strategies substantiation as well as the choice of different strategic options are rather complex. A structured and schematic presentation of the issue is illustrated in the following figure.

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[4] G. Orzan, O.I. Macovei, C.Iconaru, **A. Perju** – *An empirical TAM-based model of Romanian SMEs' intention to continue using online marketing techniques*, , Metalurgia International, Vol. 8, 2012,p.152 .

Strategic objectives of distribution

↓

Market characteristics ▪ products ▪ demand ▪ offer

↓

Distribution channels

↓

Logistics

↓

Distribution costs

↓

Distribution audit
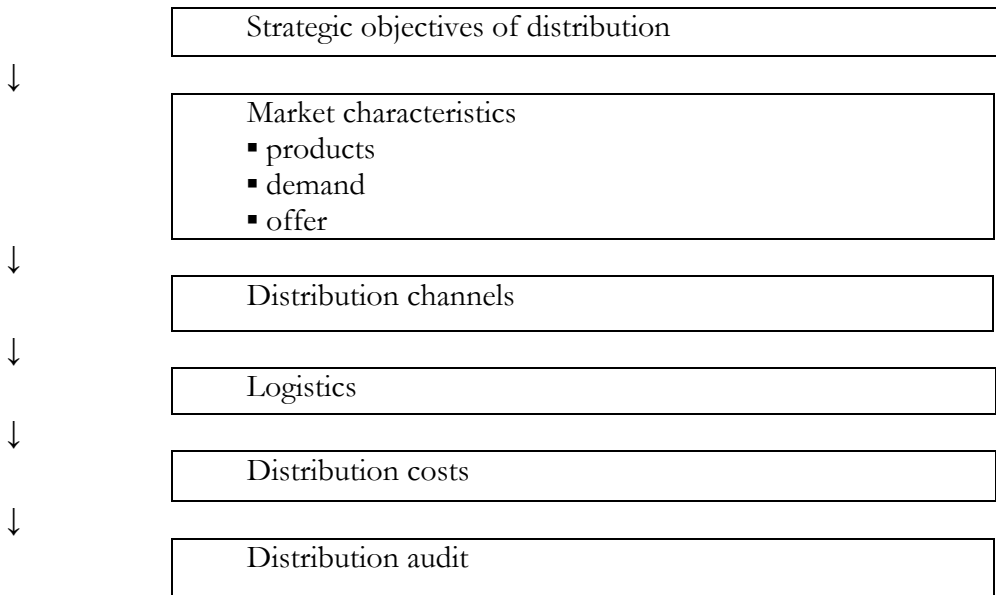
Figure no. 4
The rationale of the distribution strategy

(Adapted and processed from J.J. Lambin: *Le marketing stratégique*, McGraw-Hill, Toronto, Paris, 1989, p. 242)

The framework coordinates of the distribution strategy of grounding process consists of the following aspects: determining the structure of the distribution network - rationale for the presence of intermediaries and opportunities for the vertical or horizontal structure of a distribution circuit; determining and defining the intensity of market coverage concerns - analysis of product characteristics , the coverage offered by various types of distribution, different aspects specific to each market area; determining the structure of communication tactics to be adopted in dealing with intermediaries and users of the products. To these aspects in the framework establishment of distribution strategies, three important elements are added: economic calculation, management aspects - especially those concerning control - and opportunities for adaptation.

Conclusions

The distribution concept encompasses the regulation of goods and services movement between production and consumption, as well as meeting the users' needs, providing them with a range of services, such as proximity of purchase, the

opportunity to choose from a large assortment of goods that correspond to their needs and demands. In this respect, the main functions of the distribution process, considered when formulating relevant policies are:

- o the transfer of ownership of products through sales and purchase agreements;
- o product movement - transportation, storage, conditioning, handling, dismantling or assembling them;
- o management of specific marketing activities, such as decision making concerning the collection of market information and use of said information.

Trying to adapt to new requirements and economic changes, the distribution systems of goods and services have suffered multiple transformations over time. Within these transformations, distribution methods have also evolved uninterruptedly, outlining new ways or systems, as well as new strategic distribution models.

All logistics activities must be conducted in through an integrated system in which individual decisions are based on lucrative insurance and benefit of a whole - the company or distribution channel that it belongs to or is affiliated with in various forms and activities. The strategic concept of distribution - where logistic system is included - aims to ensure, at a certain time or in a given period, and within a determined budget, an optimum combination of distribution channels, sales forces and physical distribution of products achieved by the company that will allow it to reach its objectives.

Shaping the place and role of logistic distribution strategies implies a meaningful analysis to provide the practical valences of good structuring of logistics activities and their appropriate inclusion in the managerial concept. The analysis covers planning and overall strategy of the company, programming and marketing planning, marketing strategy and, finally, the distribution strategy. Concerning the functions of distribution strategies, it is shown that they are subordinate to the basic functions of distribution.

Regarding the choice of distribution strategies, we mention that a number of issues can be considered, that can be taken as the criteria of comparison and choice. These concern: the category of intermediaries acting in different market areas, the number of distribution circuits that may be retained as a strategic choice, the size of distribution circuits, the nature and degree of specialization of the marketing channels used, the structure of each channel and the degree of selection of distribution, the rights and obligations of each participant in the distribution system, the implications of strategic alternatives on the company's management process.

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HOW POLITICAL INDICES AFFECT THE SHADOW ECONOMY

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Abstract

This paper analyses how rule of law, property rights, and other political indices affect the shadow economy, using country panel data. The literature strongly emphasizes the importance of these factors to know the level and changes of shadow economy. However, the limited number of researches uses panel country data with a relatively small number of observations, and hardly any paper has investigated rule of law and property rights and provides evidence using within country data. We use 34 countries data for 8 years from 2000-2007 that measure political indices we find strong support that its increase (improve) leads to a smaller shadow economy. Countries with some common economy features, they have normally been studied and analyzed jointly.

Keywords: Rule of law, Property Rights, Asian Countries, Panel Data Analysis

Jel: O17; O5; D78; H2; H11; H26

1. Introduction

Prospering the shadow economy may cause severe difficulties for governors because official indicators, e.g. on unemployment, labor force, income, GDP, and consumption, are distorted. Policy based on erroneous indicators is likely to be ineffective, or even wrong. Therefore, the reciprocal effects between the shadow and the official economy have to be considered when planning measures of economic policy, especially fiscal policy.

The shadow economy is commonly a well known phenomenon. It is present all over the world and has been so for a long time. Analysis of this phenomenon reveals that the related definitions, terminology, and methodology are far from being unified. For instance, the definitions focus on all productive activities whose goods and services are legal, but which are themselves deliberately concealed from the authorities, usually to make financial gains (e.g. tax avoidance or non compliance with regulations and standards). However, illegal activities (smuggling, drug dealing and the like) are occasionally included. Furthermore, terms such as the shadow,

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underground, hidden or grey economy, the informal sector, and undeclared or illicit work are used, but not always consistently and correctly. Measuring the shadow economy has a challenge to researchers, it is often impossible to measure its size directly. Moreover, several methods have been developed to quantify the size of the shadow economy. In general, three main groups can be identified: (1) modeling, investigating the causes (determinants) and reflecting indicators through the latent shadow economy variable, which is then estimated; (2) direct methods, comprising surveys of the shadow- economy behavior of households and enterprises; and (3) indirect methods, quantifying the shadow economy through the marks it leaves on the (official) economy.

In developing economies, privatization, liberalization, fairer taxation, and less regulation were all associated with a smaller underground economy and smaller state capture. Better provision of public goods to the official economy was associated with a relatively larger official economy. From a public choice perspective a government may not have a strong interest to reduce the shadow economy to a large extent due to the facts, that tax losses may be moderate as a large amount of the income earned in the shadow economy is immediately spend in the official economy. Similarly, income earned in the shadow economy increases the standard of living of a large portion of working population and the decline of the shadow economy will increase the social welfare only if a larger part of production and labor is transferred into the official economy, and also people who work in the shadow economy have less time for other things like to go on demonstrations.

Developing countries with less tax and regulator systems collected more tax income and provided more public goods to their official economies. There was a positive relationship between governance, privatization, regulation, bureaucratic discretion, and corruption in developing countries. Progress in privatization was associated with a higher quality of governance in these countries. The relationship between government expenditures and economic performance is a subject of continuing discussion in economics and public policy making. Considering both lines of theoretical argument about the effects of government size on government effectiveness, the effects of an increase in the size of the shadow economy on government effectiveness may be ambiguous (Jamalmanesh 2011,b).

Different studies have produced different estimates of the size of the shadow economy. Thus, for comparison a common methodological approach needs to be considered. One such attempt is from Schneider (2004), with a data update used in the econometric part for the period 2000–2005. At first glance, the results on the shadow economy size are surprising in their trend. The latter in particular is of relatively very low intensity. We can see that the size of the shadow economy in the countries studied ranges from around 18 to 40 percent of GDP, but over the analyzed years it has increased slightly further. The shadow economy varies considerably across the Asian countries. We follow this line of thought by using Schneider's (2010) the effect of political indices affect the shadow economy.

2. The Shadow Economy Literature

The shadow economy can than serve as an incubator for emerging small enterprises, which, once they are successfully. It is a difficult task to determine which, positive or negative, consequences of the shadow economy prevail. Several studies have been conducted across countries and over time to gain more information on the phenomenon and its causes and consequences (e.g. (Smith, 2002), (Schneider, Enste, 2002), (OECD, 2002), (Schneider, 2007), Buehn and Schneider (2012)). Determining the share of the shadow economy in GDP is important for obtaining the true state of the economy. Countries with some common shadow economy features, they have normally been studied and analyzed jointly. For instance, Feige and Ott (1999), European Commission (2004), Feige and Urban (2005), Nastav and Bojnec (2007), Schneider (2007), Buehn (2012), and many others apply various methodologies and provide an insight into shadow economy activities in transition countries. They, as well as other studies (e.g. (Johnson et al., 1999), (Schneider, Enste, 2002), (OECD, 2002), (Hatipoglu and Ozbek, 2007), (Elgin, 2010), (Cicek and Elgin, 2011), (Elgin, 2012), (D'Erasmo and Moscoso Boedo, 2012), (Biswas, et.al., 2012), Buehn et al. (2013)), have identified high administrative barriers, corruption, and non-existent or deficient rule of law as the main causes of the existence and development of the shadow economy.

The causes, effects and problems generated by increasing shadow economic activities are extensively discussed in Asian countries. Attention is drawn to the shadow economy due to the rising unemployment and the financing problems of public expenditure, as well as the rising disappointment with economic and social policies.

Illicit work is the fact that illegal activities are undesirable to official institutions. A growing shadow economy can be seen as the reaction of individuals who feel overburdened by the state and who choose the "exit option" rather than the "voice option". If the increase of the shadow economy is caused by a rise in the overall tax and social security burden together with institutional sclerosis (Jamalmanesh 2011,a).

The effects of the shadow economy on the official economy should also be taken into consideration because illicit work can be a source of allocation distortions, since resources and production factors are not used in the most efficient way. A growing shadow economy may attract workers away from the official labour market and create competition for official firms. On the other hand, at least two-thirds of the income earned in the shadow economy is spent in the official economy, thereby having a positive and stimulating effect on the official economy.

According to Chen (2004), there are at least three schools of thought on link between shadow and formal economies: dualism, structuralism, and legalism. The "dualists" argue that shadow activities have few linkages to the official economy but, rather, operate as a separate sector. This approach is based on the neoclassical hypothesis that rigidities in the official sector, introduced through legislation or negotiation, segment the market (Harris and Todaro, 1970). The dualist hypothesis asserts that these two sectors are subsidiaries through common factors that lead to

the flow of workers and activities from formal to the shadow economy. The "structuralists" consider the shadow and formal sectors as intrinsically linked. Formal enterprises promote informal production and employment relationships with subordinated economic units and workers to reduce their input costs (Chen, 2004). According to this approach, both informal enterprises and informal wage workers are inclined to meet the interests of increasing the competitiveness of regular firms, providing cheap goods and services.

Consequently, growing official economy boosts unofficial production. 3 The "legalists" direct their interest on the relationship between shadow activities and the formal regulatory environment, not formal firms (Chen, 2004), which is attributed to the fact that the capitalist interests collude with government to set the formal "rules of the game". Another viewpoint to examine the economic consequences of shadow economy on official economy is based on the analysis of the nature of this relationship. It means that the interest of economist is to know if substitution effects prevail on complementary ones. When the complementarities between unofficial and official economy overcome the substitution effects, larger shadow economy should stimulate the official growth. It fits the structuralist hypothesis. The economic explanation is that the value-added created in the shadow economy is spent (also) in the official sector. At the same time, more official production increases the demand of unofficial goods and services.

Empirical findings of Schneider (1998) also show clearly that over 66 percent of the earnings in the shadow economy are rather immediately spent in the official sector. The positive effects of this expenditure for economic growth and for the (indirect) tax revenues must be taken into account as well. Bhattacharyya (1993, 1999) found clear evidence for the United Kingdom (1960–84) that the hidden economy has a significant effect on consumer expenditures. He points out that the hidden economy has a positive effect on consumer expenditures of nondurable goods and services, but an even stronger positive effect on consumer expenditures of durable goods and services. Adam and Ginsburgh (1985) also focus on the implications of the shadow economy on "official" growth in their study concerning Belgium. They find a positive relationship between the growth of the shadow economy and the "official" one and, under certain assumptions (i.e., very low entry costs into the shadow economy due to a low probability of enforcement), they conclude that an expansionary fiscal policy has a positive stimulus for both the formal and informal economies. Shadow economy grows when individuals choose the "exit" option rather than "voice" option as the reaction to increasing burdens (Schneider and Enste, 2000). In modern societies government has a deep role including setting rules and laws, defending against external forces, supplying public goods and services, providing infrastructure, providing security and justice, and undertaking policies to facilitate domestic calmness. However, the power of government may enhance general welfare or erode it. Friedman (1997) observed that "Government has an essential role to play in a free and open society. Its average contribution is positive; but I believe that the marginal contribution of going from

15% of the national income to 50% has been negative." Karras (1996) noted that "the optimal government size is 23 percent for the average country but ranges from 14 percent for the average OECD country to 33 percent in South America; and the marginal productivity of government services is negatively related to government size." (karras, 1996).

In their study, Tanzi and Schuknecht (1995) argue that increasing government expenditure cannot be justified by social improvements since "Higher spending on social programs has not commensurately improved critical social indicators such as life expectancy, infant mortality, or school enrolment, suggesting that increases in public spending are not necessarily productive beyond a certain level". Gupta et al., (2001) also conclude that "Government spending needs to be no higher than 30 percent of GDP to achieve socially desirable goals" Thus, large size governments do not work better than small governments to reach these goals.

Schneider (2005) by estimating a basic equation for a sample of 110 developing and developed countries with further estimates for two separate sub samples of 21 OECD countries and 89 developing and transition countries, point out all three sets of regression show that shadow economy has a significant influence on official economic growth. This influence is positive for transition and OECD countries and negative for developing countries.

3. Theoretical and empirical view of shadow and official economy

Within the frame of macro-economic theories the research on the reasons for the appearance and effects of this phenomenon can be depth with. The role of financial policies, money, exchange, and commerce is shaping and development of shadow economy and development of shadow activities on different markets and effectiveness of governing policies on national accounting is highly considerable. Economic development literature has not ignored the important understanding of this domain related to production to realize the process of economic development. The role of factors such as poverty, unemployment, and expand of migration; have provided important basis for shadow economic growth which should be taken under consideration.

The dualist hypothesis asserts that these two sectors are subsidiaries through common factors that lead to the flow of workers and activities from formal to the shadow economy. The "structuralists" consider the shadow and formal sectors as intrinsically linked. Formal enterprises promote informal production and employment relationships with subordinated economic units and workers to reduce their input costs (Chen, 2004). According to this approach, both informal enterprises and informal wage workers are inclined to meet the interests of increasing the competitiveness of regular firms, providing cheap goods and services.

In terms of the hidden nature of underground activities, sectors are classified under darkish activities (household activities); darksome activities (informal sector), dark activities (irregular sector), and darkle activities (illegal activities) as it is shown in Table 2(Bovi 2005; Sajoed 2006; Pieters 2007). The informal and irregular sector is

sometimes categorized as the shadow economy, while the illegal sector would be named as the black economy. The reason that some household activities are not as a part of GDP is that they don't have to market supply. The informal sector activities are not reported in national accounts due to their minor activities, while the irregular and illegal activities are not represented in national accounts because of their hidden nature (Madzarevic, and Davor 1997).

Table 1. Classification of Activities under Underground Economy

Sector characteristic	**Household**	**Informal**	**Irregular**	**Illegal**
Produce	Legal	Legal	Legal	Illegal
Distribute	Legal	Legal	Illegal	Illegal
Market Supply	No	Yes	Yes	Yes
Tax Evasion	-	-	Yes	-
Examples	-Housewife Activities - red Cross Activators -Religious Activators	-Informal worker - Unwarranted Foreign Labor	- Smuggling - Gambling - Fraud - Money laundering	-Drug dealing Organization al Crime
Murky Degree	Darkish	Darksome	Dark	Darkle
Cause of not reporting	Non- Market Supply	Minor Activities	Hidden Activities	Hidden Activities

The status of lots of countries may be making clear by beneath institutional governance and political situations. Good institutions seem to increase formal GDP, while at the same time reducing informal GDP. Institutional governance reduces the volume of the shadow economy in developed and developing countries. However, the informal sector plays an important role in transition countries. Knowing the shadow economy causes is a tendency to control illegal activities through measures such as punishment, prosecution, economic growth or education (Schneider and Enste, 2002). With doing this study the governments will find out that which institution reduce shadow economy and which one increase it.

From the demand side, a lack of transparency may distort the information flows, thus making difficult market competition and an efficient comparison of goods and services.

So there are two views about the relationship between these two variables. One of these argues the relationship between shadow and official economy is negative and the other one emphasizes is positive.

The political system affects formal and informal economic activities. The outcome in many countries may be explainable by underlying political conditions. Bird et al. (2006) stress that "Countries may tend to achieve an equilibrium position with respect to the size and nature of their fiscal systems that largely reflects the balance of political forces and institutions, and stay at this position until 'shocked' to a new equilibrium". It is worthwhile to investigate whether the recent political economy literature on the importance of governance and institutions allow to understand the level and the changes of the shadow economy. If citizens perceive that their interests (preferences) are properly represented in political institutions and they receive an adequate supply of public goods, their identification with the state increases, their willingness to contribute increases. On the other hand, in an inefficient state where corruption is rampant the citizens will have little trust in authority and thus a low incentive to cooperate. If the government and the administration have a great discretionary power over the allocation of resources corruption is enhanced. Friedman et al. (2000) show empirically that countries with more corruption have a higher share of unofficial economy. Dreher et al. (2009) have also investigated the correlation between shadow economy and corruption. They observe the tendency that shadow economy and corruption are substitutes in high-income countries, but complements in low-income countries. Agents as the political elite, administration staff, and legislators have a discretionary power if institutions are neither credible nor working well (Teobaldelli and Schneider, 2012). The effect of institutions for the shadow economy is demonstrated empirically in Dreher et al. (2009). This has the negative consequence that citizens lose their trust in the authority. In countries where corruption is systemic and the government budget lacks transparency and accountability the obligation of paying taxes cannot be assumed to be an accepted social norm. Institutional instability, lack of transparency and rule of law undermine the willingness of frustrated citizens to be active in the formal economy (Teobaldelli, 2011). Furthermore, there might be a crowding-out effect of morality among the tax administrators when there are a great number of corrupt colleagues. Moreover, regulatory restraints and bureaucratic procedures not only limit competition and the operation of markets, but also provide a better fundament for corrupt activities. If individuals and businesses believe that neither contracts will be neither enforced nor productive efforts protected, their incentive to be active in the shadow economy increases. Citizens will feel cheated if they believe that corruption is widespread, their government lacks accountability, and that they are not protected by the rules of law. This increases the incentive to enter the informal sector.

4. Panel Data Analysis for Political Indices effects on Shadow Economy in Asian Countries

The estimates of relationship between political indices and shadow economy present 34 Asian countries[3]. First, we present results of fixed effect models in table 1.

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[3] - We used these 34 Asian countries data for estimate of models: Armenia, Azerbaijan, Bahrain, Bangladesh, Belarus, Brunei, China, Hong Kong, Indonesia, India, Iran, Japan, Jordan, Kazakhstan, South Korea, Kuwait, Lebanon, Malaysia, Mongolia, Oman, Pakistan, Philippines, Qatar, Russia, Saudi Arabia, Singapore, Syria, Taiwan, Thailand, Turkey, UAE, Ukraine, Vietnam, and Yemen.

Variables used in these models are extracted from valid statistical resources and is resulted to different specifications.

Table 2: Component of the Shadow Economy in Asian countries (Fixed Effect Models)

Depended Variable: Shadow Economy (SE)	Model 1	Model 2
Rule of Law (RL)	0.49 (2.7) ***	0.41 (5.3) ***
Government Effectiveness(GE)	-0.21 (-1.7) *	-0.41 (-1.89) **
Property Rights (PR)	-0.08 (-2.3) ***	-0.06 (-1.42)
Political Stability (PV)	-0.13 (-1.8) *	-0.13 (-3.1) ***
Fiscal Freedom (FF)	0.08 (3.2) ***	
Control of Corruption (CC)	-0.33 (-1.4) *	
Regulation Quality (RQ)		-0.18 (-2.6) ***
Growth Rate of Labor Force (GL)		-0.007 (-2.1) **
Voice and Accountability (VA)		-0.09 (-1.9) **
Constant	-0.71 (-3.4) ***	-0.46 (-10) ***
R^2	0.72	0.67
Observations	272	272
F-test	22.6	20.3
Normality test	(192) ***	(369) ***
Test cross-section, period fixed effects	(79) ***	(64) ***

*-In both specifications, * denotes significant at 10% level; ** significant at 5% level; *** significant at 1% level.

In table 2 both models are OLS and most used variables in these models are consonant with shadow economy. Fiscal Freedom (FF) which in the first model has been significant indicates a measure of the burden of government from the revenue side, extends shadow economy. The above result showed with increase Fiscal freedom the shadow economy decrease. Also, in first model clearly it is seen that control of corruption (CC) cause decrease in volume of shadow economy. Political stability (PV) in first and second model has been significant. These models indicate that this variable causes limitation of shadow economy in Asian countries. Regulation quality (RQ) is indicating of institutional quality in societies and it is anticipated that decreased shadow economy by increasing it. This variable which has been significant in both model, authenticates this matter. Growth Rate of Labor Force (GL) in formal economy results in decrement in shadow economy actives. This problem has been indicated in second model. One of the democracy indications is that importance of governance corporation debate not only before decision making, but also after that and in execution performs well. For this matter voice and accountability (VA) has introduced. This variable which has used in 2nd results in decreasing of shadow economy volume.

One of the issues in shadow economy study is subject of applicability and efficiency of government. Whatever the government is more effective, it can practice more effectiveness against non-efficient bureaucratic and shadow economy. Government Effectiveness (GE) variable has been significant in three models and confirm this subject. Rule of Law (RL) is one of the key variables in institutional studies concerning shadow economy that could be resulted in good governance. There is not this variable consonant with theoretical bases, in two models coefficient of this variable has been positive. Property rights (PR) also cause limitation of shadow economy and this variable has been significant in two models.

5. Conclusion

We have study of the effect of the political incidences like rule of law, government effectiveness, and regulation quality for 34 Asian countries on shadow economy for 2000-2007 using the panel data analysis. The empirical results of this study indicate that in Asian countries; improve in political structure leads to decrease the shadow economy considering high value of regulation quality. Also the results demonstrate that the voice and accountability, political stability and control of corruption can decrease shadow economy for Asian countries. Change informal activities to formal, rule of law, simplification of rule, control of corruption, and knowledge enhancement, increasing the opportunities for prompting the official institutions in clearly area can improve the formal economy and decrease the shadow economy.

Appendix A

Table A.1 Characteristics of sample data					
Vaiables	**Source**	**Mean**	**SD**	**Min**	**Max**
Shadow Economy	Schneider 2007	28.1	12.46	10.3	61
Political Stability and absence of violence	World Bank	-0.16	0.87	-2.39	1.36
Government Effectiveness	Heritage	0.08	0.78	-1.25	2.45
Rule of Law	World Bank	0.01	0.79	-1.31	1.79
Control of Corruption	Heritage	-0.02	0.85	-1.41	2.37
Regulation Quality	World Bank	0.05	0.83	-1.97	2.0
Political Stability (ICRG)	ICRG	4.72	0.96	1.84	6.43
Government Spending	World Bank	71.17	18.13	7.60	95.40
Fiscal Freedom	IMF	4.88	0.79	2.4	6.2
GDP Grow	IMF	5.91	4.37	5.69	34.50

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THE EUROPEAN UNION- VERSION 2.0
-A FEDERAL EUROPE OR NO EUROPE-

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Abstract

Nowadays, the EU is still the most ambitious project of the last decades, an economically driven project, with extremely high expectations for the new economic strategy and for the future. How could the EU address the current crisis in a more pragmatic way, but also pave the way for Europe's future? The EU, in spite of its difficulties, has made Europe a better, more peaceful and more prosperous place. This paper will describe and analyze the EU alternatives for the next years. The author is aware that any scenario may suffer significant and consistent changes, but the reality is that Europe must decide on its future this year.

Keywords: European Union, reforms, federalism, institutions

JEL Classification: E66, F59, F60, O52

The world is struggling nowadays with the need for global governance, as a channel and at the same time an instrument, in the context of the present multipolar international system. If in the '80s the global governance was divided into two regions and political doctrines, nowadays none of the world countries or superpowers hope or can respond to the present challenges -the endless economic crisis, more and more trade regulation, political instability, environmental issues.

A common watcher of the news, regarding global governance, can say that in the last two decades the western economic model has succeeded at the international scale. Unfortunately, things are far more complicated. For example the increasing levels of interdependence between nations and regions, are generating a slow but steady shift in the world economic power but not to WEST, as we can mistakenly believe. All the economists are watching now again to EAST.

The European Union is sadly respecting the pattern mentioned above. More than five years of economic crisis have had a very important and also negative effect on the world economy in general and the EU, especially. The EU regional model, almost unanimously admired before 2008, has proven severe imperfections both in

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design and functionality. Beside the economic imperfections the EU framework has also disclosed the need for institutional reforms.

As a result of the crisis, the EU member states have become more and more interested in putting in order their finances, and less for EU institutional cohesion. EU member states have disagreed on almost every major international issue proving that the European single voice is more an idealistic picture of the realities. The inability of the EU to act as a unit on both domestic and international issues has limited the reach and appeal of its soft power and diplomatic influence.[2]

The Eurozone has recently shown some signs of recovery but the EU is still considered as a "weak link" in the global governance. Beside the financial struggles, the institutional reform is the most discussed topic in the mass-media themes in the European Union. Although severely disapproved, the EU's response to the last crisis has resulted in the creation of new supranational institutions and mechanisms which simply looked unimaginable a few years ago. These include agreements for an EU-banking union, the European Stability Mechanism (ESM), the "fiscal compact" treaty, and the role for the European Central Bank (ECB).

For the second time since 2008, the European Union will experience this year a massive leadership refresh. Between May and November, the news coming from the offices of president of the European Commission, president of the European Council, foreign policy high representative, and president of the European Parliament will all be a top story for all the European media. EU citizens will also vote for their representatives in parliament in 2014.

Basically there are two directions that EU can follow in the next years. **EU can coagulate after the emergency years** or **it will develop in a mode of chaotic, ad hoc dealing strategies**. Disputes over these issues were already intense and probably will continue to be so throughout 2014.

It is not a secret that in the near future, the EU will be under strong pressure. Unfortunately this pressure will come mostly from inside the Union, being generated both from its own institutions and from its member states, in their attempt to provide clarity once for all on where it wants to evolve constitutionally and in terms of political reforms.

In a European Union more and more seen as a giant with clay legs, the question remains…..do we actually need a new Reform Treaty, or more dedication and inclination towards consensus, in accordance with the EU motto "United in diversity"?

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[2] Summary Report -Europe and the Future of Global Governance, Council of Councils Rome Regional Conference, September 8–10, 2013, Ministry of Foreign Affairs, Rome, Italy

The necessity of a significant reform in the EU institutional and functional framework is not actually a new issue on the debaters' agenda. For example, most of the analysts of the European integration phenomenon considered the Treaty of Maastricht as a huge step   towards at that time, concerning the European construction. In fact it really was. The Treaty was basically a merge of the 3 initial treaties: the treaty regarding the European Coal and Steel Community, the treaties of Rome, regarding the European Economic Community and the European Atomic Energy Community. At that time the future of the EU was a brighter one, the Common Market and the single coin in the United Europe represented two of the most ambitious initiatives in the history of the modern diplomacy.

The Amsterdam Treaty was meant to ensure the continuation of the integration. Despite the fact that The Amsterdam Treaty was not so unique and ambitious in terms of content, both treaties showed to us that the integration process in Europe was a dynamic one at that time.

A turning point in the European institutional competitiveness, let's say so, was the treaty of Nice. In fact the treaty provided the institutional reform necessary to allow the candidate states to be part of the European Union. After the ratifying process which was not a smooth one, the European construction evolved to a new level in its evolution. The experience of the EU functioning process is showing us today that all that treaties were not able to deal with the difficulties generated by an almost permanent enlargement process of the EU in the past decades.

Through the Treaty of Lisbon, the institutional reform reached its another milestone, the European Parliament becoming, from that point, co-legislative for almost all domains. The Treaty of Lisbon did not transform the European Union into a new "super-state" but it did introduced new institutional innovations.

Today, despite UK struggling efforts for a new and comprehensive institutional reform, the likelihood of a treaty change is almost certainly much lower than anyone thinks. Many member states are opposing silently or not to a reform, because the EU has recently reached an unwanted stage of rigid and uncompetitive union, both economically and politically. When the Lisbon Treaty is challenged, the whole deal could disintegrate, and it is hard to believe that in an electoral year for many European countries this radical reform scenario will be seriously taken into consideration.

Maybe the best example in this case is the economic and political situation in France, where a superb economic and political reform agenda has been delayed because of the government's unprecedented weakness. And such political incapacity can be seen almost everywhere in the Union. It seems like the FATHERS OF EUROPE have not provided credible followers, concerning politics at least.

In the EU's eastern neighborhood, the newly escalated geopolitical challenge with Russia will test furthermore the Union strength. The crucial question in that situation will be if the EU has the necessary resources and the political motivation to face this unfriendly challenge. The hostilities started with the European Commission

antitrust case against the Russian giant Gazprom. The dealing of those issues will engage for sure a significant political effort in Brussels and in Europe at least in 2014.

The EU is also engaged in playing a diplomatic role in its southern neighborhood. Then, there is Turkey. The EU will be hard-pressed to find smart diplomatic answers to the Turkey question, despite the uncertainty, and the socio-political instability in the region.

So, indeed 2014 seems to be a very important mark in the EU timeline. I am saying that because the EU must decide fast if the answer to all that issues already presented is the refurbishing of the Eurozone, the EU's core or the Union continues its ideological and economic drifting.

If the answer is YES to the first hypothesis, the Eurozone needs three things: banking union, fiscal union and political union.

The banking union seems to be a necessity if we want to speak furthermore about euro, as a single currency. The realities show us that the states are less capable to control the banking system individually, and it is clear that the corporative model was successfully adopted by banks putting individual states into a very delicate position. In that context, the member states will have to understand that a Single European Currency System cannot be effectively managed at the national level.

The second need seems to be the fiscal union, and when it comes to that issue, things get …let's say, muddy. That because a potential fiscal union should and will include a much larger central EU budget, apparently financed by some kind of EU taxes, etc.

A fiscal union will not happen if the EU does not promote and create political union. And now these things get really interesting. Why? Because a political union is unlikely, at least in the foreseeable future. And we have enough arguments to prove that such union will not happen in Europe. Just two or three ideas…..for a political union will need first a new institutional reform, and for it to happen over the next five years, Europe needs a unity and uniformity in terms of politics that does not have and cannot hope to achieve. Second, it is clear that the rapid falls in interest rates that came after the introduction of the euro led to excessive spending in member states like Greece, Spain or Ireland. The crisis has put the accent on the role of Germany into the union economy, making the others look weak. If the EU implemented a fiscal and political union now, it would look for sure too Germanic, rigidly rules-based. And it will be correct to look so, since Germany has paid the bills in recent years. Even if Angela Merkel is determined to become the first Chancellor of Europe in her third term of office, in my opinion France and The UK will not accept such solutions….ever.

In the recent years numerous analysts have compared throughout the U.S. creation process with the European one. The fact is that the US spent 80 years, and a terrible Civil War to complete their own integration, transitioning from a free confederation of colonies, and states, into a true single union. In Europe's case, with

such divergent ideologies and a history far more complex than the Americans, the perspectives look …complicated.

Even without a fiscal and political union, the European Commission has recently gained new powers to supervise not only fiscal spending but also other macro-economic developments, such as wage growth and real estate prices, which could lead to the re-emergence of imbalances. The European Central Bank, together with national supervisors, is getting the power to supervise big Eurozone banks, and if need be, close them[3].

For now the new institutional framework in the Eurozone is not having a direct control upon the fiscal and economic policies of the 18's union countries. But probably without a unified political and fiscal system as background it will be hard to offer a real help for countries that find themselves temporarily in trouble.

A failure of that EU refurbishing will lead the Union to an uncertain direction.

According to numerous researchers and analysts if the EU does not find quickly its own path, perhaps it's time for Europe to throw out the EU project itself. And that because it seems that the EU has failed in giving right answers to most of the problems it faced.

For more than four years, EU officials have addressed the economic recession with remarkably poor solutions. The EU imposed severe austerity measures, particularly in those countries with the highest debts. The effects of those measures are let's say uncertain. How well is it working? Quoting Ronald Reagan's famous question to voters in his 1980 campaign: Are people better off now than they were four years ago?[4] And if is not sufficient, another famous US citizen, Paul Krugman, an economist this time, was stating in 2010 about the EU that "the beatings will continue until morale improves." [5]

In terms of institutional reform need, the Union must quickly decide if the EU is or not a political union. Otherwise the EU officials trespassing into the national governance of member nations represent a proof of ongoing undemocratic behavior. Who is now fully responsible for the people needs? The national parliaments or the EU Parliament? The reality shows us that the responsibility is often passed on from one institution to another, despite the clear institutional procedures.

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[3] Katinka Barysch , The future of the EU means muddling through,
http://forumblog.org/2014/01/reinventing-europe/
[4] http://www.businessweek.com/articles/2012-10-11/are-you-better-off-than-you-were-four-years-ago
[5] http://krugman.blogs.nytimes.com/2010/09/20/the-beatings-will-continue-until-morale-improves/?_php=true&_type=blogs&_r=0

A more upsetting signal could be the recent reaction of the German taxpayers who apparently won't intend to pay the costs of the European experiment. Some polls conducted in 2013 suggested that 26% of Germans, fearful of the future of their economy and resentful that their savings had suffered, were prepared to vote for an anti-euro party. The figure rose to 40% for the 40 to 49-year-old age group.[6]

Conclusion

As if to confirm the strategic importance of the Brussels 2014 agenda, the European Council, the EU's most important decision-making institution, did an unusual thing on December 20, 2013. It gave the EU foreign policy the supreme mandate to create, for the first time, a comprehensive EU foreign policy strategy. This could be a certain sign for us that a strategic decision has been made, and Europe's vote is for federalism. The timing could be the best one, with a new leadership crew being selected over this year, and so many big issues on the agenda, there is some hope that Europe will wake up and restart the engines.

The EU urgently needs measures to improve its democratic legitimacy and the decisions made in its institutions. After the European Parliament elections (May 2014) the EU must refresh several key deciders:
- President of the European Commission;
- President of the European Council;
- High Representative/Vice President for Foreign Affairs & Security Policy;
- 27 other members of the Commission;
- The new President of the fresh elected Parliament.

This substantial renewal of EU senior deciders will clearly affect the direction of the Union over the next years.

As a corollary, the lesser evil for Europe seems to be now the federalism. Europe has lost precious time with the Union construction, and I don't know if Europe can still compete with the global economy in a divided formula. Like Luka Orešković said: "Direct, pan-European democracy would probably break the crust off. As for the contributing nations, direct democracy would mean direct power, commensurate with population size. No longer would unelected Brussellian bureaucrats have the political whipping hand, no longer would Europe remain as opaquely undemocratic."[7]

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LINKAGES AMONG CORPORATE GOVERNANCE, MANAGEMENT ACCOUNTING PRACTICE AND ORGANIZATIONAL PERFORMANCE: EVIDENCE FROM A SOUTHEAST ASIAN COUNTRY

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Abstract

This paper applies a Difference-in-Difference method and Sobel's procedure to examine the complex relationships among corporate governance, management accounting practice and organizational performance, and finds out that the organizations with the majority of independent directors and the leadership separation most likely adopt management accounting practices and as a result achieve the most enhanced performance. In contrast, those with the minority of independent directors and the leadership combination least likely adopt management accounting practices, which leads to the least enhanced performance. Furthermore, it also offers evidence on the mediation of adopting management accounting practices in the effect of corporate governance on organizational performance. The findings can help business managers with building effective management accounting systems, which fit their firm's structures of corporate governance, so that they can achieve the possible best success.

Keywords: Difference-in-difference method, Corporate governance, Management accounting practice, Organizational performance

JEL Classification: C31, G34, L25, M41

1. Introduction

Corporate governance is mentioned as the structures for directing and managing organizations, which concerns the relationships among the organizational management, its board of directors, its shareholders and other stakeholders. Good corporate governance practices will help organizations to mitigate the conflicts of interests among stakeholders. They play a vital role in reducing agency costs due to the separation between ownership and management as well as the majority of independent directors in the board. This will hence create competitive advantages that lead to sustainable economic development as well as improved performance for the organizations (Cadbury 1992).

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Management accounting practices are generally regarded as important controlling tools in providing managers with financial and nonfinancial information to help them make better business decisions and maintain effective control over corporate resources. Johnson and Kaplan (1987) argue that organizations need management accounting practices to provide timely and accurate information in order to facilitate the control of costs, pricing decision, as well as the measurement and improvement of productivity. Several researchers have claimed that the new techniques have influenced the management accounting practice, and have turned its focus from a simple role of financial control to a complex role of creating value by better employing resources (Otley 1999; Fullerton and McWatters 2001; Haldma and Laats 2002).

Corporate governance practices are suggested as the determinants of adopting management accounting practices in business (Cromie et al. 1995; Salvato and Melin 2008; Christine et al. 2011). Nonetheless, to the best of our knowledge, previous research has not empirically investigated this causal relationship. This paper seeks to explore empirically the effect of corporate governance practices on the adoption of management accounting practices. In addition, good corporate governance practices and the high adoption level of management accounting practices can also result in enhanced organizational performance. Previous studies have examined these casual relationships (White and Ingrassia 1992; Beasley 1996; Ajibolade et al. 2010; Aman and Nguyen 2012). However, they have investigated the relationships of organizational performance with corporate governance practices as well as with the adoption of management accounting practices in separate research models of organizational performance. This paper finds it necessary to include both corporate governance practices and the adoption of management accounting practices into an integrated research model of organizational performance, and then simultaneously explore their influences on organizational performance. More importantly, we employ a *Difference-in-Difference* method to determine the effects of corporate governance practices on organizational performance as well as on the adoption of management accounting practices. The Difference-in-Difference method illustrates a quite clear comparison in differences among the four groups of firms.

Furthermore, grounded on the research on the mediation by Baron and Kenny (1986), we can see that the mediating role of adopting management accounting practices is important in the effect of corporate governance practices on organizational performance. Although the mediating effect is important, prior studies have not investigated this intervenient relationship. We think it essential to determine the role of adopting management accounting practices in interfering with the casual relationship between corporate governance practices and organizational performance, in which the casual relationship is weakened by the adoption of management accounting practices.

Business conditions are ever changing all over the world, especially in Southeast Asia, which is highly vulnerable to climate change, but plays an important role in working toward a global solution to sustainable development. In addition,

Southeast Asia is also one of the most dynamic and rapid economies. The business environment experiences more fluctuation there than in the developed ones. Given that Southeast Asia countries are more susceptible to fluctuation, it is more worthwhile to investigate the factors leading to improved performance in Southeast Asia based organizations. In particular, Vietnam is chosen as a case study for this research, because it is the most rapidly growing economy and a member of Southeast Asia as well as a member of the World Trade Organization (WTO). In addition, as the second most populous Southeast Asian country after Indonesia, Vietnam expects that its new status as a signatory member of the international trading system will make increasingly large contributions to the world economic growth. The dynamic and rapidly changing business environment enables organizations in Vietnam pay more attention to effective management tools in order to create competitive advantages and achieve better performance. However, the number of studies on such management tools as corporate governance or management accounting practices in Vietnam is still humble. It is important to carry out more research on these areas in Southeast Asia in general and in Vietnam in particular. As a result, in order to fill this gap, we conduct this paper for the organizations in Vietnam as a Southeast Asian member.

The paper offers statistical evidence that good corporate governance practices make important contributions to the higher level of adopting management accounting practices as well as to improved organizational performance. In particular, organizations, which have the board composed of the majority of independent directors and the separation of chairperson and CEO, most strongly affect the adoption of management accounting practices as well as organizational performance. In contrast, organizations, which have the board containing the minority of independent directors and the combination of chairman and CEO, most weakly impact on the adoption of management accounting practices as well as on organizational performance. In addition, this paper finds out that the organizations, which enjoy the higher level of adopting management accounting practices, will generate the higher organizational performance. The findings also statistically support that adopting management accounting practices in business will mediate the influence of corporate governance practices on organizational performance. In order words, when entered into the research model of organizational performance, the adoption of management accounting practices will lessen the direct impact of corporate governance practices on organizational performance.

This paper delivers some contributions. To the literature, it is the first to provide statistical evidence on the relationship between corporate governance practices on the adoption of management accounting practices. Moreover, it is also one of the first to statistically evidence that adopting management accounting practices plays the mediating role in the effect of corporate governance practices on organizational performance. These findings provide researchers with a clearer picture on corporate governance practices, management accounting practices and their relationships in Southeast Asian countries. To managers, this paper offers them with

better understanding of the relationships among corporate governance, management accounting practices and organizational performance as well as an insight on the mediating role of adopting management accounting practices in the association between corporate governance and organizational performance. Consequently, they can make better decisions on the choice of good corporate governance structures as well as appropriate management accounting practices in order to create competitive advantages over their competitors in a dynamic and rapidly changing business environment in Southeast Asia, and so enhance their organizational performance.

This paper continues with "theoretical framework", which reviews the relevant literature and then arrives at hypotheses, followed by "methodology". The methodology describes the way to measure the variables in the research model, how the data is analyzed, as well as the way to collect the data. The results and conclusions are presented in the two subsequent parts.

2. Theoretical Framework

This part tries to explain the complicated relationships of corporate governance practices with adopting management accounting practices as well as organizational performance. It is given that corporate governance practices impact on organizations' decision on adopting management accounting practices in business, thereby leading to enhanced organizational performance. Grounded on the suggestions by Baron and Kenny (1986), it is argued that the characteristics of corporate governance can intervene in the relationship between the adoption of management accounting practices and organizational performance. These complex relationships will be discussed in more detail below.

2.1. Role of Corporate Governance Practices

Corporate governance is defined as ways of bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors (Mayer 1997). Corporate governance practices are often concerned with the composition and function of organizational boards. In a study of Cadbury (1992), corporate governance instruments are regarded as a monitoring mechanism to minimize the agency costs due to the separation between ownership and management as well as the majority of independent directors in the board, and thereby improve organizational performance. The corporate governance practices are mentioned as the compositions of director boards as well as chief executive officer (CEO) duality that indicates the situation where the positions of chairperson and CEO fall in one person (Cassell 2012).

Management accounting practice is a management tool designed to provide reliable and essential financial or nonfinancial information that an organization needs to make business decisions. It is considered as a part of management practices, whose role is to offer useful information for management planning and control in order to enhance business effectiveness (Kaplan 1983). In addition to traditional

management accounting practices such as traditional budgeting, cost volume profit analysis and variance analysis, organizations should also relate their control tools to more advanced management practices (such as activity based costing, total quality management and balanced scorecard) that satisfy customers' requirements, so will gain competitive advantages (Lucas 1997).

Organizational performance is defined as the actual accumulated results of all the activities of an organization having achieved its goals. Within an organization there are often two primary outcomes analyzed, which are financial performance and nonfinancial performance. While nonfinancial performance is assessed on the items of innovativeness, quality, and customer satisfaction (Hudson et al. 2001; Kaplan and Norton 2007); financial performance is measured on the items of return on asset and on equity (Droge et al. 2003). Both these items of financial performance and nonfinancial performance are used as "organizational performance" in this paper.

A study by Salvato and Melin (2008) indicates that the empowerment of organizational management to independent directors with their outstanding qualifications, expertise and experience will lead to a high degree of formalization. The independent directors have to report their jobs to their shareholders; they hence need formal management tools to control effectively business activities (Cromie et al. 1995). In addition, Christine et al. (2011), in their research on "Corporate governance and management accounting in family firms", consider it essential to establish a separate unit in charge of management accounting, where formal management accounting tools should be employed for formalized management practices. They also imply that professionalization possessed by independent directors is related with the adoption of more sophisticated accounting management practices. Agrawal and Chadha (2005) find that the probability of restatement is significantly lower in companies whose boards or supervisory committees include outside independent financial experts, while higher in firms where CEOs hold the firm's major shares. Their findings are consistent with the argument that independent directors adopt formalized management practices, which create more faithful earnings reports. Further, Sam et al. (2012) elicit that the characteristics of CEOs play an important role in making decision on the adoption of computerized accounting practice. They suggest that there is a relationship between the adoption of computerized accounting practice and CEOs characteristic. Based on the above arguments, we can formulate the following hypothesis.

H1: Corporate governance practices impact on the adoption of management accounting practices.

It is implied by Nicholson and Kiel (2007) and Kaymak and Bektas (2008) that the boards, into which independent directors are appointed, will counter an agency problem because these boards can monitor any self-interested actions by managers. This may diminish agency costs, and therefore lead to improved firm performance. Furthermore, independent directors are selected by their outstanding qualifications, expertise and experience, so they may effectively affect business decisions, which eventually results in benefits to organizations. Firms with a person

holding positions of both chairperson and CEO can suffer an agency cost if this CEO pursues his own interest at a cost of other shareholders (White and Ingrassia 1992). In addition, Beasley (1996) and Bebenroth and Donghao (2007) offer an argument that independent directors play a unique monitoring role for the organization, which will minimize agency costs, and ultimately improve firm performance. A firm suffers worse performance, since its board cannot monitor and dismiss an underperforming CEO. Hence, the chairperson and CEO positions should belong to different individuals so that the power of control is decentralized and thereby agency costs are mitigated. In relation to corporate governance practices, Subramanian and Reddy (2012) ascertain that the disclosures of information about the corporate governance practices even also help the organizations win the confidence of stakeholders, which may eventually enhance organizational competitiveness. Grounded on the above arguments, we posit the hypothesis below.

H2: Good corporate governance practices likely improve organizational performance.

2.2. Role of Management Accounting Practices

The purpose of adopting management accounting practices is to facilitate decision-making by collecting, processing and communicating information that assists managers to plan, organize, manage and assess business processes, firm strategy as well as firm performance. In a research on management accounting, Ajibolade et al. (2010) confirm a positive relationship between the use of management accounting practices and firm performance. Wang and Huynh (2013) argue that the higher use of management accounting information will help managers to enhance their business performance. The role of accounting information practices in enhancing firm performance is also statistically supported by Williams and Seaman (2002) and by Yulius (2010). Furthermore, a number of studies have confirmed influence of e-commerce, information practice and information technology on firm performance (Choe 2003; Ismail 2007; Schulz et al. 2010). These instruments function similarly to management accounting practices in which they are all aimed to enhance efficiency of organizations. Therefore, based on the previous findings, we suggest the following hypothesis.

H3: The adoption of management accounting practices likely enhances organizational performance.

The causal relationships between variables in a research model are often more complex than a simple relationship between a predicting variable and a predicted variable. The association between two variables in a research model is often interfered with by a third variable. A procedure to examine the third variable intervention on the effect of the explanatory variable and the explained variable is introduced by Baron and Kenny (1986). Whether the interfering effect exists is determined by three conditions. First, an explanatory variable significantly impacts on a explained variable. Second, it also simultaneously imposes a statistically significant effect on a third variable. Third, the third variable, in turn, determines the

explained variable. If the three conditions are satisfied, then it can be proposed that the third or intermediary variable intervenes in the effect of the explanatory variable on the explained variable. Further, a technique suggested by Sobel (1982) is used to explore the intervening effect by examining the statistical significance for the indirect effect of the intermediary or mediating variable. A null hypothesis, that there is no the indirect influence of the mediating variable on the association between the explanatory variable and the explained variable, is statistically tested.

As above discussed, hypothesis 2 (H2) posits that good corporate governance practices can lead to improved organizational performance, while hypothesis 1 (H1) conjures that corporate governance practices are related with the adoption of management accounting practices. In addition, hypothesis 3 (H3) suggests that the adoption of management accounting practices likely results in enhanced organizational performance. Following the arguments by Baron and Kenny (1986), these hypotheses let us come to the hypothesis below.

H4: the adoption of management accounting practices can mediate the relationship between corporate governance practices and organizational performance.
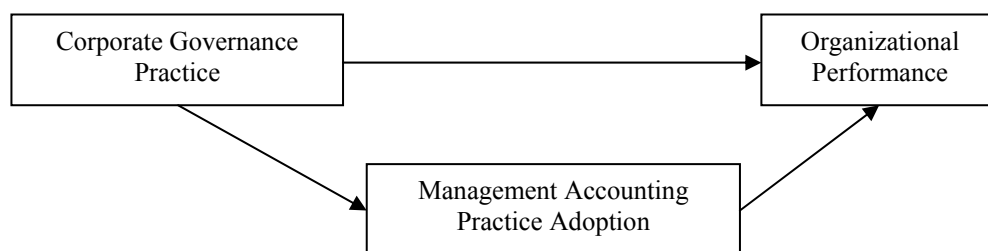
Fig. 1: Research Framework

The above-suggested hypotheses allow us to build a research framework as in Fig. 1, in which corporate governance practices are proposed to impact on organizational performance as well as on the adoption of management accounting practices that is in turn posited to affect organizational performance. The adoption of management accounting practices is also given to mediate the association between corporate governance practices and organizational performance

3. Methodology

3.1. Measurement of Variables

The measurement *of Corporate Governance Practices (CGP)* is adapted from (Cassell 2012), which refers to corporate governance as the proportion of independent directors (CGP1) as well as the duality or the separation of the positions of chairperson and CEO (CGP2). Both the variables are two dummy variables. The majority of independent directors is coded as 1 if the proportion of independent

directors is more than 50%, otherwise as 0. The separation of the positions of chairperson and CEO is coded as 1 if the positions of chairperson and CEO are separate, otherwise as 0.

A five-point scale is employed to measure *Adoption of Management Accounting Practices (MPA)*. The measurement ranges from 1.never considering, 2.decided not to introduce, 3.favored to introduce, 4.intended to introduce, to 5.under implementation of management accounting practices, adapted from Cinquini et al. (2008). The factor "MPA" consists of the following six dimensions that are traditional budgeting (MPA1), cost volume profit analysis (MPA2), activity based costing (MPA3), total quality management (MPA4), variance analysis (MPA5) and balanced scorecard (MPA6), which is suggested by the prior studies (Lucas 1997; Hyvonen 2005; Al-Omiri and Drury 2007).

Organizational Performance (OPF) is assessed by using a five-point scale from 1.no growth, 2.a little growth, 3.average growth, 4.fast growth to 5.very fast growth. A comparison to industry-average for each item was made. To help in making comparisons, the following items, which are returns on asset- OPF1, returns on equity- OPF2 (modified from Droge et al. 2003) as well as innovativeness- OPF3, quality in products or services- OPF4, and customer satisfaction- OPF5 (adapted from Hudson et al. 2001, and Kaplan and Norton 2007), are considered. Organizational performance is defined as the actual outcomes of financial and nonfinancial performances in an organization against the outcomes of its industry-average over the last year. Financial performance is based on the dimensions of return on asset as well as on equity; whereas nonfinancial performances is assessed on the items of innovativeness, quality in products or services, and customer satisfaction.

3.2. Statistical Analysis

This paper applies the Difference-in-Difference method to investigate the influences of corporate governance practices on the adoption of management accounting practices as well as on organizational performance. The Difference-in-Difference method is a research approach for examining the casual relationships, often based on comparing actual differences among four groups of the research model (Wooldridge 2009). In order words, it allows us to estimate the effect of treatment on different groups. This method measures the difference in a result after and before the treatment as well as the difference in a result between the treatment and control groups. Besides a group that is affected by the treatment, the three others are not influenced by the treatment. The group, which already received the treatment, is called "a post-treatment treated group". The three other groups are namely "the pre-treatment treated" that is treated before the treatment, "the pre-treatment non-treated" that has not been treated in the period prior to the treatment, and "the post-treatment non-treated" that is not treated in the current period. To evaluate the treatment influence, we could just compare the treated groups before and after the treatment. We employ a control group to determine and separate the

treatment effect. The Difference-in-Difference method is performed simply by taking the estimate of each group's result, from the following regression model (1), before and after the treatment. The explanatory results are displayed in Table 1.

$$y_i = \beta_0 + \beta_1 \, treat_i + \beta_2 \, after_i + \beta_3 \, treat_i {*} after_i + \beta_4 \, X_i + e_i$$
(1)

Where: 'treat' obtains 1 if belonging to the treatment group, or 0 if belonging to the control group; whereas, 'after' gets 1 if after the treatment, or 0 if prior to the treatment.

Table 1: Difference-in-Difference Method and How It Corresponds to the Model

	Treatment Group	Control Group	Difference
Before	$\beta_0 + \beta_1$	β_0	β_1
After	$\beta_0 + \beta_1 + \beta_2 + \beta_3$	$\beta_0 + \beta_2$	$\beta_1 + \beta_3$
Difference	$\beta_2 + \beta_3$	β_2	β_3

In order to examine the effect of corporate governance practices on the adoption of management accounting practices and on organizational performance, a Difference-in-Difference procedure is utilized. Grounded on the research model, we can come to a estimated equation: $y_i = \beta_0 + \beta_1 \, treat_i + \beta_2 \, after_i + \beta_3 \, treat_i{*}after_i + \beta_4 \, X_i + e_i$. For organizational performance as a dependent variable, we denote 'y' as 'organizational performance', 'treat' as 'the majority of independent directors', 'after' as 'the separation of the positions of chairman and CEO', and 'X' as the adoption of management accounting practices. For the adoption of management accounting practices as an explained variable, we set 'y' as 'the adoption of management accounting practices', 'treat' as 'the majority of independent directors', 'after' as 'the separation of the positions of chairman and CEO'. The majority of independent directors obtain the value of 1 if the proportion of independent directors exceeds 50%, otherwise it gets the value of zero. The separation of chairperson and CEO is coded as 1 if the positions of chairperson and CEO belong to one individual, otherwise it is zero.

Then, Sobel's (1982) technique is used to evaluate the statistical significance for the mediating role of adopting management accounting practices in the effect of corporate governance practices on organizational performance. The method by Sobel (1982) is to test whether the mediating effect is statistically significant. The intervening influence is determined by investigating the statistical significance for the indirect effect of corporate governance practices on organizational performance. To explore the intervenient effect, the null hypothesis, which there is not a difference between the total effect and the direct effect (or an indirect effect is zero), is tested. The two sets of models, which are (1) "OPF = $a_1 + b_1{*}CGP1 + c_1{*}MPA$" and "MPA = $a_2 + b_2{*}CGP1$" as well as (2) "OPF = $a_1 + b_1{*}CGP2 + c_1{*}MPA$" and "MPA = $a_2 + b_2{*}CGP2$", are applied to discover the intervenient impacts of adopting management accounting practices on the connection of organizational

performance with corporate governance practices (CGP1 and CGP2). We utilize a t-test o test whether the indirect effect of corporate governance practices on organizational performance is different from zero. A t-statistics $(t_{indirect})$ is a ratio of the indirect effect coefficient $(b_{indirect})$ to its standard error $(s_{b\text{-}indiecrt})$, in which $b_{indirect}$ is equal to $b_2{}^*c_1$, and $s_{b\text{-}indiecrt}$ is sqrt($c_1{}^2 s_{b2}{}^2$ *plus* $b_2{}^2 s_{c1}{}^2$). When the t-statistics is more than a critical value of P_{value} of 0.05, the null hypothesis is rejected, which indicates that the indirect effect is statistically different from zero or the mediating effect exists.

Prior to exploring the causal relationships and the mediating effects in the model, internal consistency for the two variables 'the adoption of management accounting practices' and 'organizational performance' is tested with reliability analysis to investigate the degree to which numerous items of the same measure agree with one another. The internal consistency for these two variables is tested, since they are composed of several items and we need their composite variables (by taking the averages of their own items). Subsequently, the impacts of multicollinearity among the independent variables in the estimated equations are also examined with the Pearson correlations. In order to satisfy the suggested limits by Nunnally (1978), item-total correlations had better exceed 0.5 and simultaneously the acceptable level of the Cronbach's alpha should be more than 0.7. The reliability analysis offers information about the associations among individual items in the scale. If the relationship is strong, the scale will yield consistent outcomes and so is reliable. Pearson correlations among the independent variables in the research models should not be more than 0.8, the acceptable highest level suggested by Kennedy (1992).

3.3. Data Selection

We collected the data from a sample of the 705 Vietnamese organizations listed publicly in the two only Vietnamese Stock Exchanges, in which 308 organizations are listed on Ho Chi Minh Stock Exchange and the other 397 organizations on Ha Noi Stock Exchange. We employed the initial solicitations to get responses from key informers with experience in corporate governance and management accounting. The questionnaire was completed with a manager involved in corporate governance and management accounting for each targeted organization. The questionnaires were sent to 475 organizations by email and in person interviewed with managers in 230 organizations. Of 475 questionnaires emailed, 243 were returned. However, 91 questionnaires did not deliver enough information as required. Hence, only 152 complete questionnaires are offered. Of the 230 interviews scheduled to be face-to-face performed, only 185 offered the good results for our questionnaire. Lastly, our sample is made up of 337 good replies with satisfactorily required information.

4. Empirical Results

Reliability analysis is the first procedure utilized in this paper to the reliability of the data. Table 2 exhibits the results of reliability analysis. Since, the item-total correlation of 'MPA6- balanced scorecard' is 0.348 (untabulated) that is lower than 0.5, the acceptable limit by Nunnally (1978), we remove it out from our data. As a result, the variables "the adoption of management accounting practices" only still includes five items, which are traditional budgeting (MPA1), cost volume profit analysis (MPA2), activity based costing (MPA3), total quality management (MPA4), variance analysis (MPA5).

Table 2: Results for Reliability Analysis

Item	Item-total Correlations	Cronbach's Alpha	N of Items
MPA1	0.739		
MPA2	0.713		
MPA3	0.678	0.884	5
MPA4	0.771		
MPA5	0.723		
OPF1	0.710		
OPF2	0.610		
OPF3	0.628	0.835	5
OPF4	0.625		
OPF5	0.611		

These five items is performed with the reliability analysis again. All of the five obtain their item-total correlations of over 0.5 (the lowest is 0.678 of MPA3 and the highest belongs to MPA4 at 0.771). The Cronbach's alpha achieves 0.884, which passes the lowest limit of 0.7, suggested by Nunnally (1978). Likewise, the five elements of organizational performance all get their item-total correlations of over 0.5 (the lowest is 0.610 of OPF2 and the highest is 0.710 of OPF1). In addition, the Cronbach's alpha reaches to 0.835, satisfying the lowest limit of 0.7. Overall, these results show that these ten items obtain sufficient internal reliability. Therefore, they are reasonably retained for further analyses.

Table 3: Correlations among the Variables

	CGP1	CGP2	CGP1*CGP2	MPA	OPF
CGP1	1.000	0.324[***]	0.728[***]	0.379[***]	0.463[***]
CGP2		1.000	0.710[***]	0.455[***]	0.504[***]
CGP1*CGP2			1.000	0.390[***]	0.544[***]
MPA				1.000	0.543[***]
OPF					1.000

Significance Level: ***= 0.01, Pearson: 2-tailed

The problem of multicollinearity is really serious, because its presence causes the ordinary least square estimators to be inaccurately estimated. Multicollinearity occurs in multiple regressions when two or more of the explanatory variables in the regression model are themselves highly correlated. Hence, we conduct the correlation procedure to examine the problem of multicollinearity. Before carrying out the correlation procedure, we create new composite variables for the two variables 'the adoption of management accounting practices' and 'organizational performance', by averaging items within the variables, because these two variables consist of five items per each. The two new variables created are MPA and OPF, which represent the adoption of management accounting practices (MPA) and organizational performance (OPF). Table 3 provides the results of correlations among the five variables used in analysis that are CGP1, CGP2, CGP1*CGP2, MPA and OPF. All of the correlations among the five variables are under 0.8, the highest value proposed by Kennedy (1992), which implies that the problem of multicollinearity does not exist in our analysis.

Table 4: Summary for Ordinary Least Square regression

Predicted Variable	Predictive Variable	Coefficients	Standard Error	*t-statistics*	P_{value}
	CGP1	0.193	0.091	2.121	0.035
	CGP2	0.231	0.092	2.527	0.012
OPF	CGP1*CGP2	0.242	0.118	2.055	0.041
	MPA	0.278	0.040	6.926	0.000
	C	2.701	0.146	18.491	0.000
R-squared		0.438			
F-statistic/P_{value}		64.623/0.000			
	CGP1	0.671	0.119	5.660	0.000
MPA	CGP2	0.843	0.116	7.272	0.000
	CGP1*CGP2	-0.456	0.158	-2.877	0.004
	C	3.371	0.074	45.390	0.000
R-squared		0.285			
F-statistic/P_{value}		44.227/0.000			

To examine the effects of corporate governance practices on the adoption of management accounting practices as well as on organizational performance, firstly we estimate the two models with OLS regression. The results are displayed in Table 4, which indicates that the adoption of management accounting practices, the majority of independent directors, the leadership separation of chairperson and CEO as well as the interactive term of 'the majority of independent directors' times 'the leadership separation of chairperson and CEO' put statistically significant effects on organizational performance. The influence of adopting management accounting practices on organizational performance achieves the significance level at 0.01, whereas the others obtain the significance at 0.05.

Table 4 also reveals that the adoption of management accounting practices in business is statistically affected by the majority of independent directors, the leadership separation of chairman and CEO as well as the interactive term of 'the majority of independent directors' times 'the separation of the positions of chairman' at the 0.01 significance level. Both the models achieve the goodness of fit at the 0.01 level with *F-statistics* of 64.623 and 44.227. The variables in the research explain 43.8% of the variations in organizational performance, while only explain 28.5% of the variation in the adoption of management accounting practices. These findings imply that while adopting management accounting practices is determined by corporate governance practices, these two kinds of practices both lead to better organizational performance.

The results from the OLS procedures statistically support our hypotheses 1, 2 and 3 (H1, H2 and H3). Nonetheless, they do not clearly explain how the items of 'corporate governance practices' separately influence organizational performance as well as the adoption of management accounting practices. For more clarity, we undertake the Difference-in-Difference method to analyze the differences in the effects of the items of 'corporate governance practices' on organizational performance and the adoption of management accounting practices. The Difference-in-Difference technique yields the outcomes in Tables 5 and 6, in which we set the group with the majority of independent directors as 'treatment' (the group with the minority of independent directors as 'control') and the group with the combination of leadership as 'before' (the group with the separation of leadership as 'after').

Table 5: Results of Difference-in-Difference (for Organizational Performance)

	Majority Group	Minority Group	Difference
Combination	2.701 + 0.193	2.701	0.193
Separation	2.701 + 0.193 + 0.231 + 0.242	2.701 + 0.231	0.193 + 0.242
Difference	0.231 + 0.242	0.231	0.242

The results provided in Table 5 point out that the organizations with the majority of independent directors and the separation of leadership make the improvement in performance by 0.473 (or 0.231 + 0.242) units, compared to the organizations with the majority of independent directors and the combination of leadership. The former also produces more performance than the organizations with the minority of independent directors and the separation of leadership by an amount of 0.435 (or 0.193 + 0.242) units. The performance generated by the organizations with the minority of independent directors and the combination of leadership is 0.193 units or 0.231 units lower than the organizations with the majority of independent directors and the combination of leadership or those with the minority of independent directors and the separation of leadership, respectively.

Table 6: Results of Difference-in-Difference (Management Accounting Practice Adoption)

	Majority Group	Minority Group	Difference
Combination	3.371 + 0.671	3.371	0.671
Separation	3.371 + 0.671 + 0.843 - 0.456	3.371 + 0.843	0.671 - 0.456
Difference	0.843 - 0.456	0.843	- 0.456

Table 6 offers evidence that the difference in the adoption level of management accounting practices between the organizations with the majority of independent directors and the separation of leadership and those with the majority of independent directors and the combination of leadership is 0.387 (or 0.843 - 0.456) units. The adoption level of management accounting practices in the former is bigger than the latter. In contrast, the adoption level of management accounting practices in the latter is larger than the group with the minority of independent directors and the combination of leadership by an amount of 0.671 units. While the organizations with the minority of independent directors and the separation of leadership create 0.843 units more performance than the group with the minority of independent directors and the combination of leadership; the former organizations enjoy less performance than those with the majority of independent directors and the separation of leadership by 0.215 or (0.671 - 0.456) units. Overall, the findings imply that the group with the majority of independent directors and the separation of leadership most strongly influence the adoption level of management accounting practices as well as organizational performance; whereas the group with the minority of independent directors and the combination of leadership imposes the smallest influences. The group with the minority of independent directors and the separation of leadership takes the second position in the effect, while the group with the majority of independent directors and the combination of leadership ranks the third.

Table 7: Regression Results for Mediation

Predicted Variable	Predictive Variable	Coefficients	Standard Error	*t-statistics*	P_{value}
OPF	CGP1	0.614	0.064	9.562	0.000
MPA	CGP1	0.609	0.081	7.498	0.000
OPF	CGP1	0.399	0.062	6.412	0.000
	MPA	0.354	0.039	9.153	0.000
OPF	CGP2	0.672	0.063	10.694	0.000
MPA	CGP2	0.734	0.078	9.356	0.000
OPF	CGP2	0.433	0.065	6.700	0.000
	MPA	0.326	0.040	8.152	0.000

In order to investigate the mediating influence of adopting management accounting practices on the association between corporate governance practices and

organizational performance, we utilize the suggestions by Baron and Kenny (1986) and the analyses introduced by Sobel (1982). The results obtained from these analyses are described in Tables 7 and 8. As seen in Table 7, the proportion of independent directors and the separation of leadership both statistically affect adopting management accounting practices as well as organizational performance at the 0.01 significance level; while organizational performance is improved by the adoption of management accounting practices at the 0.01 statistical significance level. Grounded on the arguments by Baron and Kenny (1986), these findings induce us to posit that the adoption of management accounting practices interferes with the association between corporate governance practices and organizational performance. Furthermore, Table 8 presents evidence on the statistical significance for these mediating effects. The relationships of organizational performance with the proportion of independent directors and the separation of leadership are mediated by the adoption of management accounting practices at the 0.01 statistical significance level. Therefore, our hypothesis 4 (H4), which states, "The adoption of management accounting practices intervenes in the relationship between corporate governance practices and organizational performance", is statistically supported.

Table 8: Results for Sobel Tests

Mediation	Relationship	$t_{indirect}$	P_{value}
MPA	CGP1 and OPF	5.790	0.000
MPA	CGP2 and OPF	6.161	0.000

5. Conclusion

Previous research has investigated the relationships of organizational performance with corporate governance practices as well as the adoption of management accounting practices. Nevertheless, to the best of our knowledge, these relationships have been only examined in separate research models. This paper includes both corporate governance practices and the adoption of management accounting practices into an integrated model to study their effects on organizational performance. We are the first to apply the Difference-in-Difference technique to investigate the effects of corporate governance practices on the adoption of management accounting practices as well as on organizational performance. We also are the first to discuss and explore the mediating role of adopting management accounting practices in the effect of corporate governance practices on organizational performance. This mediating role is discussed and investigated according to the arguments by Baron and Kenny (1986) and the procedures proposed by Sobel (1982).

The findings reveal that good corporate governance practices in an organization will bring about improved organizational performance. Good corporate governance practices also induce managers more likely to adopt management

accounting practices in business. In addition, this paper discovers that organizations, which pay more attention to management accounting practices and adopt them at high levels, will enjoy more performance than the others will. Furthermore, the adoption level of management accounting practices is found to intervene in the association between corporate governance practices and organizational performance. When entered into the research model of organizational performance, the adoption of management accounting practices will reduce the direct effect of corporate governance practices on organizational performance.

To the literature, this paper provides statistical evidence that organizations, where the board contains the majority of independent directors and the positions of chairperson and CEO separately belong to two different people, most powerfully influence the adoption level of management accounting practices as well as organizational performance. Playing the most second affecting role pertains to those with the minority of independent directors and the separation of leadership. On the other hand, organizations, in which the board contains the minority of independent directors and the positions of chairperson and CEO belong to an individual, most weakly affect the adoption level of management accounting practices as well as organizational performance. The group with the majority of independent directors and the combination of leadership takes the third affecting role. Moreover, this paper is the first one to offers evidence on the mediating role of adopting management accounting practices in the influence of corporate governance practices on organizational performance. To organizational managers, this paper sheds an insight on the relationships among corporate governance practices, the adoption of management accounting practices and organizational performance in Southeast Asian based organizations. It also provides them with better understanding of the intervening effect of adopting management accounting practices in Southeast Asian based organizations on the relationship between corporate governance practices and organizational performance. These will allow the organizational managers to make better decisions on the choice of good corporate governance practices as well as management accounting practices in order to create competitive advantages in a dynamic and rapidly changing business environment in Southeast Asia, and so enhance their organizational performance.

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EUROPEAN UNION'S PRIORITIES FOR THE 2014 – 2020 MULTIANNUAL FINANCIAL FRAMEWORK IN ROMANIA[1]

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Abstract

The European Union (EU) budget is one of the most concrete instrument in order to boost investments. In some of European regions, the EU budget is the only way to get public investment because there are not enough sources at national level.

In this context, the 2014 – 2020 Multiannual Financial Framework it's a spending plan that translates the European priorities into financial terms and draws the basic lines for the annual budgetary exercise. It sets the maximum annual amounts which the EU may spend in different political fields for the benefit of 500 million Europeans.

For Romania, the priorities from the next Multiannual Financial Framework are considered a crucial issue regarding the sustainable regional development that is both needed, and desired.

Keywords: cohesion, european funds, Europe 2020 Strategy, multiannual financial framework, European priorities.

JEL Classification: J24, O15, O19, Q01

1. Introduction

With this article, my goal is to evidence the importance of the European funds, especially for Romania, in the next multiannual financial framework. The "new" Cohesion policy (for the 2014-2020), through its developing tools, tries to reduce disparities between Member States, especially when it comes to management and impact. Even if, in the last year, the theme of administrative simplification has been among the favourite subjects of discussion in Romania, the complexity of cohesion may increase significantly with the identified challenges and the new proposed measures.

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2. **Development challenges for Romania's growth**

Even if Romania has benefit from European funds in the 2007 – 2013 Multiannual Financial Framework, it continues to face major development challenges.

In order to remove obstacles to development and to unlock the country's economic potential, according to the Partnership Agreement, there were identified *five development challenges*, which could easily be considered also priorities, for Romania's growth:

1. The competitiveness challenge;

2. The people and society challenge;

3. The infrastructure challenge;

4. The resources challenge and

5. The administration and government challenge.

1. The competitiveness challenge

The overall level of economic activity in Romania is still very low. Examination of structure and performance makes clear, at least, some of the challenges for competitiveness in Romania: internationally uncompetitive levels of productivity in many areas of industry; the present under-representation of higher value adding services within the economy and fragmentation, excessive standardization, inefficient use of resources in Romanian Research & Development (R&D) academic environments and the absence of strategy for developing research-intensive institutions.

2. The people and society challenge

In Romania, there are great disparities in many areas, but the most significant ones are related to topics like wealth, opportunity, education, skills and health. The identified ones (disparities) have a profound territorial character and there are pronounced variations between regions and, also, between urban and rural areas. There are great challenges in restoring the performance of the education system and, in the context of a depressed demand for labor, in making education attractive. Besides creating a modern and well-equipped educational infrastructure, there are challenges to overcome in extending access to early education, combating early school leaving, increasing the relevance of education and training to the needs of the labor market and opening access to tertiary education and to lifelong learning.

3. The infrastructure challenge

The national transport infrastructure is underdeveloped taking into consideration the volume of goods and passengers volume that transit Romanian territory, and accessibility remains a major barrier to regional growth. As regards Information and Communications Technology (ICT) infrastructure, basic broadband should be universally available by 2015 as a result of existing initiatives, although take-up remains low. However, Romania faces particular challenges in extending New Generation Access in rural areas where, in the absence of public intervention, it is estimated that by 2020 less than 50% of households will be covered with speeds over 30Mbps.

4. The resources challenge

Romania is well endowed with energy resources, a significant proportion of which is from renewable sources and has potential for further extension. While the efficiency of Romania's electricity generation, transmission and distribution systems is close to the EU average, efficiency in energy use is poor, notably as a result of badly insulated residential and public buildings combined with inefficiency in the district heating transmission and distribution systems. The extension and modernization of the water and wastewater infrastructure continues to be one of the most important priorities in improving Romanian living standards. Waste management is still far short of European standards with low levels of re-use, recycling and energy recovery. Romania has as transition period until 2017 to phase out non-compliant landfills. There is a pressing need to enhance environmental protection and to shift to more sustainable practices in agriculture, construction, extractive industries and, generally, in business.

5. The administration and government challenge

Romania is still characterized by weak administrative capacity of public institutions and a predisposition towards bureaucracy and disproportionate regulation that seriously impinge on the
competitiveness of Romania's business environment. Despite efforts to implement a robust policy process in Romania, reforms are urgently needed to improve the quality of public administration. Romania has taken numerous steps to create a strong, independent and well respected justice system. While progress has been made in many areas, it still remains a need for further capacity building, reform and modernization. The absence of an effective system of cadastre represents a significant obstacle to the development and implementation of infrastructure, property development and consolidation of agricultural land.

Actions under the five development challenges will contribute towards Romania's Europe 2020 targets as follows:

National EU 2020 targets	Current situation	Development challenges				
		I	II	III	IV	V
70 % of the population aged 20-64 to be employed	63.8 % (2012)	*	*			*
2 % of GDP to be invested in R&D	0.48 % (2011)	*	*	*		*
Reduction of greenhouse gas emissions with 19% (compared to 1990 level)	51.84 % (2011)	*		*	*	*
24 % of total energy consumption from renewable sources	20.79 % (2012)	*		*	*	*
Reduction of 10 Mtoe (19%) in the primary energy consumption	16.6 % (2012)	*		*	*	*
Less than 11.3% of children should leave school at an early age	17.4 % (2012)		*	*		*
At least 26.7% of 30-34–year-olds should complete third level education	21.8 % (2012)		*			*
580,000 less people should be at risk of poverty or exclusion (compared to 2008 levels)	240,000 (2011)		*			*

Source: Romanian Partnership Agreement for the 2014 – 2020 Programming Period, First Draft, October 2013

Romania will become a modern and competitive economy by tackling the above five development challenges through a multi-dimensional approach in order to realize the economic growth aspirations reflected in the global objective of Partnership Agreement.

3. Romania's Thematic Objectives

For the 2014-2020 Multiannual Financial Framework, Romania will make investments using European Structural and Investment Funds (ESIF) resources under all these Thematic Objectives that relate to the Europe 2020 Strategy.

These Thematic Objectives relate to the five challenges and the main development needs for Romania:

DEVELOPMENT CHALLENGE	THEMATIC OBJECTIVE
Competitiveness	Strengthening research, technological development and innovation
	Enhancing access to, and use and quality of, innovation and communication technologies
	Enhancing the competitiveness of small and medium-sized enterprises, the agricultural sector and the fisheries and aquaculture sector
People and society	Promoting employment and supporting labor mobility
	Promoting social inclusion and combating poverty
	Investing in education, skills and lifelong learning
Infrastructure	Enhancing access to, and use and quality of, innovation and communication technologies
	Promoting sustainable transport and removing bottlenecks I key network infrastructures
Resources	Supporting the shift towards a low-carbon economy in all sectors
	Promoting climate change adaptation, risk prevention and management
	Protecting the environment and promoting resource efficiency
Governance	Enhancing institutional capacity and an efficient public administration
	Enhancing access to, and use and quality of, innovation and communication technologies

Source: Romanian Partnership Agreement for the 2014 – 2020 Programming Period,
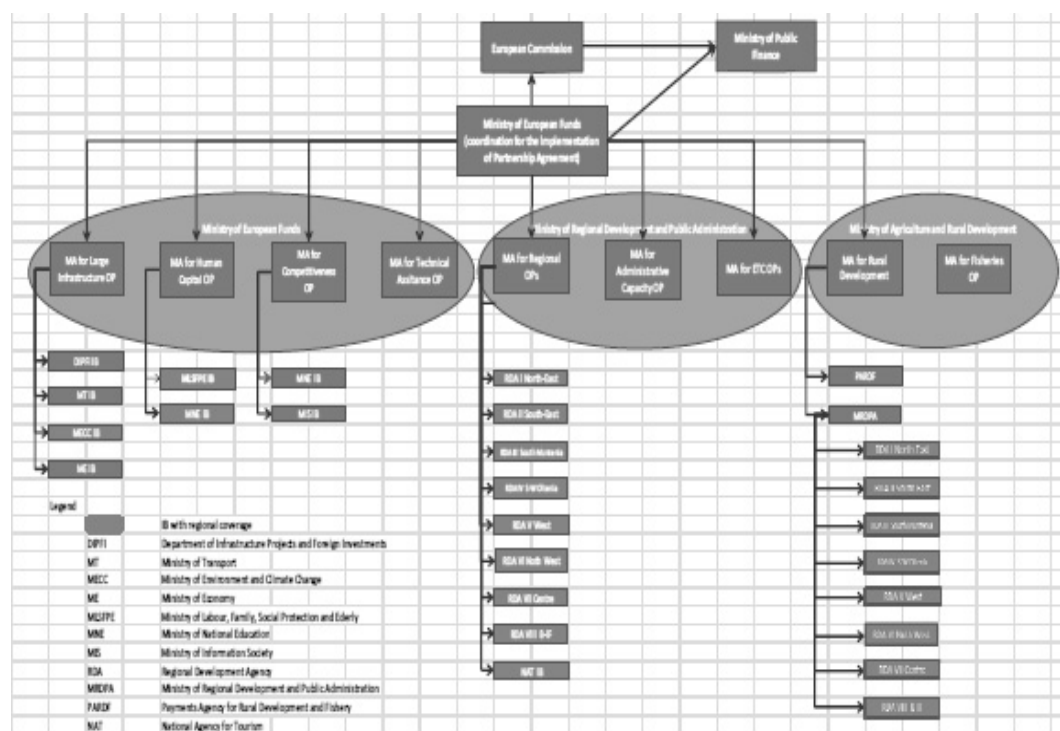First Draft, October 2013

Considering these five development challenges, established also as national priorities, there were also defined six operational programmes in order to contribute at the global and strategic objective – a reduction in the social and economic disparities between Romania and EU member states:

OPERATIONAL PROGRAMME	FINANCIAL ASSISTANCE ALLOCATED (BILLION EUR)
Large Infrastructure	9.07
Regional	6.47
Human Capital	3.44
Competitiveness	1.26
Administrative Capacity	0.52
Technical Assistance	0.3

Source: www.fonduri-ue.ro

4. Romanian Institutional Framework

The 2014 – 2020 Romanian institutional framework, as shown in the diagram below, was inspired by the Polish model and will concentrate the management functions in three core lines ministries that have already demonstrated good management capacity: The Ministry of European Funds, The Ministry of Regional Development and Public Administration and The Ministry of Agriculture and Rural Development.

Source: Romanian Partnership Agreement for the 2014 – 2020 Programming Period, First Draft, October 2013

5. Conclusion

The programming and implementation process of the ESIF, for 2014-2020 period, represents a key aspect for Romania's economic growth and development - which will be achieved in a sustainable manner as required under EU Treaty. Sustainable development is an assumed direction for future, determining the increasing quality of life of Romanian people.

Taking into consideration the developing realistic economic, social and territorial policies, directed towards sustainable, smart and inclusive growth, the new

programming period represents a great opportunity for Romania to consolidate the experience of 2007-2013.

To this aim, Romania will encourage collaboration between policymakers and practitioners in order to improve the effectiveness of policy implementation regarding European funds.

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THE ROLE OF POWER IN EFFECTIVE LEADERSHIP AND FOLLOWERSHIP: THE ALBANIAN CASE

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Abstract

The selected topic being treated in this paper is "The Role of Power in Effective Leadership and Followership". This topic is actually very little studied in the context of Albania and we judge that literature is not enough, for this reason we considered it appropriate for further research. This paper analyzes the use of power by leaders, the role it plays in effective leadership, and since the power is situational we intend to learn more about cases and situations where it is used. Also what is interesting is that this paper devotes a large space and makes part of it the power exerted by followers, because it is often perceived that power is possessed only by leaders. We will examine the role of followers and some main assumptions regarding their use of power. Some central questions that are raised in this paper and which we intend to give a response at the end are: What is the role of power in effective leadership and followership? What kind of power is used more in the Albanian context and why?

Keywords: *leadership, followers, power, effectivity, empowerment.*

INTRODUCTION

It is spoken very little about the use of power by the leaders either in administrative and political aspect. The studies carried out are insufficient for an important concept like power. Many scholars elaborate on the different theories of power, but in fact there are very few of those who throw light on the concrete application of power in certain social contexts. So through this paper is intended to fill a gap in current knowledge. Power is a complex topic and because of this in writing on power exist difficulties in maintaining a clear line of argument. Except that you have to be very precise in the use of language there is also a different requirement that the wording should be cross-linked with each other.

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The approach that we followed in order to interpret power in a more objective manner was through empirical research. As interested researchers in organizational analysis we judge as very important the study of the role of power to Albanian leaders. Power is a very little discussed topic openly in the workplace. Certainly among each other employees find it easier to talk about power, who has it, is it centralized or not, is it misused or not. We, as researchers wanted to be a voice that would highlight the reality of power usage in organizations. Moreover for us it was a challenge exploring this reality in our country, given that in the past we have inherited the shadow of an authoritarian leadership, for which you can not talk easily, you can not express what you think but you just have to humble yourself and obey.

Power is a tool used every day in organizations, and moreover organizations would not exist without power relations. To have things done leaders need to influence others. This means that power is a very important tool in achieving organizational goals and objectives. Leaders must recognize their power, must know how to use it effectively and how to precede its positive or negative effects. By learning how power operates in organizations, you will be better able to use that knowledge to become a more effective leader (Lunenburg, 2012).

One of the goals of this paper has been to describe the distribution of power as the economy describes the distribution of wealth and income. But this analysis is difficult because power is a multidimensional concept and for this reason it is difficult to be measured and to determine its amount. Although the importance of a good leader can not be denied, followers also play an equally important role in the success of any group or organization (Curphy & Roellig). For this reason, our goal is to look at the other side of the coin. For us it is important to identify followers perceptions about their power, which base of power do they mostly use, what do they need in order to be more effective and how they judge the power used by their leaders. We have attempted to measure the distribution of power in 30 companies in our country (Albania), taking empirical data on how much power do the leaders have (leaders deriving from the role of managers) and how powerful are the followers. In fact, respondents were asked to give their judgment about how powerful they think they are in their organization. Then we analyzed the data and also considered other influencing variables. Leaders are diverse and appear in various types. When this study attempts to study the power of leadership, it refers leaders that derive from the role of manager. Certainly leadership in organizations is exercised by managers. But we are aware that leaders can derive also by other roles than that of the manager. In a company or organization can be present, for example, hidden leaders but the measurement or distribution of their power is difficult to be identified. Due to these difficulties, the focus will be narrowed and here are studied leaders who are such because of their formal position in their organization.

Raised hypotheses that this paper will try to test are:[4]

- There is a notable correlation between the power that an individual believes he has at work and her / his hierarchical level in his / her organization.

- It is likely that in Albanian businesses power is concentrated in the hands of a few selected individuals.

- There does not exist a general organizational climate that encourages delegation.

LITERATURE REVIEW

Understanding the concepts we judge that it is of utmost importance. In everyday life we use so many terms often interchangeable with each other without knowing that each of them has an essential difference from the other and actually we are not using the right term. Socrates, the famous philosopher of ancient Greek stated that "the beginning of wisdom is a definition of terms" (Trump, 2009). Regarding the meaning and use of terms like power and leadership in the language of our daily life and in different disciplines, there are taxonomic difficulties and there is not a generally accepted understanding either from researchers or from the wider community of people. These terms carry a variety of connotations, creating uncertainty, confusion and what is meant is vague and complex.

Power, Leadership and Followers

What is power? Power can be defined as "the ability to marshal human, informational, or material resources to get something done" (Rees & Porter, 2008). Power is the opportunity to build, to create, to nudge history in a different direction (Pfeffer, 1992). Another influential definition is given by R. Dahl: "A has power over B to the extent that he can get B to do something that B would not otherwise do" (Bass, 2008). Power is something concrete that any individual can possess. Power can be possessed by all people in the organization and not necessarily only by those who possess authority. It can be distributed to all hierarchical levels and can be exercised upward, downward or horizontally. Power can affect a set of decisions in the organization. As organizations become more global, individuals must lead and manage around the world. Their teams are dispersed, and they often have to lead using influence rather than the formal unilateral decision-making authority used in days past (Bal, 2008). Frequently people perceive power with a negative connotation

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[4] Raised hypotheses are independent of each other.

because they connect it with concepts like punishment, domination, and control. David C. McClelland (1975) has observed: "In American society in general, individuals are proud of having a high need to achieve, but dislike being told they have a high need for power". In our opinion power in itself is neither good nor bad. But it is precisely its way of using what determines whether it is functional or dysfunctional (harmful). However there is also a positive face of power usage, which contributes in achieving individual, group, and organizational goals and objectives. When power is used in an ethical way for fair purposes there is nothing wrong with the definition that it carries. Effective leadership is not based on having power, but rather on how the leader uses the power (Sims, 2002).

Leadership is studied in a variety of contexts, in almost all forms of social organization, ranging from nation, army, business, etc. Many different theories have been posited about leaders since the time of Plato and Aristotle, whether they are born or created by a number of factors and psychosocial circumstances. Leaders are products of their time, environment, and their followers. "Leadership can be better understood as a phenomenon constructed in minds and eyes of the audience, as much as in the deeds and character of the observed leader"(Sinclair, 1998). Leadership can not be understood without followers. Follower's inexistence implies simultaneously leader's inexistence. As Kelley (1992, p 12) points out "Without his armies Napoleon was just a man with grandiose ambitions". This makes us understand that leadership is a group phenomenon. Follower is not a term that implies weakness or a term that carries a negative connotation, but rather it is a prerequisite that allows leadership to exist. We can find followers anywhere. Followers can be embodied in many ways: employees, constituents, stakeholders, or just individualswho believe in a cause (Ricketts, 2009).

Leadership and power are two closely related concepts. Power has played an important role in leadership practices. Leadership means power. We think that leadership may not be conceived without power. While an individual can exercise power without being a leader, an individual may not be a leader without power. Leadership is the exercise of power; therefore leaders must develop the proper bases of organizational power in order to use it effectively and efficiently in influencing others. Scholars such as French and Raven, Kruglanski, Hersey and Marshall Goldsmith suggested that there are seven different bases of power: (Daugherty & Williams, 2009).

➢ Legitimate/ Position Power; Expertise Power; Relationship Power; Informational Power; Referent Power; Coercive Power; Reward Power.

Followers have an equally important role in the success of the organization. Both of these roles can be active (Hollander, 1992) which means that there is a mutual influence. Leaders and followers influence each other, and both of them can

possess power. The dynamics of leadership and followers is the same. Those who can lead in some cases may follow in some other cases. Most managers play both roles. (Kelley, 1988) Leadership is a reciprocal relationship, where followers play an active role, at the same time they influence and are influenced by leaders. It is often perceived that power is possessed only by leaders. Scholars have found that power is a function of leaders, followers, and situations. In other words, power is a function of the relationship. According to Foucault power must be analyzed as something that circulates (Scott & Hirschkind, 2006). Today it is possessed by you but tomorrow it may be in the hands of others. Power is exercised within the network and in this network individuals not only circulate but also they move continuously from the position of one who suffers the power, in that of one who exercises it (Foucault, 2009).

Leadership, Followers and their Power in Albanian Reality

For years in the Albanian reality the term" leadership" had a restricted use and referred only to the political leadership. In fact even nowadays we still have this deficiency inherited from the past. If you talk about a leader, in our country people's minds go to political leaders, not to business leaders. If for any reason of study an interested person would look for publications, books or search on internet for data on the Albanian business leaders, unfortunately, he/she will find very little, as little as it can be counted on the fingers of one hand. The universities have only recently begun to offer programs on 'Leadership', seeing it in the organizational context.

Concurrently, if we look at the usage of the term" manager" we will notice that it has been unknown in job titles for years during the dictatorial system. In those years there was a lack of the term that would really implicate a proper definition of an individual that was engaged in functions such as planning, organizing, controlling and directing. What mostly could be heard was the use of such terms as chief engineer, charge nurse which had a traditional connotation. And of course this deficiency is rooted prior to 1990.

Management is influenced by some particular dimensions of the external environment. In our country the management system has some special characteristics. Some of the dimensions that influence and shape these characteristics are cultural system, economic system, socio-political context, etc. Our country was in fact the last place among the countries of Eastern Europe that ended the communist regime. The collapse of the communist system was also the collapse of the planned economy. From there we began the road toward a market economy. Many people with the" hidden spirit" of entrepreneurs started business activity without proper education, without qualifications or required experience. According to Ronald Inglehart's researches (1999) result that "an individual's priorities reflect the

socioeconomic environment. Albanians were very poor. They had no private property as the system obscured those norms that had to do with private property issues. It was therefore expected that at the beginning of transition Albanian individuals aspired to improve their economic situation for a higher economic prosperity and needed to show that entrepreneurial spirit. Businesses were intuitive and did not emerge as a result of analyzing or studying the environment in which they would operate. Due to long isolation, young entrepreneurs had no knowledge acquired from other countries. Everything was unknown; an equation with several unknowns and everything should be redesigned and relearned from the beginning.

Cultural norms imposed by the communist regime significantly affected the cultural formation of Albanians. Albanian society had a hierarchical structuring. The whole organizing had a hierarchical nature. Political leader, the leader of the first level, was the one who had power, his party ruled society. This was the appearance of power that people faced, and it was the structure of the organization that they knew. So there is no wonder that it was implemented and in business. The leader was seen as a symbol of authority and domination, all other individuals (followers) were only executants of orders, and they had no power and should see themselves as worthless before the system and organization.

With the democratic climate in the early 90's, many cultural norms dictated by the regime were overshadowed. The owner of the business (at the same time the manager) had to manage the business in a totally different situation. Most of the businesses were managed by owners and their relatives. This has affected the organization and management. Nowadays the Albanian business is dominated by micro-enterprises and their organizational structuring is simple (Llaci, 2010). According to INSTAT (2012) in Albanian economy operate about 104275 private businesses. The main part of businesses operate in the services sector, specifically there are about 88026 producers of services and a significant part operate in the trade sector, specifically about 45273 businesses. (INSTAT, 2012) For a relatively new economy and all the time in transition, there is a great necessity and need for effective leadership. The business leader is mainly a self-made creature that goes ahead by intuition.

RESEARCH METHODOLOGY

Our intention was neither to verify nor to falsify the existed theories; we wanted to make a deep exploration of the usage of power in Albanian companies. There are various techniques used to realize this research study. In order to have a deep investigation and an exploratory study we intertwined different techniques with each other, such as literature review and survey. We used primary and secondary sources. As secondary sources we used all possible sources of contemporary theoretical literature of Albanian and foreign authors, articles in the press and documents from the internet. As primary data source, a survey of 200 respondents of

different ages in 30 different companies in the city of Tirana was conducted. The field research began on 01 October 2012 and ended on 01 December 2012. Some of the questions were borrowed from the survey carried out by the Centre for Creative Leadership in the U.S. based on the project "The Ideas2Action". It is considered good practice and also recommended to borrow a questionnaire that has passed its trials and was accepted by the scientific community. This is because for them it can be said that they already meet the criteria of reliability and validity of measurement (Kocani, 2006). The questionnaire contained 15 standardized questions.

Theoretical population consisted of individuals in role of leaders and followers. We recall here the pact that this paper has done from the beginning: we studied leaders that derive from the role of manager. This study is based on a sample of 100 leaders and 100 followers. We used a random sampling. We used a sampling that does not identify respondents, in order not to reduce the reliability and validity of the data. Primary data collected through the survey, were processed through SPSS 16 statistical program to find possible statistical links of variables taken into consideration. Hypothesis will be tested through Chi-square ($\chi 2$) test.

Another supplementary way used to explain the role of power in effective leadership and followership was casual observation on behavioral models of leaders and followers.

Limitations

We are quite aware that this study is not a complete analysis and contains restrictions. The number of units of analysis may prevent the extraction of generalizations. Another limiting factor is the time available to conduct surveys. The study was concentrated only in medium and large enterprises in Tirana city. We did not have real opportunities to extend the sampling to others cities of Albania.

Another problem may be insincere responses from respondents. Because they may be afraid to say the truth if their leaders misused power. Speaking about the power of your boss is not always easy. Most people do not talk about power openly.

DATA ANALYSIS

From the synthesis of research results in business companies in the city of Tirana, was noted that the typical respondent in the category of leaders was a male (54 percent), between the age of 31-40 years old (70 percent). Typical respondent in the category of followers was a female (59 percent), between the ages of 21-30 years

old (67 percent). This fact demonstrates that even in private companies men are mostly those who lead, who give orders while women are mostly those who follow.

The perception of power is a central feature that characterizes our lives. There is practical evidence that there is a notable correlation between power and hierarchical vertical dimension. This is evidenced by the answers given by survey respondents. We asked them to rate their power at work. 93 percent of the leaders surveyed rated themselves as being moderately to extremely powerful at work, while 76 percent of the followers surveyed rated themselves as being not at all powerful to moderately powerful. In order to pick out the correlation coefficient we analyzed the variable of the amount of power that the respondents perceived they had with the variable of the position that they hold, and resulted that the coefficient[5] of Pearson's R was -0.802 and the significance[6] was .000. The statistical level is accepted at the quota of p < .05. According to table 1, the observed statistics of chi – square test 1,722, with freedom degree 9, proving that the hierarchical position affects the amount of power, since the security level .000 is lower than 0.05. What does this tell us? Who has influence and power is determined by where the individual is positioned within the institutional structure. The correlation is very strong which means that this relationship is unlikely to occur by chance but it really exists in the population. The result is representative, highly significant and it is a positive test for our first hypothesis. So we can conclude that there is a difference between the power of leaders and the power of followers in the population.

Tab1.   Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	1,722 E2ᵃ	9	,000
Likelihood Ratio	233,965	9	,000
Linear-by-Linear Association	128,080	1	,000
N of Valid Cases	200		

a. 2 cells (10,0%) have expected count less than 5. The minimum expected count is 1,00.

Symmetric Measures

		Value	Asymp. Std. Errorᵃ	Approx. Tᵇ	Approx. Sig.
Interval by Interval	Pearson's R	-,802	,024	-18,910	,000ᶜ
Ordinal by Ordinal	Spearman Correlation	-,813	,020	-19,641	,000ᶜ
N of Valid Cases		200			

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[5] Correlation: 0.8 strong, 0.6-0.8 moderate, 0.3-0.5 not bad, less than 0.3 weak.
[6] Significance (, 000) means that the chance is less than 1 in 1000. There is so little chance.

power * position Crosstabulation				
Count				
		Position		
		1	2	Total
Power	1	0	2	2
	2	0	36	36
	3	0	25	25
	4	7	5	12
	5	3	8	11
	6	2	24	26
	7	23	0	23
	8	35	0	35
	9	18	0	18
	10	12	0	12
Total		100	100	200

In surveyed companies the power is not distributed at all levels. Only 44 percent of the leaders surveyed and 21 percent of the followers surveyed believed that their organization empowers people at all levels. The majority of respondents in each category believed the opposite: power is concentrated in the hands of a few select individuals. According to table 2, the observed statistics of chi – square test is 12,057 with freedom degree 1. Since the significance ,001 is lower than ,05 we can conclude that this is a positive test for our second hypothesis, so our hypothesis is proven. We can say that power is centralized in the hands of a few executives in Albanian companies.

Tab2 Chi-Square Tests					
	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	12,057[a]	1	,001		
Continuity Correction[b]	11,031	1	,001		
Likelihood Ratio	12,255	1	,000		
Fisher's Exact Test				,001	,000
Linear-by-Linear Association	11,997	1	,001		
N of Valid Cases[b]	200				

a. 0 cells (,0%) have expected count less than 5. The minimum expected count is 32,50.

b. Computed only for a 2x2 table

56 percent of the leaders surveyed and 71 percent of the followers surveyed believed that "there does not exist a general organizational climate that encourages delegation". According to table 3, the observed statistics of chi – square test is 4,854 with freedom degree 1. Since the significance ,029 is lower than ,05 the third hypothesis is proven. How can this be explained in the context of Albania? In our opinion, this may result from various reasons. The first reason may be related to the

historical development of these companies. Many Albanian companies have grown following the formal way of their evolution. In small businesses owner-manager has a legitimate power imposed by private property. There is a centralization of decision-making process. Secondly, it is likely that the Albanians' preference for avoiding uncertainty and risk may be a convincing argument for this phenomenon. Albania scores 70 (Wohlfahrtstaetter, 2012) on the uncertainty avoidance dimension. Our society has a low level of tolerance for uncertainty and risk. This owner-manager is reluctant to delegate authority to his subordinates as a result of fear of losing power and at the same time does not allow others to manage its business (except his relatives) because he considers both of them as foreign and unreliable. Thus Albanian managers tend to control everything, to avoid failure and the unexpected.

Tab 3   Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	4,854ª	1	,028		
Continuity Correctionᵇ	4,228	1	,040		
Likelihood Ratio	4,880	1	,027		
Fisher's Exact Test				,039	,020
Linear-by-Linear Association	4,830	1	,028		
N of Valid Casesᵇ	200				

a. 0 cells (,0%) have expected count less than 5. The minimum expected count is 36,50.

b. Computed only for a 2x2 table

Through our survey we intended to understand more about the power in the Albanian context. There is a consensus between leaders and followers regarding the statement "my organization teaches its leaders how to use their power". The majority of respondents said that leaders had participated in the training courses in order to learn more about power sources and their effective use. We have good news about the way that top leaders use their power. Nearly 63 percent of followers and 70 percent of leaders believe that power is not misused.

What kind of power is used more in the Albanian context and why? Leaders and followers use different power bases. The top three most frequently sources of power used by leaders are: the power of expertise (98 percent agreement), legitimate power and the power of charisma (88 percent agreement), and the power of relationships (85 percent agreement). What about the followers? The top three most frequently sources of power used by them are: the power of charisma (92 percent agreement), the power of expertise (88 percent agreement), and the power of information (75 percent agreement). How can we translate these results? The possession and demonstration of expertise to show what a leader can do, is important for Albanian leader. Being recognized as an expert in a particular field, Albanian leader satisfies his need for high reputation. Albanian leaders and followers also accept inequalities in the distribution of power. This is why legitimate power is

also among the most frequently leveraged sources of power. The followers use more the power of charisma and expertise, because these power bases derive from the personality traits and knowledge that an individual possesses, and do not depend on variables such as age, hierarchical position, etc. Besides senior positions in the organizational hierarchy, there are other positions that often have access to information, such as secretaries, executive assistants, etc. Access to valuable information produces power because information is a resource that can be exchanged.

The three sources of power Albanian leaders and followers believe will be most important to leverage in the next five years are: the power of expertise, the power of relationships and the power of information. Wisdom has always been power. Information value has notably increased and relationships have a transformative impact on individuals. 50 percent of the survey respondents used contacts to gain something for themselves. Nearly a quarter (30 percent) of respondents used contacts to help others, as for example, finding a job for their friends, helping their peers succeed is their work, helping their subordinates to get the payment of stand-by hours, etc. Only 20 percent of respondents used their contacts, networks, and their relationships to help their company.

How do Albanian leaders and followers behave when power is exercised over them? Individuals in top positions demonstrate resistance when the power is exercised over them, while those in lower hierarchical levels tend to agree. In a culture such as ours with a high power distance, where predominate micro-enterprises and the owner is the director/manager is logical that leaders perceive themselves as holders of power and that only they can use it to influence the behavior of others and to produce the desired results from them. In an organizational culture where the legitimate power is very popular it is expected that the followers accept the power that is exercised over them.

We talked a lot about the power of Albanian leaders and followers but we have not mentioned yet the reasons why followers follow their leaders. In order to give an adequate answer why people follow leaders, we shall try to analyze the basics mindset of followership. Participants in the survey were asked to identify the reasons why individuals choose to follow certain leaders. What was proved by the data processing was that leaders and followers did not agree with each other. 36 percent of the leaders surveyed said that: "they follow because they have faith in us". This reason was accepted by only 26 percent of the followers surveyed. 30 percent of followers said that: "we are rational beings and have to calculate what we lose and what we gain. If we may lose our job, then it is better to follow".

CONCLUSIONS

The distribution of power may differ from one organization to another, from one country to another. For this reason we undertook this study of power in the context of our country (Albania). We may conclude that leadership still is a masculine role since that the typical respondent in the category of leaders was a male (54 percent). Typical respondent in the category of followers was a female (59 percent). In fact, such results are not surprising but expected in the reality of Albania. Our national culture has masculine bold shades. Therefore, these results can be attributed to Albanian patriarchal culture that generates injustice against women. According to Hofstede, Albania scores 80 on masculine/feminine dimension (Wohlfahrtstaetter, 2012). There are observed significant gender differences in the workplace; however, there are efforts to change things.

We tested our hypothesis using the chi-square test. We confirmed our first hypothesis: There is practical evidence that there is a notable correlation between power and hierarchical vertical dimension.

In Albanian companies surveyed the distribution of power is unequal. Second Hypothesis: Power is concentrated in the hands of a few select individuals, is confirmed. Leaders have more power than their followers and thus they have more privileges.

There does not exist a general organizational climate that encourages delegation. Concluding this we can say that our third hypothesis is also also confirmed.

Folloerws agree and accept when power is exercised over them. Followers comply with directives without putting them into question. They think that they gain more from obedience than resistance. According to them a smart person should do a cost benefit analysis of followership.

In Albania leaders do not use just one base of power but they combine different bases. Leaders mostly use the power of expertise, legitimate power, the power of charisma, and the power of relationships. Followers mostly use the power of charisma, the power of expertise, and the power of information. We can not say if the usage of these bases is either wrong or right because we consider that there is no universal best way to influence people. There are no available recipes. Power bases are influenced by situational variables. Culture is one of those variables. We suggest that top management must provide to leaders opportunities to improve power sources.

To upcoming researches we suggest: to expand the sampling that we used in order to generate more accurate results; and to undertake surveys in more companies, in various industries, in order to avoid the influence of the uniqueness of organizational culture of a particular industry. In order to study the power in more dimensions we suggest other researchers to conduct a similar survey for political leaders and their followers.

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THE ECONOMIC VALUE OF PROSTITUTION

Cristian Giuseppe Zaharie,
Claudiu Andreescu[1]

Abstract

The study analyzes the economic advantages of the permissive regulation of this practice in Romania and abroad.

Keywords: prostitution, causes, taxation, advantages.

JEL Classification: E01, E20, Y90

An analysis posted on the site ˝MONEY.ro˝ showed that *˝the Romanian state would gain approximately 200 million euros a year, if prostitution were legalized and if all the 40,000 prostitutes in Romania paid taxes for their incomes˝.[2]*

Such amount might increase by adding:

- the increase of the number of prostitutes as a result of the a permissive regulation of such occupation in favor of its practitioners; the social specific weight of the number of persons practicing paid sex might grow from 0.19% to 0.60 – 1.00%, creating a situation similar to some states such as Spain or Brazil;

- the development of some economic and commercial activities related to this practice.

The   European states where prostitution is legalized and regulated collect from this activity an amount ranging between 57 million euros and 2.3 billion euros.

˝Except for the situation of Denmark, where no taxes are imposed on this activity, in all the other states where this practice is accepted, the incomes deriving from the services supplied by sex workers are subject to tax ˝.[3]

In the Czech Republic, the prostitution market was evaluated to approximately 760 million euros in 2008*, ˝being mainly dependent on the tourists coming in from the European Union ˝.[4]*

˝In Holland, this activity yields annual incomes of over 1.8 billion euros. The Dutch state collects over 288 million euros each year from taxes on prostitution˝.[5]

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[2] Http://www.MONEY.ro_prostitutie.

[3] Prigoana Silviu, [˝Motivation of the law draft concerning the exercise of authorized sexual activities˝], 2010-2011, pag. 3.

[4] SVU, April 5, 2002, ˝Prostitution in the Czech Republic˝, Czech Statistical Bureau Report.

[5] Marie-Victoire Louis, ˝Legalizing Pimping, Dutch Style˝, Le Monde Diplomatique,1997.

"The brothels authorize by the municipality of Amsterdam (a number of 142) yielded in 2008 incomes of over 100 million euros, to which there were added collection increases in the tourism field".[6]

At present, the taxation of prostitution in Holland is pretty high, apart from the social insurance contributions paid by the employee and by the employer, *"by applying 19% VAT and 16% income tax."*[7]

In Hungary, over 10,000 legally authorized sex workers provide the Hungarian state annual incomes exceeding 57 million euros.

This activity yields a financial mass of *"over 1 billion euros cumulated from paid sex services (350 million euros) and from the pornographic industry (700 million euros)."*[8]

In Germany, the persons conducting this activity annually provide to the state over 2.3 billion euros, including social insurance, this amount being calculated for the year 2007. The sex workers have an average number of 1.2 million of clients a day, the yearly turnover being estimated to 6-10 billion euros.

The lands North Rhine-Westphalia, Baden, Württemberg, and Berlin implemented a tax system by which the enterprises in question must pay taxes in advance, an amount established on a daily basis, that is paid to the fiscal authorities by brothel owners. *"In North Rhine-Westphalia, the tax is 25 euros per working day, while in Berlin it is 30 euros. In May 2007, the federal government proposed a uniform taxation, of 25 euros a day in all lands"*.[9]

The first city in Germany that introduced a special local tax for sex services was Cologne. The tax was established in the beginning of the year 2004 by the Local Council of Cologne with a municipal majority made up by a coalition of Christian Democrats and Ecologists.

This tax is applied to the services of striptease, peep shows, porn movies, sex show, massage parlors, and prostitution. *"As far as the prostitution is concerned, the fiscal debt is of 150 euros a month for each employee, to be paid by the employer or by the independent worker. A certain zone o the city is tax free (the Geestemünder Strasse Zone). In 2006, the municipal council collected 828,000 euros from this tax"*.[10]

In Austria, the authorities collect annually over 100 million euros from the practice of prostitution.

The Austrian prostitution yields annual incomes of *"over 630 million euros"*.[11] There are also proposals related to the taxation of this activity made by the political environment of several states, an example in this point being Spain, with a prostitution market estimated at present to *"approximately 40 billion euros,"*[12] or Thailand, *"whose relevant market was estimated in the year 2003 at over 4.3 billion dollars."*[13]

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[6] David Charter, *"Half of Amsterdam's Red-Light Windows Close"*, London.

[7] Ioana Mihai, [*"Prostitutes Pay Taxes and VAT in Amsterdam"*], Business Magazin, January 21, 2010.

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Conclusions

In my opinion, the financial benefits that might be obtained by a permissive regulation of prostitution are obviously real, but the value thereof must be analyzed circumspectly. In some states that have permissively regulated this occupation (analyses made in Germany, Turkey, Mexico, Columbia, Venezuela etc.), the value of fiscal evasion in this field is appreciated to be very high. The majority of persons the practice this occupation independently avoid to comply with the legal regime applicable or comply only partially, thereby trying to avoid paying the fiscal and social contributions. In a more reserved opinion, the income that might be achieved by the Romanian state by the taxation of this activity are estimated ˝to over 100 million euros˝.[14]

Considering that in Romania there are 40,000 persons practicing prostitution, who have an average of 2-4 clients a day, working 5 days a week and 11 months a year, at an average tariff of 100 lei/session, there results an annual taxable income of 44,000-88,000 lei/worker, and the entire field would yield between 1,760,000,000 and 3,520,000,000 lei a year, or between 410,000,000 and 820,000,000 euros a year, contributing to the budget with 65,600,000 – 131,200,000 euros a year. To this sum there are added the social contributions and the eventual other taxes applicable. The question worth asking is how many of the prostitutes will work legally, paying all contributions, how many will pay part of such contributions, and how many will continue to work illegally? The experience of other states shows that most of them will continue to work illegally, by not paying taxes, very few will pay part of such contributions, and even less will pay them entirely. This situation must be analyzed considering the high level of social contributions in our country.

Even if the amount of 60-200 million euros could be collected for the budget, it would not represent very much, considering, for example, that the deficit of our country was of 6.7 billion euros in 2011.

There is also the issue of budget expenses imposed by the law enforcement in point of record and control activities. They would be minimal as compared to the amounts collected by the state (since the activities mentioned are not permanent). The authorization of such activity would be subject to taxation in any case.

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DOES PROSTITUTION HAVE ECONOMIC CAUSES?

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Abstract

This study analyzes the causality of the social phenomenon of prostitution, showing that its origins are not limited to economic factors.

Keywords : prostitution, causes, motivation, mentality.

JEL Classification : E01, E20, Y90

The economic motivation of prostitution is, generally speaking, one of the most frequent ideas presented when analyzing the causality of this contemporary social phenomenon found in all countries. I personally appreciate that prostitution is determined by 3 factors :

- first, the moral and cultural pattern of the prone person, which is generated, above all, by the cultural, family, and relational environment (see the rare frequency of this practice in the educated, ultra-religious, environments, and in small communities where social control is more intense);

- secondly, the economic motivation required for the practice of this occupation (the sex industry is concentrated in the rich states);

- to a lesser extent, the risks generated by the negative social reaction of communities where the practitioner works, the extent of social control and the tolerance toward such practice of the community members (for example, the social tolerance within numerous communities in Spain or Holland and partially in Germany).

The economic motivation is not the main cause, since prostitution is extremely frequent in developed states such as : the United States, China, Japan, the UK, France, Germany, Holland, Belgium, Spain, Canada, Denmark, Austria, Switzerland, Italy, Czech Republic, Hungary, Australia, New Zealand, Taiwan, Israel etc. But also very frequently, the practitioners originate from the neighboring poor states. Such practitioners tend to a greater extent to develop their activity in states where prostitution pays well, is legal, and eventually not discourages (Germany, UK, Austria, Switzerland, Spain, Turkey). I skeptic towards the appreciations that indicate poverty as the essential cause of prostitution.

Practicing prostitution depends on the individual's mentality and morality, while he regulation of such occupation is related to the evolution of mentalities, the social tolerance the pragmatism and targets of the political power. In some

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states (for instance in Romania, India, Ukraine, Republic of Moldova, Kazakhstan, some African and Latin American states), poverty seems nevertheless to be a determining factor.

Even here there is a historic and cultural line that is specific to each people. To a great extent, the social tolerance covers nearly the same situation with some peoples, that has existed for centuries, until the present day. In the cultural Europe and in Latin America, prostitution is generally tolerated by the states (except for the periods of historic experiments : Inquisition, Nazism, Communism), while in the United States, Asia, and in the Islamic space the deed is punished. If in Romania the main cause of prostitution is the economic situation corroborated with the lack of professional perspectives, throughout the world the situation is far more complex, with a larger causality.

Poverty is a major determining factor in areas such as : Eastern Europe, Russia, South America, Central America, Mexico, Africa, Central and South-Eastern Asia, and so on. Nevertheless, poverty is not the only cause, which results from comparing the top of the world countries in point of the gross domestic product (GDP) per inhabitant with the list of states with a high prostitution rate. Between social poverty, legal regulation and GDP per inhabitant there is a direct influence, but not an absolute determination. The fact that the economic aspect is not the single cause of such practice results from comparing the evolution of the social phenomenon, of the legal regulation of such practice, and of the social weight of its practitioners in states with a comparable GDP per inhabitant.

The states of the world in point of their gross domestic product.
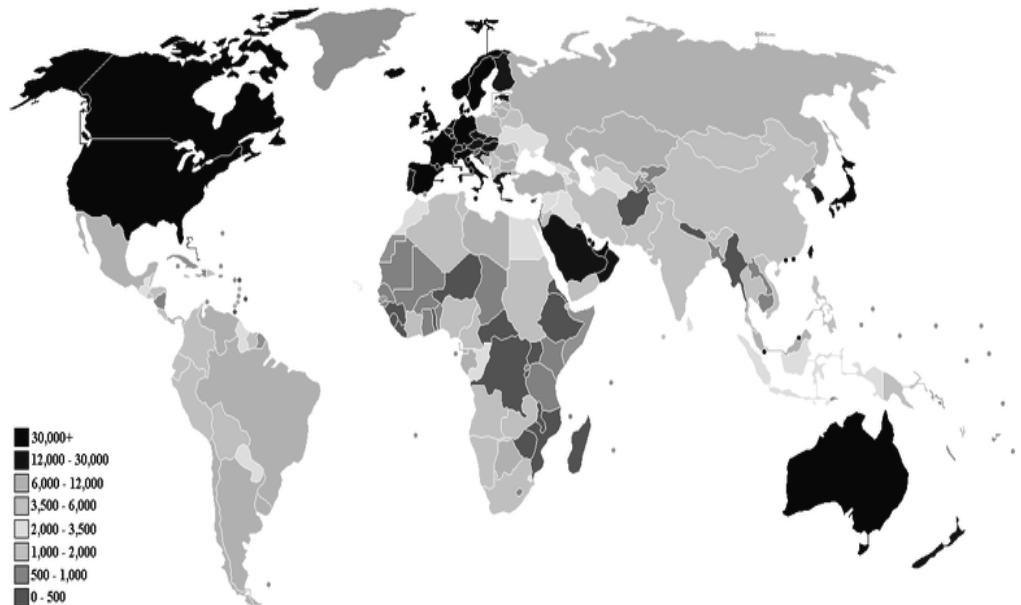
In dark red are marked the states with the lowest GDP per inhabitant, and with dark blue are marked the countries with the highest level if this indicator.[2]

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[2] Http://www.wikipedia.en_list of countries by GDP.

Between social poverty, legal regulation and GDP per inhabitant there is a direct influence, but not an absolute determination.

The fact that the economic aspect is not the single cause of such practice results from comparing the evolution of the social phenomenon, of the legal regulation of such practice, and of the social weight of its practitioners in states with a comparable GDP per inhabitant

Here is the GDP per inhabitant of the richest 10 states in the world, as estimated by the International Monetary Fond (IMF) in American dollars for the year 2010:

- 1st place Luxembourg – 104,390;
- 2nd place Norway – 84,543;
- 3rd place. Qatar – 74,422;
- 4th place Switzerland - 67,074;
- 5th place. Denmark – 55,113;
- 6th place . Australia – 54,869;
- 7th place . Sweden – 47,667;
- 8th place. United Arab Emirates – 47,406;
- 9th the United States – 47,132;
- 10th . Holland – 46,418.

In 5 of these states (places 1, 4, 5, 6, and 10), practicing prostitution is legal (in 3 of them it is even legally regulated), while in other 5 it is illegal (places 2, 3, 7, 8, and 9).

But look at the GDP per inhabitant of the 10 poorest countries in the world, as estimated by the International Monetary Fond (IMF) in American dollars for the year 2010 :

- 173rd place – Eritrea – 423;
- 174th place Guinea – 420;
- 175th placeMadagascar – 391;
- 176th place Niger – 383;
- 177th place Ethiopia – 364;
- 178th place Malawi – 354;
- 179th place Sierra Leone – 325;
- 180th place Liberia – 226;
- 181st Democratic Republic of Congo – 188;
- 182nd place Burundi – 177.[3]

In 4 of these states (places 175, 177, 179, 181), practicing prostitution is legal (in none of these states it is legally regulated), and in other 6 it is illegal.

High prostitution rates are found in rich society states (for example : Germany – 0.49%, Spain -0.64%, Portugal – 0.26%, Holland – 0.30%, Austria –

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[3] **World Economic Outlook Database, International Monetary Fund**, October 2010.

0.21%, Japan – 0.20% etc.), but also in countries with a low living standard for the majority population (for example: Brazil – 1.04%, Thailand – 0.44%, India – 0.23%, China – 0.37%-0.75%).

     - The lack of education and instruction contribute to the perpetuation of this phenomenon in the same areas. It is true that in some states, where there a good educational process is established, there is a high prostitution rate (for example : Germany, Holland, Switzerland, Denmark, Belgium etc. In these states, nevertheless, prostitution is sometimes practiced by sometimes even over 2/3 of the market, by practitioners of foreign origin.

     - The wars between nations, but also the civil wars, favor the perpetuation of this phenomenon, directly by the relations that are established between the members of military or paramilitary forces ad the prostitution networks, but also indirectly, by the alteration of the social and economic climate and the generation of some situations of power gap in some territories. As a result thereof, jobs are lost and numerous families are torn apart following the death of one of the spouses.

     In 1945, with a population less than half of the present one (311.7 million inhabitants) in the United States there were 1.2 million prostitutes, while at present their number is of approximately 500 thousand.

     The situation may be explained by the decrease of the living standard determined by the war period. Civil wars or regional conflicts led to the increase of the prostitution rate in states such as : Serbia, Kosovo, Bosnia-Herzegovina, Tanzania, Uganda, Kenya, D.R. of Congo, Ethiopia.

     Both in Europe and throughout the world, cultural and religious factors have a maximum influence on the perception of the prostitution phenomenon by the civil society. In Romania, the Romanian Orthodox Church expressed several times its opposition against legalizing prostitution and rejects any law draft on this topic. Apparently, the role of the dominant religion of a country does not seem very important as far as the legal regulation of the prostitution is concerned, since the Church is a private law person which no longer exercises a dominant influence in society.

     Apart from the influence of clerics on the electoral mass (especially in the rural space), there is also another influence of religion, which is more subtle. The religious precepts have become, during the centuries, an inseparable part of the culture, morals, and civilization of the state societies. Even if we are not religious, we do our moral reasoning considering the acquired moral values, among which religious precepts have melted in. This generates, in my opinion, a dominant national mentality. Such collective mentality transcends nevertheless the nations, superposing to a great extent to the geographic space dominated by the great religions and rites.
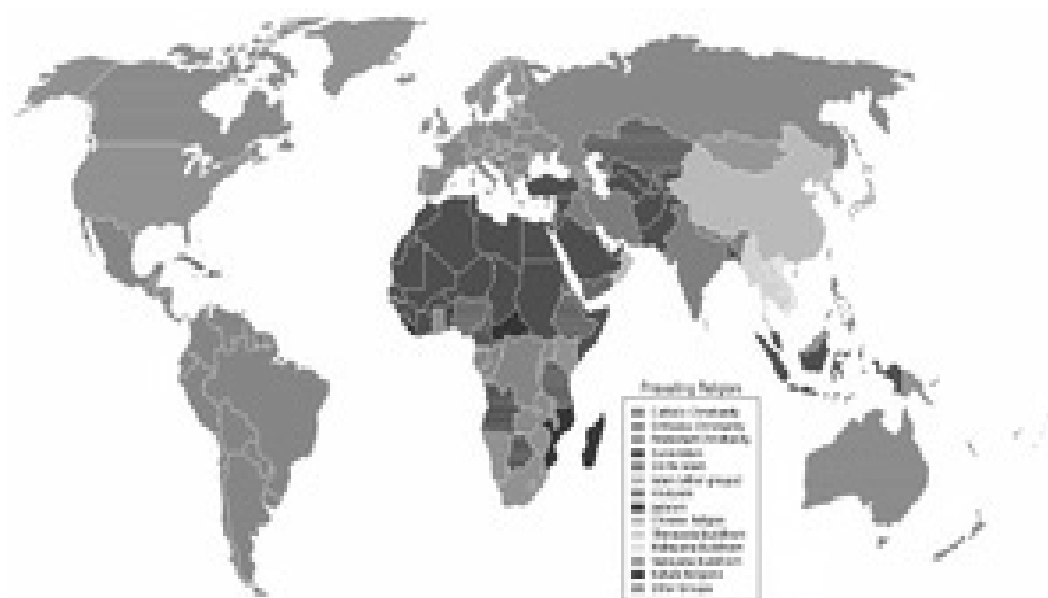
The dominant religions of the world. In purple are marked violet the states that are mainly Catholic, in blue the protestant ones, in red the Orthodox Christian ones, in green the Islamic ones, in yellow the Buddhist ones.[4]

Conclusions

By analyzing the relation between the cultural and religious space and the legal regime instituted on prostitution, I appreciate that :

- in the Catholic space, the permissive regime is predominant;

- in the areas inhabited by Greek Orthodox there is a limited tolerance of this phenomenon;

- in the areas inhabited by old rite Orthodox, such practice is not tolerated by the state;

- in protestant countries, this practice has a controversial position, being generally unaccepted or barely accepted;

- in the countries inhabited by a Hindu majority prostitution accepted in general, under certain conditions;

- in the countries with majority Sunni or Shi'a Muslims, Buddhists of any rite, prostitution is prohibited y the law, even if it exists as a phenomenon in society. It is observed that this appreciation is valid to a greater extent in the states throughout the world than in the states of the European Union. Probably in certain areas of Europe, the influence of the dominant cult is lower due to the distance between the public authority and the church, to the establishment of the layman education, to mass-

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[4] Image taken from http://en.wikipedia.org/wiki/Major_religious_groups.

media, and to a relative mix of religious persons, due to historic causes and migration of persons within the European Union.

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COPYRIGHT PROTECTED PLASTIC ARTWORK IN THE LIGHT OF THE EUROPEAN AND ROMANIAN LAWS AND THE ARTWORK VALUE RELEVANCE

Mihai Olariu[*]

Abstract

The plastic artwork, as a species of the "work of art" genre, is subjected to copyright. However, the law does not define plastic artworks, which are generally included in non-exhaustive listings, in phrases of the types: "plastic or graphical artworks, such as...". This study analytically presents the categories of artworks that may be included in the plastic artwork group, in the light of the European and Romanian law. At the same time, the study analyses the legal relevance of an artwork value, under all its aspects.

Key words: artistic work; plastic artwork; sculpture; painting; engraving; lithography; Scenography; tapestry; ceramics; glass and metal plastic; design; artwork value; artwork protection

JEL Classification: K11 (Property Law); K30 (Other Substantive Areas of Law-General)

The term "art" broadly designates any human activity relying on knowledge, exercise, perception, imagination, and intuition. More restrictively, art is also characterised by the lack of (practical) functionality, by knowledge, and aesthetics.

In the Age of Enlightenment, arts included the various forms of the so-called fine arts: the classical genres of painting and graphics, sculpture, architecture, and may other secondary genres; dramatic art, having as main genres theatre, dance/choreography; music having as main branches vocal and instrumental music; literature with the epic, dramaturgic, and lyrical genres.

Starting the beginning of Modernism, the forms artistic expression, and the artistic techniques and means expanded significantly. For instance, photography and applied art were included in the category of plastic arts. Dramatic art, music, and literature, and plastic arts are currently supplemented by the so-called new media, such as radio and television, cinematography, etc.

The phrase "plastic arts" designates all practices or activities leading to a representation through visual images, using dots, lines, colours, shapes, or volumes. In French, the phrase *arts plastiques* derived from the Latin *ars* and from the Greek

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plastikos and initially defined three-dimensional arts, such as sculpture or architecture, to then include painting, drawing, and engraving. Unlike *decorating* or *applied arts* - which were regarded as "minor", especially during the Neoclassic and Academic Ages (the end of the 17th century and up to the 2nd half of the 20th century) - plastic arts were regarded as "major", being the most appreciated. In the linguistic Anglo-Saxon area, the term *plastic arts* only defines the arts with three-dimensional manifestation, while the broad meaning of the plastic art notion is rendered through the phrase "visual arts".

Even in Romanian, pursuant to the development of new techniques such as "video art" or "conceptual art" - which are hard to define as "plastic" – the term of "plastic art" – in its broader sense - is increasingly replaced, in the artistic language, with the phrase *visual arts.*

The equivalent of plastic arts in German is "Bildende Kunst". German did not import an equivalent of the recent English phrase "visual arts".

The term "plastic arts" was traditionally associated to the term of "fine arts" or "belle arte", the equivalent of the French "beaux-arts", and of the Italian "belle-arti".[1]

The plastic artwork, as a species of the "work of art" genre, is subjected to copyright. However, the law does not define plastic artworks, which are generally included in non-exhaustive listings, in phrases of the types: "plastic or graphical artworks, such as...". Thus, the Law no. 8/1996 on copyright and related rights, as republished stipulates, in art. 7, that "original intellectual creation works in the literary, artistic fields, […] such as: [...] f) photographic works, as well as any other works rendered through a process analogue to photography; g) graphical or plastic artworks, such as: sculpture, painting, engraving, lithography, monumental art, Scenography, tapestry, ceramics, glass and metal plastic, drawing, design, as well as other artworks applied to products with practical use; h) architectural artworks, including drawings, mock-ups, and graphical works developed as part of architectural projects; i) plastic artworks, maps, and drawings in the field of printing, geography, and science in general" are subjected to copyright.

In the European Union law, Directive no. 2001/84/EC on the resale right granted to the author of an original artwork, of September 27, 2001, stipulates, in art. 2, entitled "Resale right for the benefit of the author of an original work of art" that "For the purposes of this Directive, "original work of art" means works of graphic or plastic art such as pictures, collages, paintings, drawings, engravings, prints, lithographs, sculptures, tapestries, ceramics, glassware and photographs, provided they are made by the artist himself or are copies considered to be original works of art."

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[1] Between 1931 and 1942, The Arts University in Bucharest was entitled the "Belle Arte" Institute, and between 1950 and 1990, it was called the "Plastic Arts Institute". Between 1864 and 1931, art universities were called "beaux-arts universities".

In the absence of a legal definition, but starting from the listing of "works of art", it may be summarised that the notion designates all artistic practices of activities generating a representation through visual means, using dots, lines, colours, shapes, or volumes. Hereinafter, we shall analyse the plastic art genres listed in the relevant laws in the field of copyright.

Sculpture is a branch of plastic arts dedicated to the development of three-dimensional artistic images, by carving or shaping a piece of material. As an art of three-dimensional shapes, sculpture in general, and stone sculpture in particular, represents one of the oldest means of visual expression of human thoughts and feelings - older than cave painting - the significations and themes whereof - initially exclusively zoomorphic and anthropomorphic - are common to both artistic genres.

Hence, practiced since immemorial times, stone carving has known, along the millennia, periods of maximum and complex boost in Ancient Egypt and Classical Greece, in the Hellenic countries, and in the Roman Empire, in ancient India and in pre-Columbian America, in Gothic, Renaissance, Neo-Classical, and Romantic Age Europe, or in the contemporary world everywhere, characterised through unprecedented diversification of working styles and techniques. Ever since ancient times, stone carving manifested in all currently known fundamental aspects: as an independent, autonomous art or as an auxiliary art, subordinated to and integrated in, architecture; as transfigured reflection of reality or, quite on the contrary, as non-figurative creation, with purely decorative function. [2]

Painting is the branch of plastic arts representing reality in two-dimensional artistic images, using colours (oil, aquarelle, gouache, acryl, ink, etc) applied on a surface (canvas, paper, wood, glass, etc.). In the theory of modern art, painting is regarded as a universal category including all artistic creations rendered on surfaces. However, the types of paintings vary depending on the materials and supports used and on the artist's working technique: frescos suppose the painting of a freshly plastered wall, while still wet (colours chemically combine with the support surface and they finally set after drying); stained glass is obtained through the combination of differently coloured or painted pieces of glass; the pointillist technique is characterised by the combination of small dots, which the viewer can individually join, if he watches the support from the correct distance.

Engraving is a plastic art genre including as techniques the digging, incision, perforation, or shuttering of a generally flat surface using various physical or chemical procedures, for the subsequent printing and multiplication of the image, or in order to obtain an individual artistic object. Individual engraving is used for the inscription or decoration of the various items with shapes or decorating motifs. If

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[2] Similarly to wood or other material carving, regardless of the indicated situations, stone carving of all times fall - depending on their technique and purpose - into two large categories: free-standing (in the round) and attached (in relief). The former are referred to as such because they can be viewed from all sides, *a tutto ronda*, according to an Italian phrase or *ronde-bosse*, according to the French one, both consecrated as such in our specialised literature (available at www.putna.ro);

engraved on precious, semi-precious metals or moulds for coins or medals, they belong to the glyptic art.

Lithography represents a technique consisting of the printing of the image from a flat typographic surface directly onto the paper passed through the press. The typographic surface is developed on a lithographic stone (dense chalk) or on a metallic board (zinc, aluminium). Developed by the German Alois Senefelder in 1796, the lithographic technique quickly expanded in Europe and America due to the less complex process and to the quality of materiality and expressiveness effects, similar to those of drawing.

Monumental art is the field of plastic arts that relates to large-sized works[3], generally carved. Mosaic, painting (fresco) and stained glass are monumental art genres, each having their specific features in terms of the plastic procedures used. The term "monumental sculpture" is frequently used in art history to determine, on the one hand, the category of a concrete oversized work, and on the other - simple in concept, virtuously performed, rigid and stable, with timeless qualities. In general, monumental sculpture is directly related to the surrounding environment (architecture or landscape), marking a space with a memorial, religious, funerary value or one that is consecrated to illustrious historical personalities who played an important role in certain geographical areas. Monumental sculpture has been known ever since ancient times (Colossi of Memnon, Egypt, 25th century BC; the colossal statues of Ramesses II, 15th century BC; the Pergamon Altar, 2nd century BC); and importantly developed along several centuries (the Statue of Liberty in New York, 1886; the Statue of Christ the Redeemer, 1931, Rio de Janeiro, etc). Another monumental art genre is the mosaic, which creates images using coloured glass or ceramic cubes glued with mortar onto the wall. The mosaic art has been known ever since Antiquity (Ishtar Gate, the New Babylon, 6th century BC), and has importantly developed in the Roman and Byzantine art (San Vitale Church, Ravenna, 5-6th century, Saint Sophia's Cathedral in Constantinople, 9th-11th century, etc.). Finally, the term of stained glass designates decorative compositions made of coloured glass, joined between lead elements, to obtain specific images. Generally, the metal structure frame for which the glass shapes are created is dictated by the geometrical, segmented shape of the details, which forms the visual integrity of the composition. Stained glass, as monumental art, attained its peak in the Gothic age, being almost omnipresent in European cathedrals. To conclude, we can state that the phrase "monumental art" includes works of art belonging to other plastic art genres, which, however, stand out through sizes and functions.

Scenography was traditionally defined as the "art of painting and setting the scene in theatre", or as the "art of creating the plastic ambiance (scenery, props, lighting) in theatre, cinematography, etc.". In other words, the scenographic character of a work of art is given by its very destination. If a board is painted to create an atmosphere as part of a performance, the painting will be regarded as a scenographic

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[3] From Lat. *monumentalis-grandios*

work of art. However, the scenographic work of art is unitary, and it is not only a mere combination of pre-existing plastic works of art. Most of the time, the scenographic work of art includes elements with no artistic value if taken individually - a certain type of scene lights; the management of the space on a scene; the costumes of the performing artists etc. –, but when combined by the scenographer, they render a certain image on the space and the theatre or cinematographic work to the public. Thus, scenography is an autonomous art, which aims at triggering a certain type of emotion, by creating artistic images and, more broadly, an "artistic atmosphere".

Tapestry is a form of textile art, which consists of weaving a piece of fabric on a vertical or horizontal loom. The fabric is made up of braids called woof and warp. The warp is parallel to the vertical of the fabric (if the weaving is performed on the vertical loom) and represents the bearing element of the fabric, while the woof is crosswise, being introduced between the warp braids during weaving. Tapestry is generally used in interior design, either hung onto the wall or on a vertical surface. Tapestry originates in Ancient Egypt, and it greatly developed in Medieval Europe, but it still is very spread.

Ceramics is the art of processing the plastic mixture made of common clays, kaolin, quartzites, talc, graphite, and coke in various percentages, through the homogenisation, shaping, decoration, glazing, drying or burning thereof. Depending on the composition and on the artist's working procedure, ceramic may be gross (unbaked or baked pottery – terra cotta) and fine (porcelain, faience, etc).

Glass and metal plastic is a type of plastic art involving the three-dimensional shaping of the two materials. Glass plastic works can be clear, opaque, or can include colours obtained from various pigments. Metal plastic works are achieved through the shaping of the various metal types (platinum, gold, silver, bronze, iron, alloys, etc).

Drawing is the graphical representation of an object, a face, or a landscape on a two-dimensional, flat, or curve surface, generally, using lines, dots, spots, symbols, etc. Drawing may be monochromatic or colourful.

Collage is a form of plastic art characterised through the combination of different shapes (with or without artistic content) in order to obtain a new unitary artistic form. Previous shapes are glued together on a base. The term "collage" originates in the French "coller" ("to glue"). Though it has a quite lengthy history, collage mainly became a modern art genre starting the beginning of the 20th century, having as representatives Georges Braque[4] and Pablo Picasso.

The works of art applied to practical use products are dedicated to the individualisation - through plastic art-specific aesthetic elements – to industrially ("batch") manufactured utility goods. This category of works of art benefits from a double protection system, both in relation to copyright, and under the laws on "industrial drawings and designs". This added protection derives from the very fact

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[4] Georges Braque (1882 –1963), French painter, initiator of the artistic style referred to as "cubism", along with Pablo Picasso

that, due to their destination and reproduction manner, applied works of art fall under the scope of industrial copyright, and, in the light of the way they were developed, they fall under the scope of copyrighting.

Design was defined as a "multidisciplinary field interested in the overall factors (socio-economic, technical, ergonomic, aesthetic, etc.) that contribute to the aspect and quality of the large batch product." In other words, design is a creative activity, which takes into account the development of new forms for practical use items. However, unlike the industrial model or drawing - where the applied shape or drawing aim at individualising the product through its aesthetic aspect – design aims at "facilitating and rationalising the manufacture of the product"[5]

Architecture was defined as the "science and art of the organisation and building of spaces required for human life and activity"[6] or as the "art of designing and constructing buildings and building complexes based on certain proportions and rules, depending on the nature and destination of the structures"[7]. Because it has both a functional, and an artistic value, the evolution of architecture depends upon the types of materials used in a certain age (wood, stone, brick, concrete), the destination of the building (dwellings, religious buildings, industrial, military buildings, etc.), and on the spiritual environment it is developed in. The basic architecture elements volume, surface, and plan – organised based on a certain pace, characterise architectonic styles. Depending on the perception of the time (i.e., towards the functional or the spiritual), architecture accentuates either the structure of the buildings (classical Greek, Renaissance, or 20th century architecture), or the general shape and the decor, in order to trigger an emotion or accentuate national specificity (Egyptian, Baroque architecture, etc). Depending on the destination of the building, architecture is divided into: civil, religious, military, industrial, etc. A new architectural genre is landscaping, defined as the art of intervening over the landscape in order to obtain an aesthetic space. The destination of the architectonic work is, however, irrelevant in terms of copyright protection, according to the provisions in art. 7 from the Law no. 8/1996 on copyright and related rights, as republished.

Being both an artist, and a technician, "the architect is, however, protected as the developer of original forms, and not as a technician using purely engineering processes"[8]. According to art. 7 lett. h from the Law no. 8/1996 on copyright and related rights, as republished, "even the plans, the mock-ups, and the graphical works that are part of the architecture projects" are protected. Art. 84 from the aforementioned law also concerns the "architecture and urbanism studies and projects exhibited in the vicinity of the architectural work site". Pursuant to the analysis of the two articles, it follows that architectural works of art play a double

[5] A.Bertrand, La propriete intellectuelle, Livre II, Belfond, Paris 1995, p.26, quoted by V.Roş, D.Bogdan, O.Spineanu-Matei, Dreptul de autor şi drepturile conexe.Tratat, All Beck Printing House, Bucharest, 2005, p. 147

[6] Dicţionar Enciclopedic, Enciclopedică Printing House, Bucharest, 2009

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[8] Colombet Cl., Propriété littéraire et artistique et droits voisins, Dalloz, Paris, 1999,p.64

role: on the one hand, the plans, the mock-ups, the graphical works making up the architectural projects, and, on the other hand, the structure built. Or, even if the plans are not followed by the actual development of the project, the architectural work will be copyright-protected. This also is the conclusion that follows from the formulation of the Romanian legislator which, in paragraph 2 from art. 84, stipulates: "the building of a work of art, whether fully or partially developed based on another project, can only be performed with the approval of the holder of the copyright over the respective project."

Due to the relativity of art assessment criteria in general, the legal protection granted to works of art ignores their value. However, in our opinion, it is the just solution, because in social evolution, artistic and aesthetic standards have significantly developed, and the granting of legal protection only to the works of art regarded as valuable at a certain point, would deprive subsequent generations from the access to the works of art rejected by a certain socio-aesthetic circumstance.

The solution is also adopted *expresis verbis* by the Romanian legislator, which, in art. 7 paragraph 1 from the Law no. 8/1996 on copyright and related rights, as republished, stipulates that "original intellectual creation works in the literary, artistic, or scientific works, regardless of the creation method, the expression manner or form, and independently of their value and destination […]" are protected.

We believe that the legislator understood to include in the notional scope of the term "value" both the aesthetic value of the work, and other elements characterising the work, such as: the content of the work; the sizes thereof, and its commercial value.

In so far as the aesthetic value of the plastic work of art is concerned, it should be stated that, despite the commonly attributed meaning, the term "aesthetics" does not only designate the category of "beauty", but it also supposes the capacity to trigger and communicate emotions that are specific to the receiver's senses. Or, in order to achieve this goal, the mere contemplation of "beauty" does not suffice. A series of contemporary artistic movements actually focus on the rejection of the conventional notion of "beauty".

Or, if the aesthetic value of the work were accepted as a criterion for the legal protection thereof through copyright, the law courts – called upon to rule on the fulfilment of the aesthetic criterion – would make an arbitrary decision affecting "the author's legal security. The law does not hold the capacity to decide whether a work of art is valuable or not, to distinguish between art and pseudo-art. The law has to treat all works equally, whether perfect or not, so as to avoid arbitrary decisions. The courts should only fulfil their mission of telling the truth, while leaving it to the academies to grant prizes and to the history to decide whether the work survived the author and the times when it was created, through its value, the only guarantor of immortality"[9]

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[9] V.Roş, Dreptul proprietăţii intelectuale.Curs universitar, Global Lex Printing House, Bucharest, 2000, p.76

In so far as the content of the work of art is concerned, it concerns the approached theme, which, in our opinion, may not be regarded as a criterion in deciding whether copyright protection is to be granted or not. "The protection of the work cannot be rejected because it does not comply with good manners, it is sacrilegious or anticlerical"[10]. Even if the work is, through its content, against the good manners of the time, it cannot be deprived of legal protection. The morality of society is a relative and changing notion, and a valuable work, regarded as obscene at a certain time, could be accepted, or even appreciated by subsequent generations. Such an example is the work of the painter Edouard Manet[11], "The Luncheon on the Grass". Featuring a group made up of two men wearing suits and two naked women, having a picnic, the scene scandalised the public and the critics of the time, because of the usual ambiance in which the female nude - only approved of at the time to evoke mythological themes - was presented. Regarded as shameless and challenging, the work was rejected from the "Official Salon" - an exhibition yearly held in Paris. In 1906, 23 years after the painter's death, the painting was exhibited at the Louvre, the largest and most prestigious art museum in France.

The dimensions of the work should not be a criterion in deciding whether to grant legal protection or not. A huge painted canvas, or a miniature the artistry whereof is hard to perceive at first sight; the Sistine Chapel, painted by Michelangelo over several years, or one of Da Vinci's unfinished drafts, are equally protected. Obviously, the works of art involving various author involvement levels will be differently appreciated by the public, critics, or the works of art market, but, as already shown, this appreciation is not relevant in terms of copyright protection.

Finally, legal protection is granted to a work of art regardless of its commercial value. The commercial value of works of art, set on the specialised market as the relation between demand and offer, may differ based on various criteria, but especially pursuant to the aesthetic value thereof as acknowledged by the public or the specialised critics. Generally, the commercial value of a work of art is only set after the work is "achieved" and disclosed, when it already is - if original - subject to copyright. However, especially in the case of works of art belonging to widely known authors, the commercial value of a future or still undisclosed work of art can be estimated based on the author's market share - set based on the commercial value of previous works belonging to the same author. In these cases, the commercial success of a work of art is the very granting thereof to a certain author. An eloquent example to this end is the case of the portrait entitled "Bearded Young Man" – attributed to Rembrandt - from the famous Thyssen collection, evaluated by Christie's auction house in 1986 to approximately ten million dollars. Immediately after the publication of the conclusions of "Rembrandt Research Projekt" - where Dutch experts stated that the work might have been painted by one

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[10] Bertrand A., La propriete intellectuelle, Livre II, Belfond, Paris 1995., p.152
[11] Édouard Manet (1832 –1883), French painter, precursor of Impressionism. Starting from the great artists' tradition, Manet was able to join the old time suggestions with modern elements, which brought him the title of "Painter of Modern Times" (Charles Beaudelaire).

of Rembrandt's students, but in a very similar style - the market value of the work dramatically decreased, to no more than $ 800,000. Similarly, in the case of a living painter, the value of an unfinished work may be evaluated according to his market share. Or, regardless of this aspect, as already shown, the future work will be copyright-protected, immediately after it was completed.

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