The deadlock of Economics

"The financial crisis has contradicted the statement that Economics
deserves to be treated as a science.
A science is measured by its capacity of explaining, predicting and prescribing."
Moisés Naím

The methodological option according to which the essential is situated at the level of the human condition designated a stage in the history of science from which all the failures of economic theory originate. Labor (especially as production) and action in general (therefore as societal innovation as well) were suitable to measurement and calculus, empiricism and factualism, as well as positivism and phenomenologism. Humanity was the palpable expression of things, facts and events, seen as quantitative effects perfectly dimensioned by methods and by rational instruments. Economic theory has already proclaimed the making of the new man, an Adam animated only by the rational. Homo Oeconomicus was proven to be the awaited demiurge of the new universe – the artificial one – precipitated from his imperial reasoning, meaning the reasoning which institutes rationality, efficiency and growth as fundamental law.

For the comfort of Economics, human nature has been banished to the tenebrae called *caeteris paribus*. The occasional rise to the surface provokes disasters – called crises – as a result of greed, of uninhibited drive for appropriation, of the panic of losing the freedom of gain, of the moral hazard or – worse – as a result of the irrational exuberance of believing that by wanting more you can initiate the fission of the minimal effort which will generate the never-ending maximal effect.

The founding rift of Economics was not all to different in consequences from the dissociation operated in the Renaissance between the natural things – as an opera of the Grand Creator, which are at most revealed to us – and man-made things, the only ones that can be rationally understood.

The basic principles of Economics, but the final cause too – which is wealth – have only conquered the sector of the human condition, and the consolidation of power meant ever more productive action. The human condition has been condemned to unlimited progress. From the moment in which Homo Faber (in the role of Homo Oeconomicus) has invented tools for producing other tools the human nature has emerged as absolutely derisory. Rationality began battling with its own, permanently shifted by progress, limits.

But as nowhere nor at any time that which is left in the dark did perish but has followed the path of life towards light, so does human nature send from the unknown *caeteris paribus* the Phoenix bird in order to discover a safe haven amid the deluge of the crisis.

Unfortunately for too many times by now the signals that the disaster has a cause in Economics' vocation of ignoring the unity between the human nature and the human condition have not been taken seriously. Economics has chosen the easy path of considering itself a science by manipulating the linearity of the human condition and by refusing to insure the success of becoming a true science by betting on the deciphering of the discreet (non linear) behavior of the human nature. It saw itself as an arithmetic of the fabrication, missing the opportunity of becoming a geometry of the aspiration. It sophisticated its technique of inventorying the bricks in the construction, forgetting how important it is to project the shape which would include the infinite number of bricks. It specialized in knowing the structure and function of the tree, having no regard for the preeminence of the forest.

When Economics got fixated on the efficiency of producing objects it had to accept the limitations of the order generated by the individual, step by step, condemned though by the unpredictability of independent behaviors and by the impossibility of following the natural law of cycles, as a specific norm of large numbers. It's not accidental that Economics has started its scientific edifice on the private ground of the domicile where human liberties, as rights and obligations, are amoral in their natural isolation. Here, within the simple framework of the individual household could Economics provide evidence with regard to predicting the end result without a test. Here the power of the human condition was equal to the enhancements of the human nature. Economics has thus taken notice of the necessities limited by objects. Its force of foreseeing was maximal in these conditions.

In reality it is here where Economics has forever failed as an enterprise with material predestination. When it escaped – helped by the moderns – from the placental comfort of the domicile the predictability wanted by social expectations was needed, a function that in order to achieve Economics had to do something different, to experiment on a large scale, and to become something else: political. Instead of experiencing a predictable rationality it found itself overwhelmed by fulgent passion. Regularity became a credible illusion while reality, evermore subjective, is irrational.

To call what comes next, Economics has to roll the dice.

Marin Dinu

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The Use of Performance Contracts for Delivery of Social Services in the United States

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Abstract. *Devolution and the New Public Management has increased the privatization of government service and enhanced the role for the nonprofit sector in the United States. Performance contracts are viewed as a method for holding service providers accountable for outcomes. This paper outlines the findings of a two year study which took place at the University of Delaware between September 2005 and April 2007, entitled* The Forward Together Project. *Ad hoc implementation of performance contracts are found in the state; some as a result of federal mandates, others as championed by leadership. Ingredients desirable for successful performance contracts are explored in this paper. Although the research cannot conclusively attribute performance contract to more effective and efficient service delivery, it does provide evidence of expanded use of performance contracts and the potential for improved accountability and service delivery relationship between state government and nonprofits.*

In part as a result of the New Public Management, government organizations are devolving their responsibilities for services. This includes from the national government to states to local governments, as well as from government to non-profit and for profit organizations. The phenomenon of increasingly privatized government services and its implication for an enhanced role for the nonprofit sector in the United States is well-documented throughout much of the public administration literature.

Performance contracts are viewed as a method for holding service providers accountable for outcomes. Yet, despite their increasing popularity, many questions about this emerging trend have remained largely unanswered. A team of

researchers[1] from the University of Delaware has been involved in studying various aspects of the relationship in the contractual arrangement between state government, human service agencies and non-profit organizations.

This paper will focus on the performance contract arrangements with the research questions: What is the impetus in government and the nonprofit sector in Delaware to implement performance contracts? What agencies are involved in the performance contracts? And finally, is it leadership, mandated requirements or both that promote the performance contract arrangement?

The methodology includes quantitative and qualitative data from on-line surveys conducted with nonprofit and government agencies, in person interviews with performance contract administrators and nonprofit recipients, focus group, and a workgroup that has been meeting to address issues around performance measurement and evaluation. The theoretical framework will be established through the literature on the subjects of performance contracting and leadership.

The research methods consisted of a series of 44 in-person interviews, administration of two separate online surveys for a total of 111online responses, document analysis, and focus groups. These are discussed in greater detail in the case study.

Key words: public management; performance contracts; leadership; personnel management.

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JEL Codes: M12, M53, M54.
REL Codes: 12C, 14G.

Performance contracts

Government contracting is not new. However, performance contracting is a relatively new phenomenon (Donahue, 1989). Performance contracts with a private or nonprofit organization specify what type and level of performance the vendor is to achieve. This performance-based contract model has proliferated in the last 10 years as the contracting regime has evolved (Smith, Lipsky, 1993, p. 91). These authors also explain that government agencies increasingly favor performance-based contracting with nonprofit organizations for social services "as a means to spur contractor achievement" (p. 81).

There have been previous cycles of shifting service provision between the government and nongovernmental sectors. In his historical review of government - nonprofit sector relations in the US, UK, Japan, and Israel, Young (2000) identifies periods in all countries in which human services were provided predominantly by government or predominantly by nongovernmental organizations, and periods in which there was a blend.

Implementation is also occurring in other European states. For example, contracts for performance management are found in Central and Eastern European states. According to Matei and Matei (2008) these are at the beginning stage and are in need of statistical measures to evaluate level of performance.

Performance contracting has been reinforced by legislation at the federal level and in some state governments[(2)]. The concept of performance-based contracting was formalized in 1991 with Policy Letter 91-2 issued by the Office of Federal Procurement Policy in the US Office of Management and Budget. The Federal Acquisition Regulations of 1997 incorporated the requirement reinforcing the Government Performance and Results Act of 1993. The federal government expected that federal agencies would apply performance-based contracting to 50% of their eligible service contracts, by 2005. The State of Delaware passed the Delaware Governmental Accountability Act in July 1996 mandating the reporting of agency performance measures to the General Assembly's Joint Finance Committee budget hearings.

The shift from regulatory contracting to performance contracting is significant (Behn, Kant, 1999). "It reflects changes in the basic role of the contract, in the assumptions on which the contract is based, in the incentives that the contract seeks to create, and in the expectations of the various parties" (p. 471). The new philosophy of performance contracting is based on the assumption that an effective way to get a contractor to help accomplish a specific public purpose is to pay that contractor only when it actually does something that contributes to achieving the purpose. The vendor is not explicitly instructed on how to complete the task but rather is given flexibility on the implementation as long as the results are achieved. This differs greatly from the regulatory contracts that seek to regulate the behavior of each vendor with the assumption that there is one best way to fulfill the purpose of the contract. Behn and Kant (1999, p. 474) summarize the differences in Table 1 found at the end of the document.

Performance contracting and accountability for social services in a changing environment

Donahue (1989) argues that there is an inherent tension between pay for activities and pay for results. In addition, contracting for social services is inherently more complicated than contracting for commodities for at least two reasons: One, a market for the service does not exist; if government does not buy the service, no one will. Two, the technology necessary to produce the desired outcomes or outputs is uncertain, unknown, or maybe even nonexistent; neither the agency nor the vendor know precisely what a vendor should do to help to achieve the agency's mission (Behn, Kant 1999).

The social service delivery provided by the nonprofit sector and funded by government experiences a one-way model of accountability or hierarchical accountability with the following process: governments legislate and fund programs that public servants design and oversee, nonprofit providers then carry out the activities assigned to them, as illustrated in a study on social service delivery in Nova Scotia (Brown, MacDonald 2006). Similar findings have been documented by Whitaker, Altman-Sauer, and Henderson (2004).

According to Henderson et al. (2003, p. 19) "traditional accountability practices often reflect and support an adversarial rather than a cooperative relationship, diverting attention from the public services that are the reason for the partnership". Brown and MacDonald (2006) found that government-nonprofit conversations are subjected to the same tendency as board-staff conversations within nonprofits; the tendency to focus on operational issues which are more concrete and less demanding than conversations about mission, goals, outcomes, and performance. Yet, this lack of focus creates a gap in leadership and accountability visible to funders and donors. Money is then shifted to leaders who demonstrate competency in producing results through highly innovative and effective collaborations or new ventures ((Marsh, 2007).

Several ingredients were found as needed for success in contracted services:

Leadership

According to Marsh (2007), the talents needed for leadership in today's environment requiring leading beyond boundaries is for people with a track record in:

1. Creating wins across communities.
2. Resourcefulness-Leaders who are creative in leveraging resources, looking for opportunities to multiply their impact through the efforts of others.
3. Communication savvy.
4. Self-awareness and humility.
5. Adaptability.
6. An appetite for continuous learning and adventure.

Communication

The government-nonprofit contracting relationship requires dialogue, or more specifically, "a process of mutual understanding that emerges when participants treat each other with equality, not coercion, and when they listen empathetically to one another's concerns in order to prove their fundamental assumptions

and world views" (Robert, 2002, p. 660). Whitaker et al. (2003, p. 16), view this as the "key in helping accountability move beyond surveillance and towards service quality improvements".

Nonprofit boards are involved in the relationship between the nonprofit and government only as it is reported by the executive director. In this environment, Boards are maintained at arm's length and are at the mercy of the Executive Director (Brown, Mac Donald, 2006).

Partnership and teamwork is needed between the government agency staff and the contractor. This requires trust, open communication, and strong leadership (Washington State, 2005).

Training

Training of staff and contractors is needed for establishing performance measures. This ingredient is in keeping with what the Forward Together workgroup on performance measurement and evaluation identified as needed most in the state of Delaware. In the first workgroup meeting the pressing issues were identified, most notably:

1. The need for differentiating between program evaluation and performance measurement.
2. Stakeholder involvement in the identification of measures.
3. The need for clarification of terms through consistent definitions.
4. Training materials on performance measures and evaluations.
5. Use of the logic model to include the theory of change. For example, what changes are expected to occur as a result of participating in the program?

The committee focused its work on the last three: the definition of terms in performance measurement and evaluation, the training materials, and the logic models.

A report from the State of Washington (2005) reinforced the selection. The Office of Financial Management did a thorough study on the use of performance contracting in Arizona, Illinois, Minnesota, Wisconsin, a variety of local agencies and the Federal Government. In summary, they found the need for a consistent language for terms used in performance measurement and evaluation.

Confusion in definitions among various departments and regulations cause different interpretations of how performance based contracting is defined. Also related to the workgroup, they found the importance of training for all parties involved in contracting process, especially performance contracts.

Planning

Government should ensure that the contractors already have a strategic plan and performance measures for its programs (Washington State, 2005). In cases where this is not available, the measures may be imposed without alignment with the mission of the program.

Internal management

Internal management systems are necessary to support both the government agency and its contractors (Washington State, 2005). Nonprofits often do not have the wherewithal to support the technology necessary to implement and maintain the data system. In the case of Delaware, the Department of Labor is able to provide technical support to its contractors.

State of Delaware as a case study

In order to achieve a deeper understanding of an existing set of relationships, this work focused exclusively on human services provided in the State of Delaware. Delaware is a small state with a population of approximately 850,000 located in the eastern seaboard of the United States. Because of its size, human services are provided, by or through State agencies, with very little involvement of county or municipal governments. Within State government, attention is focused on the most critical state agencies responsible for providing social services: the Department of Health and Social Services (DHSS), the Department of Labor, and the Department of Services for Children, Youth and their Families (DSCYF). Among the nonprofits, attention is focused on only those nonprofits that currently have contracts with DHSS and DSCYF to provide human services.

Between September 2005 and May 2006, a variety of strategies were used for gathering data on the current status of nonprofit - state government relationships in delivering human services in Delaware, including:

- Focus groups of
  - Nonprofit Leaders
  - State Government Leaders
  - Foundations and Funders of nonprofits
- Structured in-depth Interviews with nonprofit and government staff who deal with contracts between the state and nonprofits
- Web surveys of both nonprofit and state government personnel
- Document analysis (budgets, requests for proposals (RFP), websites, contracts).

The sample of interview subjects was developed with consideration given to ensuring the many diverse services supported by the state were represented and the number of respondents in a given field was proportional to the level of contract dollars appropriated. Respondents were either state contract administrators or leaders of nonprofit organizations (i.e. executive directors) that hold significant state contracts. Although the work was carefully undertaken, due to the small sample size, and its nonrandom nature, the results of the interview and survey are not considered statistically significant and, therefore, not meant to provide replicable results; rather they informed the research project and provided qualitative and quantitative data to gain better understanding of the state-nonprofit relationship.

Initial meetings with key leaders from each sector guided the impetus of the project, and led the project team to devise the survey instruments around four broad areas of concern: administrative, reporting and technology matters; costing and financial matters; level of partnership; and performance measurement. These four areas were the basis not only for the initial instruments, but as predominant issues became more defined within each area; they formed the foundation for four working groups. The working groups were formed for the purpose of identifying and finding solutions to improve the working relationship between Delaware state government and nonprofit organizations. The following pages will explore the literature, assess the status of performance-based contracting in Delaware's public-nonprofit

contracting relationship, and analyze the results of the working group devoted to performance measurement.

Findings on performance contracts in Delaware

Within Delaware, performance measurement and performance-based contracting are not well developed. In the two major state departments reviewed, contracting decisions are made – for the most part – at the division level; often times even more minutely, at the contract manager level. Within DSCYF, four separate divisions and two distinct offices exist, while DHSS boasts twelve separate divisions. Thus, although the level of coordination is somewhat greater within DSCYF, the smaller of the two departments, state contracting is more or less fragmented and decentralized. Individual contract managers and division leaders are able to exercise a great deal of discretion in contract design, accounting for the wide variation in service arrangements.

Perhaps as a result of the absence of a more centralized system for contracting, the state as a whole has not placed a priority on performance-based contracting. Although many respondents indicated their inclination to move toward paying for results, only three specific divisions were identified that held true performance-based contracts: the Division of Vocational Rehabilitation (DVR), the Division of Substance Abuse and Mental Health (DSAMH), and the Division of Family Services (DFS). More details about these specific cases will be presented later.

Other respondents noted a statewide trend involving the increasing use of what is referred to as "unit cost" contracts. Unit cost contracts require service providers to propose a single cost such as a per diem or per person rate, and service providers are then paid according to the number of units of service provided. These contracts differ from "cost reimbursable" contracts, wherein service providers submit their total program budgets to their state contractors for reimbursement. The motivation for such a change is ensuring that adjustments are made so that nonprofit service providers are paid for the *quantity* of service actually rendered.

Both of these contract types are examples of traditional, regulatory contracts as noted by Behn and Kant (1999). Although the state is trying to enforce accountability, neither ties pay to performance; rather, pay is tied to service delivery with process measures, *not outcomes*. In an early meeting, high level state officials reported that they felt confident in being able to identify malfeasance through annual site visits and other formal and informal communications with providers, but less confident about ensuring that clients received quality service. Annual site visits were reported by virtually all state and many of the nonprofit respondents as conducted as a matter of routine or when necessary, such as in the event of a "critical incident." When combined with the state's requirement for providers bidding on services through the RFP process to meet specific budget allocations regarding operating and administrative costs, these two functions of state monitoring serve primarily to assess utilization of inputs and processes, precisely as described by Romzek (1998).

Conversely, nonprofit service providers felt that their state counterparts were too far removed from the programs to share a deep understanding. For example, in interviews

nonprofits indicated that they were often unsure of why the state was collecting certain pieces of data and wary about the manner in which it would be interpreted. Such statements are characteristic of the adversarial relationship predicted by Behn and Kant (1999) of regulatory contracting.

Understanding the context of Delaware social service contracting leads to the question: why has the state failed to embrace performance-based contracting on a broader scale? Several explanations seem to prevail. Many state contract managers, and nonprofit leaders alike, are uncomfortable with the concept of performance-based contracting, for different reasons. State contract managers are not sure precisely how to tie pay to performance, or which measures are the best to use, while still cost efficient to track. Determining outcomes for most social services can be less than straightforward, to say the least. One state respondent was quoted as saying "The services we're offering are meant to improve the end of a person's life. How can we measure if we've done this?" Thus, problems with current attempts to measure contract performance abound. The development of effective performance measures for human services has evolved slowly over more than a decade of efforts by governments creating contracts for those services. Performance-based contracting, which relies more on evidence of achieving performance outcomes than on evidence of inputs or processes, has evolved even more slowly.

During interviews, many respondents actually chuckled before replying to questions about whether or not they received or were able to include performance incentives or bonuses in contracts. To be done effectively, real incentives must be in place, so performance-based contracting requires a commitment to ample funding (Hatry, 2006). Only 44% of state respondents and a mere 14% of nonprofit respondents indicated that the state always pays for the full cost of services contracted. This creates an environment where it is clear that the state expects nonprofits to at least partially subsidize state funded services with grants or funding from other sources.

Despite the challenges associated with performance measurement and performance-based contracting, when asked during in-person interviews how the state's performance expectations of nonprofit service providers have changed in the last five years, the overwhelming response was that they have become higher. More specifically, nonprofit and state respondents tended to feel that the state continues to demand more from nonprofits for the same or less funding, and there is an urgent sense among state respondents that the state needs to ensure they "are getting what we pay for." As a result, state contracts increasingly demand more evidence based programming and are more likely to include aspects of performance measurement.

Among respondents in both nonprofits and state government, it is a widely held perception that performance measurement will – and should – be expanded in the near future. It is expected that more contracts will be performance-based. Neither sector appears to be well prepared for the transition. As previously noted, influence from the Federal government has been strongly in favor of moving toward measuring and reporting outcomes. Particularly of interest is the Government Performance and Results

Act of 1993 (GPRA), which has mandated the use of outcomes measurement in programs that are funded by the federal government. Often, this responsibility is passed on to state and local governments responsible for implementing programs with Federal or joint funding. Thus, the Federal government has played an important role in introducing performance-based contracting at the state level, as will be exhibited by the Division of Vocational Rehabilitation found later in this paper.

Sixty-five percent of nonprofit respondents disagree or strongly disagree with the statement that nonprofit service providers currently have adequate capacity to effectively measure and report performance outcomes (see Figure 1). State respondents share their concern about the capacity of nonprofits with whom they contract.

State respondents are no more confident of their own abilities to develop and manage performance based contracts. State respondents know this is necessary and valuable, but that they have not yet developed effective performance measures and do not have a staff of contract managers who are prepared to manage such contracts. In fact, the state respondents do not express strong confidence in the degree to which they train contract managers to deal with the current contracting arrangements (see Figure 2).

These findings are not particularly surprising. Much of the relevant research has identified weaknesses in contract management, the development of performance measures, and the ability to focus on outcomes rather than inputs. In an effort to understand the possible reasons for slow progress in the performance management arena, we asked our respondents about the degree to which nonprofit service providers are involved in determining appropriate performance measures. In interviews, half of the state respondents indicated that nonprofits are consulted when setting performance standards (see Figure 3). In a related (but not identical) question on our nonprofit web survey, 40% of nonprofit respondents agreed or strongly agreed that their organization is involved in helping craft performance measures and outcomes applied to state contracts (see Figure 4). It is the responsibility of the state to make final determinations about the performance and outcomes measures to include in state contracts, and to enforce those measures equitably in all similar contracts.

When contemplating the role of Delaware's state government in promoting performance-based contracting, the state appears to fall short. None of the interview respondents were aware of, or able to articulate, the role of Delaware's Office of Management and Budget (OMB) in setting performance standards. Unlike Minnesota, Florida, Virginia and other states, Delaware does not have a central office responsible for evaluation and performance monitoring. It is important to note here that while performance-based contracting can, and has occurred as a result of governmental mandates, it has also arisen in the absence of such requirements. Thus, we would infer that in such instances, leadership has provided the necessary momentum to make performance-based contracting a reality.

Since nonprofits are frequently not consulted on appropriate performance measures as noted above, nonprofits not presently involved in performance-based

contracting may see implementation as a threat. Cost considerations have also undoubtedly hampered performance-based contracting from becoming a reality in Delaware. It is no secret that state government spending has been a source of tension in recent years, especially as the federal government has made efforts to further reduce expenditures, cutting aid to states through the Deficit Reduction Act.

Examples of contracts in state government

Despite the intentional proclivity of state government to be slow to respond to change, a few strong examples of performance-based contracting exist and provide examples for duplication and precedent. Each of the examples shares some common characteristics, which will be explored further in the coming pages. Particularly, in each instance client outcomes are well defined and articulated in addition to being accepted as appropriate by both parties involved in service delivery. Additionally, the implications of introducing the new method of contracting seem to have a resoundingly more positive effect on the relationship between state government and nonprofit service providers than expected.

Division of vocational rehabilitation

The US Department of Labor's Employment & Training Administration (ETA) funds job training programs to improve the employment prospects of adults, youth, and dislocated workers. These programs are delivered primarily by states including Delaware through the One-Stop Career Center System. Training programs can vary from state to state depending on the skills that are needed to compete for jobs in the local area. All programs are aimed at boosting workers' employability and earnings.

Delaware's state Division of Vocational Rehabilitation (DVR) within the Department of Labor is responsible for administering the Federal job training programs associated with Temporary Assistance for Needy Families (TANF) funding. Nationally, the process of developing outcomes for job training programs is relatively straight forward, when considered within the context of other social services. In fact, the outcomes associated with job training – in this case, improved employability and/or increased earnings – are so widely undisputed that the Federal government has mandated a set of performance standards to be implemented by state agencies. The performance standards which states must report on include: "participant program completion rates; participant job-placement rates…; participant wages at placement; retention rates at six months after job placement…" (Henrich, 2002).

Despite the seeming inflexibility imposed by mandated outcomes requirements, the state is ultimately given "considerable discretion to shape their own performance-incentive policies and training-service strategies to achieve performance goals," (Heinrich, 2002, p. 715), DVR represents an example of performance-based contracting that exists because of government mandates, and when asked for their opinion on how effective performance measures are in producing positive outcomes for clients, both the state respondents and the nonprofit respondents that hold contracts with DVR agreed that, in this instance,

performance measures are very effective. In a personal interview in 2006, one nonprofit that holds performance-based contracts with DVR pointed out that the arrangement allowed for a better working relationship with the state because of the clarity of the contract terms, noting "we know exactly what is expected of us."

Division of substance abuse and mental health

The Division of Substance Abuse and Mental Health (DSAMH) is located within Delaware's Department of Health and Social Services. The division functions with two directors, one for substance abuse services, and the other for mental health services. Although the division's two subsections may experience an overlap in clientele, services are contracted out separately. Additionally, within DSAMH, there is a disparity in the use of performance-based contracting: many of the substance abuse contracts are performance-based, but the mental health contracts are not. However, both components of the division are moving in the direction of requiring evidence based programming for contracts although they are not required to by federal mandates.

For substance abuse contracts, the state has tied pay to performance targets such as attendance and graduation rates. Similar to what was seen in DVR, in this instance, the state sets forth a payment amount and pays the provider a percentage of that amount based on the nonprofit providing the service to a person. While attendance rates are typically thought of as an input or process measure, in this case they are used as a proxy for the outcome. Additionally, when a person successfully completes the program, the service provider is eligible for a "graduation bonus."

Again, both the nonprofit and state interview respondents indicated that a predetermined limit on the amount of money to be paid out could serve to minimize the incentive. In the words of one nonprofit respondent that holds this type of substance abuse contract "...they capped the graduation bonuses so you could only get paid for 15 a year, but in fact, hundreds of people graduate, so, it's not really an incentive." Another nonprofit service provider indicated that using attendance rates as an outcome measure posed an unfair challenge since, ultimately, the client's decision to attend the program or not on any given day is out of the nonprofit's control.

Interview respondents from mental health indicated that they were interested in implementing performance-based contracting, but they had not yet been able to determine an appropriate funding mechanism. They also indicated that one of the outcomes under consideration would be the number of hospitalizations a client experienced. Avoiding hospitalization is one of the major goals of mental health services since it tends to be relatively costly and invasive.

Division of family services

The Division of Family Services (DFS) is located within the Department of Services for Children Youth and Their Families, the smaller of the agencies considered by the Forward Together project. DFS utilizes performance-based contracts for many of their family support programs, which encompass an array of support and

counseling services. One such example are contracts for "reunification services" in which the service provider's main objective is to bring children that have been separated from their families back into their homes. The state sets an objective such as "80% of families will be successfully reunified." Providers are then paid regularly according to rates established for the service within the contract, but the performance-based incentives are not earned until nine to twelve months after reunification occurs. This is done with the intentions of "…addressing problems at a deeper level so that there is no reentry into the system, because if there is, you don't qualify for the incentive. Providers work very hard to achieve all of the outcomes…" Again, this is an example where the support to implement performance-based contracts grew not from federal or state mandates, but rather, out of leadership at the division level.

Both state and nonprofit interview respondents described Delaware's present system as having components that withhold pay when outcomes are not met as well as providing incentives or bonuses for higher levels of performance. Challenges and obstacles raised by both sides of the contracting arrangement include: the amount of time spent collecting data; targets that may be more or less appropriate for the populations being served; and the challenges associated with having pay withheld prior to outcomes being reached.

Concluding remarks

The potential for performance measurement and performance-based contracting to be further utilized within Delaware state government is evident. It appears that their implementation has occurred when governmental mandates are present, as well as when they are not. Additionally, performance measurement and contracting have taken on a negative connotation among groups within the state that have not moved toward their implementation, producing a level of unnecessary anxiety around the issue that may hinder their further spread.

The nature of today's problems is not solvable by a single government institution. Added to this dilemma is the requirement for management that expands not only agencies, but also sectors calling for leadership to focus on results when no one is in charge. These findings seem to imply that strong leadership is necessary - not only within each sector, but also across sectors – to produce a social service delivery system that is better informed on the subject and thus positioned to reap the possible benefits. Leadership needs to be able to connect results with policy while working with the understanding that leaders cannot control performance. It is in communicating information that leaders may be able to exercise authority to get things done.[3]

The findings from the Forward Together project cannot tell us positively whether performance measurement and contracting produce more effective and efficient service delivery, the ultimate goal and a point that is often debated in the literature (see for example Pollitt and Bouckaert, 2004). However, they do point to expanded performance-based contracting as a possible solution for improving accountability and the service delivery relationship between state government and nonprofits.

Differences between regulatory and performance contracting

Table 1

Regulatory Contracting	Performance Contracting
Pay for inputs, processes, and technologies	Pay for results
Adversarial relationships	Cooperative relationships
Regulations drive behavior	Payments for results drive behavior
High certainty	Low Certainty
Low responsibility	High responsibility

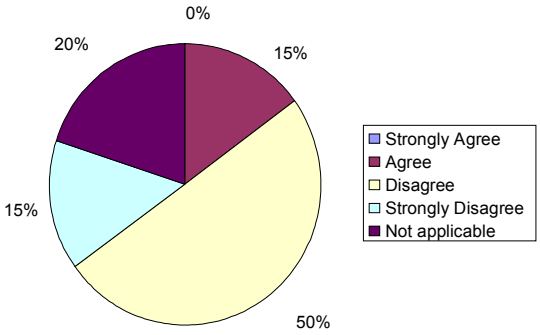

Figure 1. *Nonprofit Respondents: Nonprofit service providers currently have adequate capacity to effectively measure and report outcomes*

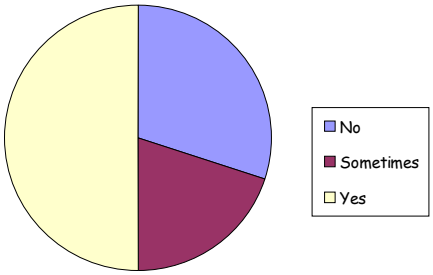

Figure 3. *State Respondents: Nonprofits are consulted when setting performance standards*

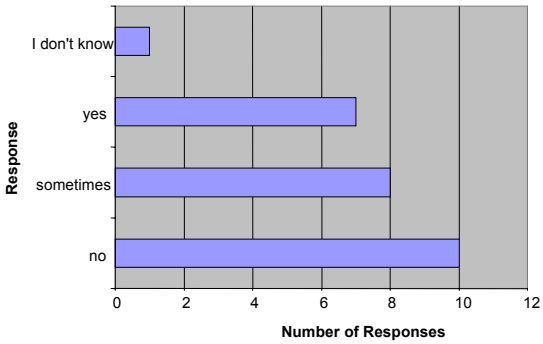

Figure 2. *State Respondents: There is adequate training for State Contract Managers*

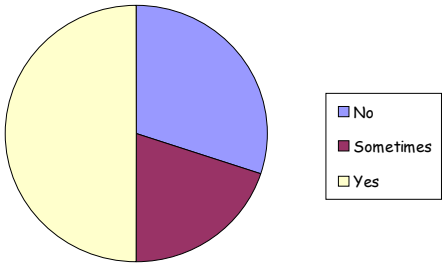

Figure 4. *Nonprofit Respondents: My organization is involved in helping to craft performance measures and outcomes State applies to contracts*

Notes

(1) Forward Together Research Team* include Maria P. Aristigueta, Deborah Auger Kathryn G. Denhardt, Lynne Foote, Lauren Miltenberger, and Yimin Li University of Delaware, Center for Community Research and Service, and Institute for Public Administration. This research was made possible through the support of the Jessie Ball duPont Foundation, a research grant from the College of Human Services, Education, and Public Policy at the University of Delaware.

(2) Departments in States: Minnesota, Pennsylvania, Arizona, North Carolina, Wisconsin, Massachusetts, Oregon, Kansas, Maine, and Florida are found in the literature as utilizing some form of performance based contracts.

(3) This conclusion was greatly enhanced by Don Kettl's presentation at the University of Delaware on 13 April, 2007.

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Marketing of Local Public Services under the Reduction of Administrative Expenditures

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Abstract. *The concerns for reducing administrative expenditures have been expressed in the last 10-15 years in concrete initiatives. It is worth to remark the occurrence of networks concerning the application of Standard Cost Model (SCM), aimed to reduce administrative expenditures for affairs. Even the European Commission aims to elaborate and implement a strategy to reduce administrative costs for affairs inside the European Union. We find similar initiatives in OECD, several European states, i.e. United Kingdom, Denmark, Netherlands, Sweden, Norway, as well as other countries. An international project "Cross Country Benchmarking" is important in this respect.*

These concerns have developed and diversified due to the worsening of the economic crisis. The crisis effects, already visible in the public sector too, lessen more and more the possibilities of satisfying the citizen's needs. The marketing specialists bring up more and more frequently new marketing instruments that, giving the context, should generate products and services meant to satisfy the citizens' needs. The product and service, in itself, as well as their price, become the main marketing instruments. The present paper proposes an assessment, based on the two instruments of the public marketing mix, of the way in which the reduction of the administrative expenditures can lead to a reduction in the price of the public services or to their diversification with regard to the consumers' needs. By using elements specific to the production theory, the product management shall be substantiated, as well as the strategies regarding the prices of the public services.

Key words: public marketing; administrative burden; strategies; expenditure reduction.

JEL Codes: H76, M31, M38.
REL Codes: 13G, 14G.

1. Introduction

From private marketing to public marketing

Improving the activities of the public organisations makes more and more reference, in the last decades, to adopting and adapting the instruments that the private sector is using in order to carry out its activity more efficiently. From the practices transferred from the private to the public sector, we emphasize: measuring and assessing the activities, cost-benefit and cost-effectiveness analyses, subcontracting (Kotler, Lee, 2007, pp. 8-9), etc. For the public service marketing, there are extended relevant analyses from Bréchignac – Raubaud (2001), Matei (2006), as well as Proctor (2007). At the same time, theoretical or empirical specialised researches deserve to be mentioned, as they capture particular aspects of public marketing; in the public administration, Nedelea (2007), Matei (2008) or, in general, the non-profit sector, Burguete Vazquez (2004), Mauri (2004), Toca (2007), Hințea (2008), and others, as well as their implications in the quality of the local services: Gutierez Rodriguez (2009), or in the public service performance: Matei and Matei (2008). The literature, through papers of reference in the field, Kotler and Lee (2007), emphasizes the need for a new approach of the issue of marketing in the public sector, starting from the observed reality in many public institutions, where the marketing concept comes down to one of its instruments, namely promotion. "Marketing turns out to be the best planning platform for a public agency that wants to meet citizen needs and deliver real value. Marketing's central concern is producing outcomes that the target market values. In the private sector, marketing's mantra is customer value and satisfaction. In the public sector, marketing's mantra is citizen value and satisfaction." (Kotler, Lee, p. 11).

The administrative burden – strategies and mechanisms of reduction

The concerns for adequate administration of public expenditure have been always present with the main objective focused on efficient use of resources in view to obtain high economic performance.

In the latest 10-15 years to these efforts, some concrete initiatives were associated on reducing public expenditure, both for the public sector and private sector.

The terminology and contents of administrative costs are different and depend on the analysed situations and contexts. In various situations, they refer to expenditure for achieving the information obligations. According to the International Standard Cost Model Manual, the administrative burden refers to "expenditures generated in companies, when they meet the information obligations, required by public administration based on the legislative rules".

The extension of this issue towards the public sector will lead to an extension of the sphere of administrative burden to "compliance costs for enterprises, services and citizens, including administrative and bureaucratic (operational) costs as well as capital costs"[(1)].

It is worth to remark, from this perspective, the occurrence of some networks concerning the application of the Standard Cost Model (SCM), aiming to

reduce the administrative expenditures for businesses. Even the European Commission aimed to elaborate and implement a strategy for reducing the administrative costs for the businesses inside the European Union. We find similar initiatives in OECD and several European states as well as other countries, for ex. United Kingdom, Denmark, Netherlands, Sweden, Norway etc.

SCM Network comprises for the time being over 19 states and organisations, and recently also Romania. In fact, for Romania, the Strategic Plan of the General Secretariat of Government for the period 2007 – 2009 – management component – comprises as priorities on medium term, "preliminary analysis of the issue of administrative burden, development of a general methodology to assess the administrative costs and to elaborate a concrete action plan in order to implement the Standard Administrative Cost Model"(2).

Public expenditure represents "the ensemble of annual expenditure with public nature of a country, financed on the basis of public budgetary resources" (Dobrotă, 1999, p. 98). In fact, public expenditure reflects the political choices of the Government, representing costs of the elements of economic policy aiming to deliver public goods. These costs relate to delivering goods through the budget of the public sector or represent expenditure in the private sector, induced by regulations and laws made by the public sector.

What we called the administrative burden of private companies can be framed in this second category of expenditure. The costs from the first category are in fact public expenditure, as such, of which a part represents the costs of bureaucracy in any public administration. In an extended meaning for the administrative burden, the costs of bureaucracy are in this category for a public administration.

The premises of a strategy of public marketing based on the reduction of administrative burden

The most relevant instruments for the substantiation of a public marketing strategy for local public services under certain reduction policies for the administrative burden will be the product management and the price. By product it should be understood both public goods and services. The product management will consider their components and their types in the public sector. The discussed marketing strategy will comprise both the preliminary ideas with regard to the target-markets, the product positioning, as well as the other elements of the marketing mix. For the local public services the sales prognoses refer to the utilization degree or the anticipated participation level.

The economic analysis represents the basic operation for the assessment of the economic attractiveness. This refers mainly to the anticipated total cost (Ct_a) and to its comparison to the financial or non-financial benefits of the public service. The economic analysis creates the necessary link between the two named marketing instruments. The anticipated total cost will substantiate the price as the most important factor that influence the decision of a buyer. From this perspective, the most relevant aspects that are to be taken into account in the local public services will be:

- Through the applied price, the public service pursues to cover its direct costs and its eventual indirect costs, or to maximize its sales, the degree of participation or utilization;
- The assessment of the public market demand or, better said, in the public sector, the citizen's interest;
- Establishing the demand sensitivity against the price;
- Assessing the product cost, more precisely the direct costs and the indirect ones;
- Pointing out the weight of the administrative expenditures in the product cost and of the demand elasticity against their variation.

The reduction of the administrative expenditures and, as a consequence, of their weight in the final price of the product will substantiate for a public organization, its own strategy of price adjustment. The field literature (Kotler, Lee, 2007, p. 76) points out also other elements of the strategies of prices' adjustment in the public sector through the use of vouchers, special tariffs, discounts, etc.

I. The administrative burden

I.1. The evolutions

The weight of public expenditure is different and depends on the development levels for the public or private sector. Reported to the latter, the administrative burden in the public sector will have a certain non-linear evolution. It is worth to mention the models formulated by Musqrave (1974) and Rostow (1960), stating that in the earlier stages of growth and economic development, investments in the public sector are high, providing the core social infrastructure. The purpose of these investments is to help economy to reach higher development stages, where, although the state will continue investments, their role will be to complete the private investments. The conclusions of the two economists are relevant also for the evolution of the administrative burden, both in the public and private sector.

- While total investments increase as proportion from GDP growth, the relative share of the public sector decreases (Musqrave, 1974, p. 35).
- When economy reaches the maturity stage, the mix of public expenditure will be oriented from the expenditure for infrastructure to expenditure for education, health and welfare services (Rostow, 1960, pp. 9-10).

Therefore, if we take into calculation the total administrative burden obtained by summing up those from public and private sector:

$$PA_{tot} = PA_{public} + PA_{private} \qquad (1)$$

it will have the following characteristics:

PA_{tot} can be considered constant, for certain periods of economic development;

PA_{public} and $PA_{private}$ are variables in time;

between PA_{public} and $PA_{private}$ there is bidirectional transfer due to effects of dislocation between public and private expenditure, specific for different periods of economic and social development.

The above assertions are based on Peacock-Wiseman analyses, stating that: "Governments have the trend to spend more money and the citizens do not wish to pay many taxes. Consequently, the Governments

should take into consideration the wishes of their citizens" (Payne et al., 2006, p. 37). In this context, it occurs the so called *effect of dislocation,* namely the public expenditure dislocates the private expenditure in certain periods, such as crises periods.

I.2. The assessment

The idea to assess the administrative burden is based on simple judgments, focused on the structure of the public sector, respectively private sector. In the specialised literature, public expenditures are grouped depending on different administrative or economic criteria. An administrative classification of expenditures could be as follows:

- *organic*, when expenditures are grouped depending on institutions: ministries and other central bodies, administrative-territorial units, other public institutions;
- *functional*, when expenditures are grouped depending on the profile of the activity of public institutions: public power and general administration, justice and police, international relations, army, culture, education, social actions, economic actions.

Taking into account the economic criterion, the classification is as follows: operational expenditure, transfer expenditure and investment expenditure. In this context, the administrative burden in the public sector will be included, mainly, in the operational expenditure and it will be direct proportional with the number and size of the institutions concerned.

The assessment of the administrative burden in the business environment, consequently in the private sector, takes into consideration another philosophy. The roots of such activity are situated in the Netherlands, when at the beginning of 1990s it formalised the first methods for assessing and reducing the administrative burden for small and medium sized enterprises. The practical experience and positive results of the Netherlands were undertaken by several EU Member States, representing general concerns of each organisation to reduce bureaucratic expenditures.

The administrative burden, as shown in the introduction of this paper, represents those expenditures done by a company to achieve its information obligations to the state. Consequently, the assessment activity for the administrative burden should start with precise identification of information obligations. "An information obligation (IO) represents the duty to draw up and keep record of certain information and to make them available to public administration or other authorised institutions. It is a compulsory activity for companies. Each information obligation comprises a number of data requirements, and the companies should submit them"[(3)].

The assessment of the costs for administrative activities imposed by IO respect the following scheme, which represents in fact the structure of SCM.

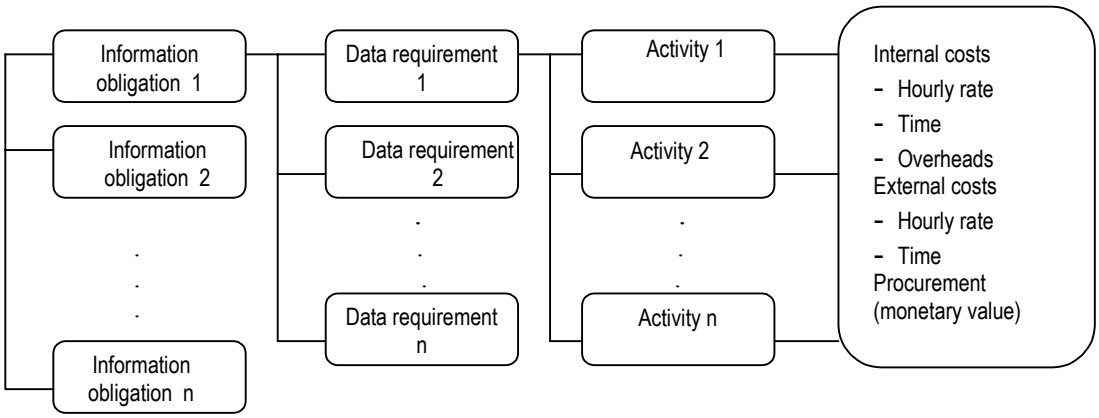

Figure 1. *Structure of the Standard Cost Model (SCM)*

Source: International Standard Cost Model Manual, 2005.

Combining the components above described, we obtain the core formula for SCM:

Administrative cost [3, 4] = Price × Time × × Quantity (population × frequency) (2)

where:

Price: price consists of a tariff, wage costs plus overhead for administrative activities done internally or hourly cost for external service providers;

Time: the amount of time required to complete the administrative activity;

Quantity: comprises the size of the population, the accomplished businesses affected and the frequency of the activity that must be completed each year.

I.3. EU– the need of a "fresh wind" on reducing bureaucracy

In the EU, since the middle of 1990s, we witness the pressure for reducing the administrative burden, necessary to be paid to administration. This effort embraces various forms: "best practice", "one-stop-shop", etc.

Since January 2008, at EU level, a group of 15 experts was set up, led by the former Prime Minister of the German Lander Bavaria, Edmund Stoiber, group subordinated to Commissioner Günter Verheugen, direct responsible with reduction of bureaucracy in the EU. Stoiber wants to make "brave recommendations", wants to bring "fresh wind" in the too quiet EU initiative on reducing bureaucracy, declares his spokesman.

The expenses due to EU compulsory bureaucratic requirements should decrease by 2012 by 25%, meaning around 150 billion Euros for the European economy. Roland Berger expert, belonging to the group in the European Commission, states: "without discussions, we shall develop new proposals. Beyond the existent laws, we shall take into consideration new laws. Additionally, we should analyse what has to be regulated at EU level and what has to be solved at national level. In this situation, it is compulsory to put under the question mark the tasks received and assumed by EU bureaucracy up to the present."

The European Union has three priorities in the next three years for SMEs:

- reducing bureaucracy by 25%;
- intensifying youth qualification for the economic activities;
- increasing (direct and indirect) EU financing for SMEs in 2007-2013; it will be by about 50% greater related to the previous period of time. SMEs in the EU spend 5% with bureaucracy from their revenues; 30% from the expenses with bureaucracy of SMEs can be reduced in the next years, signifying tens of billion euros available for SMEs development and consumption;
- creating a commission for reducing the administrative burden for SMEs that received already 600 proposals and it analyses them; EU launched an action to simplify the existent legislation, aiming:

– to eliminate the useless provisions and regulations;
– to eliminate the provisions repeated in several regulations;
– to eliminate the provisions that cannot be applied.

I.4. Romania – incipient stage

The topic of reducing the bureaucratic expenses was introduced recently on the working agenda of the public authorities. In the first part of the paper we presented the introduction of this topic in the Strategic Plan of the General Secretariat of the Government for the period 2007 – 2009.

The Governance Programme 2009-2012 stipulates the elimination of the administrative barriers through:

- elaboration of simple, clear and stable legislation;
- simplification of formalities on companies entrance and exit from the market;
- reduction of administrative procedures on obtaining authorisations, approvals and certificates.

In order to simplify the procedures for authorisation of the activity of the companies, there are taken into consideration the following:

- elimination of double copies and authorisations, certificates, licences and permits that are not compulsory according to acquis communautaire and practices in the EU Member States;
- implementing unitary procedures in order to obtain authorisations;
- simplifying the application of tacit procedure by:

– recognising the authorisation based on the certificate issued by the register of the public authority, attesting that the inquiry was submitted and it was not issued in the legal term;
– establishing the individual accountability and contravention accountability for the staff with tasks in issuing the certificate;
– reducing the terms to issue the authorisations, certificates, licences and permits for the companies, so that the highest term will be of 15 days (instead of 90 days). If the authorisation is not obtained in 15 days from the competent authority, it is tacit approved.

In order to reduce the bureaucratic expenses, a specialised website should be

achieved, providing all the information necessary to obtain authorisations, certificates, licences etc. The website should be achieved under Government patronage and it should be updated permanently.

It should be implemented an electronic system to submit online the demands in order to obtain authorisations, certificates, licences and permits for the activity of the companies.

All these actions aim to reduce bureaucracy and administrative expenditures on authorising the company activity, improving the transparency and simplifying the administrative procedures, enhancing the relation of administration with the companies.

Since January 2008, Romania, through the General Secretariat of the Government, belongs to the network of the users of the instrument on standard expenditures. The governmental strategy will have a chapter dedicated to reducing bureaucracy. In this chapter the focus will be on the financial aspect and simplification of legislation. The Government should have established the percentage to reduce the bureaucratic expenditures. At EU level, this percentage represents 25%. For Romania, the objective is to have a competitive percentage.

The initiatives to reduce the administrative burden of enterprises were focused on the SMEs sector, for the beginning.

In 2006, it was achieved the inventory for authorisations, certificates, licences and permits for the activity of companies, finding out that 34 public institutions have competences in their issuance. It is a total number of 534 authorisations, certificates, licences, permits and there are authorisations under the responsibility of several public institutions.

The real number of authorisations, certificates, licences and permits is 488; the difference between the total number and the real number results from the existence of double competences for issuance.

The legal duration to issue authorisations, certificates, licences and permits is between 5 working days and 90 days, only for 21.3% of the authorisations (only 104) the procedure of tacit approval is apply.

II. Determining the economic performance when reducing the administrative burden

The proposed model starts from the idea that the economic performance in the public sector is determined also by the used strategies of public marketing. The quantitative approaches are necessary in order to substantiate the marketing instruments described in the introductory part of the paper.

As a consequence, we shall start from an approach, which has become classical, of the production process in an enterprise, using the function of production, Cobb-Douglas.

$$Y = A \times K^{\alpha} \times L^{\beta} \qquad (3)$$

where:

Y – output resulted from the production process;

K –fix capital of the enterprise used in the production process;

L – labour force involved in the production process;

A, α, β are constants with economic significances, well established, namely:

A – coefficient of dimension, α - elasticity of production related to capital, and β - elasticity of production related to labour force. We will consider the variables and

coefficients as value expression.

From (3), a series of performance indicators can be defined, mentioning the average productivity (average output) as well as the marginal productivity (marginal output). On its turn, the average productivity can be determined depending on capital (R_K) or labour force (R_L) as follows:

$$R_K = A \times K^{\alpha-1} \times L^{\beta}\ , \qquad (4)$$

respectively,

$$R_L = A \times K^{\alpha} \times L^{\beta-1} \qquad (5)$$

II.1. The formal model[5]

The model describing the influence of reducing the administrative burden on the economic performance is based on the following important hypotheses:

- in the public organisation there is a policy for reducing the administrative burden, determined both by own, internal measures and external measures;
- the administrative burden is within a relation of proportionality both with the total capital, K_t, and total labour force, L_t.

In a simplified expression, this second hypothesis is translated through existence of positive, sub unitary constants λ, μ so that the administrative burden *PA* is as follows:

$$PA = \lambda \times K_t + \mu \times L_t \qquad (6)$$

- under the situation of reducing the administrative burden, the flows of money are used exclusively in production, assuming that they will determine an increase and a diversification of it.

Consequently, in the absence of other influences, we shall have:

$$K_t = K + \lambda \times K_t \qquad (7)$$

$$L_t = L + \mu \times L_t$$

Solving (5) and introducing in (3) we obtain:

$$\frac{Y}{(1-\lambda)^{\alpha}(1-\mu)^{\beta}} = A \times K_t^{\alpha} \times L_t^{\beta} \qquad (8)$$

If we write:

$$Y_t = Y / (1-\lambda)^{\alpha}(1-\mu)^{\beta} \qquad (9)$$

Y_t will have the significance of a total production that will be obtained using totally the capital and labour force, so with zero administrative burden.

The expression: $k = (1-\lambda)^{\alpha}(1-\mu)^{\beta}$ (10) will be defined as a *factor of influence for the administrative burden on production*.

- In the case of a policy for reducing the administrative burden spread out on several years, n, we obtain a succession of effects overlapped, due to annually factors of influence,

$k_1, k_2, ..., k_n$ and consequently:

$$Y_t = Y / \prod_{i=1}^{n} k_i \qquad (11)$$

where:

$$k_i = (1-\lambda_i)^{\alpha}(1-\mu_i)^{\beta} \qquad (12)$$

represents the factor of influence of the administrative burden on production in the year *i*.

Through a similar judgment we obtain factors of influence on average productivity depending on capital, k_K, or depending on labour, k_L, namely:

$$k_K = (1-\lambda)^{\alpha-1}(1-\mu)^{\beta}, \qquad (13)$$

respectively,

$$k_L = (1-\lambda)^{\alpha}(1-\mu)^{\beta-1} \qquad (14)$$

In the context of the theoretical model design, the total cost (C_t) will be:

$$C_t = K_t + L_t \qquad (15)$$

So, the final price of the product, P_f, will be stated against the initial price, P_i, as it follows:

$$P_f = \frac{C_t}{Y_t} = \frac{C_t}{Y} \times k = P_i \times k \qquad (16)$$

From (16) results an assessment of the price reduction due to the reduction of the administrative burden. It can be observed that in the scientific substantiation of public marketing, the influence factor of the administrative burden upon production has an essential role.

II.2. An empirical model

In order to provide an example on the above mentioned issues, we turned into consideration the autonomous regies RA "Apa", Braila, Romania, (RA "Water"), whose general objective is to develop the system of water and sewerage at local level through modernisation and its enlargement to peripheral areas of Braila Municipality.

Analysing the statistic data during 2000 – 2005[6] we obtain:

Empirical data on the variables of function Cobb – Douglas

Table 1

Year	Production (Y)	Capital (K)	Wage expenses (L)
2000	12,510,578	24,253,760	4,821,499
2001	11,430,219	18,552,430	5,675,151
2002	12,490,810	20,537,752	5,122,277
2003	13,821,040	25,003,426	6,069,335
2004	15,733,981	25,683,846	6,841,239
2005	18,844,835	31,368,067	7,813,556

The determination of constants for the function of production (3) imposes, first of all, its logarithmic process. Consequently we obtain (Matei, Matei, 2007, pp. 11-24):

$$\ln Y = \ln A + \alpha \ln K + \beta \ln L \qquad (17)$$

From Table 1, in the same manner, through approximation:

Empirical logarithmic data of the function of production Cobb-Douglas

Table 2

Year	ln Y	ln K	ln L
2000	30.3	30.8	19.5
2001	29.7	30.5	20.2
2002	28.7	30.7	19.8
2003	30.2	30.8	20.2
2004	30.3	30.9	20.3
2005	30.8	31.3	20.6

From calculation reasons, in order to determine in a unique manner, the constants A, α, β, we shall divide the analysed period in two sub periods, 2000 – 2002, respectively 2003 – 2005, and we shall obtain for the first period:

$$\alpha = \frac{3}{2}, \quad \beta = -1/4.$$

In order to ensure that these constants are unique we shall repeat the procedure for the second period of time. After checking, the results are compatible.

III. Conclusions - a hypothetic situation regarding the substantiation of a public marketing strategy

Formulating a hypothetic situation for reducing the administrative burden at the level *l = 5%* and m = *10%,* we obtain, using (10), that the value of the factor of influence on production is:

$$k = \sqrt{\left(\frac{19}{20}\right)^3} \times \sqrt[4]{\frac{10}{9}} = 0.951 \qquad (18)$$

Consequently, the limitation of the administrative burden at the level above described will involve an increase of

production by *1/k = 1.051,* namely 5.1%. Calculating the average productivity depending on capital or labour, we shall discover that the reduction of administrative burden does not lead necessarily, at least for the present example to its increase.

In fact, using (13), respectively (14), we get:

$$k_K = 1.0006,\ k_L = 1.056 \qquad (19)$$

leading to the following finding: an insignificant reduction of the average productivity depending on capital and a reduction by 5.3% of productivity depending on labour force.

Therefore, the conclusion is as follows: while reducing the administrative burden there are necessary measures to change the structure of production so that the average productivity increases, in the same time with the increase of the total production.

In what regards the price, according to (16) and (18), it will suffer a reduction of 4.9%.

Notes

(1) See Good Practice Guidelines for the Management of the Evaluation Function", http://europa.eu.int/comm/dg19/evaluation/en/goodpracticieen.htm.

(2) According to Government of Romania – General Secretariat, „Strategic Plan of the General Secretariat for the period 2007 – 2009", pp. 13, www.gov.ro.

(3) See International Standard Cost Model Manual; measuring and reducing administrative burdens for business", SCM Network, Oct., 2005, pp. 8.

(4) See also „Méthodologie commune de l'Union Européene pour l'estimation des coûts administratifs imposés par le legislation – Manuel operationnel", http:/ /www.europa.eu.int/comm/secretariat_general/impact/docs_en.htm, p. 3.

(5) A similar and detailed description can be found in Matei, A., (2008), Performance of Public Expenditure Management at Local Governance in Romania, Transylvanian Review of Administrative Sciences, no. 23E/June/2008, pp 59-74

(6) Data from the Bulletins of the National Institute of Statistics during 2000 – 2005 as well as from reports and financial statements, transmitted by R.A. „Water" to local authorities.

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Is the Incidence of the Monetary Policy on the Mortgage Market Possible?

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Abstract. *The article sets out to approach mortgage markets and their impact on the financial structure and on the financial stability. The synthesizing of studies done lead to the conclusion that the institutional characteristics of the mortgage market influence the monetary policy shocks on the prices of housing and consumption. In developed countries, transmission of such shocks is stronger because of mortgage markets mature and flexible. Regarding this aspect, there are significant divergences in the structure of the mortgage market between the main industrialized countries. Also, the reaction of central banks to the speculative bubbles on the mortgage markets is extremely reduced, thus formulating a series of interrogations related to the lack of concern of monetary authorities regarding the price of real assets.*

Key words: mortgage market; monetary policy; speculative bubble; central bank; real assets.

JEL Codes: E52.
REL Codes: 8J, 14K.

1. Heterogeneity mortgage markets

The importance of houses in the wealth of natural persons, the importance of economic boom cycles in the financial stability and role of mortgage markets characteristics in transmitting monetary policy show that it is important to consider the mortgage market as a part of the financial structure. This situation is particularly adequate in Europe, where the creation of the single financial services market had a reduced impact in the way that there are numerous divergences, which shows the fact that there are significant differences compared to other regions where the mortgage market is homogenous within each monetary area (Calza et al., 2007, pp. 235-241).

In the US, the mortgage and mortgage products market has known a significant growth in the last years, becoming the largest market with fixed interest rate. While in the US more than half of the mortgage market is secured, the European market of mortgage products continues to be reduced. The situation reflects the existence of a number of characteristics of mortgage market in the US, which encouraged the increase of securing and reducing the need of mortgage credits. The American mortgage market is currently dominated by mortgage banks which typically represent the originators of loans. These, in turn, are sold on the primary market to enterprises sponsored by the US government (governmental agencies) which play a pivot role on the American mortgage market. The governmental agencies purchase individual packages of mortgage loans from certain banks, either owning them in the balance sheet or selling them on the secondary mortgage market. Currently, in the US there are five mortgage governmental agencies with different corporate structures: one fully private (Sallie Mae), a public agency (Ginnie Mae) and three other agencies with a hybrid statute (Fannie Mae, Freddie Mae and FHLB).

These three agencies have private shareholders but function with the implicit guaranteeing of the state and with certain advantages (tax exempts and registering fees).

Fannie Mae and Freddie Mae are the largest agencies, being created in the 1930's and 1970's, as part of an effort to increase the number of house owners and improve the mortgage market. Fannie Mae and Freddie Mae have two main business lines: on one hand they buy mortgages, hold them and issuing nesecuritizate bonds; on the other hand they offer MSB type warranties (mortgage backed securities), in the last years significantly increasing the importance of these business lines. For the products specific to the mortgage market, MBS have increased in the US with an annual percentage of 10%, the balance of these operations reaching 4,4 trillions USD, compared to 3,8 trillions USD, treasury bonds (in 2007/2006).

The involvement of governmental agencies Fannie Mae, Freddie Mae together with investment banks such as Goldman Sachs, Merrill Lynch and Bear Sterns in operations of securing mortgage markets have triggered and sustained the crisis, first manifested in the US under the name of

subprime crisis. According to this mechanism, a bank could grant any volume of mortgage loan because it could sell them further, to a financial institution, receiving the entire value of the loan plus the interest.

The financial institutions (mentioned above) have secured these credits by cumulating them in an issue of financial derivatives, considered to be very secure, with AAA rating which were purchased by large banks or countries' treasuries. Thus, non-performing loans were wrapped in financial derivatives with superior ratings which were due either to the implicit guaranteeing by the state or due to the solid financial situations and the ties between the rating agencies and investment banks. The institutions involved in securing the loans have succeeded this way to gain considerable profits such as Lehman Brothers (which increased its income from 1,5 billion USD in 2003 to 4 billion USD in 2007) considering that the ones who purchased the derivatives did not know what they contained.

When this scheme collapsed, the governmental agencies and investment banks have registered significant losses (Fannie Mae lost in 2007-2008 more than the combined profits of 2000-2006). In the table 1, there are some of the institutions involved in the acquisition of AAA derivatives packages which contained non-performing credits.

Total losses generated by subprime credits

Table 1

Institution	Type of institution	Value of loss (billions) $
Switzerland UBS AG	bank	37.7
Citigroup-USA	bank	39.1
Merrill Lynch	Investment bank	29.1
HSBC – Great Britain	bank	20.4
Royal Bank of Scotland – Great Britain	bank	15.2
Morgan Stanley	Investment bank	11.5
AIG	bank	11.1
Wachovia Bank – USA	bank	11.1
Deutsche Bank - Germany	bank	7.7
Mizuho Financial Group - Japan	bank	5.5
Societe Generale	bank	3

Source: www.federalreserve.gov/releasses/h8/current.

Compared to the American market, the European market of mortgage products is very reduced, and the mortgage backed securities – MSB make up 50% of the total secured European market, this component being liquid only in Great Britain and the Netherlands. In the last years, the number of cases of securing mortgages originated in other countries was limited. The main reason the European mortgage market remains fragmented and insufficiently developed is the harmonization of the legal framework, which affects both the characteristics and rules applicable to mortgage loans and securing each loan, reflecting a variety of mortgage products in the European countries.

The prices of houses have had spectacular evolutions in the last years in the industrialized countries. Like the prices of other assets, the prices of houses is influenced by interest rate in certain countries, this being a channel of transmitting

the monetary policy. Because the prices of houses, monetary variables and macroeconomic aggregates change, as a response to some shocks in the economy, it is difficult to see the causality relationship between them (Monacelli et al., 2008, pp. 2-22).

After the decline of capital market and the fall of economy in 2000-2002, the monetary policy has relaxed in the majority of developed countries, creating favorable conditions for increasing the prices of houses. Thus, the monetary policy has become less adapted to the mortgage in a series of countries, the interest rate on the long-term remaining low and the price of houses continuing to rise.

The prices of assets, respectively the prices of houses are not among the objectives of central banks, but clearly the oscillation of house prices may have important implications on the economic activity and inflation. The consequences of sudden modifications of house prices on the financial stability require a proper regulation of this domain. The major decline of the price is often associated with the economic collapse and triggers considerable crisis when the value of the nominal collateral is declining significantly. Regarding the reactions of monetary policy to the modification of houses prices there are empiric reduced evidences which show that central banks change their monetary policy rate as a necessary reaction to the implications of house prices on inflation and economic growth. Monetary policy may react to other variables, such as oil shocks, productivity drops, interest rate shocks. The analysis of these correlations in countries such as Japan, Sweden, Great Britain and Australia suggests that central banks were preoccupied mainly with inflation and interest rate, paying little attention to the prices of commercial and residential properties. Recent speeches (at the level of 2007) about this issue suggested that banks should have to produce a shift of monetary policy, if you wanted to restrict substantially the rapid increase in the price of assets.

Even in the time of speculative bubbles, the policy of central banks is uncertain, as the lag of monetary policy is long. In the opinion of central bank governors "*the price of real assets is important for central banks only to the information they provide about macroeconomic evolution, not being at all regarded as a monetary policy objective*" (Filardo, 2005, pp. 291-298).

Debates on this theme had a public character in Great Britain, where house prices tripled in 9 years (until 2004). Starting with November 2003, the Committee of Monetary policy of The Bank of Great Britain gradually increased the repo rate with 125 basis points up to 4,75%. Also, in December 2003, the British government changed the index of RPIX properties, determined by taking into consideration the price of houses. In the context of the current crisis, BCE has operated the most drastic reduction of interest rate in its 10 year history reaching a level of 2,5% and the Bank of Great Britain reduced the reference interest rate to 2%, the lowest level since 1951.

2. Transmission of monetary policy through the "housing channel"

The institutional differences between mortgage markets are often quoted as a source of differences which manifest between different countries, from the point of view of the way the impulses of monetary policies are transmitted within the economy.

The size and distribution of mortgage debt, the average maturity of contracts and the type of interest rate are the main characteristics able to determine the effects induced by interest rate modifications on the income and collateral. Authors, such as *Guy Debelle* (2004, pp. 51-64) show that an increased weight of the interest variable rate for mortgage contracts leads to an effective mechanism of transmitting monetary policy through "housing channel". Studies done by Bank of International Settlements show that monetary policy brings about stronger effects in Anglo-Saxon countries than in Europe. Different authors approached this subject, showing a series of aspects: *Matteo Iacoviello* (Iacoviello, Neri, 2008) shows that variations in the magnitude of responses to monetary policy shocks manifests in European countries thanks to differences between financial systems; *Angeloni* (Angeloni et al., 2003, pp. 29-30) considers that the institutional differences in financing houses is a possible explanation for the response of private consumption to monetary policy shocks in European Union, compared to the US; other authors (Calza et al., 2007) set out to apply VAR model on the case of three Anglo-Saxon countries (Canada, US, Great Britain), 7 European countries (Germany, Italy, France, Spain, Netherlands, Belgium as well as Denmark), taking into consideration the period 1980-2004, to assess the mortgage market in response to monetary policy.

In order to indentify monetary policy shocks, authors used *the Cholesky factorization standard procedure* for estimating the variance-covariance matrix. Results indicated that an increase of interest by 100 base points determines the decrease of both private consumption and houses' prices. Transmitting monetary policy is strong in Great Britain, Netherlands and the US and has a reduced level in France and Germany which is strongly correlated to the degree of development of the mortgage market. The model highlights the response of houses prices to monetary policy through the following indicators: mortgage debt – GDP ratio, the weight of ownership, the index of integration in the mortgage market and the loan/houses value ratio. In all cases authors have found a clearly positive relationship: the reaction of houses' prices to the monetary policy shock with variable structure of interest rate consists of a response of 1,82% in the case where mortgages are refinanced and 0,38% in the case where it is not allowed, which signifies a strong reaction of houses prices in case of flexible mortgage markets.

The transmission of monetary policy with impact on the mortgage market is done through three channels, respectively: a) the channel of nominal debt; b) the channel of collateral and its constraints; c) the channel of asset prices. It is important to highlight the fact that the first two channels act independent to the manifestation of prices rigidity.

The most intense subject approached in specialty literature is the channel of credit and its sensitivity on the prices of houses. The existence of this channel is correlated to the structural characteristics of the houses financing system, especially to the institutional organization and level of efficiency. The transmission of monetary policy through the credit channel is linked to the mortgage market as well as to other sectors of the economy. Mortgages are a part of collateral assets and their features are strongly influenced by the prices of these assets. Such a correlation may explain the attitude of banks which increase the investment side in the mortgage market, in the period of price increases. The credit channel may be regarded both as a source (as a result of institutional deposits) and as a destination (at the user level). As a source, thanks to the volatility of houses' prices, loans on the mortgage market are considered risky. If a negative shock of monetary policy increases the aversion to risk of the bank's management than the reduction of asset levels may affect mainly the loans for houses, if on the mortgage market the lack of liquidity starts to show. In this case, banks will adjust crediting policy. The manifestation of a state of reducing and segmenting of loans for houses affects the demand coming from the population in a higher measure than in case of current usage goods. The reduction of credit loans, in the absence of state funds or alternative credit institutions, has as effect the fragmentation of demand, in this sector more than in other ones.

The relevance of credit channel in the houses market can be explained by a major structural feature: the organizing of the houses financing system. Referring to this aspect, three models are identified:

a) the bank oriented model (Finland, Great Britain, partially Germany);

b) the mortgage market model (partially Germany);

c) state model (Norway and partially Finland).

The bank oriented model is characterized by the strong presence of institutional depositors (commercial and mortgage banks). In Finland, 80% of the houses market is covered by these institutions and in Great Britain, 90%. In Germany commercial, savings banks and credit cooperatives covers 45% of the market and the rest is assured by mortgage banks, Bansparkassen. Thus, the banking system, through its nature, is strongly linked to the credit channel, because the sum of funds that can be loaned is strongly dependent to the monetary policy actions due to the founding of the activity of these institutions on short-term deposits.

The mortgage market model is characterized through the strong role of mortgage institutions, the main difference to the banking system model being the source of the funds of these specialized intermediaries (respectively, the issuing of long-term titles as mortgage and municipal bonds). Thus, it is argued that the existence of this mechanism based on mortgage bonds is at least linked to the credit channel, a sign that the monetary policy has limited effects on the credit offer.

The state model is characterized through the relevant presence of the state (directly or indirectly) through public banks. In Finland, the state assures between 10% and 20% of

the mortgage loans through the State Fund for Houses and in Norway this percentage is situated at 40%. Mortgage loans are generally restricted to the social houses or in some cases to particular categories of beneficiaries.

Matteo Iacoviello shows the correlation between the credit channel, effectiveness in houses financing and the type of institutions involved in the activity on the mortgage market by using VAR methodology of analyzing houses market. Taking into consideration a multitude of variables (real GDP, inflation, monetary policy rate, real price of houses, total loans from all the mortgage institutions, interest rate on the mortgage market, short-term interest rate) have led to identifying the credit channel in Finland, Germany, Norway and Great Britain with different effects (reduce in Great Britain and strong in Finland).

Another model that describes to what extent the credit channel may be part of the monetary policy transmission policy is that of *Ben S. Bernanke* (Bernanke, Gertler, 2001, pp. 1-7). This is based on the macroeconomic effects of credit market's imperfections, in the sense that each imperfection generates external costs of fund increases, which in turn affects the crediting decisions. In this context, the endogenous developments of the credit market (through variations in the value of the collateral) acts through amplifying and propagating macroeconomic shocks. In conducting monetary policy, the price of real assets is important, especially in the case of speculative bubbles, without reaching a consensus regarding the most adequate strategy of monetary policy. In Bernanke's opinion (2008, pp. 3-6), monetary policy must not be used aggressively in order to burst a speculative bubble. Referring to this subject a series of questions may be formulated, respectively to what extent the monetary policy can identify the speculative bubble and whether monetary policy is the best mean of deflating the speculative bubble.

Ideally, a speculative bubble may be managed through the moderate adjustment of interest rate. Even if the speculative bubbles are identified, they cannot be influenced in a predictable manner by monetary policy. Each strategy of reducing the speculative bubble induces a series of substantial costs due to short-term deviation of macroeconomic objectives of monetary policy, as well as due to political complications or moral hazard problems.

3. The reaction of central banks in banking crises generated by the mortgage

The frequency of banking crisis generated by variations of mortgage markets in the last 25 years (beginning with the crisis in the northern countries and ending with the recent crisis in the US) justifies the interrogation regarding the way central banks intervene.

The involvement of central banks in the management of banking crisis is done through the fulfillment of the role of final lender. From this point of view there were questions related to the reason of the financial support that is granted by the central bank to the financial institutions and especially to banks, the non-financial entities being excluded. To this question the answer can be formulated depending on the distinction

between the two traditional characteristics of banks, respectively the vulnerability to losing confidence and externalities associated with the bankruptcy of banks (Hoggarth, Soussa, 2000, pp. 166-174).

The vulnerability of banks comes from their lack of liquidities, which in case of powerful crisis affects the entire banking system.

Bankruptcy of an increased number of banks or just of some important banks may influence the economic policy and especially the payment system. Such externalities imply or suggest that the bank's bankruptcy, generated either by liquidity problems or by non-fulfillment of solvency can sometimes justify the intervention of public authorities, the involvement of the central bank not being necessary. But every involvement is justified only if other solutions are not possible and if the benefits of financial stability exceed the involved costs, respectively the increase of moral hazard risk. In these conditions, the management of bank crisis implies a certain preoccupation for preventing them which is possible through: ensure or guarantee deposits, through regulation and surveillance. Such taken measures can reduce the systematic risk which generates banking crisis but cannot eliminate it completely.

Considering this, for some public authorities, the avoiding of banking bankruptcies is possible through the development of the private sector, supplier of important liquidities, case in which central banks fulfill the role of middlemen, trying to convince the individual banks of the potential of the ones that seem less solvable. In such a case, the private sector subsidies the bankrupted banks and brings back the market discipline. The coordination of banks' actions, through the private sector, brings on a series of difficulties due to the short-term competitive advantage of banks with surplus of liquidities during the crisis. In such circumstances, moral persuasion and the regulations of public authorities are necessary in order to establish a cooperation attitude between competitive banks.

The experiences of the last two centuries prove that, when the financial institutions are insolvent, authorities try to organize the private capital sector. In countries where competition of the financial system has certain degrees of limitation, semi-private institutions were established with the aim of solving liquidity issues of small banks. It is the case of Germany, where in the 70's LikoBank was created, considered by Bundesbank as a penultimate lender. When the organizing of liquidity issues and organizing of private sector is not possible through individual banks, the requirement of liquidities must be approached at the level of the entire banking system and through the intervention of the central bank, as a last rank lender.

Another problem regarding the role of last rank lender of the central bank is that of the interest rate to which it grants loans, respectively at a penalty rate of interest. Such a practice generates a series of effects, of which we keep in mind:

- aggravating the state of crisis of banks which cannot reimburse the loans granted at a higher rate of interest;
- supplies signals on the market, which favors an inadequate evolution of activity and offers managers the possibility of taking enhanced risks.

The basic idea, which must come out of such a situation, is that the central banks, together or separate from other surveillance of banking systems institutions, impose conditions in fulfillment of the role of last rank lender, of which penalizing interest rates, which limits their ability to engage in a multitude of activities.

Besides this aspect, it is important that central banks inform of the enforced politics before the manifestation of banking crisis, the role of these advance notifications being that of reducing the uncertainty and moral hazard. More concrete, the announcements coming from central banks are necessary for banks with solvency issues to know if they are going to be backed up or not. The aspect is of high importance, which results from the elements that are found in the Report of countries in the Group of 10 (1998), where it is mentioned that in actions of backing up financial institutions it is necessary to state how, when and under what circumstances the help can be granted. The aim of such a transparency is to eliminate ambiguity from the interventions of the central bank (Hunter, 2008, pp. 5-7).

As a conclusion to the issue of central bank intervention in bank crisis management the following statements can be made:

- The involvement of central banks in the solving of banking crisis is based on the vulnerability of banks to the liquidity crisis and on the impact which banking bankruptcy has on the entire financial system and on the economy.
- As the distinction between the lack of liquidity and insolvency is not clear in practical activity, the central bank is involved indirectly through facilities granted to the private sector or directly including the ensuring of deposits as well as the surveillance of the banking system;
- Solving banking bankruptcies brings about official costs, materialized into provisions constituted for covering capital risk or losses produced by granting liquidities to banks which can become insolvent. This is the reason why the aim of each intervention by the central bank, the terms and conditions in which these are performed must be limited only to the situations through which the maintain of the financial system's stability is ensured.

The multitude of approaches found in the specialty literature, regarding this subject, can be illustrated and completed with the measures adopted by central banks in 2007-2008, with the aim of ensuring financial stability of which: reducing monetary policy rates and supplying liquidity to the banking system. Exemplified by the measures adopted in several countries affected by the crisis.

The interventions of US Central Bank – in the context of the crisis were implemented in august 2007, in the day when BNP Paribas registered considerable losses from three of its funds, which owned assets in the form of secured subprime titles. As a direct and immediate consequence, European Central Bank responded immediately with short-term liquidity injections totaling 94,8 billion $ being the most important operation of the kind in the last 9 years. In the same day, FED increased the level of open-market operations, measure followed by a series of

other interventions, which can be synthesized in the following way (for the period august 2007-march 2008).

- 5 modifications of the *federal funds rate target* totaling 225 basis points, respectively 2,25 %;
- Creating and modifying the mechanism "*Term Auction Facility"* (TAF) as well as a "swap" line with European Central Bank (ECB) and National Bank of Switzerland (totaling 36 billion USD);
- Modifications in the program of the program of "lending securities" and initiating the one called *"Term Securities Lending Facility"* (TSLF);
- Extending the crediting towards primary dealers by creating the facility *"Primary Dealer Credit Facility"* (PDCF).

Falling housing prices has resulted in 2007, in the US, an unprecedented situation and the quality of mortgages knew a powerful depreciation. On the 9th of August 2007, the American financial system started to crash. Losses incurred by banks were due to owning important secured mortgage titles. In this context, the traditional instruments based on interest rates proved ineffective, reason for which the FED had to try a variety of new intervention ways. Thus, beginning with 2007, FED modified the way it granted credits to commercial banks trough the creation of facilities "The Term Auction Facility" and by granting direct loans to investment banks. It also made dollar/euro swap transactions with ECB and dollar/Swiss franc with the Bank of Switzerland. The extraordinary loans granted to investment banks completed the intervention measures of the FED, which totaled over 500 billion USD.

In table 2 there are some directions of actions of central banks in a series of countries. In comparison with these, the measures adopted by National Bank of Romania beginning with August 2008 have contrasted with the ones adopted by large central banks. In the first place, in August 2008, The National Bank of Romania published *The New Crediting Regulation for the population,* through which banks were coherced to establish way the maximum degree of debt, differentiated on clientele categories and credit destination. The general effect was that of diminishing credit sizes, in an ampler context of lack of liquidities in the banking system. In October, commercial banks borrowed from National Bank of Romania through "credit facilites- the lombard" credit the sum of 49 Billion RON (the equivalent of 13 Billion EUR) 28 times more than the total sum borrowed in the 1st of January – 1st of September 2008 period. Also, the liquidity crisis has been highlighted through the reduced volume of deposits constituted by banks at NBR, in average 5 times less than in previous months (570 million EUR in October 2008). The injections of liquidites done by NBR have consisted of permanent facilities, repo operations and sway type bilateral transactions.

Measures adopted by central banks in the view of ensuring stability in the context of the crisis

Table 2

Central Bank	Concrete actions
Federal Reserve Fund (FRF)	• Purchased bonds worth of 600 billion USD, issued and guaranteed by mortgage credit institutions • Granted a support of 200 billion USD for consumption credits and loans for small enterprises • Purchased bonds worth of 100 billion USD issued by Fannie Mae and Freddie Mae and other 500 billion, value of bonds guaranteed by the same institutions • Supported with 200 billion USD the crediting of students, credit cards and auto market • Starting with January 2008 till the end of the year, has succesively reduced refference interest rate which was reduced from 3,25% to 0,25% - in December, with the tendency towards 0,11% - in January 2009 (at a rate of 0% of interest Central Bank cannot inject money into the economy through banks)
Bank of England	• Reduced the monetary policy interest rate to 2%
Bundesbank	• Did not reduce interest rate • Adopted a plan of sustaining financial system worth of 400 billion EUR
Bank of New Zealand	• Reduced the reference interest rate to 5% (the lowest level in the last 5 years)
Bank of China	• Performed the most significant reduction of interest rate in the last 10 years (for 1 year loans, the interest rate became 5,58%, and for deposits 2,52%)
Bank of Japan	• Reduced interest rate from 0,5% to 0,3% • Accepted as guarantees bonds issued by BBB rated companies
BNR	• Maintained throughout 2008 the interest rate at 10,25% level, in the context of a profound liquidity crisis • In February 2009 has reduced the monetary policy interest rate level from 10,25% to 10

Contemplating on these events and interventions lead inevitably to the interrogation regarding the revision of monetary policy objectives of central banks and the direct ways of acting. If until recent years the discussions were dominated by the role of last rank lender of the Central Bank, the risks taken by this institution or the separation of this role with the Treasury, these interrogations are not valid anymore. In the context of the financial crisis, the Central Bank represents the sole official organism which can act fast enough through effective interventions and the monetary policy may exert considerable influences on the mortgage market and price of real assets.

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Some Aspects Regarding the Analysis of the Life Insurance Market

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Abstract. *This paper aims to draw-up an analysis of the life insurance market in Romania. This survey is drawn up for the period 2003-2006 and the data used for this analysis were taken over from the Annual Reports published by the Insurance Supervision Commission. Life insurance market in Romania is a steady growing market as a result of the economic growth and the purchase power but is still far away from the development stage of the European markets.*

Key words: insurance market; gross written premium; mathematic reserves; inflation rate; insured value.

JEL Codes: G22, G23.
REL Codes: 7J, 11C.

To start with, we shall proceed to an overall presentation of the situation to be faced at the level of the life insurance market. To this purpose it is compulsory to underline the absolute volume of the subscribed gross premiums, both in nominal terms and real terms, as well as the evolution of these indicators over the analyzed period.

Subscribed gross premiums evolution (2003-2006)

Table 1

Indicator/year	2003	2004	2005	2006
Total subscribed gross premiums (nominal)	619,932,113	746,025,160	1,037,995,713	1,138,281,900
Inflation rate	14.10%	9.30%	8.60%	4.87%
Total subscribed gross premiums (real)[1]	543,323,500	598,201,735	766,407,821	801,425,082
Absolute increase as against the previous year (nominal)	-	126,093,047	291,970,553	100,286,187
Absolute increase as against the previous year (real)	-	54,878,235	168,206,087	35,017,261
Relative increase as against the previous year (nominal)	-	20.34%	39.14%	9.66%
Relative increase as against the previous year (real)	-	10.10%	28.12%	4.57%

[1] Underlying year = the year 2002. [2] Available online at http://www.insse.ro.

Source: CSA Yearly Reports 2003 – 2006, Statistical Yearbooks of Romania[2] 2003–2006, self calculation. The amounts are expressed in RON.

As noticeble, the market followed up an up warding trend during the period 2003 – 2006, when the global volume of the subscribed gross premiums out of life insurances had almost doubled, from 619,932,113 RON to 1,138,281,900 RON (in nominal terms). If taking the year 2002 as the undelying year and eliminating the influences of the inflation over the considered four years period, we note that the market reached the volume of 801,425,082 RON in 2006, increasing from 543,323,499.56 RON in 2003. The following diagramme is showing a synthesis of the evolution of the Romanian life insurance market, as it is presenting the total volume of the subscribed gross premiums both in nominal and real terms:

In accordance with the values previously presented, the increase rates in nominal (real) terms counted for 20.34% (10,.\10%) in 2004 as against 2003, for 39.14% (28.12%) in 2005 as against 2004 and for 9.66% (4.57%) in 2006 as against 2005. The tramendous differences between the nominal rates and the real rates of increase are the consequence of the fact that during the analyzed period the inflation has reached high values within the first three years (14.10% in 2003, 9.30% in 2004 and 8.60% in 2005), while it has diminished below the treshold of 5% in 2006 only, when the recorded inflation rate counted for 4.87%. Bellow we are presenting the annual variations of the volume of subscribed gross premiums out of life insurance, both in nominal and real terms.

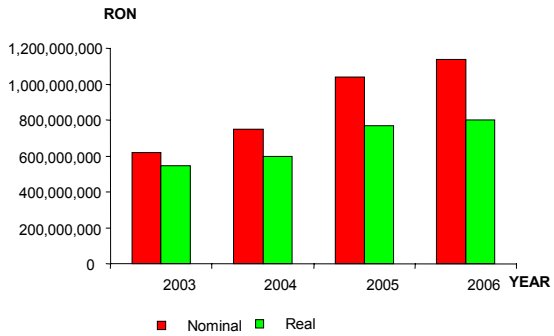

Figure 1. *The subscribed gross premiums from life insurance, during the period 2003–2006*

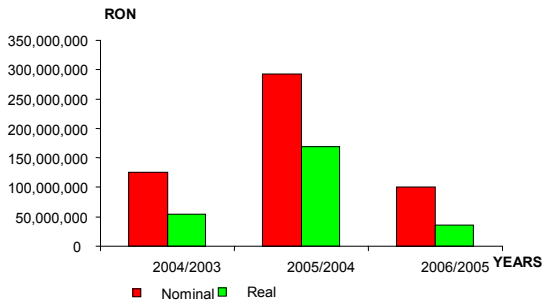

Figure 2. *Annual increases of the market during the period 2003–2006*

Is is also of interest to analyse the weight held by the life insurance in the frame of the total insurance market from Romania. Contrary to the European countries taking the advantage of a real tradition in the field of insurances, where the financial culture of the extended public is exceeding the average level, the life insurances are playing a small part in the Romanians' life, from the point of view of their importance. In our country, the main concern of those applying to insurance products goes to the protection of the goods the respective individuals are holding. Thus, during the period 2003 – 2006, the life insurances have counted for about 20 – 23% in the total of the insurances market, while the real dynamics of the life insurance market was, generally speaking, inferior to the real dynamics of the general insurances market. The only one exception is given by the year 2005, in fact a year during which the life insurance market recorded the most significant increase in the context of the analyzed period.

Insurance market evolution in Romania during 2003-2006 period

Table 2

Indicator/year	2003	2004	2005	2006
Total subscribed gross premiums out of life insurances (nominal)	619,932,113	746,025,160	1,037,995,713	1,138,281,900
Total subscribed gross premiums out of general insurances (nominal)	2,021,742,747	2,697,574,672	3,379,170,106	4,591,002,641
Weight of life insurance within total market	23.47%	21.66%	23.50%	19.87%
Weight of general insurance within total market	76.53%	78.34%	76.50%	80.13%
Relative increase as against the previous year (nominal) – life insurance	-	10.10%	28.12%	4.57%
Relative increase as against the previous year (nominal) – general insurance	-	22.08%	15.35%	29.55%

Source: CSA Yearly Reports 2003–2006, self calculation. The amounts are expressed in RON.

As shown by the table, for the year 2003 the structure of the Romanian insurance market counted for 23.47% life insurance and 76.53% general insurance. Comparatively with the year 2003, in 2004 the weight of life insurance within the total market decreased by 1.81 percentage points, becoming 21.66%. Meantime, the weight of the general insurance increased up to 78.34%. The year 2005 marked a slight increase of the life insurance market within the total insurance market, this weight reaching now the level of 23.50% (an increase of 1.84 percentage points as against the year 2004) coming back, in fact, to the value of the year 2003. Accordingly, the weight of the general insurance within the total market diminished to 76.50%. As for the year 2006, the weight of the life insurance within the total market marked the most dramatic decrease of the overall of the analyzed period: the life insurance market reached a level of 19.87% of the insurance market (decreasing by 3.63 percentage points as against the year 2005). Meantime, the weight of the general insurance increased, exceeding, for the first time within the interval 2003 – 2006, the barier of 80% of the total of Romanian insurance market.

In order to achieve a pertinent description of the market it is necessary to study also the ration between the global

volume of the subscribed gross premiums and the gross domestic product (GDP). This ratio, known as the penetration degree of life insurance[1], is emphasizing the contribution of the life insurance sector to the forming of the gross domestic product. As shown by the following table, over the four years, the volume of the subscribed gross premiums out of life insurance counted for between 0.30% and 0.36% of the GDP, a very low value if comparing it with those recorded at the level of many countries of the European Union[2]. The penetration degree of the life insurance reached the maximum value of 0.36% in the year 2005, increasing by 0.06 p.p. as against the year 2004 and by 0.05 p.p. as against the year 2003, while in 2006 it diminished (comparatively with the year 2005), reaching the value of 0.33%. Meanwhile, the penetration degree of the general insurance was higher, reaching values between 1.41% and 1.67% for the analyzed period.

Subscribed gross premiums volume (2003-2006)

Table 3

Indicator/year	2003	2004	2005	2006
Total subscribed gross premiums out of life insurances (nominal)	619,932,113	746,025,160	1,037,995,713	1,138,281,900
Nominal GDP	197,564,800,000	246,468,800,000	288,047,800,000	342,480,000,000
Penetration degree of the life insurance	0.31%	0.30%	0.36%	0.33%
Penetration degree of the general insurance	1.41%	1.46%	1.54%	1.67%

Source: CSA Yearly Reports 2003 – 2006, Statistical Yearbooks of Romania 2003–2006, self calculation. The amounts are expressed in RON.

As regards the ratio between the economic growth and the dynamics of the life insurance market, it has to be pointed out that during the years 2004 (as against 2003) and 2006 (as against 2005) the life insurance market increased slower than the overall economy (the elasticity coefficients[3] of the total volume of subscribed gross premiums as againts the GDP counting for 0.82 ad, respectively, 0.51). In the year 2005, when the life insurance market recorded the most spectacular increase this ellasticity coefficient recorded a value of 2.2, which means that the dynamics of the life insurance market exceeded the general economic growth. The values of these elasticity coefficients are compatible with the outcomes being previously achieved for the indicator penetration degree of the life insurance.

Another indicator relevant for our analysis is given by the volume of the subscribed gross premiums out of life insurance, per capita. The size of this indicator, called life insurance density[4], is pointing out the concern of the potential life insurance consummers as to acquire such products. For comparison, we have included in the table the general insurance density as well. The outcomes are shown by the following table.

Subscribed gross premiums volume evolution (2003-2006)

Table 4

Indicator/year	2003	2004	2005	2006
Subscribed gross premiums out of life insurance per capita (nominal)	28.52	34.42	48.00	52.77
Subscribed gross premiums out of life insurance per capita (real)	25.00	27.60	35.44	37.15
Relative increase as against the previous year (nominal) – life insurance	-	20.69%	39.45%	9.94%
Relative increase as against the previous year (real) – life insurance	-	10.40%	28.41%	4.83%
Subscribed gross premiums out of general insurance per capita (nominal)	93.02	124.47	156.27	212.84
Subscribed gross premiums out of general insurance per capita (real)	81.53	99.80	115.38	149.85
Relative increase as against the previous year (nominal) – general insurance	-	33.80%	25.55%	36.20%
Relative increase as against the previous year (real) – general	-	22.41%	15.61%	29.88%

Source: CSA Yearly Reports 2003–2006, self calculation. The amounts are expressed in RON.

As it can be seen, the volume of the subscribed gross premiums per capita recorded an up warding evolution over the period 2003 – 2006, both as nominal and real terms. If considering the fact that life insurance density in nominal terms almost doubled during the four years (from 28.52 RON/inhabitant in 2003 to 52.77 RON/ inhabitant in 2006), the evolution in real terms was somehow "smoother" as a result of the attenuating effect of the inflation. Thus, the subscribed gross premiums out of life insurance, in the prices of the year 2002, from 25 RON in 2003 to 37.15 RON in 2006. Out of the previous table we can conclude also that the general insurance density is about 4 times higher that the life insurance density (which in fact is normal as the life insurance market is representing 20% only of the insurance market), while the dynamics of the general insurance density is superior to that of the life insurance (both nominal and real), excepting the year 2005. The following diagramme is pointing out the life insurance density and the general insurance density for our country, during the analyzed period:

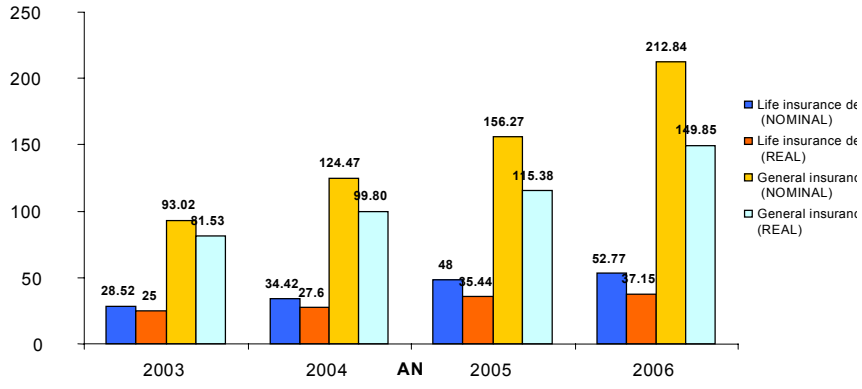

Figure 3. *Life insurance density and general insurance density during the period 2003–2006*

The relative annual variations of the life insurance density went from 20.69% in 2004 as against 2003, to 39.45% in 2005 as against 2004 and to 9.94% in 2006 as against 2005, in nominal terms and from 10.40% in 2004 as against 2003, to 8.41% in 2005 as

against 2004 and to, respectively, 4.83% in 2006 as against 2005, in real terms. The evolution (both in nominal and real terms) of the subscribed gross premiums out of life insurance per capita is shown by the diagramme bellow:

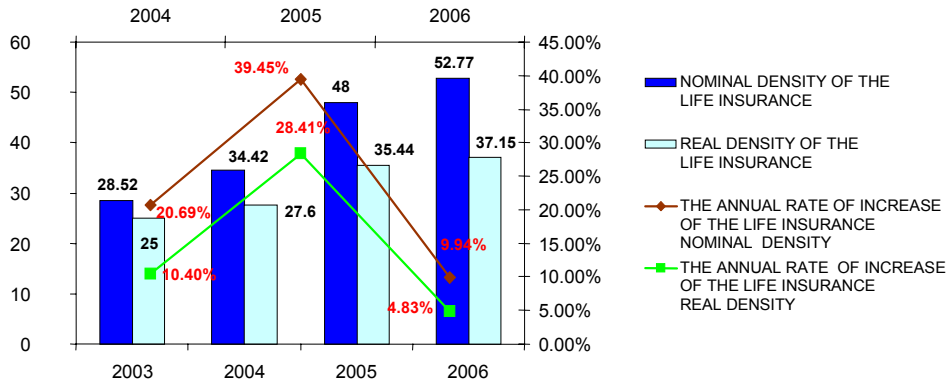

Figure 4. *Evolution of the density of life insurance during the period 2003–2006*

In Romania the life insurance market is recording an up warding trend, as pointed out by the annual rates of: 10.10% in 2004 as against 2003, 28.12% in 2005 as against 2004 and 4.57% in 2006 as against 2005 (in real terms). Thus, by the end of year 2006, the market counted for 1,138,281,900 RON, which means over 320 million EUR. The specialists are forecasting that the increasing tendencies will keep on maintaining over the next years as well.

The structure of the Romanian insurance market is the consequence of a poor purchasing power of the population as well as of the persistence of the lack of financial culture, the life insurance being considered as luxury products. The Romanians are applying for insurance products mainly for the protection of their belongings: consequently, within the total market the life insurance is holding a weight of about 20% only. If comparing with other European countries (not necessarily the developed ones), this percentage is a very small one.

The gross compensations paid for life insurance increased from 62,499,098 RON in 2003 to 140,824,708 RON (about 40 million EUR) in 2006, the relative yearly changes counting for 10.20% in 2004 as against 2003, 19.12% in 2005 as against 2004 and, respectively, 37.89% in 2006 as against 2005 (in real terms). The weight of the gross compensations paid in the frame of the total subscribed gross premiums increased from about 10% in 2003 to 12.37% in 2006.

The technical reserves of the companies are representing warranties for the safety of the insured persons and, consequently, they are holding a central position within the activity of life insurance. They amounted 2,238,411.928 RON (about 63,5 million EUR). The study of the reserves enlightens the fact that the mathematical reserves are the most important component of the technical (their weight increasing from 68.31% in 2003 to 77.30% in 2006). The other categories of technical reserves are

holding much lower weights: premiums reserves – 16.17% in 2006, reserves for benefits and returns – 5% in 2006, while the damages reserves (both notified and not notified) and the reserves for un-expired risks are representing bellow 1% of the total technical reserves meant to life insurance.

As far as the re-insurance activity is concerned, the weight of the premiums being ceased to re-insurance, in the total subscribed gross premiums counted for 2.81% in 2003, 3.75% in 2004, 3.11% in 2005 and 2.47% in 2006, when the ceased premiums to re-insurance counted for 28,142,358 RON (a little bit less than 8 million EUR).

The Romanian life insurance market is a concentrated market where the first two companies held a cumulated market quota of over 50% during the interval 2003 – 2006, while the first five companies held a market cumulated quota up to even 80% in 2003, diminishing gradually to about 71% in he year 2006. The undeniable leader of the market kept on being, all over the entire period making subject of this analysis, ING ASIGURĂRI DE VIAȚĂ, which, in 2006, held a market quota of 38.29%. The following positions went to AIG LIFE (12.14%), ASIROM (7.73%), ALLIANZ ȚIRIAC (7.66%) and GRAWE (5.67%).

If considering the gross compensations paid, the first position has been held every year by the company ASIROM, which in 2006 paid compensations amounting 70,944,097 RON (over 20 mil. EUR).

The analysis led to the conclusion that, generally speaking, the technical reserves of the insurers have been directly correlated with the volume of the activity they are running. Thus, during the interval 2003 – 2006, the company ING ASIGURĂRI DE VIAȚĂ, the leader of the life insurance market in Romania, kept technical reserves amounting 46 – 48% of their cumulated volume at the level of the entire market. In 2006, the quantum of the technical reserves of ING ASIGURĂRI DE VIAȚĂ counted for 1,072,112,044 RON (about 304 million EUR). Other companies, which maintained significant reserves (in 2006) are AIG LIFE – 243,564,498 RON (69 million EUR) or ASIROM – 234,421,673 RON (66.5 million EUR).

From the point of view of the profitability of the life insurance activity, it is to be noted the fact that, over all the four years considered by the analysis, ING ASIGURĂRI DE VIAȚĂ kept on being the market leader as to the technical outcome of the life insurance activity. In the year 2006, this technical result consisted of a profit of 44,541,817 RON (about 12.6 million EUR), almost triple in comparison with the outcome recorded in the year 2003. ING has been followed by ASIBAN, AIG LIFE, AVIVA and BCR ASIGURĂRI DE VIAȚĂ, which recorded profits between 6 and 36 million RON.

Taking into consideration the above facts and conclusions, we do consider that there is a favorable ground for the further development of the life insurance market in Romania, which for the time being is placed faraway from other European markets.

However, in time, the increase of the population's purchasing power as well as the diminishing of the lack of financial culture at the general level of the public will definitely cut off the handicap as against the other market. At last but definitely not the

least, the gradual diminishing of the market concentration degree will generate the conditions for competition development, which will lead to increased concerns of the insurers as to supply competitive and diversified products, to the obvious benefit of the consumers of life insurance products.

Notes

(1) Available online at http://www.insse.ro.

(2) According to CSA.

(3) A comparison in this sence will be presented later.

(4) The elasticity coefficient of the total volume of subscribed gross premiums as against the GDP is determined as the ratio between annual modification of the subscribed gross premium and the annual GDP modification (in %).

(5) According to CSA.

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Dashboard Auditing of Activity-Based Costing (ABC)

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Abstract. *This article aims to define the dashboard auditing according to the specifics of Activity-Based Costing method (ABC). It describes the main objectives of dashboard auditing, the criteria that a dashboard auditor should meet and the step-by-step stages of the entire dashboard auditing process according to the Activity-Based Costing method (ABC).*

Key words: systematic/random dashboard auditing; auditor; auditing agreement letter/contract; statement letter; accomplishment letter.

JEL Codes: M41, M42.
REL Codes: 11E, 14I, 14J.

Can we perform the dashboard auditing of an enterprise? Is such an auditing necessary? In what follows, we will try to answer these questions, starting from the definition, objectives and successful factors of auditing.

The audit is defined by the standards of ISO 9000 of 2000 as: "*Independent methods, processes and documents that allow us to obtain auditing and assessment evidence in an objective manner in order to determine the degree to which auditing criteria are met*". From the facts presented above, we can easily infer that auditing does not represent a form of control, a check or a validation. The assessment is achieved by means of direct observation and judgment, accompanied by the necessary measurements, balance or analyses. The specific demands to be met are confirmed by tangible evidence(1).

We should make a clear-cut difference between the notions of *diagnosis* and *auditing*. Most economists do not clearly separate the spheres of these two notions. The auditing represents a methodical and formalized examination of a field (system, method, proceeding, etc.), as well as reference (pre-established instructions determined in accordance or non-accordance regarding the possible areas of improvement). Diagnosis represents the examination that follows a particular method applied by a consultant or an analyst to a certain field (enterprise, commercial policy, social policy, etc.), but without a reference acknowledged by a group of specialists. In other words, diagnosis represents a finding, a picture taken from a special perspective, analyzing strengths and weaknesses, proposing solutions.

To put it differently, we can try to define dashboard auditing as *a collection of methodical independent processes and documents that allow us to obtain auditing evidence in an objective manner in order to determine the degree to which dashboard auditing criteria are met.*

A dashboard auditing should consist of *random checks* of tangible justifying evidence and data included in the dashboard. Also, the dashboard auditing pre-supposes the general evaluation of significant information about piloting indicators.

The dashboard auditing process can be classified according to: objectives, reference domain, entity under control, auditing environment for which decisions are made.

The main objectives of dashboard auditing are:

- to prove the degree of accordance (or non-accordance(2)) of the established enterprise objectives, pursued by means of the main dashboard directions (strategic policy, commercial policy, strategic segments) considered by enterprise management;
- to determine the degree of dashboard efficiency, of fulfilling the informational objective, according to the objectives envisaged by the enterprise management;
- to provide information for the improvement of dashboard elaboration methods, as well as the accounting system according to the Activity-Based Costing method (ABC).

In order to ensure the correct implementation of the dashboard auditing process, we must take into account certain requirements that should better match the ones envisaged by the enterprise management. These are mostly related to:

- implementing dashboard auditing;
- emphasizing the directions of action through the dashboard auditing plan;
- appointing auditors (or other authorized experts) to carry out the dashboard auditing process;
- granting authority and independence to auditors so they can accomplish their tasks.

According to the manner of implementation, we distinguish between: *internal dashboard auditing* and *external dashboard auditing*. The internal dashboard auditing is carried out by inside enterprise auditors, whereas the external dashboard auditing is achieved by outside enterprise auditors (auditing firms). According to the degree of planning, we distinguish between: *systematic dashboard auditing* and *random dashboard auditing*. The systematic dashboard auditing is carried out regularly (at equal intervals), obeying all the requirements defined by the inside policies and enterprise strategies, covering all areas of the dashboard process. This type of auditing is performed in view of a systematic analysis of dashboard, for its continuous improvement. The random dashboard auditing is carried out at unequal intervals, in order to check the correct application of corrective[3] and preventive[4] actions, as a result of removing certain dashboards or if some important changes have occurred in their construction. It can be started out before, during or after the implementation of an activity, product, etc. This type of auditing allows for a quick detection of the consequence which a certain event could generate, triggered by the enterprise dashboards.

To ensure the effectiveness of the dashboard auditing process, we need an auditing team, made up of auditors or other qualified persons.

What are the criteria that underlie the choice of dashboard auditors?

Generally speaking, the criteria are the same, established by the standards of the authorized institutions in the field. In other words, auditors should:

- have proven technical competence in the auditing domain (dashboard especially);
- have at least three years' experience in the field;
- demonstrate affinity with the other members of the auditing team;
- be available during the specified dashboard auditing period.

The responsibilities of dashboard auditors include mainly:

- participating into the election of other auditors (auditing team);
- preparing an auditing plan;
- presenting the auditing team with the entities that are to be audited;
- electing the persons in charge with the supervision of all auditing stages and the coordination of the other auditors;
- presenting the auditing report to the company representatives in an easy,

understandable form that will not give rise to misinterpretations or misunderstandings among the parties involved in the auditing process (department leaders, enterprise management).

The auditors must respect a methodology that includes work stages and investigation proceedings specific to each of these stages. One can thus distinguish the following stages:

- planning the dashboard auditing activity;
- selecting and restricting the objectives in the order of their importance;
- certifying the objective evidence related to the examination process;
- applying the proceedings specific to dashboard auditing;
- formalizing the procedures and notifying the findings made during dashboard auditing;
- highlighting deviations;
- establishing the legal liability (responsibility)[5] for any findings that represent deviations from legal standards or from the auditing mission references;
- taking the necessary measures to correct undesirable deviations;
- completing and drafting the dashboard auditing report;
- communicating the dashboard auditing report and using it in the process of making further decisions for the continuous improvement of the enterprise performances.

Given the fact that the notion of "*dashboard auditing*" is a relatively new concept in Romania, we can only bring up some theoretical clarifications regarding the manner in which the dashboard auditing questionnaires and the dashboard auditing plan should be set up. Any methodological specifications are to be made in further studies, more thoroughgoing, backed up by specialists in the field. This represents an objective of our further research that will focus on the development of this field and especially of the newly launched concept.

1. Accepting the dashboard auditing mission

At this point, the auditor must know if he is capable of starting and finishing the mission he is in charge with, namely the dashboard auditing according to the Activity-Based Costing method (ABC). Based on his own skills and professional motivations, the auditor decides to accomplish the dashboard auditing and he must consider the following aspects:

- if he meets the legal requirements to perform the dashboard auditing;
- if he has the required competence to reach the dashboard auditing objectives, the necessary resources, an auditing team specialized in dashboard auditing and enough time to perform and finish the auditing mission.

In order to prevent the occurrence of any misunderstandings or unpleasant events, the customer and the auditor can enter two forms of legal agreement, previous to the beginning of the dashboard auditing process:

1. *Auditing agreement letter* (AAL). In this letter, the objectives, expectations and

responsibilities of the auditor towards the customer are described, as well as the form of the final report.

2. *Auditing agreement contract* (AAC). If a contract is to be closed between customer and auditor, it will stipulate the rights and obligations of the parties, the activity to be performed, the relevant costs, the duration of the auditing process and the type of documents to be examined, namely submitted to the dashboard auditing process.

2. Directing and planning the dashboard auditing activity

At this stage, the chief of auditing team (the person in charge) must clearly delimit the duration of examination within the auditing process, must make sure that the organization systems of the enterprise are compatible with the proceedings that are to be applied by the auditing team. Strictly speaking, the following aspects must be considered:

1. to identify the risks relevant for the enterprise under auditing, through general knowledge of the enterprise. General knowledge of the enterprise means that the auditor should know its activities well enough to allow him to understand the auditing process. Once understood and assessed adequately, they can have a significant impact on the dashboard auditing report.

2. to identify the significant activities and processes that represent the dashboard auditing source, based on the data that structure the piloting indicators. By collecting this information, the auditor tries to identify the analysis risks that he needs to focus upon.

3. to prepare the calendar of the auditing process and apply it. Its purpose is to accommodate the objectives, proceedings and areas of highest importance, in order to prepare the auditing report and formulate the general conclusions of the dashboard auditing process.

Among the techniques used to collect the necessary information for dashboard auditing, we can enumerate: dialogue and interview (based on questionnaires), internal documentation analysis (activity identification records, piloting indicators copybook).

The identification of the highest importance areas starts from the premise of general knowledge of the enterprise. In fact, the auditor and his auditing team focus their efforts on examining only the significant information that corresponds to the objectives of the auditing plan and his opinions, namely that information related to the reference documents, necessary documents for the services involved in the respective auditing process (department), people in charge with preparing the dashboards according to the Activity-Based Costing method (ABC).

The significance limit represents the point that reflects the concentration degree of importance of the examined data. It allows, on the one hand, focusing the activity on the significant elements and figures that go beyond the significance limit, and, on the other hand, to avoid useless efforts, errors and figures that go below the significance limit.

There is the risk of the auditing team missing significant errors, due to a wrong choice of information examination procedures and this is a fact directly linked to the auditors' work.

3. Dashboard examination

The auditing team must apply documentary control proceedings, chronological and systematic classification of the reference documents and control of the people in charge with preparing the dashboards. The chief and the auditing team establish the representative samples and proceed to random checking. The random checking procedure is conclusive inasmuch as the number of the examined documents is large enough.

Among the analysis techniques, we can enumerate: calculation of piloting indicators, estimation, comparison, fluctuations and tendencies or, as case may be, regrouping data to check the coherence between:

- figures (data) from the activity identification records and indicators notebook;
- allocation costs necessary to determine indicators and cost drivers used;
- criteria which the cost drivers must meet.

Dashboard auditing questionnaire – which we may call *dashboard auditing support* – will allow the concentration of all aspects connected with dashboards: maintenance, development, formalization and standardization of conversations connected to dashboards. This questionnaire can be developed and adapted according to the audited domain (objectively orientated dashboard, area oriented dashboard, strategic segment dashboard, etc.), but it can never replace the auditor's work. Its purpose consists in using documents, finding deviations and thus pointing to the successful direction of auditing, the credibility of the instrument and the auditor's credibility as a specialist. The adjustment of the questionnaire can be done according to the demands applied to the activities under auditing or to the degree of knowledge and experience in the auditing domain (certificate, competence certificate, previous experience, etc.).

4. Organizing work and closing the dashboard auditing mission

During the dashboard auditing process, the auditors must cooperate with the people (department) in charge with dashboard preparation, safely measure up the documents under auditing, fulfill their established duties, communicate, clarify and meet the auditing demands, record the observations[6] and report the conclusions that they reach as a result of performing dashboard auditing.

Before formulating his opinion on the dashboards according to the Activity-Based Costing method (ABC), the auditor proceeds to the performance of activities that enable him to ensure the acquisition of all the necessary information.

The auditing team must strictly comply with deontology[7] and the deontological code. The deontological code requires an

auditor to respect his interlocutors, pay attention to both the form and the contents of an issue, to be rigorous in his observations, keep a positive attitude, pay attention to diversions, not to fuel internal conflicts, find the deviations, base his observations on facts, focus on the auditing objectives and grant the benefit of a doubt in the absence of evidence that shows otherwise.

5. Completing dashboard auditing; preparing and presenting the dashboard auditing report

The overall examination of dashboards aims at a systematical check of the consistency among the dashboard figures. These figures come from sources such as: activity identification records, activity list, cost drivers list, piloting indicators notebook.

The overall dashboard examination requires one to check whether the legal provisions and regulations have been obeyed, as well as the degree to which the disclosed information corresponds to the significance limit. The dashboard auditing process is completed with a revision of all the activities established by its objectives and a written declaration from the enterprise management, called *statement letter*.

Through the statement letter, the enterprise management recognizes their responsibility in approving the dashboards and certifying their authenticity. If there is no sufficient and adequate evidence, the auditor can get written declarations from the management on all the significant aspects emphasized in the dashboards. The written declarations given by the management cannot replace the evidence[8].

The dashboard auditor is entitled to request a statement letter in the following two situations:

1. The enterprise management provides the auditor with all the necessary documents for perfecting the auditing and those documents that have a significant impact on the dashboards.

2. The enterprise management has no knowledge of the irregularities committed by the management team members or department members involved in the dashboard elaboration process and which have a significant impact on the legal and objective preparation of dashboards according to the Activity-Based Costing method (ABC).

If an auditing agreement contract has been closed between the auditor and the enterprise management, the dashboard auditing process is finalized with an *accomplishment letter*. The legal dashboard auditing is closed by two reports:

1. The *general* dashboard auditing report;

2. The *modified* dashboard auditing report (if it is the case).

The general dashboard auditing report must ensure the certification of regularity and truthfulness of dashboards, according to the Activity-Based Costing method. The auditor certifies the dashboard auditing report by signature. This signature means that the auditor assumes full responsibility for accomplishing the auditing according to professional standards. The report includes two main parts: the first part, related to the auditor's opinion on the dashboard, and the

second part, related to the validation of the specific verification and to the legal information and regulations particular to dashboards according to the Activity-Based Costing method.

The opinion on dashboards can be expressed: with/without reservations or by certification refusal, respectively. The certification *without reservations* is expressed by the accomplishment without objections of the dashboard auditing according to the Activity-Based Costing method. The certification *with reservations* can occur as a result of either disagreement or limitation.

While checking the accounts and examining the dashboards of the Activity-Based Costing method (ABC), the auditor can discover deficiencies which need to be rectified. To this end, the auditor must address written reports to the enterprise management. These reports are called *modified reports*. As a result of being informed about the deficiencies, the enterprise management must take responsibility for their adequate correction. If the dashboard auditing team's recommendations are put into practice, this will result in an improvement of the enterprise performances.

Notes

(1) Tangible evidence – data that demonstrate the existence or authenticity of certain aspects.

(2) Non-accordance – unsatisfying some exigency.

(3) Corrective actions – actions undertaken in order to eliminate the causes of some non-accordance or as a result of detecting some undesirable situations.

(4) Preventive actions – actions undertaken in order to eliminate the causes of some *potential* non-accordance or as a result of detecting some undesirable situations.

(5) Responsibility can be: material, administrative, civil, commercial and criminal.

(6) Observations – findings of facts performed during the auditing process that provide tangible evidence.

(7) Deontology – department of ethics that studies the standards and obligations for a particular professional activity.

(8) Papers, registers and other record documents.

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Considerations on the Remuneration System of the Public Administration – an Analysis on Electoral Cycles and Scenarios Development

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Abstract. *The paper aims to identify trends in the characteristics of the number of employees and the average salary in public administration in the last two election cycles in the period 2000-2008 compared with other sectors and proposes a series of three scenarios for the evolution of salaries in public administration. Within the three scenarios we estimate a number of variables such as average salary in the public administration, the number of employees, the ratio between the number of employees in the public administration and other sectors, the ratio between the average salary in the public administration and other sectors. The results obtained from the analysis of the three scenarios allow us to formulate the hypotheses for the development of a new scenario: the average salary will increase each year by 15% and the number of employees will decrease each year by 9%. At the end of the paper we proposed a series of recommendations to define a new remuneration law for civil servants in the immediately following period.*

Key words: public administration; salaries; remuneration law for public administration.

JEL Codes: H83, C10.
REL Codes: 13G, 10A.

1. Study objectives

The study has as the starting point for analysis a series of data from the National Statistics Institute (INS), regarding the evolution of the number of employees and average salaries in various sectors. Data refer to the period between 2000 and 2008.

The study mainly aims to achieve two objectives. First one is to identify characteristics of the evolution of the number of employees and the average salary in public administration (PA), compared with other sectors such as industry, agriculture, construction, education and health. Second, using three scenarios we identified a number of possible developments in the PA, if a series of decisions are taken regarding the employment system and wage policy.

2. The evolution of the number of employees in public administration

Reform of the remuneration system of PA should also consider a new resizing of the number of employees in PA. In this respect it is recommended to make a review of the size of existing structures of PA. The statistical data used in the study highlights a series of features on the evolution of the number of employees in the PA at the last two election cycles:

- In September 2008, in the Public Administration and Defense (PAD) worked a total number of 214.1 thousand people. The increase compared with September of the last year was 1.1 thousand persons, this figure representing a relative growth of 5.5%. In the same period, the number of employees in the economy increased by 2%. The increase of the number of employees in administration and defense accounted for 12.2% of the total increase in the number of employees throughout the economy. In the same period, the number of employees in industry has decreased by 63.8 thousands (4.1%).
- Throughout the analyzed period, with the exception of 2001, the number of PAD employees increased each year. The major growth was recorded in 2007 (13.07% from the previous year) and 2005 (7.9%).

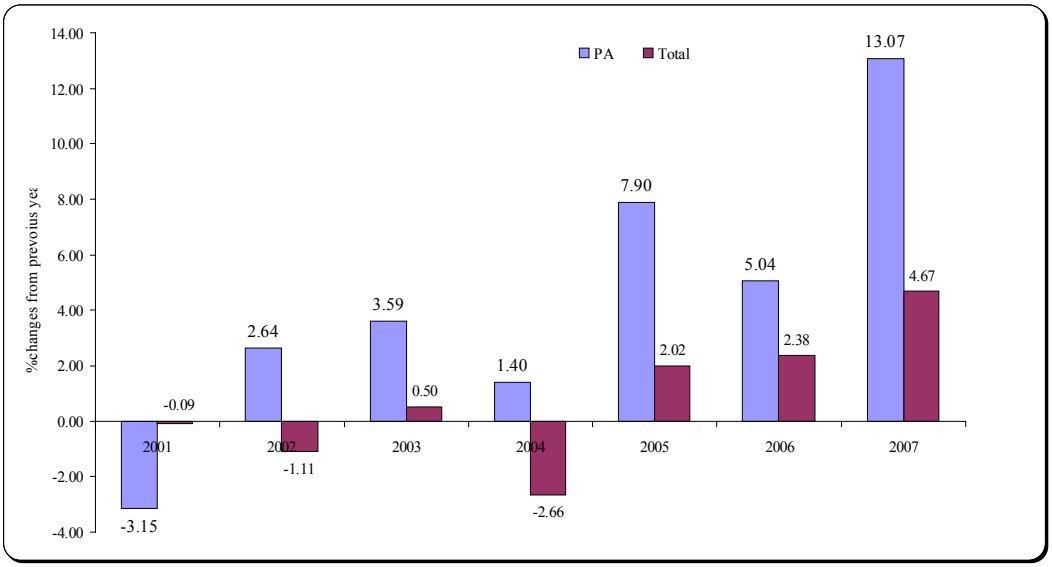

Figure 1. *Annual growth in the number of PAD employees and the total number of employees in the period 2000-2007*

▪ Throughout the analyzed period, 2000-2008, the increase was 33.8%.

▪ With the exception of 2001, during all other years the relative increase in PAD was greater than that of the number of employees in the total national economy. Over the analyzed period the total number of employees in the economy increased by 262,293, of which 20% are the new employees in PAD.

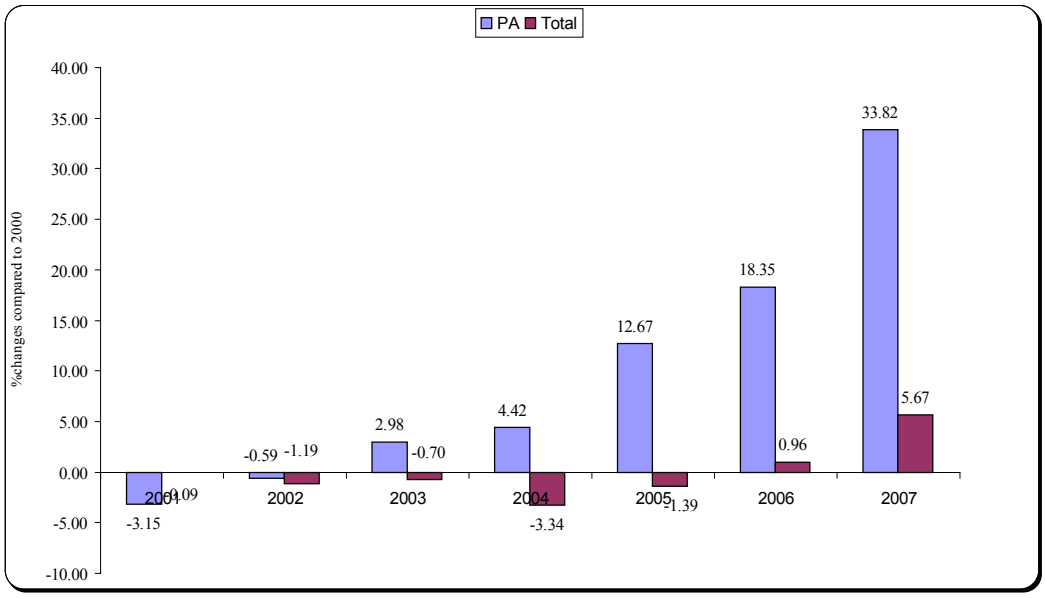

Figure 2. *The increase of the number of employees in the PA and in the total economy, in each year during 2001-2007, compared with 2000*

▪ The differences are significant during the two political cycles. Table 1 shows a series of comparative figures in those two periods for the evolution of the number of employees in the economy and the number of employees in the PAD. Based on the obtained results we make the following comments: (i) In both political cycles there was a significant decrease in the number of employees in industry and agriculture; (ii) In the second cycle, there was a more significant increase in the number of employees in constructions, trade and real estate activities; (iii) In the PAD the evolution was different in the two election cycles. If the first cycle, the increase was only 1% per year, in the second cycle, the average annual increase was almost 9%. During the last election cycle, the number of employees in PAD grew by almost 38.6%, resulting in a corresponding increase in salary costs; (iv) The share of employees in this sector out of the total number of employees increased by almost one percent over the past four years of governance, reaching 4.4%.

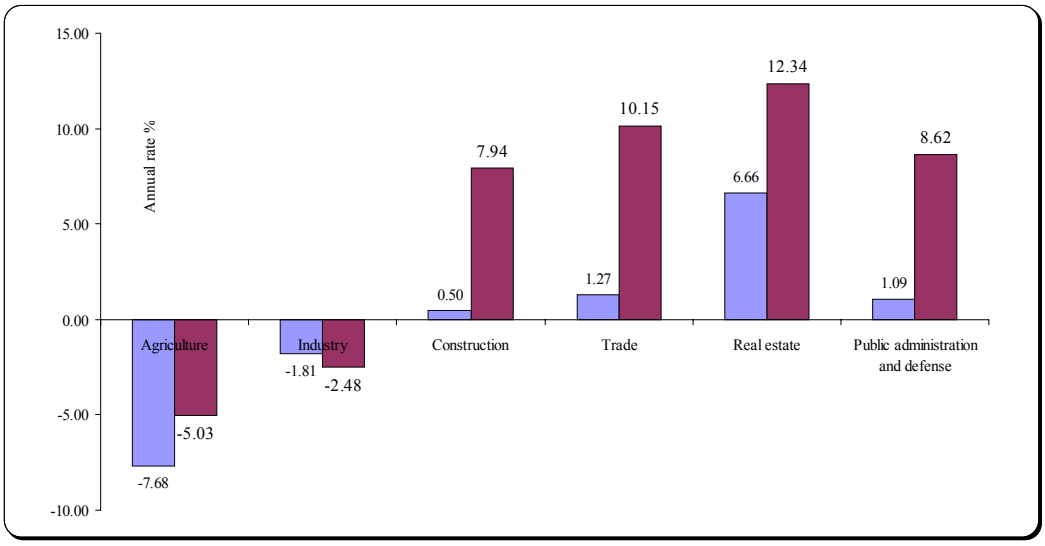

Figure 3. *Average annual number of employees on areas of activity during the two election cycles*

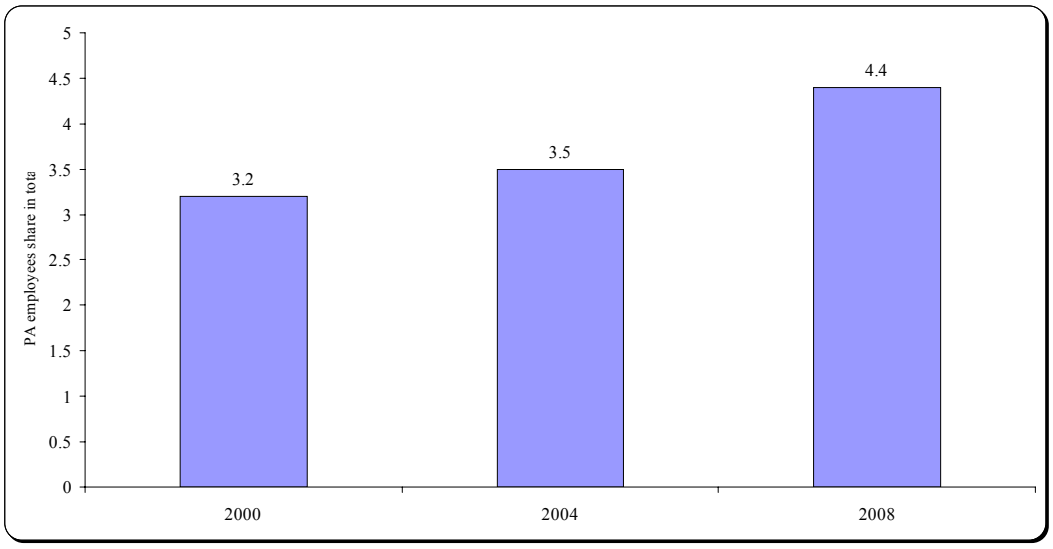

Figure 4. *Evolution of PA employees share in total number of employees during the period 2000-2008*

The elaboration of the new remuneration law must be preceded by a realistic and transparent analysis of the public administration and local authorities structures in the purpose to identify reserves of personnel at the system level. This will allow:

- A more flexible definition of the structures of the institutions of the central and local public administration;
- Identification of reserves to be used to provide salary increases for employees;
- The introduction of modern management in the civil service, based on performance and quality services.

Features on the changes in the number of personal during the electoral cycles

Table 1

	Total changes, absolute values (number of persons)						
	Total	Agriculture	Industry	Construction	Trade	Real estate	Public administration
2000-2004	-154,189	-40,045	-131,828	6,385	29,360	52,022	6,544
2004-2007	416,482	-15,267	-126,308	83,102	200,937	95,653	43,492
	Annual growth rate during both periods						
2000-2004	0.84	-7.68	-1.81	0.50	1.27	6.66	1.09
2004-2007	3.01	-5.03	-2.48	7.94	10.15	12.34	8.62

Source: own computations with data provided by INSSE, Bucharest, 2008

3. The evolution of salaries in the public administration

The statistical date reported by the INS allow us to analyze the trends over the time and to make comparisons between wages in this sector of activity and the other branches and sectors of national economy.

The evolution of the rate between the salaries in the PA and other sectors for the period 2000-2007

Table 2

	2000	2001	2002	2003	2004	2005	2006	2007
PA/Total	1.42	1.39	1.35	1.43	1.41	1.56	1.82	1.92
AP/AG	1.99	1.95	1.87	2.02	1.90	2.37	2.66	2.79
AP/IND	1.37	1.35	1.33	1.42	1.41	1.58	1.91	2.05
AP/EDU	1.49	1.46	1.35	1.45	1.30	1.40	1.48	1.70
AP/HLH	1.16	1.10	1.19	1.16	1.24	1.23	1.30	1.24

Source: own computations with data provided by INSSE, Bucharest, 2008.

Following the results in the Table 2 we make the following comments:

- The average salary in PA is higher than the average salary in the economy. Comparisons made with agriculture, industry, education and health emphasize the higher values of the salary in administration.
- The salary in PAD increased at a higher rate over the period, compared with those in sectors taken as a basis for comparison. We show in this sense the relationship for years 2000, 2004 and 2007 in the Figure 5.
- There were significant differences in salary policy during the two political cycles. If in the first cycle the ratio between the salary of the PAD and other sectors remained relatively constant, in the second cycle the growth in PAD salary was stimulated far more than in other sectors.
- Average salaries in PAD were greater than that of health and education. Moreover, during the past four years differences have increased in the favor of the PAD.
- Data from the first nine months of 2008 highlight a number of adjustments to the salary of PAD related with other sectors. Thus, the ratio between the salary of PAD and the average nominal salary at the national level decreased in the last nine months, reaching the value of 1.59.

Average salary and the rate between PA and the other sectors

Table 3

Activity sector	Nominal average salary (lei)	The rate PA - other sectors
Public administration and defence	2,066	1.00
The whole national economy	1,296	1.59
Agriculture	889	2.32
Industry	1,243	1.66
Education	1,385	1.49
Health	1,235	1.67

Source: own computations with data provided by INSSE, Bucharest, 2008.

▪ Average hourly salary in the public administration is greater than the national average, according to statistical data published by the INS Monthly Statistical Bulletin nr. 9/2008. The chart in Figure 5 shows rate between the values of this indicator from the PAD and other sectors of the national economy. Comparing with the national average, the cost in PA zone is over 60% higher. Hourly wage costs in the PA are 50% higher than those of education and 70% higher compared with those of health.

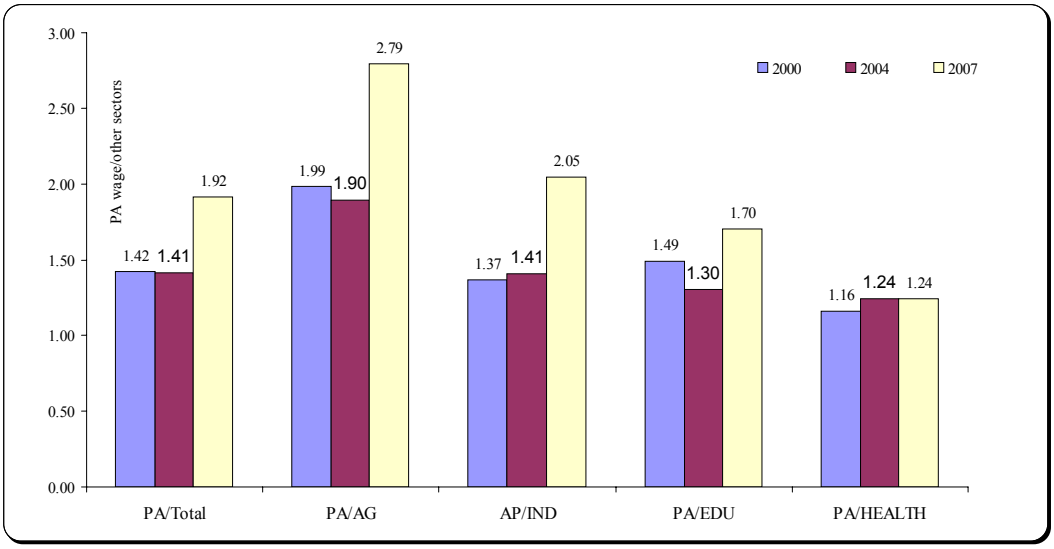

Figure 5. The *evolution of the average salary in PA and other sectors during the period 2000-2007*

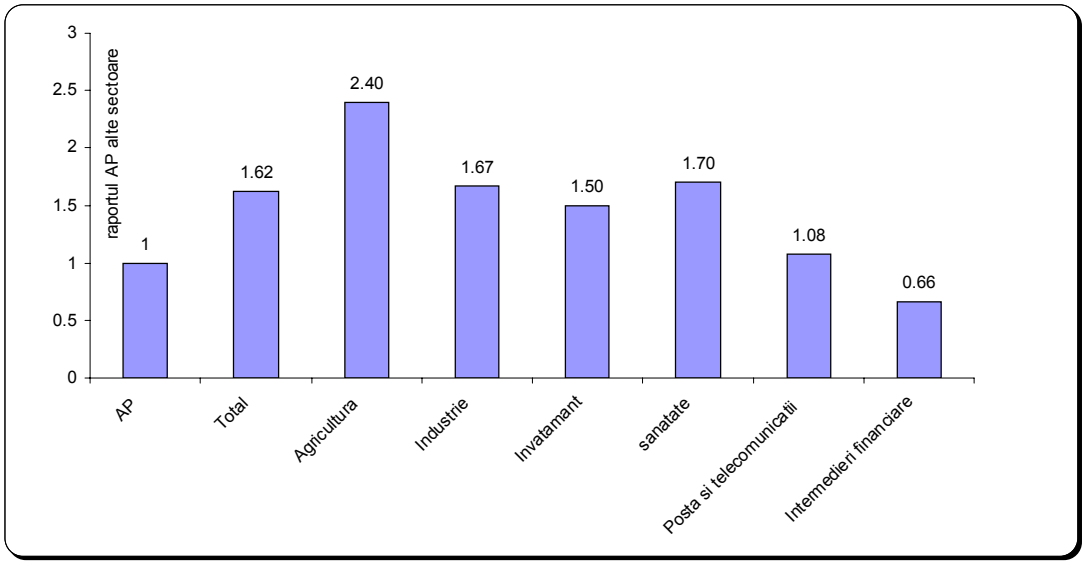

Figure 6. *The ratio of average hourly salaries in the PA and other sectors of the economy*

▪ Reforming the remuneration system of the public administration should also consider and evolution of the average salary in health and education.

The rate between the nominal average salary in the health system and the other activity sectors

Table 4

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total	0.83	0.87	0.84	0.85	0.87	0.91	0.95	0.91	0.95
Agriculture	1.99	1.95	1.87	2.02	1.90	2.37	2.66	2.79	2.32
Industry	0.79	0.84	0.83	0.85	0.87	0.92	1.00	0.97	0.99
Construction	0.95	1.00	0.98	0.97	0.99	1.08	1.16	1.08	1.12
Education	0.86	0.91	0.84	0.87	0.80	0.82	0.77	0.81	0.89
Administration	0.58	0.63	0.62	0.60	0.62	0.58	0.52	0.47	0.60

Source: Own computations based on the data in the Monthly Statistical Bulletin, 9/2008, INS, Bucharest.

Hourly average salary

Table 5

	Total	Agriculture	Industry	Construction	Education	Administration	Health
Average hourly salaries (lei/hour)	7.80	5.52	8.29	6.43	8.43	12.63	7.42
The rate health/ohter sectors	1.05	0.74	1.12	0.87	1.14	1.70	1.00

Source: Own computations based on the data in the Monthly Statistical Bulletin, 9/2008, INS, Bucharest.

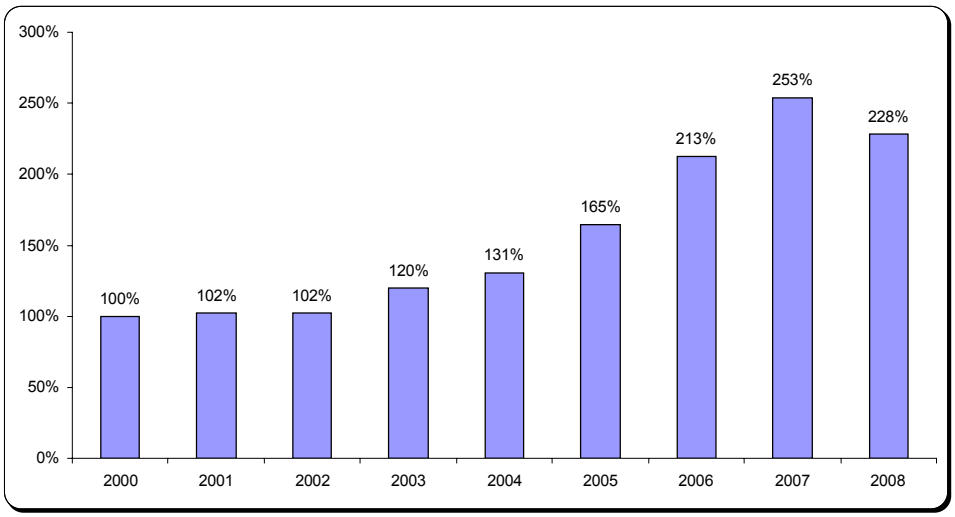

Figure 7. *The evolution of real salary in PA during each year compared with 2000*

Figure 7 highlights an increase in the average nominal wages in public administration in September 2008, compared with 2000 almost 2.3 times. Wage increases are different on the two election cycles:

- For the first period the increase was 6.9% per year;
- For the second period the increase was 15%.
- For the whole analyzed period, the average annual growth was 10.9%. For Social assistance (SAS) the value was 16.6%.
- Figure 8 shows the evolution of wages in parallel with the PA, Health and Social assistance (SAS). The gap has narrowed since 2008.

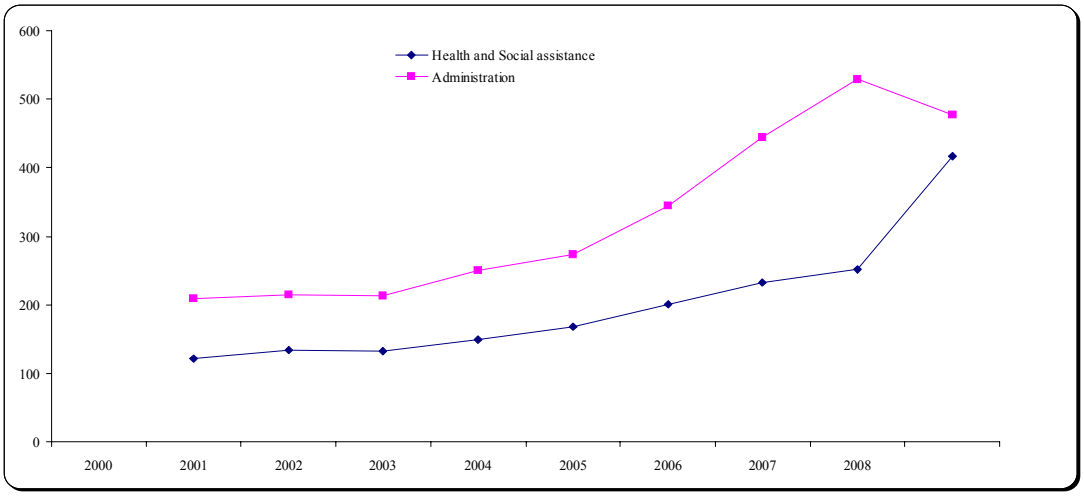

Figure 8. *Evolution of real wage (1999 prices) of the Public Administration, Health and Social assistance in 2000-2004*

4. Scenarios regarding the evolution of the remuneration system in the public administration

Rules and principles

Developing a new remuneration law will have to consider several issues:

- Define a remuneration strategy and law for the employees in the PA that take into account a set of principles that are accepted by the whole system.
- Linking the remuneration law in PA with a new remuneration system of all employees in the public sector.
- Redefining the functions of the state, from the perspective of reducing the bureaucracy and increasing the quality of the services that the state assumes.
- Linking the new remuneration law with other processes taking place in PA, such as continuing the process of decentralization, better formulation of public policies, the strategy of continuous training of civil servants, etc.
- Defining the new remuneration law must start out with critical analysis of the reform of civil service that was undertaken during 2004-2008. A special attention should be given to a critical analysis of some important documents that have supported the conduct of civil service reform in the last period. We regard in this respect: (i) The strategy for public administration reform. This document sets out explicitly the creation and implementation of a uniform system of salaries for public servants. In this document there have been explicitly specified the steps needed to implement a new philosophy of the remuneration system of the civil servants, (ii) The PAL Programme of the World Bank, (iii) Phare projects that were conducted to support the reform in the Reform Strategy of PA, on the component of the reform of the civil service.

General considerations regarding the proposed scenarios

In the definition of the scenarios on the salaries evolution in PA we start with the

formulation of the hypotheses. We propose in the following three scenarios. We present the assumptions that the scenarios are based on and the variables to be estimated.

I. Scenarios hypotheses

Variant 1

- The number of employees in PA increases every year with the average percent of the past four years.
- PA average wage increases by the same average annual rate from the past four years.
- The projected values are expressed in 2008 prices.
- To make the calculations we considered the average number of employees in the PAD published the Monthly Statistical Bulletin no. 9/2008.

Variant 2

- The number of employees in PA remains unchanged in time horizon analyzed, at the level of September 2008.
- PA average salary will increase by 50% at the beginning of the first year of the period for which scenario is developed.
- The projected values are expressed in 2008 prices.
- To make the calculations we considered the average number of employees in the PAD published the Monthly Statistical Bulletin no. 9/2008.

Variant 3

- The number of employees in the PA comes back to the number in 2004 following the optimization of the structures in the central and local public administration.
- PA average wage will increase by 10% every year.
- The projected values are expressed in 2008 prices.
- To make the calculations we considered the average number of employees in the PAD published the Monthly Statistical Bulletin no. 9/2008.

II. Estimated variables.

- Average salary in PA.
- The number of employees in PA.
- The rate between the number of employees in PA and other sectors.
- The rate between the average salary in PA and other sectors.

The development of the scenario in variant 1

To develop this scenario we start from the following:

- The number of employees in the PAD in September 2008 was equal to 214.1 thousand people;
- The average annual rate of increase in the number of employees in this sector over the past four years was 9%. If this growth rate is maintained over the next four years, then the number of employees in this sector will follow the data presented in Table 6 for the period 2009-2012.

Estimated number of employees in PA

(thousands of persons)

Table 6

Year	2009	2010	2011	2012
Estimated number of employees	233.4	254.4	277.3	302.2

This situation is completely ineffective for reforming the PA, at least because of the following reasons: (i) it will lead to an

increase in excessive bureaucracy and central and local public administration; (ii) the costs of salaries of employees creates a great pressure on public budget (iii) increasing the number of employees creates a major difficulty for the introduction of a new remuneration law for civil servants; (iv) The administrative capacity of ANFP and INA would not allow the proper employment and promotion of the public servants and proper continuous training of the civil servants.

- The average nominal wage increases each year with average growth over the past four years, so with 15%. In those circumstances we obtain the values in the Table 7 for the average nominal salary costs and total salary costs in the PAD. We considered an average exchange rate of 3.8 lei/euro.

Salaries' characteristics under scenario 1

Table 7

	2008	2009	2010	2011	2012
Average salary (lei-person)	1,662	19,11.3	2,198.0	2,528.0	2,907.0
Average salary (EU/person)	437.4	503.0	578.4	665.2	765.0
Salary costs (thousands lei)	4,270,010	5,353,169	6,710,039	8,411,155	10,541,395
Salary costs (thousands euro)	1,123,687	1,408,729	1,765,800	2,213,462	2,774,051

Source: Computations based on the assumed hypotheses.

Data from the Table 7 emphasize the following:

- The average nominal wage will record an increase by 328 Euro/person over the analyzed period;
- Total annual costs incurred by the PAD in the form of nominal wages will register an increase of 1,650,364 euros in 2012 compared with 2008. Relative growth is 146.9%.

Major risks that arise in this scenario are related to: (i) excessive growth of bureaucracy in the central public and local administration; (ii) pressure from the union to increase wages; (iii) increased unsatisfaction among the employees because the current law does not favors the competition and creates a series of gaps between different categories of employees; (iv) decrease the quality of services offered to citizens by the central and local public administration; (v) the major difficulties in implementing reform measures from the PA.

The development of the scenario in variant 2

To develop this scenario we start from the following:

- The number of employees in administration is not reduced, rather than through voluntary departures and retirement.
- The wages in this sector will increase by 50% at the beginning of the first year and over the next three is not granted other salary increases. Under these conditions, we obtained values from the Table 8 for the average nominal wage costs and total wage cost for PAD.

Salaries' characteristics under scenario 2

Table 8

	2008	2009	2010	2011	2012
Average salary (lei-person)	1,662	2,493	2,493	2,493	2,493
Average salary (EU/person)	437.4	656.1	656.1	656.1	656.1
Salary costs (thousands lei)	4,270,010.4	6,405,015.6	6,405,015.6	6,405,015.6	6,405,015.6
Salary costs (thousands euro)	1,123,686.9	1,685,530.4	1,685,530.4	1,685,530.4	1,685,530.4

Source: Computations based on the assumed hypotheses.

Results from the table 8 emphasize the following: (i) the average nominal salary will record an increase by 218.7 Euro/person for the analyzed period; (ii) the total annual costs incurred by the PAD in the form of nominal wages are in amount of 561.843 million Euro starting with the following year; (iii) In whole period under consideration the additional costs incurred by the PAD will 2247373895 thousand Euros.

The major risks of this situation are related mainly to the following: (i) creating a major pressure on the public budget because the amounts allocated to support the wage increase; (ii) the formulation of wage demands from other categories of employees such as higher education. Under this scenario, if the wage increase for the employees in health and education are much lower, it will be an increase in the disparities between the average salaries of PA and other public sectors; (iii) the increase in absolute terms of the gap between largest and smallest wages in the PA; (iv) maintaining an excessive bureaucracy in the public administration and reduced quality of services provided by it.

The development of the scenario in variant 3

To develop this scenario we start from the following:

- The number of employees in the PA and defense in September 2008 was equal to 214.1 thousand people;
- It will be a reduction in the number of employees in this sector by reducing it in the next four years so that in 2012 the number of civil servants will be at the same level as at the end of 2004. Under these conditions we foreseen a reduction in the number of employees each year by 9%.
- Starting from the above assumptions, the number of employees in this sector during the period 2009-2012 will be according to data presented in the Table 9.

Estimated number of employees in PA

(thousands of persons)

Table 9

Year	2009	2010	2011	2012
Estimated number of employees	194.8	177.3	161.3	146.8

- To estimate the other two variables we consider an increase of the average salary by 10% each year. Under these circumstances we obtained the results in the table 10 for the evolution of average wage and salary costs for the whole analyzed period.

Salaries' characteristics under scenario 3

Table 10

	2008	2009	2010	2011	2012
Average salary (lei-person)	1,662	1,828	2,011	2,212	2,433
Average salary (EU/person)	437.4	481.1	529.2	582.1	640.4
Salary costs (thousands lei)	4,270,010	4,273,600	4,278,646	4,281,783	4,286,562
Salary costs (thousands euro)	1,123,686.9	1,124,631.7	1,125,959.5	1,126,785.1	1,128,042.5

Source: Computations based on the assumed hypotheses.

The results from the Table 10 emphasize the following:

- The average nominal wage will record an increase by 203 Euro/person for the analyzed period;
- On the whole period under consideration the additional costs incurred by the PAD for salary increases will 17,422.240 thousand Euros.

This situation can be effective if we take into account the following aspects: (i) the increase of the ability of funds absorption recommended that the central and local public administration should have flexible structures, the employees should have a high degree of training and specialization and financial incentives should be an important element for the effective functioning of them; (ii) running diagnostic tests on the short term at the central and local public administration level to know the efficiency of public administration in the current structure; (iii) increasing the salaries of employees of PA, together with greater responsibility for the work performed; (iv) analyzing the possibility of outsourcing some activities of PA to the private sector; (v) greater harmonization between the civil service reform and decentralization process.

The major risks that arise in this scenario are related to the following: (i) the trade union resistance to maintain the current number of employees; (ii) increase the number of unemployed people in Romania and the costs of payment for unemployment compensation and collateral costs.

Comparative analysis of scenarios

Figures 9, 10 and 11 show the evolution of the important variables of the three analyzed scenarios: the number of employees, and the monthly average salary and the costs with salaries per year for PAD.

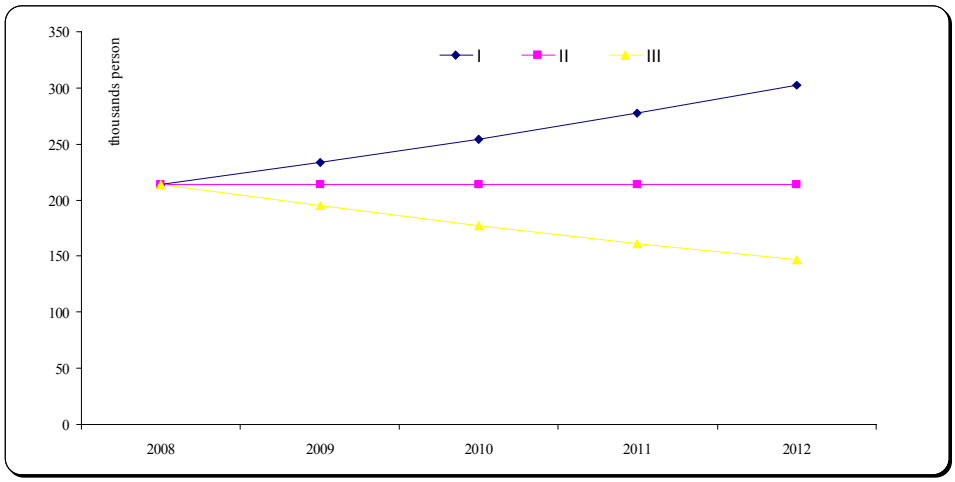

Figure 9. *The evolution of the number of employees in the PAD in 2008-2012 in the three scenarios*

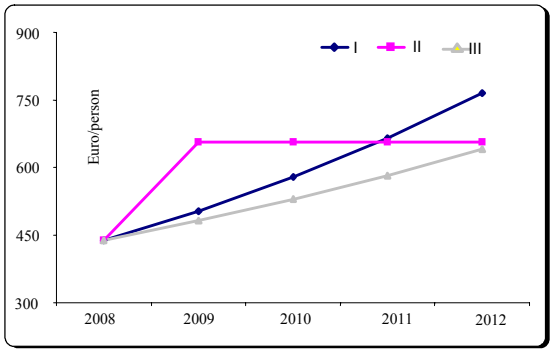

Figure 10. *The evolution of average salary per employee for 2008-2012 in the three scenarios*

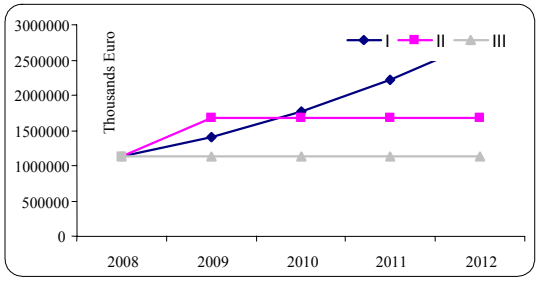

Figure 11. *The evolution of the total nominal annual salary for the period 2008-2012 in the three scenarios*

The results obtained above allow us to formulate the following preliminary comments:

- The current conditions in the economy and excessive bureaucracy in the public administration do not allow an increase in the number of employees according to the assumptions in scenario 1.
- In contrast, a wage increase for civil servants according with scenario 1 provides the highest salary in the year 2012. This is 17% higher compared with the situation in scenario 2 and by 19% compared to that of scenario 3.
- Wage costs in the year 2012 are the highest in scenario 1. They are 65% higher compared with scenario 2 and 145% higher than those of scenario 3. From this perspective, this scenario can not be accepted.

Based on the above assumptions we formulate the hypotheses for a new scenario: (1) the average wage will increase each year by 15%; (2) The number of employees decreases each year by 9%. In this reduction will include outputs from the system through retirement and possible firing of the staff.

5. Final comments and recomendations

Taking into account the results of studies that were conducted by various institutions of public administration, but also the approach taken in this study we formulate in the following a series of final conclusions and recommendations for defining a new remuneration law for civil servants in the period immediately following.

1. The macroeconomic approach to reforming the remuneration system in PA. In the approach taken to define a new remuneration law it should be considered the following:

i. Make a macro-level analysis to estimate the salary costs of the civil servants covered by the state today.

ii. Comparing salaries of civil servants with those of other employees in various public sectors, bearing in mind that large gap between salaries for employees in different sectors generates social convulsions.

iii. Critical analysis of the existing administrative structures of central and local public administrations in order to identify possible opportunities to reduce the number of employees.

iv. The analysis of the effectiveness of implementing the reform strategies in PA and Phare projects for 2004-2008.

2. A new approach to the relationship between fixed and variable salaries of the PA. It is recommendable a redefinition of wage benefits and increases, both in number, but also as a share in the wages of civil servants. In the study conducted by the *Hay Group* of the variable part of the salaries is grouped into five categories: (i) Allowances for function, which include benefit for audit and management, (ii) Allowances for activities/projects which consists of compensation for participation in competitions and commissions for settling disputes, compensation for participation in the disciplinary commission, allowance for preventive financial control, compensation for membership of the unit of project implementation, (iii) Allowances that depend on the activity nature, including compensation for activity in toxic or harmful environment, bonus for activity under special conditions, (iv) Allowances for performance that is the merit salary, increases and allowances, (v) Allowances granted for Ph.D. title, increases for age and loyalty/stability.

3. A series of increases that are now given has to be redefined so as to promote and to attract young people in the civil service. For example, within a few years it is recommended to eliminate the increase for age. This situation would create a financial reserve for the stimulation of certain competences at the civil service level.

4. The remuneration system to be proposed is recommended to be as simple as possible to ensure a salary transparency in public administration.

5. The salary of the PA is recommended to be correlated with the salaries of other public sectors such as education and health.

6. Discussing the draft remuneration law of the civil servants in a broader framework, including major players involved in this process.

7. Developing of the rules for implementing the new remuneration law, with it, such that its implementation to be transparent and to assess the consequences of implementation on economic and social level.

8. Creating an appropriate statistical tool at ANFP or INS (National Statistics Institute) to allow the collection of statistical data needed to carry out regular studies of the characteristics of the salary of civil service.

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Grounding the Marketing Strategy of the Organizations in the Field of Health Care

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Abstract. *The application of marketing in the health services presents certain particularities determined by market characteristics, of the organizations, products, staff and consumers. The consumers of health services are different of those of other goods and services, due to the lack of information concerning the means of rendering a service and its price, the means of taking a decision, the purchase and consume conduit, the capacity limited by the assessment of the services' and result quality. In addition, within the last years there have been registered major changes in the conduit of the consumer of health services pursuant to the significant modifications occurred at the demographic and social level.*

Under these conditions, the grounding of the strategies of the organizations which function in the health field, both at macroeconomic, and microeconomic level, cannot be performed without a deep knowledge of the consumer of health services, with its needs, preferences, and its conduit of purchase and consume.

Key words: patient; consumer; need of health services; demographic and social changes; image of health services.

JEL Codes: I11, M31.
REL Codes: 5C, 14G.

The marketing, during its wide evolution, begins with the investigation of the market and the knowledge of the consumer with its needs, wishes, and conduit of purchase and consume. Thus, the consumer represents the element of reference in the activity of any organization, this one couldn't exist without those who support its activity.

The consumers of health services differ from those of other goods and services, due to some particularities which result from the market specificity, the performer – client relations, the manner of organization of the health system. Unlike other fields, where, usually, the number of the consumers is limited, within the health services, anyone may become theoretically a consumer on a certain moment, and, therefore, the potential market is very large.

In spite of all these, the organizations in the field do not perceive the consumers as such. Traditionally, the individuals are not considered consumers of health services but when they get sick, although many of them resort to the periodical control or to routine analyses. This restricts the application of marketing in health (Rădulescu, 2008).

However, there are services of health to which one resorts not due to a disease condition, of treatment and prevention, but due to some aesthetic desires of the consumers (aesthetic surgery, skin care, programs of weight loss etc.), when the organizations focus on obtaining profit and resort to different marketing techniques to attract the consumers.

The main elements which differentiate the consumer of health services from other consumers are (Thomas, 2005):

- its incapacity to establish in most of the cases the need of services, the doctors deciding what is best for the consumer, what services it needs; the consumer may refuse the treatment, but usually this does not happen;
- due to the intervention of a paying third party, most of the time, the consumer does not have knowledge about the price, this not representing an element on which relies the service purchase. This situation generates positive aspects as well, which consist in delivering medical services independent of the payment capacity of the consumer, but negative aspects as well, since the end consumer or the doctors do not limit to the use of these services, the costs for the system being very high. On the other hand, only few suppliers of health services may use the price as a marketing instrument fighting with the competition (Laing and co., 2002);
- the consumer usually decides in terms of some subjective criteria, which involve a series of personal and social factors and not in terms of some objective criteria;
- the access to specialised medical services is made in terms of references and cross-references system, the petition and the consume not being influenced by the end consumer, but by doctors, thus the target of the marketing evolution is not always the end consumer, but the physicians from primary assistance;
- another differentiation factor consists in the lack of information considering the attributes of the service and its quality. There is no base in the assessment of the services' quality, the consumer following to differentiate the organizations or services on the grounds of the supplier reputation or superficial factors such as endowment with different machines, the amiability of the staff or the quality of the alimentation;

- the possibility to choose between several options is limited, many health services being non- replaceable, where as the number of specialists is limited;
- the limited capacity in the assessment of the result of the service, both due to the lack of information and to the high competition involved by some services;
- the consumer of health services unlike other consumers of goods and services face as well a series of factors of emotional order. Any analysis may disclose unexpected issues, any operation as simple as it may seem may have serious consequences;
- since the consume of certain health services involve hospitalization, the conduit of the consumer is strongly influenced by a series of specific factors (figure 1):

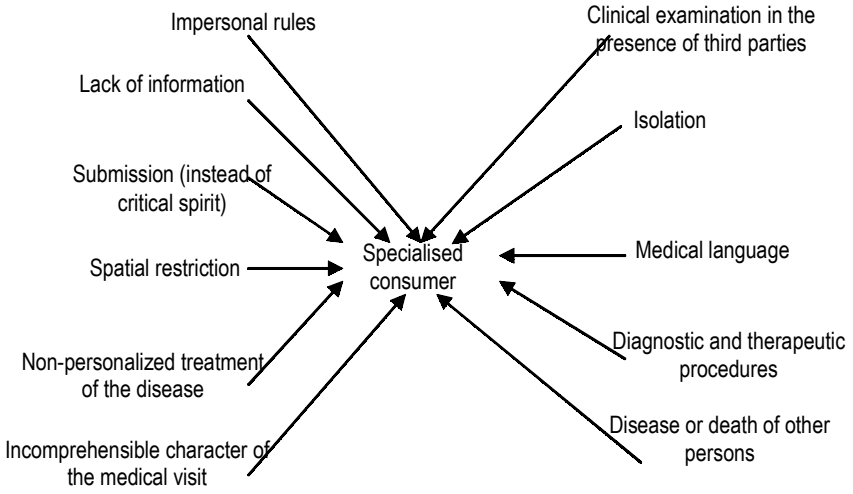

Figure 1. *Specific factors which influence the conduit of the hospitalized consumer*

Source: adaptation of Rădulescu, S. – Sociologia sănătății și a bolii, Editura Nemira, București, 2002, p. 268.

The differences between the consumers of health services and the other consumers are presented in synthesis in the following table:

Differences between the consumers of health services and the other consumers

Table 1

Characteristics	Consumer of health services	Consumer of other services
Awareness of the need	Seldom	Often
Involvement in taking the decision of purchase of the service	Seldom	Frequent
Manner of taking the decision	On subjective bases	Often on objective bases
Knowledge about price	Very little	Many
Taking decision in terms of price	Seldom	Frequent
Involvement of the paying third party	In great majority of the cases	Never
Use of the system of references and cross-references	Frequent	Almost never
Possibility to choose between several options	Limited	Unlimited
Knowledge about the attributes of the service	Less	Significant
Capacity to judge the quality of the service	Reduced	Raised
Capacity to assess the result	Limited	High
Target of the marketing evolution	Not always	Always
Application of the classical techniques of marketing	Seldom	Often

Source: Thomas, R., Marketing Health Services, 2005.

By the specific of the manner of performing a service and of the degree of involvement of the consumer at the level of the market of health services, there are distinguished several types of consumers. In general, when we speak about consumers we consider the individuals, but the organizations and the staff appear as well in this position, each of these categories possessing different needs and conduits.

Also, depending on the needs encountered at the level of the market, there are four categories of consumers:

- the first category is formed of the persons with serious problems who need specialised staff and equipments;
- the second category is formed of those who come to routine controls, the persons who come by themselves for treatment at the medical rooms;
- the third category is formed of those who need facultative services;
- a forth category is formed of the persons who do not resort to medical services, who most of the times cure themselves. The researches proved that their number is very high, and that, usually, they go to doctors if the first option did not give results. The chemist's shop offers a wide range of products for treatment at home, whereas the personal sources and the Internet facilitate this type of treatment.

Due to these reasons, Richard K. Thomas (2005) identifies several types of buyers and users of health services:

1. *the potential consumer* is any individual who may purchase a service; theoretically, in health anyone is a potential consumer;

2. *the buyer* is a person responsible with the purchase of health goods and services. as we have already mentioned, the consumer is not always the one who purchases the service, this role devolving upon the physician, the family or other persons;

3. *the patient* – although the term of patient is used often enough in the informal discussions, technically this stands for the „sick person who is under the care of a physician" (Cetină, 2005). Theoretically, an individual doesn't become a patient until a physician declares him sick, even if it has resorted previously to medicines or to cares on its own.

4. *the client* is an effective consumer, but who resorts more to the services offered by the primary assistance. This fact involves rather continuous and personal relations than impersonal and sporadic relations; a client is deemed to have mutual relations with the supplier of health services, unlike the patient who depends on and relies on the performer; the client is less dependent, more involved in the process of taking a decision and more informed with respect to its health problems than the patient. The term of client may be used especially in case of the relation between the consumer and the family physician.

5. *insured* – although the insurance companies were the first to use the term of insured for their consumers, this concept became more and more used by the suppliers of health services

In the opinion of Richard K. Thomas, in health appear, besides the individual consumers, other categories of consumers such as: medical staff, hospitals, other medical organizations, etc.

Although the physicians are rather regarded as suppliers of health services, they

may also appear as consumers for certain goods and services. Therefore, the hospitals demand the services of certain external specialists, different programmes of prevention involve their participation, the activity of many specialists depends on the references and cross-references of their colleagues. Also, the physicians, especially those from the individual medical rooms, grouped or associated, represent the consumers for the distributors of medical devices, and the enterprises manufacturing medicines.

The changes produced in the '80s in USA and in Europe, as well as in Romania after 1989 in the field of health services, were related to the passing from the payment mechanism based on the costs reimbursement to the mechanism of payment in advance (based on probability). Following the new systems of payment, the organizations were forced to consider the potential petition for services, the unitary cost for each service and the sensitivity to price of the buyer.

In addition, besides the change of the payment mechanism, the approach of the governments concerning the structure in the field of health determined a series of transformations concerning as well the number of tenderers on the market. The liberalization and privatization of the sector led to the increase of competition, since anyone with enough economic resources may enter on the market.

In addition, in the last decades there are noted significant changes at the level of population as well, on three plans - age, family and education, fact which needs a rethinking of the marketing strategies of the organizations in the field.

- *Age* – No tendency is more obvious than the extension of the life duration in all developed countries. In USA over 21% of the population were in 2005 over 65 years, and in the next 30 years it is estimated that this percentage shall increase, fact which shall determine higher costs assigned even than those for defence industry. The statistic data referring to the dimension of the population emphasizes also an increase of the life duration of the population in the states members of the European Union, as well as modifications in the structure of the population on age groups, especially through the increase of the number of old population (Adăscăliței, 2004).

The increase of the number of old consumers determines the development of some specific health services, such as the asylums, the care facilities on long term, the facilities for granting medical and life assistance etc.

The challenge for the organizations in the field of health services shall be to attract those segments of old consumers who posses medical insurance or who may allow to pay the services which these organizations offer.

Structure of the family

Considering the average dimension of a family, it is noticed that an important share belongs at present to the families formed of a single person, especially in the north countries, whereas the countries in the south area are characterised by families formed of five or several persons. In addition, the number of women occupied outside the household has increased.

Like the ageing of the population, this restructuration of the family shall also affect the marketing strategies of the health organizations, especially by introducing

some new types of services. Thus, there have appeared the ambulatory services, whereas the clinics and the medical rooms extended their program. By these measures, the organizations offer to the occupied persons as well the possibility to take care of their health.

More than that, the future strategies of the organizations in the health field must be adopted considering as well the fact that the working women, due to their role in taking decisions in the family, influence the conduit of purchase and consume of the family.

Education and attitude of the consumers

The education appears as a determinant element in the definition of the nature of the health services' market. The education level of the population has registered as well significant decisions in the last decades, at almost all the segments of the consumers, in the European countries and in USA.

The suppliers of medical services must acknowledge the fact that the educated population is increasing, the consumers are more preoccupied of their health, they ask questions and they search answers. This day, more than ever, the consumers are searching the services offered by responsible organizations, oriented towards market, towards the client.

In addition, the consumer is regarded at present from a new perspective, as a combination between the traditional patient and the contemporary consumer, possessing more knowledge about the health system, opened towards innovations and with an active role in the process of establishing the diagnostic, the treatment and in the maintenance of health.

The individuals regard themselves rather as consumers than as patients, and they expect to receive information, they demand to take part in the decisions which affect them directly and insist on receiving health services at the highest qualitative level.

Thus, at the end of XX century, only few organizations in the health field from USA were still using the term of patient due to its narrow sense, the term being replaced with that of client, consumer, insured, depending on the situation. Since the term of "patient" involves a dependent status, any of the other terms show an active participation of the individual in the issues which regard its health.

In addition, this preoccupation for education is manifested, especially, at the level of the services of fighting against diseases, an increasing number of people joining different organizations which have as purpose the prevention of health.

The knowledge of the consumer's conduit and of its satisfaction pursuant to the purchase and consume of the service represent the starting point of any marketing evolution. From this point of view, the organizations in the health field take also measures with a view to change the perspective of approaching the activity, passing from the orientation towards the product to the orientation of the activity towards the consumer

In this context, leaving from the modifications which occurred both at the level of the offer and of the demand, we have performed a research which had as purpose the image of the health services in Romania among the population, both in the urban and rural environment. Due to certain reasons,

the research performed had an exploratory and instrumental character, the sample studied being formed of 100 persons, selecting the persons who resorted in the last year at the health services.

Leaving from the research purpose there have been established a series of main and secondary objectives, within the respective evolution: the extent within which the image of the health services is formed, among the population; the nature of the image – favourable/unfavourable – at the level of primary assistance and specialised services; the characteristics of the health services which contribute to the formation of the image at the level of different medical units; the differences existent between the image formed by the population about the private and public services; the differences existent between the image formed about the health services different categories of consumers; perspectives of the health services in Romania in the context of integration in the European Union.

Pursuant to the analyses of the data resulted from data processing, there may be drawn the following conclusions:

- when they have a less serious health problem over 70% of the persons interviewed resort first of all to the family physician, whereas when they have a serious health problem, over 40% of the persons interviewed resort to the family physician, 33% to the services offered by hospital, 10% to ambulance. The resort to the family physician is determined, first of all, by its role within the health supply system from our country, through which the basic services are delivered by the family medical rooms, whereas the access to the specialised services may be possible only in terms of references drawn up by it.

- over 70% of the persons interviewed have a formed image concerning the health services, but on the whole, this is less favourable, both at the level of the services offered by the family physician and at the level of the hospital services;

- the main aspects, of which the persons interviewed are discontent are related to the waiting time to have access at the services of primary assistance, to the program of the physician and to its breach especially in case of the persons with age between 25-55 years, to the endowment with medical equipment, as well as to the attitude and the conduit of the medical staff especially of the nurses; the population from the urban environment is affected the most by the waiting time and by the program of the family physician, whereas the population from the urban environment by the distance up to the medical rooms/hospitals and by the cost.

- the services offered by hospitals have an image less favourable, even unfavourable among the population from Bucharest and Ilfov county, the main aspects which lead to this situation aiming to: the quality of the alimentation, the comfort offered and the quality of the services offered, the image not being influenced significantly by age, sex or residence environment. Therefore, for the improvement of the image there should be changed the hygiene and the alimentation, the endowments with medical equipments and last but not least, the conduit of the staff.

- the private medical units have a better image among the population that the state ones, especially the private medical and stomatological rooms; these being more appreciated by the persons aged between 18-45 years with high income. This image is influenced by the condition of the buildings,

by the endowment with medical devices, by the comfort in the waiting halls and by the booking system on which are based, reducing the waiting time of the consumer.

- concerning the grant of non-official payments (gifts or money) for the medical services 60% of the persons interviewed do not agree with this practice, whereas 19% express their agreement; over 65% of the persons interviewed consider the cost of the medical services paid officially or non-officially as being too high in comparison with their financial possibilities.
- over 60% of the persons interviewed consider that they do not have enough information about the health care system in Romania, and most of them are acquired from television and press.
- pursuant to the adhesion at the European Union, 67% of the persons interviewed appreciate that the services offered by Romanian organizations shall be better, since there are to register changes in the endowment with medical equipment and the quality of the medical act, in the condition of the buildings and the comfort during specialization, as well as at the level of the cost of these services, which in the opinion of over 60% of the persons interviewed shall increase.

On the whole, the image of the health services in Romania is less favourable both at the level of primary assistance, and at the level of the specialised one, this image being determined by a series of aspects related to the technical endowments (equipments, condition of the buildings, comfort, cleaning), and also by aspects related to the conduit and attitude of the staff.

The adhesion of Romania at the European Union, as well as the economic, demographic and social modifications faced by the population of our country involves the revision of the manner of approach of the health services, the identification of the real needs of the population and the elaboration of strategies and programs of action on short, average and long term, which shall determine the increase of the satisfaction of the consumer of health services from the point of view of accessibility, equity and quality.

Note

(1) Dicționarul explicativ al limbii române.

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