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INSTITUTIONAL QUALITY OF THE BUSINESS ENVIRONMENT: SOME EUROPEAN PRACTICES IN A COMPARATIVE ANALYSIS

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Abstract

In contemporary economic literature, we can find plenty of theoretical and empirical approaches which seek to highlight the most appropriate factorial variables that are associated with the institutional quality of the business environment. This study presents, in a summarised version, the institutional logic of transaction costs that was substantiated within a scientific research project. In essence, the economic performances of the business environment are circumscribed by the institutions that facilitate or constrain the entrepreneurial initiatives and the economic activity in general. In terms of empirical analysis, the comparative approach of the EU business environments illustrates various examples of (good or bad) practices with respect to the institutional quality of the business environment. By selecting certain relevant institutional variables, the original character of this research resides in developing an indicator – The Institutional Quality of the Business Environment (hereafter IQBE) which offers a dynamic perspective upon the business environments that characterise both Romania and other EU countries.

Keywords: Institutional Quality of the Business Environment, Transaction Costs, Entrepreneurship, Property Rights

JEL classification: D02, D23, K11, L26

Introduction

The equation of economic performance within the business environment will be approached and discerned differently, gradually, according to the explanatory factors that are taken into consideration. On one hand, we are talking about *the role of institutions*, that is the way in which the institutional framework guides the economic activity and, on the other hand, we are discussing about *the role of transaction costs*, namely the extent to which the institutions burden entrepreneurial activity. The analysis of the business environment's quality must begin with highlighting the institutional and administrative barriers that alter the true entrepreneurial initiative (Bjørnskov and Foss, 2008).

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Recent scientific research on the institutional foundations of economic performance proves that *the institutions protecting property rights and reducing transaction costs* are decisive for economic performance. Researchers also point out that economic performance is the result of institutions' influences on governance and economic policies. Government officials respond, in large part, to the incentives brought about by the political and legal institutions existing in society. At the same time, the structure and the quality of political institutions explain how political power, through the policies it adopts, favours or, on the contrary, inhibits economic performance.

In this context, researchers focus on measuring *the quality of the institutional factor*, so as theoretical studies are accompanied by empirical approaches, meant to highlight how intensely is the institutional factor enhancing economic development. In this respect, the indicators that measure the institutional constraints on government system are highly significant. We can include in this category *The Index of Economic Freedom*, as well as the indicators of institutional quality used in the studies of international financial organizations.

Many authors developed data series showing, in a comparative manner, the importance of the institutional factor on economic performance. Worth mentioning, in this respect, the approaches of *the legal system*, *the political system*, as well as certain indicators referring to the institutional constraints on businesses, such as World Bank's *Doing Business* report. Also, by combining several micro and macroeconomic indicators, *Worldwide Governance Indicators* manage to illustrate the evolution of "the institutional quality".

The results of empirical tests prove that, for almost any measuring methodology, the institutional factor is characterized by a statistically significant impact in correlation with the real GDP/capita. For instance, in the IMF's 2003 report "World Economic Outlook", the aggregate governance indicator alone, as an institutional measure, is capable to account for approx. three quarters of the inter-country disparities in income levels.

This study summarizes the results of the scientific research conducted as part of the grant named "Transaction Costs and Economic Performance", a project developed at the National Institute of Economic Research (NIEC) of the Romanian Academy. The defining purpose is to highlight the main institutional and administrative constraints that affect the performances of the business environments in Romania and in the European Union.

1. Methodological Background

The defining purpose of this empirical approach is to outline comparative analyses of the institutional quality of the business environment. From a methodological point of view, this approach seeks to develop an aggregate indicator regarding the Institutional Quality of the Business Environment (IQBE) by identifying and analyzing, in this respect, the most relevant institutional factors. Therefore, the first step of this empirical approach is the selection of institutional variables and the collection of related data. As a second step, the values of these specific institutional factors will be integrated, for all the countries considered within this study, in inter-country comparative analyses, through the IQBE indicator.

In order to highlight both statically and dynamically the discrepancies concerning the institutional quality of the business environment that occur within the EU member states I am going to take into consideration two groups of countries that are clearly distinguishable

in terms of institutional system and economic development. Thus, the first group will include Central and Eastern European Countries (CEE), while the second one will be formed of developed countries from the Western Europe (WE). In order to illustrate comprehensive evolutions and to draw relevant conclusions, each group will comprise five countries, all of them being EU member states. The CEE group includes **Bulgaria, Estonia, Hungary, Poland and Romania**, i.e. ex-socialist countries whose economies were (or still are, at the institutional level) subject to the transformations brought about by the transition process and who joined the EU relatively recent (in 2004 or 2007). The WE group is composed by **France, Germany, Italy, Spain and United Kingdom** – old EU member states (from 1951, 1973 or 1986) who are among the most developed European countries.

Obtaining a comprehensive image of the institutional quality of the business environment has attracted the need to consider a time period that should be as long as possible, the reference interval being 2005-2011. On one hand, this interval was due to the availability of the considered data and, on the other hand, it emerged from the need to illustrate, at least in the case of Romania, the possible adjustments that occurred between the ante and post EU accession stage.

The institutional quality of the business environment will be highlighted by the IQBE indicator that will include eight institutional factors who are illustrated by specific areas of analysis, namely: 1) Protection of property rights; 2) Ease of doing business; 3) Contract enforcement; 4) Payment of taxes; 5) Regulatory burden; 6) Obtaining licences; 7) Corruption; 8) Institutional constraints regarding trade and investment.

These areas of analysis were selected so as the IQBE indicator will illustrate the problem of imposed transaction costs whose magnitude is correlated, in an inverse relationship, with the economic performance and the institutional quality of the business environment. In essence, the areas of analysis illustrate both economic and institutional factors identified by entrepreneurs as institutional constraints that, in the logic of transaction costs economics, burden the proper functioning of the business environment as well as the economic performances. The more resources will entrepreneurs need to allocate for institutional compliance, the lower the productive performances will be.

The areas of analysis considered in this study illustrate the most important institutional variables that affect general economic activity: from the fundamental rules regarding the protection of property rights to the ease of setting up a company or closing a business, from the (monetary and time) costs involved by obtaining a licence to the ease of paying taxes etc. Being quantitatively evaluated by respecting the methodological limits in a rigorous manner, all these factors, regardless of their nature, highlight the magnitude of the transaction costs that are imposed within the business environment.

In this quantitative analysis, each area is going to be evaluated, for each studied year, by calculating a distinct coefficient that can take values between 0 and 10, 0 being the lowest value and 10 representing the highest value. In order to calculate the coefficients that correspond to each area of analysis, I am going to use data from various renowned reports, as follows:

- **Protection of property rights** – for the period between 2005 and 2009 the values are going to be calculated using data from *Economic Freedom of the World Annual Report*

(2007-2011, annually). For 2010 and 2011, the values are going to be obtained by means of data from *The Global Competitiveness Report* (2010-2012).

- **Ease of doing business** – data will be taken from *Index of Economic Freedom*, an indicator calculated by *Heritage Foundation* each year starting with 1995.

- **Contract enforcement** – between 2005 and 2009, the values will be calculated using data from *Economic Freedom of the World Annual Report* (2007-2011, annually). For 2010 and 2011, the coefficients are going to be obtained by processing data from *Doing Business Report* (2011, 2012).

- **Payment of taxes** – the coefficients corresponding to this area will be based on data included in the *Doing Business Report* (2006-2012 editions), a report realised by the *World Bank*.

- **Regulatory burden** – for the 2005-2009 period, the data that is going to be used in order to calculate the coefficients will be taken from *Economic Freedom of the World Annual Report* (2007-2011 editions). For 2010 and 2011, the values of the coefficients will be based on the data offered by *The Global Competitiveness Report* (2011-2012, 2012-2013).

- **Obtaining licences** – it will be used data from *Doing Business Report* (2006-2012 editions), a report realised by the *World Bank*.

- **Corruption** – the values of the final coefficients will be obtained by means of *Corruption Perception Index* calculated by *Transparency International* each year starting with 1995.

- **Institutional constraints regarding trade and investment** – the final coefficients will be obtained by calculating the arithmetic mean (average) of two distinct areas: *Trade Freedom* and *Investment Freedom* included in the *Index of Economic Freedom* calculated by *Heritage Foundation*.

Depending on the original data that is going to be used in order to calculate the values of each area of analysis, there are three distinct situations that impose different metodological approaches:

- if the initial scale used to measure the original data is the same with the scale used in this study (from 0 to 10), then the data will be taken as such, without any further modifications (it is the case of the data offered by *Economic Freedom of the World Annual Report* and *Corruption Perception Index*);

- if the original values are measured on a different scale (as it is the case of the data from *Index of Economic Freedom* and *The Global Competitiveness Report*), they are going to be transformed on a 0-10 scale using the following formula: $10 \times \frac{X - \min}{\max - \min}$, where X stands for the value that is going to be transformed, \min and \max being the extreme values of the initial scale (0 and 100 in the case of *Index of Economic Freedom*, 1 and 7 for *The Global Competitiveness Report*);

- for the data that is going to be taken from *Doing Business Report* it will be necessary to apply an even more complex methodology, because this report offers only absolute

values (e.g.: number of days, cost, period of time etc.) and does not offer coefficients that will place the area we are interested in on a certain scale. In this respect, the transformation on a 0-10 scale is going to be realised using the following formula: $10 \times \frac{(V_{max} - V_i)}{(V_{max} - V_{min})}$

where V_i is going to represent, in turn, the absolute value of each partial area included in the area that is going to be transformed, V_{max} and V_{min} being taken from the *Economic Freedom of the World* methodology. The final coefficient will be calculated as the arithmetic mean of the coefficients that were obtained for the partial areas¹.

If the *Economic Freedom of the World* methodology does not offer V_{max} and V_{min} , these values are going to be obtained, for each partial area, by adjusting the arithmetic mean with 1,5 X standard deviation. Both standard deviation and arithmetic mean will be maintained constant over the entire period of time, being calculated for 2005 by taking into consideration the entire set of data offered by *Doing Business Report*, not only the data for the countries included in the present study. If the V_{min} value will be negative, then it will be replaced with 0.

Finally, the value of the IQBE indicator will be calculated, for each year and for each country, as the arithmetic mean (average) of the values obtained for each area of analysis – the areas of analysis will be weighted the same within the aggregate indicator.

2. Factors that Influence the Institutional Quality of the Business Environment

As a first step, the institutional analysis of the business environment will be carried out separately for each of the components I consider to be the most relevant for an (afterward aggregate) assessment of the institutional quality of the business environment.

• Protection of property rights

Even though property rights are constitutionally protected or guaranteed, their manifestation faces a multitude of “restrictions” or difficulties in everyday life. Only when property rights are judiciously defined and efficiently protected, people will be truly able to weight the economic values – especially the transaction costs, according to Commander and Nikoloski (2010:3) – so that they are encouraged to invest and take entrepreneurial risks. An institutional arrangement that guarantees the protection and compliance of property rights will facilitate commercial activities, improving firms’ capacity to make decisions that will enhance both productivity and economic performance. (Yasar, Morrison and Ward, 2011:689).

When the institutions are not strong enough to universally guarantee the compliance of property rights, the entrepreneurial success will rather rely on political and not economic criteria (Keefer and Knack, 1997:591-592). Therefore, the negative consequences will affect not only entrepreneurial activity and economic performance, but also informal and cultural institutions, having a negative impact on a much longer term.

¹ For instance, in the case of *Contract enforcement* area the absolute values for *period of time* – number of days and *cost* – percentage of the total value are going to be transformed, one by one, on a 0-10 scale, the final coefficient being calculated as the arithmetic mean of the two partial coefficients.

- **Ease of doing business**

The reason why the bureaucratic burden generates negative effects upon entrepreneurship resides in the fact that entrepreneurs' need to comply with legislative and administrative requirements implies, obviously, the emergence of certain imposed transaction costs. Even though these imposed transaction costs are approached in a different conceptual and methodological framework, they influence entrepreneurs' decisions to invest or to start a business, as it is also explained by Wink, Sheng and Eid (2011:176). For instance, Brunetti, Kisunko and Weder (1997:20) include the regulation concerning the opening of a new business among the institutional obstacles that burden entrepreneurial activity. At the same time, Benham and Benham (2004:6-9) offer an even more clear perspective upon the relationship between the procedures required for starting a new firm and the transaction costs associated with these procedures, being preoccupied to measure, for example, the length of the process of registering a new firm officially, the monetary costs involved, the number of people involved in this activity etc.

Furthermore, the negative effects of the bureaucratic burden can also be noticed in the case of Romania: according to a recent study, the rate of early stage entrepreneurship in Romania is reduced², being lower than in most Central European countries (Matiş, 2010:18). To add more, 83% of early-stage entrepreneurs and 90% of established business owners consider that it became more difficult to start a business in 2010 compared to 2009, while 60% respectively 84% reckon that developing a business was harder in 2010 than in the previous year (Matiş et al., 2010:10).

- **Contract enforcement**

Within a comparative analysis, Yasar Morrison and Ward (2011:656) illustrate the positive relationship between firms' performances and entrepreneurs' expectations that the legal system will lead to the enforcement of contractual rights. Even more, the legislative complexity and, especially, the legislative instability represent in themselves a problem, explaining the increased uncertainty that characterizes the business environment. In this context, entrepreneurs will reassess their decisions regarding medium and long term investments and will focus only on exploiting short term economic opportunities.

The institutional deficiencies in terms of contract enforcement lead to important (monetary and time) costs for those involved in various commercial disputes. Even though the contract enforcement issue can be circumscribed to a more extensive analysis, at least in the ex-socialist countries we are, in essence, talking about the efficiency of the judiciary system.

- **Payment of taxes**

In terms of the present analysis, taxes represent transaction costs imposed by state and borne by taxpayers through their fiscal compliance. It is easy to understand that economic incentives decrease proportionally with tax hikes, the fiscal burden being evaluated inclusively according to the complexity of the procedures involved by the payment of taxes. Therefore, the fiscal burden negatively influences the quality of the business environment. Sobel (2008:642) shows that "in areas with institutions providing secure property rights, [...] contract enforcement, and effective limits on government's ability to transfer wealth

² According to the data presented by this study, Romania ranks 53 out of 59 states included in the analysis and is surpassed by countries such as Macedonia, Croatia or Greece.

through taxation [...], creative individuals are more likely to engage in productive market entrepreneurship—activities that create wealth”.

In a study concerning the institutional obstacles of doing business, Brunetti Kisunko and Weder (1997:20) include “tax regulations and/or high taxes” among the problematic aspects for doing business, the results of its empirical research highlighting the fact that, in the Central and Eastern Europe, taxes represent a major obstacle. Even after 14 years, the situation in Romania is a similar one: a recent study that, among other aspects, tries to investigate the difficulties encountered by the Romanian SMEs shows that excessive taxation is still a problem.

- **Regulatory burden**

As external and formal institutions, the legislative provisions, the norms and the administrative regulations that need to be respected within the business environment have a major influence upon entrepreneurship, investment and capital accumulation rates. Some authors of empirical analyses such as Stenholm, Acs and Wuebker (2011:2) consider that business environment regulations are the essential factor influencing the evolution of entrepreneurship³. Such an approach becomes formal with the help of some European Commission reports’ conclusions (2007a:90) showing that almost three quarters of European entrepreneurs regard the complexity of administrative procedures as the main obstacle encountered in the process of starting a business.

Therefore, every political and administrative desideratum created in order to support the business environment should necessarily take into consideration the burdening transaction costs which are imposed by regulations. At the European level, the European Commission advanced, in 2007, an action program to reduce the administrative burden generated by the European legislation, a program aimed at measuring the administrative costs and advancing solutions for their diminution.

- **Obtaining licences**

When the process of obtaining licences and permits lasts too long and implies certain additional costs, the entrepreneurial activity is strongly discouraged, the entrepreneurs often being forced to resort to corrupt practices or to operate outside of the formal economy, which is in the “underground economy”. As explained by Wieneke and Gries (2011:223), because of the very formal institutional arrangement in itself, the right to issue certain permits needed for opening a new business sometimes belongs only to the local bureaucrats, a fact which offers them a monopoly position. Institutionally benefiting from such a position, frequently exercised in a discretionary manner, the administrative bureaucracy can facilitate the formation and perpetuation of (legal) monopolies and, consequently, can extract monopoly rents that will alter the functioning of the market mechanism and will contribute to a less favorable business environment.

For instance, in Romania, obtaining a building permit takes approximately four months, and the file that needs to be submitted in this respect has to include between 14 and 16 different

³ “... a strong presence of administrative burdens, procedures, and bureaucracy related to forming or closing a business may negatively impact individuals’ intentions to engage in new firm formation.” (Stenholm, Acs and Wuebker, 2011:6).

documents. In addition, the files can be prepared only by specialists in this field, which leads to even more imposed transaction costs.

- **Corruption**

As a phenomenon that illustrates the institutional deficiencies, corruption amounts to a series of transaction costs that are used for reasons of economic optimization. But it is easy to understand that the resources mobilized through corruption are not anymore allocated for productive purposes⁴. In this respect, “corruption is a kind of tax, hence raising costs and uncertainty for business activities. Worse than tax, corruption is not transparent, not predictable and not reliable” (Dang 2012:8). Therefore, some authors consider that the negative effect of corruption on the business environment is more severe than that of the tax burden because it involves an uncertain framework. Under these conditions, not corruption in itself but its institutional sources should be the subject of the scientific and reformist concerns.

When it comes about corruption, Romania is targeted not only in the sphere of public debate but also in terms of specialised research findings (Ionescu, 2012). For instance, a study realized by *Transparency International* in 2009 shows that 22% of the Romanian people admit paying bribes to the doctor, 13% gave money to policemen, 8% to magistrates and 6% to professors⁵. Also, a study of the National Anticorruption Directorate (NAD) conducted in 2010 shows that the real sources of corruption are manifested at the level of judicial institutions because, according to the statistics of The Public Ministry, only 1,3% of the cases sent to court are charged with corruption offenses.

- **Institutional Constraints regarding Trade and Investment**

The institutional arrangement that governs the business environment of an economy truly proves its quality in the light of external commercial relations and investment decisions. International trade and foreign investments are, in general, extremely sensitive to any change in the incentive scheme that exists within the institutional framework. Therefore, an analysis regarding the economic performances of the business environment should pay careful consideration to the “external” component of the institutional constraints, the one that influences especially the international trade and the foreign direct investments.

In the European context, respecting the good tradition of reformist desiderata, trade-related legislative burden is meant to be simplified by introducing, on the Commission’s proposal (2011), a common EU commercial law. In European Commission’s view, the differences between national legislations create commercial difficulties in terms of transaction costs – for instance, the costs involved by obtaining information about the legislation applied in the

⁴ This is why the possibility of interacting with public officials without the need of making “unofficial payments” represents one of the most important factors of a favourable business environment, being, at the same time, one of the indicators that are most often used for making international comparisons on the quality of institutions (Krkoska and Robeck, 2008:576).

⁵ According to a CSOP survey conducted on the behalf of the *Association for Implementing Democracy*, a Romanian person gives, on average, 600 RON bribe every year. According to this survey, 13% of the Romanian population aged over 18 years admits paying bribe in the previous 12 months while almost three quarters (73%) of the country’s population believes that, in Romania, you cannot succeed without resorting to less legitimate means such as bribery or trading in influence.

commercial partner's country, adapting contracts according to this legislation or obtaining consultancy in this respect. Thus, by creating a set of uniform rules for the commercial contracts concluded between partners from different member states, this commercial law would reduce the legislative complexity, hence leading to a reduction of the associated imposed transaction costs.

3. The Institutional Quality of the Business Environment Indicator – IQBE

In order to calculate the IQBE indicator I took into consideration the above-presented eight distinct areas of analysis, the values obtained for each of these areas having an equal weight in the final value of the aggregate indicator. More precisely, the IQBE value was calculated as the arithmetic mean of the eight partial scores that correspond to the analysed areas, for each year and for each country included in this research.

Therefore, integrating the partial scores within an aggregate indicator allows us to draw more general and dynamic conclusions regarding the institutional reforms and economic policies that support the institutional quality of the business environment.

For instance, the value of the IQBE indicator for Romania in 2011 is 5.28 points, that is the arithmetic mean of the scores obtained for each of the eight areas: protection of property rights – 4.83; ease of doing business – 7.20; contract enforcement – 4.85; payment of taxes – 4.26; regulatory burden – 3.00; obtaining licences – 6.13; corruption – 3.60; institutional constraints regarding trade and investment – 8.38.

Table 1 presents the values of IQBE indicator for all the countries included in this study and for the entire analysed period of time. At the same time, in order to highlight the differences that exist, in terms of institutional quality of the business environment, between the two groups of countries (CEE, WE), I have also calculated the arithmetic average of the IQBE scores, for each year and for each group.

Table no. 1: Institutional Quality of the Business Environment, 2005-2011

	IQBE	2005	2006	2007	2008	2009	2010	2011
CEE countries	Bulgaria	4.84	5.16	5.34	5.23	5.32	5.31	5.42
	Estonia	7.41	7.36	7.41	7.37	7.17	7.24	7.11
	Hungary	5.95	6.00	5.88	5.82	5.80	5.80	5.81
	Poland	4.84	4.83	4.60	4.84	4.96	5.17	5.23
	Romania	4.73	5.03	5.20	5.32	5.34	5.33	5.28
CEE average		5.55	5.68	5.69	5.72	5.72	5.77	5.77
WE countries	France	6.81	6.83	6.79	6.85	6.93	6.86	6.89
	Germany	7.24	7.47	7.54	7.45	7.46	7.36	7.58
	Italy	5.33	5.39	5.46	5.36	5.33	5.32	5.39
	Spain	6.59	6.42	6.51	6.44	6.36	6.45	6.68
	United Kingdom	7.21	7.38	7.32	7.25	7.50	7.62	7.68
WE average		6.64	6.70	6.72	6.67	6.72	6.72	6.84

Regarding the graphic instrument, the comparative analyses were facilitated by conceiving a diagram that is based on eight distinct coordinates, namely the eight areas composing the aggregate indicator. For each element presented in such a diagram, the institutional quality of the business environment will be illustrated by the area of the surface determined by

merging the values obtained for each component of the IQBE. Thus, the wider the surface is, the more performant the business environment will be.

We can infer the fact that Romania's evolution shows a relative upward trend, the indicator's value reflecting a slight improvement of approx. 0.5 points in the institutional quality of the business environment until the end of the studied time interval. But it is important to notice that, compared to the rest of the countries, Romania ranks last in 2005 and, between 2006 and 2011, constantly surpasses only the values obtained by Poland.

Moreover, the CEE average is over the entire period of time greater than Romania's score. Compared to Estonia, which is by far the most performant CEE country, Romania constantly shows values that are approx. 2 points smaller. Therefore, the institutional arrangement that characterizes Romania's business environment shows another series of performance gaps, a fact which, of course, raises the problem of institutional reforms. As we are going to see below, the institutional quality of the Romanian business environment also shows certain (competitive) disadvantages compared to Bulgaria.

4. IQBE: Romania's Situation in a Comparative Analysis

Within a comparative analysis framework based on IQBE indicator, the Romanian business environment presents, during the entire period, important discrepancies in terms of institutional quality and certain vulnerabilities for some institutional factors.

For example, compared to the majority of WE countries, Romania shows great discrepancies of more than 1.5 points. From the WE group, only Italy's business environment presents an institutional quality that can be considered closer to Romania's performances. Actually, within the WE group, the institutional quality of the business environment is the highest in United Kingdom and Germany, Romania's disparities compared to these countries being higher than 2 points.

Table 2 presents the values recorded by Romania over the entire period of time and for each of the eight analysis areas. Calculating the IQBE indicator offers, in this respect, an overview of the institutional quality of the Romanian business environment as well as a basis for an inter-country comparison.

Table no. 2: Institutional Quality of the Business Environment - Romania, 2005-2011

ROMANIA	2005	2006	2007	2008	2009	2010	2011
1. Protection of property rights	5.12	5.22	5.28	5.16	5.29	4.83	4.83
2. Ease of doing business	5.50	7.46	7.32	7.49	7.49	7.25	7.20
3. Contract enforcement	5.21	5.21	5.40	4.85	4.85	4.85	4.85
4. Payment of taxes	4.40	3.08	2.79	4.18	4.33	4.24	4.26
5. Regulatory burden	3.50	4.12	4.01	3.32	3.20	3.00	3.00
6. Obtaining licences	6.11	6.15	6.39	6.43	6.44	6.62	6.13
7. Corruption	3.00	3.10	3.70	3.80	3.80	3.70	3.60
8. Institutional constraints regarding trade and investment	5.02	5.92	6.70	7.30	7.29	8.13	8.38
IQBE indicator	4.73	5.03	5.20	5.32	5.34	5.33	5.28

The scores show that *regulatory burden* and *corruption* are, both in a relative sense and in dynamic, the lowest-performant areas over the entire period of time. The evolution of the institutional quality for these two areas is a relatively constant one, without major

progresses. In fact, when it comes about corruption, the only notable progress can be observed between 2006 and 2008, as a consequence of the European pressures that occurred in the context of EU accession. But the institutional framework is not, in itself, the most favorable one in terms of business incentives. Regarding the regulatory burden, the European model involves a series of institutional constraints which are among the most serious ones. In terms of regulatory burden, Romania shows the strongest deterioration of scores (approx. 0.7 points) only one year after the EU accession, a fact which indicates that the accession did not and could not generate, for this area, a reduction in the regulatory burden.

Besides these two areas, Romania also presents low values for “payment of taxes” area – a criterion that, in 2007, reaches the lowest score recorded in all areas throughout the entire analysed period. Compared to this criterion, Romania’s situation is slightly favorable in terms of protection of property rights and contract enforcement, and the scores obtained for these two areas constantly surpass the rest of the scores⁶.

Romania records the best performances for the “institutional constraints regarding trade and investment” area, the scores being the highest in 2008 and 2011. In fact, this is the only area where Romania reaches scores which are higher than 8 points, constantly recording a favorable evolution.

The below-presented chart (Figure 1) illustrates the distribution of the institutional quality of the business environment in Romania, according to the eight areas of analysis, for the most recent year of the time period that was taken into consideration.

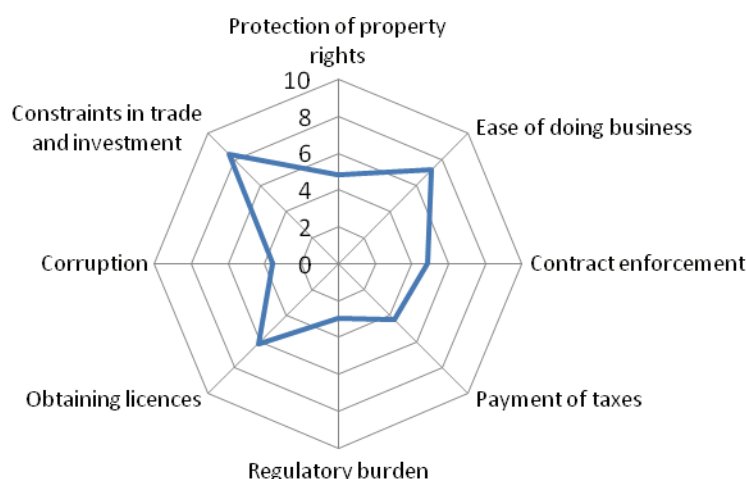


Figure no. 1: Institutional Quality of the Business Environment – Romania, 2011

⁶ But it is important to notice the existence of certain correlations between the areas of the IQBE indicator. For instance, the efficiency of property rights’ protection is reflected in the performance of the judiciary system when it comes to solving commercial disputes, the scores of these two areas showing a similar evolution both between 2006-2008 and between 2010-2011. At the same time, the reduction of the values that evaluate the dimension of regulatory and tax burden increases the difficulty of doing business, the values of this area showing a slightly decreasing trend too.

The diagram peaks oriented outward reflect favorable scores while the peaks directed inward, towards the origin of the chart, indicate institutional constraints that are burdening for businesses. Therefore, we can observe that the institutional quality is the lowest in 3 of the 8 analysis areas: protection of property rights, regulatory burden and corruption.

However, there are significant disparities in the scores of the aggregate indicator components, the difference between the most performant criterion and the one that obtains the lowest values being higher than 5 points. Regulatory burden and corruption continue to be weak areas, as the values obtained in 2011 for these two areas are lower than 4 points.

In relation to the “corruption” area of analysis, the results of this empirical research are fully confirmed by various European official reports as well as by specialized research work carried on by independent organizations. For instance, the European Commission’s 2012 report on the Cooperation and Verification Mechanism shows that, 5 years after accession, complying with the fundamental principles of the rule of law and judiciary system’s independence continue to be major problems in Romania. Even more, in accordance with the institutional quality scores obtained in the case of corruption, the European Commission shows that, in Romanians’ perception, the situation regarding corruption does not show an improvement, most of them considering that the situation has actually deteriorated (EC, 2012:11). This evolution is illustrated in a precise manner by the scores recorded for the corruption area of analysis⁷. Thus, in the above-mentioned report, EC suggests the adoption of new measures aimed at preventing and combating corruption.

In this respect, in order to highlight the progresses, or regresses, recorded in terms of institutional quality, the dynamic analysis of the IQBE components is also very important, especially in order to highlight the performance discrepancies over the entire period of time (Figure 2).

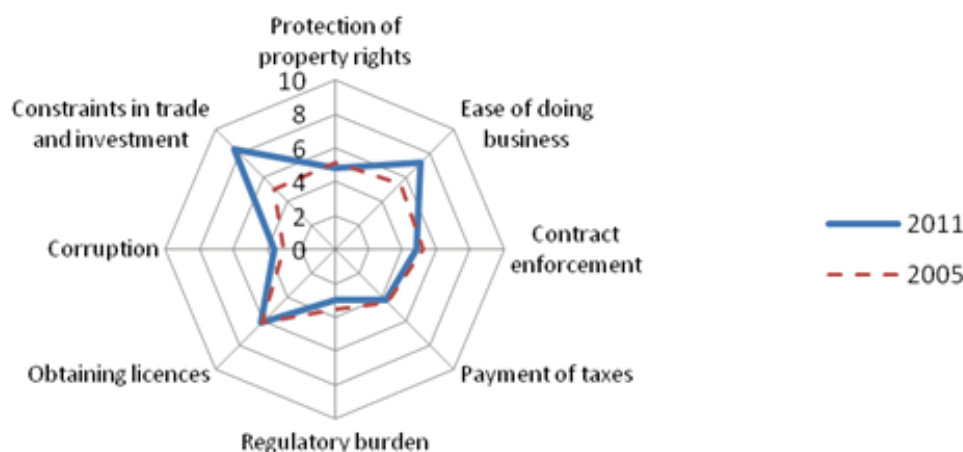


Figure no. 2: Institutional Quality of the Business Environment-Romania, 2005 and 2011

⁷ For instance, the score obtained for the corruption area was 3.70 in the year of Romania’s accession to EU, while in the latest analysed year this score decreased to 3.60.

The graphical distribution of the institutional quality shows that, compared to 2005, Romania records, at the end of the analysed period, a notable progress only in two areas: ease of doing business and institutional constraints regarding trade and investment. Therefore, the policies that were implemented over the 7-year period had a positive effect only upon the reduction of both administrative procedures that businesses have to comply to and institutional constraints associated with trade and investment.

By contrast, the regulatory burden becomes even more heavy in 2011 compared to 2005, a fact which is reflected by a slight reduction in the values obtained for this area. At the same time, Romania's scores for the contract enforcement and protection of property rights areas also record a downward trend, but the differences are not significant.

The next chart (Figure 3) presents, in a comparative manner, both Romania's scores and the value of the CEE average, for each of the eight IQBE coordinates and for the most recent year, precisely in order to highlight Romania's discrepancies compared to the group it belongs to.



Figure no. 3: Institutional Quality of the Business Environment – Romania and CEE average, 2011

We can infer that, in general, the institutional quality of the Romanian business environment is relatively convergent to the CEE average. The only notable differences are in terms of corruption (approx. 1 point) and payment of taxes (approx. 2 points). In fact, it is interesting to observe that these disparities in institutional quality performance are present in the areas that are, somehow, at the discretion of national policies (on one hand, the fiscal system and, on the other hand, corruption, especially the discretionary behaviour of public officials). Thus, the institutional convergence is stronger in the rest of the areas, but this does not imply that the economic convergence will also get to have a similar position.

But, compared to the WE countries, the institutional quality of the Romanian business environment is significantly lower, as shown by Figure 4.

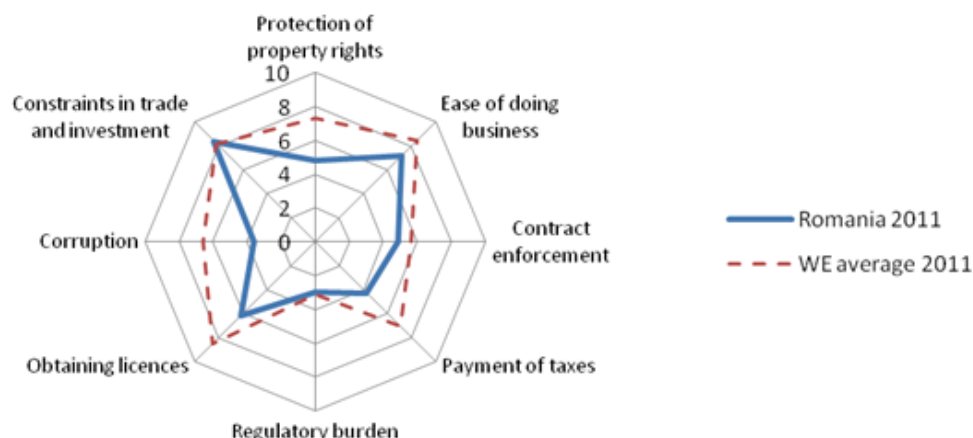


Figure no. 4: Institutional Quality of the Business Environment – Romania and WE average, 2011

The most important discrepancies in terms of institutional quality are recorded, not accidentally, exactly in the areas identified above as the vulnerabilities of the Romanian business environment. It is important to notice, at the same time, the almost perfect institutional convergence in terms of regulation, a fact which does not represent an advantage neither for the Romanian business environment nor for the business environment of the WE countries.

The only area where the score obtained by Romania has a slightly higher value than the WE average is the one that highlights the institutional constraints regarding trade and investment. In fact, it was normal that, once Romania became a EU member, the (tariff and non-tariff) restrictions on international trade would reflect as best as possible the freedom of movement, as an essential principle of a single European market. But beyond these commercial barriers, the Romanian business environment carries certain competitive advantages in terms of (fiscal, labour force) costs.

It is also interesting to draw a comparison between Romania and Bulgaria, in order to highlight the differences in the institutional quality of their business environments. Both Romania and Bulgaria became EU member states in the same year, that is 2007, have a similar institutional structure and record the lowest level on income/capita in the EU. In this respect, the next chart (Figure 5) will illustrate the scores obtained for each of the eight IQBE components, in the most recent year of the analysed period.

The only major difference in Romania's disadvantage can be observed in the case of payment of taxes, the disparity between Bulgaria and Romania being more than 2 points in 2011. Compared to Bulgaria, it seems that Romania still has to implement structural reforms in the public finance system. Apart from Bulgaria's fiscal competitive advantage (flat tax of 10% compared to 16% in Romania), the discrepancies in institutional quality

still needs to be explained, to a large extent, by the complexity and the inconsistencies of the Romanian fiscal system⁸.

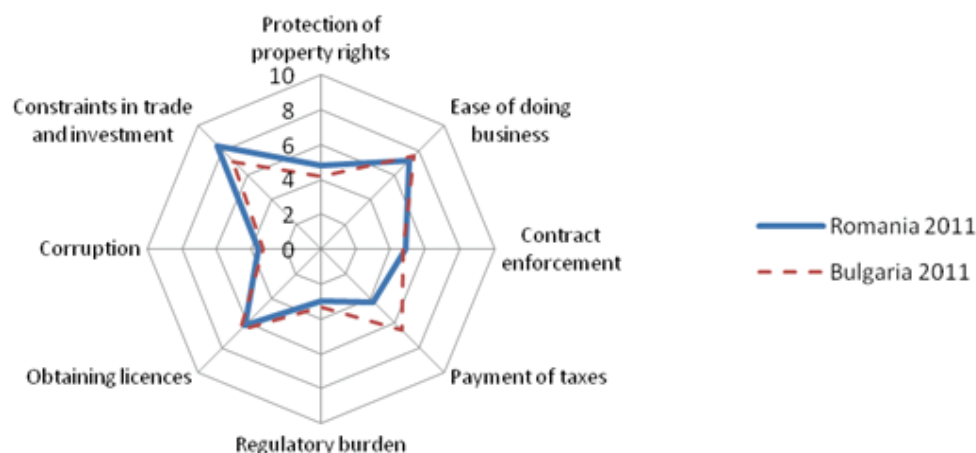


Figure no. 5: Institutional Quality of the Business Environment – Romania and Bulgaria, 2011

Conclusion

From the comparative analysis of the two groups of countries we can draw the conclusion that there still exist important gaps at the level of certain areas addressing 3 institutional factors which are essential for economic performance: protection of property rights, obtaining licences and, last but not least, state's capture through corruption.

As a general argument, the relatively low economic performances of the European business environments are due to an "excedentary" production of European legislation. In this sense, the United Kingdom launched a series of institutional reforms aimed at simplifying the legislation and the regulatory framework. Of course, this example should also be followed by the rest of the member states, as the entire EU economic area suffers in terms of business environment competitiveness, as a consequence of a suffocating regulatory framework.

Even so, like many other European administrative desiderata – as it was the case of the goals set by the famous Lisbon Strategy, a serious reform of reducing the regulatory burden affecting the business environment was not yet accomplished at the EU level. And both the data and the evolutions that are specific to this area of analysis, as well as the surveys conducted among entrepreneurs, fully confirm the absence of a visible progress in terms of reducing the regulatory burden.

⁸ For example, according to *Romania Competitiveness Report*, 2011, issued by *American Chambers of Commerce*, the 2004 Tax Code was modified through approx. 70 amendments until 2011, a fact which leads to a lower fiscal stability and predictability.

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