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RELIGIOSITY AND FOREIGN DIRECT INVESTMENT: THE CASE OF ROMANIA

Case
Study

Keywords

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Culture;
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Religiosity;
Simultaneous equations modelling

JEL Classification

C32, F21, F47, Z12

Abstract

This paper presents a quantitative approach to the analysis of the impact of cultural factors on Foreign Direct Investment (FDI). FDI is indispensable for the economic development of Eastern European countries, including Romania. In turn, FDI is determined by a multitude of factors, including cultural ones. Religiosity is an extremely important cultural factor since religion defines culture. However, the religious factor seems to be avoided in the context of FDI research. This study proposes an original reliable indicator designed to quantify religiosity –the Religiosity Index based on the review of literature in the field. This construct is analyzed as a cultural factor with an influence on FDI through simultaneous equations modeling. This allowed the author to identify the significant relationships in the multitude of bilateral and complex interrelations of FDI determinants.

INTRODUCTION

The interrelation between cultural factors and Foreign Direct Investment (FDI) cannot be defined as a straight causal one but as indirect and complex, framed in the integrated system of relationships between cross-border investments and their determinants. In addition to cultural factors, other determinant groups also produce a significant impact such as economic and market factors, technical progress and human resources; however, they also characterize the country's culture and can be classified into classes of variables relevant to culture and cultural products if the pragmatic characterization of culture is considered (Zaiț, 2012).

Among cultural factors, religiosity is one of the most important since religion shapes culture and a great part of cultural differences between nations (ethnicities) can be explained by religious confessions (Zaiț, 2012).

Mathur (2012) believes that religiosity and religious practice are not only integral parts of culture, but they often define everything related to the "core" of a culture. Religion is an integral part of culture that influences life in all societies around the world (Sasaki and Kim, 2011) and understanding religiosity inside cultures can lead to a better understanding of similarities and differences between cultures.

The literature in the field offers several significant options for the analysis of the interrelation between cultural factors and economic phenomena. The author opted for simultaneous equations modeling, which implies the elaboration of a system of linear equations and is frequently applied in the analysis of the economic phenomena, including FDI (for example, Metwally, 2004). Simultaneous equations consider bidirectional, complex relationships with a lack of explicit causality.

The author's contribution is reflected in the elaboration of the Religiosity Index – an indicator quantifying religious attitudes in a society, and in providing an adequate model for the influence of cultural (not solely) factors on FDI in Romania. The model takes into account bidirectional complex relationships regarding the attraction of FDI into economy.

The paper proceeds as follows. The second section illustrates the elaboration of Religiosity Index and the third section presents the identification of the interrelations regarding FDI determinants. The further sections present the methodology and data sources, the model itself and the results of its estimation. The last section draws the conclusions and discusses the limitations and directions for future research.

FDI DETERMINANTS AND RELATED INTERCONNECTIONS

Foreign Direct Investment is indispensable for economic growth in developing countries. This fact encourages the study of factors that stimulate or hinder foreign direct investment, which explains the location of FDI throughout the world.

When it comes to FDI analysis, economic factors are considered first of all. Out of these, the impact of Market Size (GDP) is most frequently studied (Mateev, 2009; Riedl, 2010; Sharma and Bandara, 2010; Khachoo and Khan, 2012 etc.) and positively found to influence the amount of foreign investment.

The concept of FDI searching for markets (Sharma and Bandara, 2010) also requires attention to market competitiveness. For the estimation of market competitiveness, including its positive impact on the attraction of FDI (Bera and Gupta, 2009), the Herfindahl-Hirschman Index of Concentration (HH Index) is applied.

Given the stability of the fundamental cultural characteristics of society over time, estimators can be compared in cross-sectional studies; sometimes another approach may be suitable for the longitudinal analysis of FDI in a country. Studies such as those elaborated by Lee, Shenkar and Li (2008), Dow and Ferencikova (2010) and Du, Lu and Tao (2012) quantified the cultural factor through Cultural Distance and a construct was found to be statistically significant only in one of the three studies (Lee et al., 2008). However, following the same logic that could be applied to the context of the investigation of FDI by countries of origin, the author decided to use the Cultural Synchrony tool (Zaiț, 2012), which quantifies the proximity between different cultures rather than the distance between them.

At the same time, GDP is also determined by a multitude of factors, including FDI, which is the key instrument for ensuring sustainable economic development for developing countries (Kok and Ersoy, 2009). Other issues of particular importance for sustainable economic growth include technical progress (Crespo Cuaresma and Worz, 2005; Heyne, Boettke and Prychitko, 2011) and the economy's degree of openness (Yucel, 2009).

Religiosity, as a cultural factor, influences the evolution of both FDI and GDP, being a determinant of economies and investment behavior (Jamaludin, 2013), but it is also influenced (negatively) by factors such as education, employment, or urbanization (Guveli, 2015).

In order to quantify religiosity, following the results of the research in the field (for example, McCleary and Barro, 2006; Okulicz-Kozaryn, 2010; Paldam and Gundlach, 2013; Benabou, Ticchi and Vindigni, 2015 etc.), the Religiosity Index was elaborated based on World Values

Survey (WVS) data.

METHODOLOGY

Data

The online databases of international institutions (UNCTAD, World Bank, World Integrated Trade Solution (WITS), OECD), the reports of the National Bank of Romania (BNR), the online cultural dimensions database developed by Geert Hofstede (Hofstede Insights) and the online database illustrating the results of the World Values Survey were used as resources for the data collection.

The calculation of Cultural Synchrony was based on the methodology proposed by Zaiț (2012). The final score is equal to the average of the Cultural Synchrony Indicators between Romania and each of the FDI source countries with a share higher than two percent in the total FDI inflows.

Since the results of the World Value Survey are presented for periods of time ("waves") of about five years, each wave having just one result per country, the author had to resort to missing data imputation techniques. The results of the surveys were attributed to the last year of the corresponding wave and the rest of the data were completed by the linear interpolation and the trend extrapolation techniques (since religiosity dynamics is not characterized by stochasticity) so as not to change the general trend (the result of the missing data estimation for the Religiosity Index for Romania is presented in Figure 3).

Missing data for the other variables were also imputed by linear interpolation and trend extrapolation techniques. The information on all variables used in the model and the data sources are presented in the Table 3.

Method

The weighted average technique was used for the elaboration of the Religiosity Index, the weights of the four elements being equal. The elements of the indicator were the answers to four relevant questions from World Values Survey (WVS). The reliability of the construct was tested using Cronbach's Alpha coefficient of internal consistency.

In order to elaborate an appropriate model for the bilateral and complex interrelations between the determinants of FDI, the Simultaneous Equations Modeling was used, which is frequently applied in the analysis of economic phenomena, including FDI (for example, Metwally, 2004).

The estimation of the equation parameters was made by applying the Two-Stage Least Squares Method (2SLS) (Pecican, 2005).

The significance of the discovered relationships were tested using the F statistic and the t test. The

validation of the model also included testing of statistical assumptions.

Results

Religiosity Index – an indicator of religion's impact

An index of religiosity is important because if people admit their belonging to a certain religious denomination that does not mean that they are relatively active and consciously engaged in the presumed religious life nor that they assume the related values. The higher the level of religiosity, the more the influence exercised by religion and the stronger the values cultivated by religious institutions. Thus, declaring the membership to a particular religious group is the last parameter through which people confirm the connection with the religious denomination. At the same time, the denial of belonging to a confession admits the definitive rupture of the association with it. The first step in this regard could be the decline of religiosity, which includes both extrinsic (for example, attending religious services) and intrinsic (for example, belief in God) aspects.

The Religiosity Index incorporated the results of the answers to four questions from the World Values Survey, which reflect both intrinsic (belief in God) and extrinsic (attending religious services at least once a month) aspects of religiosity, and questions related to religiosity in general (the religiosity of the person and the importance of religion). The estimator is a result of applying the weighted average technique, the weights of the four elements being equal. The analysis of the reliability of the construct including the four mentioned items was performed using Cronbach's Alpha coefficient of internal consistency. The very high value of the indicator (0,947) demonstrated the feasibility of the potential Religious Index. Moreover, the additional item analysis confirms the diminution of the Cronbach's Alpha coefficient if any of the elements of the index is removed. Therefore, the author concluded that the Index is characterized by reliability and consistency.

The initial data for the index elements is limited because the World Values Survey collects data in stages (waves) of about five years each, and the countries participating in each "wave" of the survey do not always match. The latest available survey (wave 2010-2014) was not conducted in a big number of countries and the data it provided was not enough to carry out a comparative analysis of religiosity based on the dominant religious confession. For this reason, the values of the Religiosity Index was calculated for the period 2005-2009, considering these relevant for a comparative demonstration. However, as the question regarding belief in God is missing from the 2005-2009 survey wave, it was replaced with a

question related to the importance of God (the total of the respondents gave this question between four and ten points), which do not differ significantly from those questions regarding belief in God for the 2010-2014 wave (Table 1).

The results of the Religiosity Index calculation for available European countries demonstrate that Orthodox countries are the most religious. This situation is reflected in a strong cultural influence of the Orthodox doctrine in these countries (Figure 1).

The group of Catholic countries manifests an average level of religiosity, including countries with high, average and low level of religiosity. Protestant countries are the least religious, the highest values of this group being placed in the middle area of the chart.

A very important detail is given by the fact that most of the highly religious countries are countries with a communist past (Figure 2). Therefore, it can be concluded that anti-religious communism not only failed to suppress Christian religiosity in these countries, but preserved it, isolating it from the processes that took place in the rest of Europe.

In addition to the development of democracy, civic rights and freedom, capitalism managed to ensure unprecedented growth of the quality of life and the amplification of secularization.

The results of research in the field (for example, McCleary and Barro, 2006, Paldam and Gundlach, 2013, Herzer and Strulik, 2013) illustrate that the increase in population income (and, consequently, in the quality of life) is associated with the diminishing of religiosity, and vice versa: the amplification of secularization facilitates economic growth (Lipford and Tollison, 2003; Strulik, 2012). Paradoxically, through the impediment of religious manifestation, the limitation of human rights and low living standards, communist regimes simply conserved the religious orientation of the population. This applies not only to the orthodox countries but also catholic ones. However, catholic countries demonstrate a greater decline in religiosity than predominantly orthodox ones.

Another extremely important aspect is that in countries with a religiously mixed population, with the acceleration of economic development protestant population tends to lose their religiosity faster than catholic population. It is indeed the case of Germany, where the difference of about 23% between the weights of protestant and catholic populations has disappeared in 60 years, given the fact that the catholic population has been relatively stable over time (Table 2). Although this is also the case of the Netherlands, a traditionally protestant country where the catholic confession became the dominant one as most of the protestant population "transformed" into a population without religious affiliation over time (catholic population remaining relatively stable over time).

On the other hand, there is also an opposite relationship: protestant countries demonstrate a higher level of economic development (relative to their population), followed by catholic countries, while on average the orthodox ones occupy the last positions in this regard. Thus, orthodox doctrine seems to influence negatively countries' economic development.

Therefore, it seems that the specificity of protestant religiosity stimulates a stronger economic development and consequently, the latter causes a decrease in the religiosity of the protestant population. The same logic can be applied to catholic and orthodox religiosity, the differences being given by the level and pace of economic development (determined by the specificity of the cultural impact of confession's doctrine), and by the rhythm of diminishing religiosity.

The construction of the model

Based on the relations identified in the literature in the field, the following system of simultaneous equations was developed:

$$u_{1t}, \quad f_{it} = a_0 + a_1 p_{it} + a_2 h_{it} + a_3 s_{it} + a_4 r_{it} + \quad (1)$$

$$u_{2t}, \quad p_{it} = b_0 + b_1 f_{it} + b_2 x_{it} + b_3 d_{it} + b_4 r_{it} + \quad (2)$$

$$u_{3t}, \quad r_{it} = c_0 + c_1 p_{it} + c_2 e_{it} + c_3 z_{it} + c_4 m_{it} + \quad (3)$$

The endogenous variables of the model are the following:

f_{it} = Inward FDI stocks of the i th economy in period t .

p_{it} = GDP of the i th economy in period t .

r_{it} = Value of the Religiosity Index for the i th economy in period t .

The predetermined variables of the model are the following:

h_{it} = Value of the Herfindahl-Hirschman (HH) Market Concentration Index for the i th economy in period t .

s_{it} = Average Cultural Synchrony value for the i th economy in period t .

x_{it} = Percentage of high technology exports in total manufactured exports of the i th economy in period t .

d_{it} = Percentage of trade in GDP for the i th economy in period t .

e_{it} = Percentage of tertiary education enrollment in the i th economy in period t .

z_{it} = Percentage of urban population in the i th economy in period t .

m_{it} = Unemployment rate in the i th economy in period t .

The first equation demonstrates that FDI stocks are determined by GDP value (Market size), market competitiveness, the Cultural Synchrony with

major investment partners and the level of religiosity. The GDP regression coefficient was expected to have a positive sign and the coefficient for other three variables to be negative, since the lower value of the HH Index indicates higher market competitiveness, i.e. a higher amount of FDI; Cultural Synchrony is stronger as the value of the index approaches one; since all Synchrony values for Romania are higher than one, its lower value is expected to determine the attraction of a larger amount of FDI; since Orthodox religiosity is dominant in Romania and the previous analysis indicated its negative impact on economic development, a lower level of religiosity seems to influence the attraction of a higher volume of FDI. The second equation suggests that the volume of GDP is determined by FDI, technical progress, the economy's degree of openness and the level of religiosity in society. The first three variables are expected to have a positive sign of the coefficients and the religiosity index – a negative sign, as the previous analysis suggested an association between Orthodox religiosity and a low level of economic development.

The third equation tests the hypothesis that the level of religiosity in a given society depends on the level of economic development, the level of education, the degree of urbanization and the unemployment rate. The first three variables are expected to have a negative impact on religiosity, while in the case of unemployment rates the coefficient is expected to have a positive sign.

The system of equations is mathematically complete, since the number of equations is equal to the number of endogenous variables. Applying the conditions of identifying model equations demonstrates that all three equations are over-identified, consequently, the whole model is over-identified. Therefore, the estimation of the equation parameters was made by applying the Two-Stage Least Squares Method (2SLS) (Pecican, 2005).

The estimation of the model

The results of the estimation of model parameters are presented in Table 4. The values of the adjusted R squares coefficients (applied in order to correct the possibility that a part of the variance is random, taking into account the number of independent variables) demonstrates that there is a linear and very tight connection between predetermined and dependent variables, and the F statistic confirms that the linear relationship is significant: independent variables explain the variance of the dependent variables.

The analysis of the first equation confirms the assumption that GDP has a positive impact on the attraction of FDI, as well as market competitiveness. The positive impact of Cultural Synchrony with partner countries was confirmed, but the significance of the connection was not

validated by the t test. The hypothesis of the negative impact of orthodox religiosity on the FDI attraction was denied with a high degree of significance.

The second equation confirmed the validity of all assumptions related to GDP. The positive impact of FDI on GDP volume was highly confirmed. The significant positive relationship between technical progress and GDP was also confirmed. The economy's degree of openness also has a positive impact on economic development while the level of orthodox religiosity has a negative impact on it (the impact is also significant).

Regarding the impact on the level of religiosity, the regression analysis identified ambiguous results. The third equation confirms the positive impact of economic development (not significant) and education (significant) on orthodox religiosity. The hypothesis of the negative impact of urbanization on religiosity was highly confirmed. The positive relationship between the unemployment rate and the level of religiosity was also confirmed, though without a high degree of significance.

Testing statistical hypotheses helped us to evaluate the results from another point of view. The normality of the distribution of errors was confirmed by the means of the Normal P-P Plot charts and the residual statistics. There are no problems with heteroscedasticity (homoscedasticity was determined based on the Scatterplot diagram), nor with multicollinearity (Tol and VIF scores are within the recommended limits and, consequently, the estimate is stable). As the Durbin-Watson test does not demonstrate values close to two, the Durbin-Watson significance tables were used according to the sample size and the number of explanatory variables (Savin and White, 1977). In this way, a problem regarding the autocorrelation of errors for the third equation was identified. This can influence the coefficient of determination, the parameters estimators and the value of the t test.

CONCLUSIONS

The results of the regression analysis and their validity suggest the following conclusions:

1. The general linear simultaneous equations model is appropriate for the purpose and there is a very close linear relationship between the predetermined and dependent variables, the factors explaining over 90% of the variation of the endogenous variables.
2. The GDP, market competitiveness and the level of orthodox religiosity have a significant positive impact on the attraction of FDI in Romania.
3. The significance of the positive impact of the other cultural variable – Cultural Synchrony on FDI was not confirmed, although the direction of the relationship confirmed the initial hypothesis.

4. The volume of GDP is determined by the attraction of FDI, technical progress and the economy's degree of openness (the impact is positive), while the increase in the orthodox religiosity has a negative impact on the economic development of Romania.

5. Regarding the impact of religiosity, the research confirmed the positive influence of education and the negative influence of urbanization (although the significance of the t test for these relationships could be influenced by the autocorrelation of errors).

6. Only one of the initial assumptions was denied with an acceptable degree of significance: the impact of religiosity on FDI proved to be positive. A possible explanation could be the increase in religiosity during the first years of the transition period after the dissolution of the socialist camp, which corresponded with a strong increase (in relative terms) in FDI.

LIMITATIONS AND DIRECTIONS FOR FUTURE RESEARCH

The period of time for which we managed to collect data (1994-2017) represents the main limitation of this research. Another limitation could be represented by the fact that data from World Values Survey are provided for periods of time (waves), and as a result missing data imputation techniques were used.

The future research could increase the number of analyzed countries, use simultaneous equations models for other cultural variables and change some of the variables in order to increase the validity of the model.

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TABLES & FIGURES

Table No. 1

Descriptive statistics and Pearson correlation value for ‘Belief in God and God’s importance’ questions from the World Values Survey (WVS) 2010-2014

Descriptive statistics			Correlation
WVS question	Mean	Standard deviation	
Belief in God	73,0769	20,79115	,987**
The importance of God	72,3846	20,68058	

Note. ** - $p < 0,01$

Table No. 2

The evolution of the weight of religious confessions in Germany’s total population for the period 1946-2011

Religion	Period							
	1946*		1950*		1960*		2011	
	Believers	%	Believers	%	Believers	%	Believers	%
Christianity	59,973,519	94,9	65,514,677	94,7	65,455,144	89,4	51,186,590	64,2
–Protestant	37,240,625	59	40,974,217	59,2	39,293,907	53,7	25,266,470	31,7
–Catholic	22,732,894	35,9	24,540,460	35,5	26,161,237	35,7	24,869,380	31,2

Note. Elaborated by the author based on the data from wikipedia.org; * - aggregated data for Federal Republic of Germany and German Democratic Republic

Table No. 3

Variables description for Structural Equations Modeling

Name	Description	Source	Notation
FDI stock	Inward FDI stock, bln USD	UNCTAD	f
GDP	GDP, bln USD	World Bank	p
HH Index	Herfindahl-Hirschman Market Concentration Index	WITS	h
Cultural Synchrony	Average Cultural Synchrony	Calculated by the author based on OECD, BNR and Zait (2012)	s
Religiosity	Religiosity Index	Elaborated by the author based on WVS data	r
Technical progress	Technical progress (Percentage of high technology exports in total manufactured exports)	World Bank	x
Economy openness	Economy’s degree of openness (Percentage of trade in GDP)	World Bank	d
Education	Tertiary education enrollment %	World Bank	e
Urbanization	Urban population, %	World Bank	z
Unemployment	Unemployment rate, %	World Bank	j

Table No. 4
Regression results for the simultaneous equations model

f_t	=	78,971	+	0,274 p_t	-	643,665 h_t	-	128,660 s_t	+	2,014 r_t
		(0,488)		(4,167)		(-2,290)		(-0,939)		(2,661)
		$R^2=0,931$			F=78,340			DW=1,746		
p_t	=	414,697	+	1,771 f_t	+	8,781 x_t	+	0,845 d_t	-	7,540 r_t
		(5,850)		(10,606)		(4,944)		(2,223)		(-6,496)
		$R^2=0,958$			F=132,633			DW=1,099		
r_t	=	226,159	+	0,002 p_t	+	0,220 e_t	-	3,225 z_t	+	0,479 m_t
		(5,973)		(0,361)		(14,513)		(-4,490)		(2,037)
		$R^2=0,954$			F=121,108			DW=0,591		

Note. Figures in parentheses are the t-values

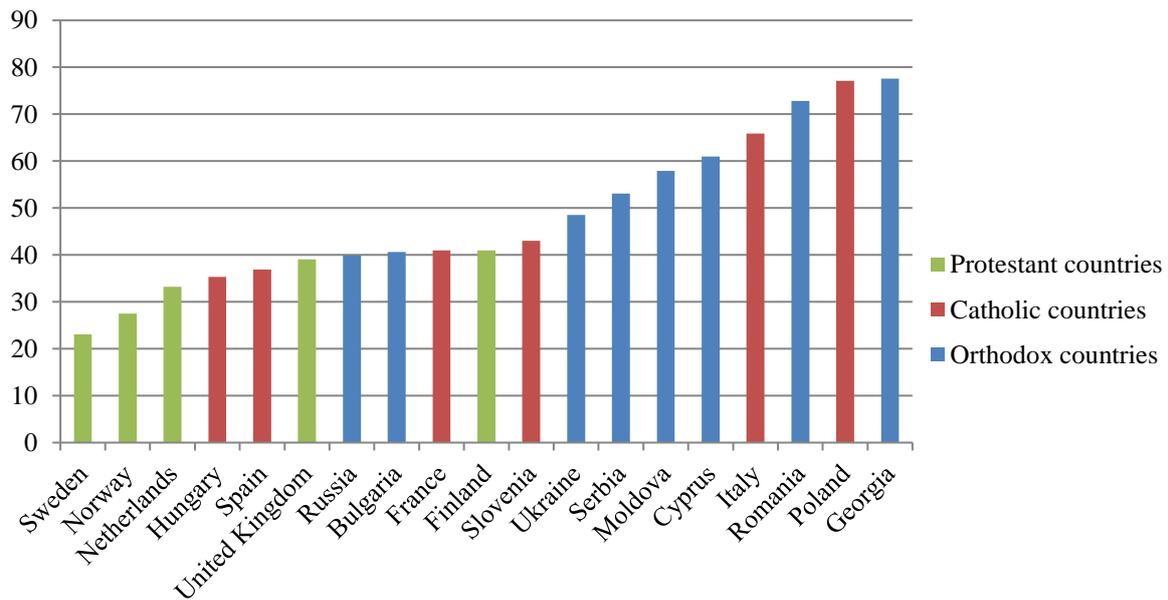


Figure No. 1

Religiosity Index values for European countries depending on dominant confession

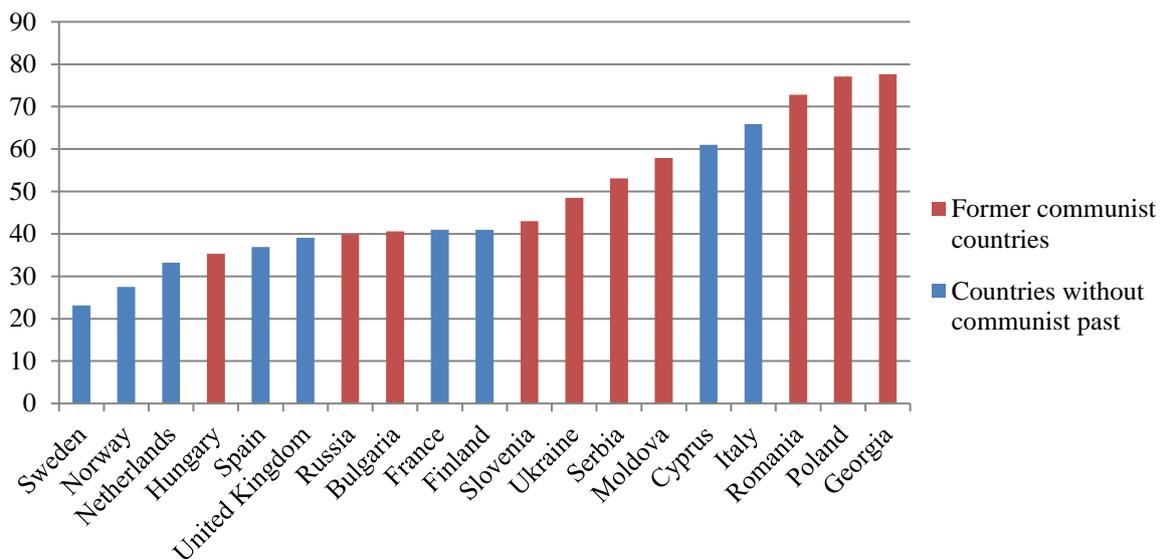


Figure No. 2

Religiosity Index values for European countries depending on the existence of communist past

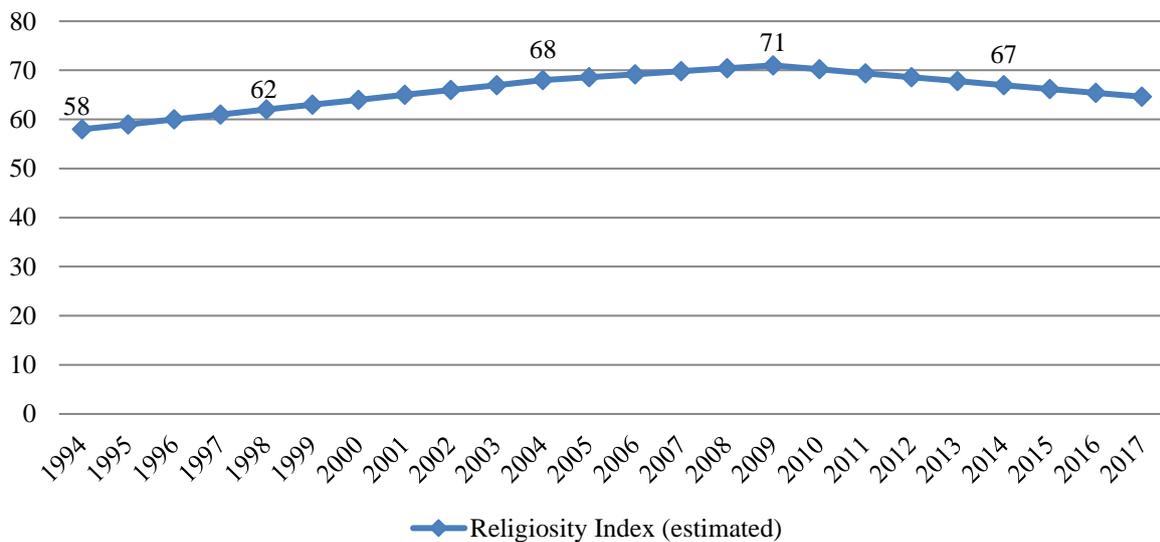


Figure No. 3

Religiosity Index estimated values for Romania

Note. Basic values, calculated based on the answers from the World Values Survey (WVS), are mentioned in the Figure above the corresponding point: 1994 – 58 (wave 2, 1990-1994), 1998 – 62 (wave 3, 1995-1998), 2004 – 68 (wave 4, 1999-2004), 2009 – 71 (wave 5, 2005-2009) și 2014 – 67 (wave 6, 2010-2014).