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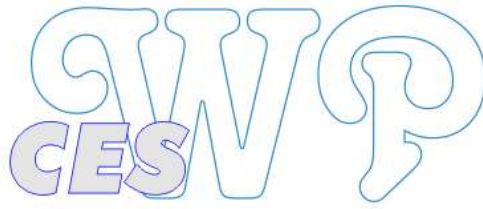
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KNOWLEDGE AND INNOVATION - ESSENTIAL FACTORS FOR OVERCOMING THE CURRENT ECONOMIC IMPASSE

Ramona Frunză¹

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Abstract: *Human resource is currently the most valuable wealth of a nation and carries with it the most important principle of development; it is about innovation, without which competitiveness is unthinkable. Romania is part of the “catching-up” group of countries in innovation. In order to assume new responsibilities and to prepare for the competition with other European countries and not only, many reforms and changes is necessary.*

Assuming these premises, in this paper, our intention is to analyze the situation of innovation at EU level and to see at what chapters our authorities must to work harder to equalize the other states from the Western European states. This thing is absolutely necessary because, now, when our country makes part from EU, it needs to invest in human resources through better education, skills and support.

Keywords: knowledge, innovation, economic impasse, technological change, research

JEL Classification: O1, O31, O32

1. INTRODUCTION

We live today in a world of rapid economic and social change. Any change typically causes other changes, which in turn cause others, and so on, in a concatenation of linked causes and effects. The fact that innovations, both technological and organizational/institutional, are the principal wellspring of economic growth is well recognized (Ruttan, 1978, p. 347). Is it also widely recognized that freedom, based on secure rights, is an essential prerequisite for the promotion of innovation and the increase in wealth that results from it (North, 1988, p. 25).

We can think of technological change as occurring in three stages: invention, innovation, and diffusion. Invention creates new technologies or improves existing ones. Until the nineteenth

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century, individuals, operating more or less on their own, were responsible for most inventions. In the second half of the nineteenth century, invention became institutionalized by the creation of research laboratories both in firms and in the public sector. Today, a large share of invention is done in government and university research laboratories or in the R&D facilities of large firms, while a much smaller fraction is performed by individuals. Innovation occurs when some agent commercializes an invention by producing something that has economic value. This can itself require much development and supporting inventions before the original invention can be embodied in saleable goods or services (thus blurring the distinction between the two). Diffusion is the spreading of invention and innovation from the place where they first occur to other firms in the same industry, to other industries, and to other countries. As technologies diffuse, they usually require changes to adapt to different situations. So, diffusion and innovation are to a great extent intertwined, they are different but closely related activities.

In many contexts, the distinction between invention and innovation is important. For example, many societies have been good at one but not the other. Being able to innovate on the platform of other people's inventions can be socially profitable, while being successful at invention but not at innovation can lead to serious social wastes. Since new technologies largely result from activities of profit-motivated agents, technological change is significantly endogenous to the economic system. Furthermore, scientific and technological knowledge is cumulative. Today's knowledge could not have been discovered or invented in the absence of many earlier discoveries and inventions.

Innovation is a process that is accumulative and it is surrounded by uncertainty (Lundvall, 1992, p. 15). It is impossible to separate innovation from evolutionary economics as well as from theories of technical change and institutional change. The interaction between innovation and economic change is an evolving terrain. It has been signaled that innovation can create employment and also can destroy employment. It means that there is something to be said about good and bad thing about innovation (Edquist, 1997, p. 27).

Modern societies are constantly adapting to new technologies. Because not all of these adaptations have been peaceful or trouble-free, technology has a bad name in some circles. That's why had existed some critics that emphasize the destructive aspects of innovation and technological change. It destroys specific jobs (while creating others), alters patterns of trade, and even eliminates entire ways of life (Nelson, and Winter, 1982, p. 48). The First Industrial Revolution destroyed the livelihood of many craftsmen, while moving work, from the villages to the new industrial towns, where the poverty and squalor that had existed for millennia in the countryside became visible to urban onlookers. The automation, restructuring, and downsizing that has resulted from the late

twentieth-century revolution in information and communication technologies (ICTs) has destroyed the jobs of many unskilled and semi-skilled factory workers as well as many in middle management. Also, while narrowing the gap between rich and poor through the first seven decades of the twentieth century, technological change has helped to widen that gap dramatically since then. But, in time, many researchers have demonstrated that technological change is the most important determinant of long-term economic growth. Through many thousands of years of economic and social evolution, our adaptations to the technologies that we have created have helped to mould and remould our economic, social and political institutions and our behavioral patterns.

2. THE CONNECTION BETWEEN INNOVATION AND ECONOMIC GROWTH

Growth depends on the introduction of innovations. Innovation means doing something that has not been done before. It could be the production of a new good, the opening up of a new market, the discovery of a new source of supply, the development of a new method of production, or changes in the rules of the game (Rosenberg, and Birdzell, 1986, p. 36).

To be leader in innovation and R&D is critical in today's hypercompetitive business environment. It involves years of patient investigation, punctuated by moments of inspiration. It positions uncontrollable creativity side by side with disciplined business process. And it is, for most companies, tremendously difficult to achieve. A successful innovating firm is the one in which the management succeeds to take maximum advantage of existing or potential markets and new opportunities by making appropriate use of the firm structures and resources (including R&D). On the other side, a successful innovation policy is a competition policy where companies see innovation as a cost-effective investment to differentiate them profitably.

The only effective measure of innovation activity is the rate of productivity improvement in an enterprise - the growth in added-value generated per employee. There are lots of ways to "game" productivity in the short-term - for example, by raising prices or by cutting staff and forcing the remaining people to work harder. But these can't be sustained - over time, they generate diminishing returns or, in the extreme case, lead to productivity erosion. What really counts is the ability to sustain and amplify productivity improvements through innovative products, process improvements or new business models. From a competitive point of view, what matters is the relative rate of productivity improvement. R&D spending and patent filings will matter little if they do not translate into faster productivity improvement - in fact, they can be a significant distraction. Those who understand this will have a significant edge as competition intensifies in the global economy. For a firm, R&D is useful to generate innovative ideas associated with design, quality and process

control, technical assistance to production and customers, or with pure research. R&D itself does not make a firm innovative. R&D can contribute to establish criteria for quality and to develop methods to verify them; also it should cooperate to find solutions to production and customers' problem. These activities are important if R&D is to really benefit a firm. R&D facilities must be interdisciplinary - they must include technical, marketing, economics skills to generate packages of new products/processes/services.

Research and experimental development comprise creative work undertaken on a systematic basis to increase the stock of knowledge to devise new applications.

In the knowledge-driven economy, innovation has become central to achievement in the business world. With this growth in importance, large and small organizations have begun to reevaluate their products, their services, even their corporate culture in the attempt to maintain their competitiveness in the global markets of today. The more forward-thinking companies have recognized that only through such root and branch reform can they hope to survive in the face of increasing competition.

Economies are slowly recovering from the most severe economic downturn since the Great Depression. To emerge from the downturn and put countries back on a path to sustainable growth, continuous innovation will be required. However, financing innovation becomes harder in economic downturns when both cash flows and investment funds are shrinking (OECD Science, Technology and Industry Scoreboard, 2009).

According to the *EU Economic Review* (European Commission, 2004), a substantial increase in knowledge investment (R&D and education) could boost potential EU growth rates by between one half and three quarters of a percentage point annually over a 5-10 years horizon. That's why, especially, in the recent countries integrated in EU (Romania and Bulgaria), it is necessary to increase the efficiency of R&D, improve the transformation of new ideas into new products, processes, services and solutions, and make the overall environment more supportive of firms wanting to increase investment in R&D. In this respect, the European Commission's action plan through *Europe 2020 Strategy* proposed a set of actions to boost public and private R&D efforts in order to approach R&D intensity (i.e. R&D expenditure to GDP ratio) of 3 % by 2020.

The level and intensity of overall expenditure on R&D are key determinants of the future competitiveness of an economy. But it is also important to look at the sectors in which this R&D is performed. The level and intensity of business R&D expenditure, as well as the structure of its funding, is therefore a key determinant of an economy's future competitiveness, and a key concern for policy-makers. This is why the European Council has stipulated that two thirds of R&D expenditure should be financed by the business sector.

A country's performance in the knowledge-based economy is not measured simply by outputs of science and technology, but must also be judged in relation to the important goal of increasing its competitiveness. A competitive economy is increasingly understood as an economy able to achieve sustained rises in standards of living for its population at low levels of unemployment. The key determinant of competitiveness is labour productivity. Gains in labour productivity are the result of increasing human capital, capital deepening and technical progress or innovation as measured by total factor productivity. The degree of innovativeness is determined by firms' own R&D activities leading to new products or processes and by spill-over effects that magnify the benefits of own R&D efforts, but also by diffusion effects associated with imported technology and the presence of multinational firms.

3. INNOVATION IN EUROPE

To create a favourable frame concerning the development of innovation and R&D, the authorities from EU have adopted many acts. An important one of them was the Lisbon Strategy and, for example, in January 2006, The Aho Report, who outlines the following areas for action:

- The need for Europe to provide an innovation-friendly market for its businesses, the lack of which is seen as the main barrier to investment in research and innovation. This needs actions on regulation, standards, public procurement, intellectual property and fostering a culture which celebrates innovation. A combination of supply and these measures to create demand should be focused in large scale strategic actions. Several examples have been identified: e-Health, Pharmaceuticals, Energy, Environment, Transport, Logistics, Security and Digital Content;
- The 3% target is seen as an indicator of an Innovative Europe, not as an end in itself. Measures are needed to increase resources for excellent science, industrial R&D and the science-industry nexus. Productivity of R&D must be increased. The proportion of structural funds spent on research and innovation should be trebled;
- Far greater mobility is needed at three levels: human resources need a step change in mobility across boundaries; financial mobility requires an effective venture capital sector; new financial instruments for the knowledge-based economy;
- Mobility in organization and knowledge means cutting across established structures to allow new linkages to be made through the instruments of European Technology Platforms and clusters.

All these measures had been taken because the European Commission is conscientious by the importance of innovation and R&D in economic growth. Innovation is essential for sustainable growth and economic development.

In time, was realized many studies regarding the statistics in Europe in innovation and R&D domain. For example, a relevant study was effectuated in 2007 year by *The Fourth Community Innovation Survey (CIS4)* in collaboration with the *European Commission of the European Innovation Scoreboard (EIS)*. This study was realized in the EU 27 at the level of 42% of enterprises from industry and services that have reported some form of innovation activity between 2002 and 2007. Enterprises with less than 10 employees weren't covered.

The results of the study show like in the table 1:

Table 1 Innovation activity and cooperation² during 2002-2007

	Enterprises with innovation activity, % of all enterprises	All types of co-operation with other enterprises or institutions	Co-operation partners:			
			Suppliers	Clients or customers	Universities or other higher education institutes	Government or public research institutes
% of all innovative enterprises						
EU27	42	26	17	14	9	6
Belgium	51	36	26	21	13	9
Bulgaria	16	22	16	13	6	4
Czech Republic	38	38	31	26	13	7
Denmark	52	43	28	28	14	7
Germany	65	16	7	8	8	4
Estonia	49	35	23	23	9	6
Ireland	52	32	23	25	10	6
Greece	36	24	11	8	6	2
Spain	35	18	9	4	5	5
France	33	40	26	20	10	7
Italy	36	13	7	5	5	1
Cyprus	46	37	24	4	2	2
Latvia	18	39	33	29	14	12
Lithuania	29	56	45	35	12	10
Luxembourg	52	30	24	22	10	8
Hungary	21	37	26	20	14	5
Malta	21	32	22	17	4	4
Netherlands	34	39	30	22	12	9
Austria	53	17	7	8	10	5
Poland	25	42	28	16	6	9
Portugal	41	19	14	12	8	5
ROMANIA	20	17	14	10	4	4
Slovenia	27	47	38	33	19	13
Slovakia	23	38	32	30	15	11
Finland	43	44	41	41	33	26
Sweden	50	43	32	28	17	6
United Kingdom	43	31	23	22	10	8
Iceland	52	29	20	20	5	13
Norway	37	33	23	22	15	16

Sources: Fourth Community Innovation Survey (CIS4) and European Innovation Scoreboard (EIS), 2007

² Innovation cooperation measures the active partnership of the observed enterprise with other enterprises or non-commercial institutions such as universities or public research institutes.

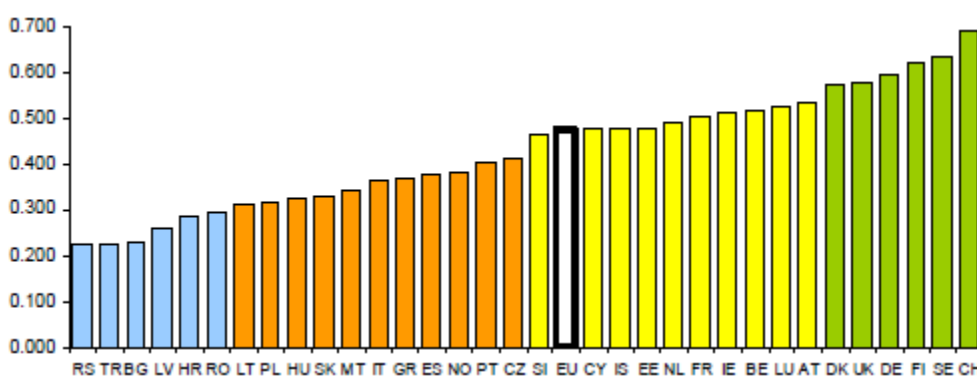
We observe that among the EU27 Member States the highest proportion of companies with innovation activity in this period was recorded in Germany (65% of enterprises), followed by Austria (53%), Denmark, Ireland and Luxembourg (52% each), Belgium (51%) and Sweden (50%). The lowest rates were observed in Bulgaria (16%), Latvia (18%), Romania (20%), Hungary and Malta (both 21%). Concerning the innovation cooperation, the highest levels were found in Lithuania (56% of all innovative enterprises), Slovenia (47%) and Finland (44%), and the lowest levels in Italy (13%) and Germany (16%).

In the EU27, the most common co-operation partners were suppliers (17% of all innovative enterprises worked with them) and customers (14%). Suppliers were the most frequent partners in nearly all Member States, with the highest levels found in Lithuania (45%) and the lowest in Germany, Italy and Austria (7% each). Cooperation with customers in innovation activities ranged from 4% in Spain and Cyprus to 41% in Finland. Innovative enterprises in the EU27 worked together much less often with universities and other higher education institutes (9%) or government and public research institutes (6%). Private-public cooperation on innovation was most frequent in Finland, Slovenia, Slovakia, Latvia and Lithuania, while it was least common in Italy, Malta, Romania and Cyprus.

Another study concerning the leaders from Europe in innovation's sector was realised by *The European Innovation Scoreboard (EIS)*, in 2010 year.

The results of the study are presented in the following:

Graphic 1 Innovation performance EU27 Member States, 2009



Source: EC, European Innovation Scoreboard, 2009.

Note: The Summary Innovation Index (SII) is a composite of 29 indicators going from a lowest possible performance of 0 to a maximum possible performance of 1. The 2009 SII reflects performance in 2007/2008 due to a lag in data availability. The grey colored columns show 2008

performance as calculated backward from 2009 using the next-to-last data for each of the indicators. This 2008 performance is not identical to that shown in the EIS 2008 as not for all indicators data could be updated with one year. The difference between the columns for 2008 and 2009 show the most recent changes in innovation performance.

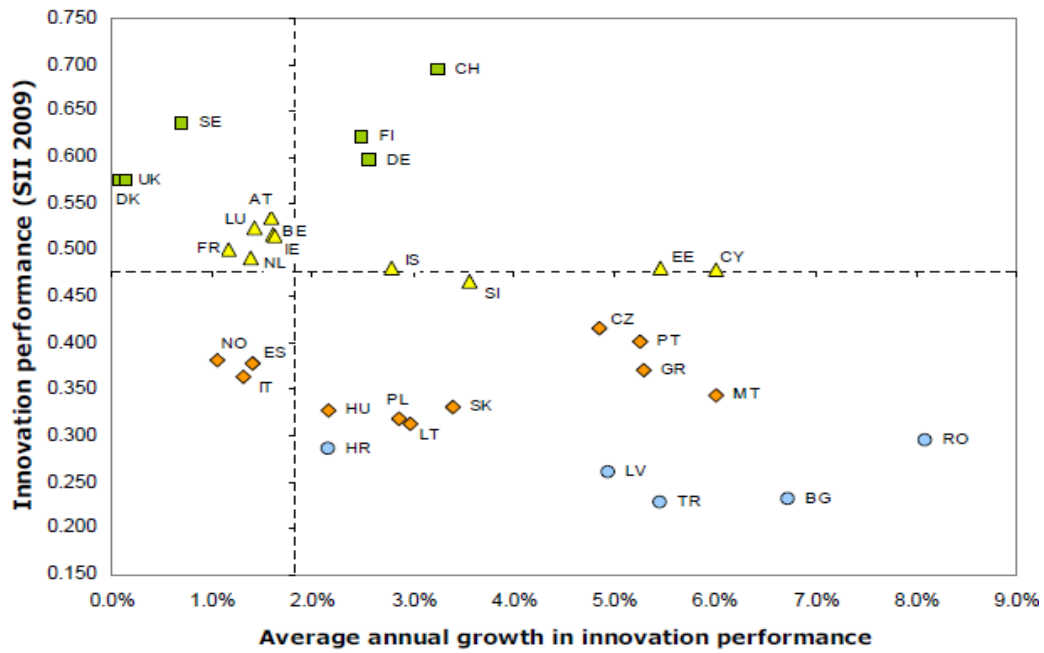
Based on their innovation performance, EU27 Member States fall into the following four country groups³:

- Denmark, Finland, Germany, Sweden, Switzerland and the UK are the Innovation leaders, with innovation performance well above that of the EU27 and all other countries;
- Austria, Belgium, Cyprus, Estonia, France, Iceland, Ireland, Luxembourg, the Netherlands and Slovenia are the Innovation followers, with innovation performance below those of the innovation leaders but close to or above that of the EU27;
- Czech Republic, Greece, Hungary, Italy, Lithuania, Malta, Norway, Poland, Portugal, Slovakia and Spain are the Moderate innovators with innovation performance below the EU27;
- Bulgaria, Croatia, Latvia, Romania, Serbia and Turkey are the Catching-up countries. Although their innovation performance is well below the EU27 average, this performance is increasing towards the EU27 average over time.

To highlight clearly, in the graphic 2 is presented the convergence in the innovation performance:

³ The country groups have been identified using the average results of hierarchical clustering using 7 different clustering methods: Ward's method, between-groups linkage, within-groups linkage, nearest neighbour, furthest neighbour, centroid clustering and median clustering.

Graphic 2 Convergence in innovation performance



Source: EC, European Innovation Scoreboard, 2009.

Note: green are the Innovation leaders, yellow are the Innovation followers, orange are the Moderate innovators, blue are the Catching-up countries. Average annual growth rates as calculated over a five-year period. The dotted lines show EU27 performance and growth. SII=The Summary Innovation Index.

So, shortly, the innovation growth leaders are:

Table 2 Innovation growth leaders

Group	Growth rate	Growth leaders	Moderate growers	Slow growers
<i>Innovation leaders</i>	1.5%	Switzerland (CH)	Finland (FI), Germany (DE)	Denmark (DK), Sweden (SE), United Kingdom (UK)
<i>Innovation followers</i>	2.7%	Cyprus (CY), Estonia (EE)	Iceland (IS), Slovenia (SI)	Austria (AT), Belgium (BE), France (FR), Ireland (IE), Luxembourg (LU), Netherlands (NL)
<i>Moderate innovators</i>	3.3%	Czech Republic (CZ), Greece (GR), Malta (MT), Portugal (PT)	Hungary (HU), Lithuania (LT), Poland (PL), Slovakia (SK)	Italy (IT), Norway (NO), Spain (ES)
<i>Catching-up countries</i>	5.5%	Bulgaria (BG), Romania (RO)	Latvia (LV), Turkey (TR)	Croatia (HR)

Source: after EC, European Innovation Scoreboard, 2009.

In the last years, the specialists in the endogenous growth theory emphasized in their papers that a country or a region can become a significant source of competitive advantage if it attracts local assets and associates externalities and economies of scale with spatial and specialization innovation clusters. This supposes the reduction of transaction costs, agglomeration, concentration, technological innovations, qualified working force etc. The economic potential of innovation clusters enjoys attention at all the decision levels from Europe.

As regards our country, the picture shows rather clearly the insufficient development of competitiveness clusters, the relatively incipient character of their formation, especially through the activity's profile, but also through the absence of some characteristics of mature clusters (Birsan, M., 2006, p. 39). The studies carried out in Romania by the Group of Applied Economy and the International Centre for Entrepreneurial Studies (CISA) emphasize a rather painful truth, namely that the native clusters are in an incipient stage: 85% of the companies have a non-innovative character, 3% are strategic innovators, 8% are intermittent innovators, 4% adopt new technologies and only 2% implement new technologies. We believe that this is mostly due to the problematic managerial capacity.

4. CONCLUSIONS

Because of factors such as globalization, increasing competition, the growing impact of information and communications technology, and the high pace of scientific and technological change, firms must innovate more rapidly than ever before. Without having innovation and R&D means to be uncompetitive. A possible explanation that some countries from Europe are poor in innovation and R&D is that the innovation policy objectives are still defined very ambiguously. They don't set clearly defined objectives at a more strategic level or link the expected outcomes to specific sets of measures. Thus, to know the way to competitiveness, the government from each member country of EU 27 must take efficient measures in this direction, and also, must invest and take all efforts to sustain innovation and R&D domain.

We consider that to have innovation and encourage economic growth a state must be disposed by: strong standards and effective enforcement of intellectual property protection, vigorous competition and contestable markets, open trade and investment in a stable economic environment, a strong and sustainable fundamental research and development infrastructure, sound policies and mechanisms to promote the science-innovation interface, efficient and transparent regulatory systems, ethics and the rule of law, and a strong emphasis on education at all levels.

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***EC, European Innovation Scoreboard, 2009.

***OECD Science, Technology and Industry Scoreboard, 2009.

THE ECONOMIC – FINANCIAL CRISIS 2007 – 2009

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Abstract: *This article takes a look at the well known economical and financial crisis, which affected all the countries in the world. When comes to Europe, the most affected countries were the Baltic countries: Estonia, Latvia and Lithuania. The economy of these countries shrank enough, so that they cope with another wave of crisis.*

Keywords: financial crisis, irrational exuberance, Baltic countries

JEL Classification: E65, F42, N14

1. INTRODUCTION

The roots of the current economic - financial crisis are so deep, whereas dates from 1977, when the American government approved the U.S. federal law, "Community Reinvestment Act," in order to help those poor people who could not afford a house. Under this facade of "equal opportunities" and "racial equality", banks have been forced to borrow low income individuals. Moreover, Fannie Mae and Freddie Mac have developed as institutions that were securing mortgages in the United States of America. This policy of "charity" was led by Bill Clinton, an advocate of the motto "A home for each American." Bush **speculated the potential in elections** and took over the reins of this policy in order to retain a part of the votes for the next election. And that's not all!

Alan Greenspan is also a "legendary hero, "as the economist Paul Krugman likes to names it, **but what percentage in good words?** Let's not blame him. However, in 1996, in one of his speeches he used the phrase "irrational exuberance." Of course nobody knew what Greenspan wanted to say, but this "irrational exuberance" was hiding in fact a speculative bubble of shares prices on the financial markets. Although he warned about this, Greenspan did not take the necessary measures: he did not increase interest rates and he did not require a necessary margin to

investors. As a result, this speculative bubble, known as the "*dot-com crisis*"⁴ demonstrated once again the insatiable greed of people.

The birth of a business model based on the new information technology was enough to start the race after profit, because, in a short while, the number of investors increased significantly. Indeed gains were substantial and shares prices were increasing more and more. Man was hearing all kind of stories about the healing effects of the new technologies, but these stories were merely "tickling stories for the psychological comfort of the audience" (Krugman, 2009, p. 168). Funds were flowing, prices were increasing, and as a result, the bubble finally burst out, shares prices have collapsed and have left a free path for the second Greenspan's speculative bubble, the housing bubble. Greenspan cannot be blamed for what happened in 2000, since his decisions have been sustained by many economists, but it should not be ignored the fact that he didn't do anything to stop the bubble to burst out.

Greenspan tried to calm the situation by decreasing the interest rates, so that in 2003, he lowered the federal funds rate target from 6.5% to 1%. Meanwhile, this drawback of interest rate was supplying continuously the increasing prices of the American homes. At this point, **came also into play** the relaxing conditions of mortgage loans that have abandoned the traditional lending standards. More people and more people wanted to buy a house, so they ignored the fact that they could not afford to pay the rates. We are now speaking of individual families "irrational exuberance" who have seen the house prices increasing and still have decided to buy a house without worries that they will not be able to pay later" (Krugman, 2009, p. 170). In these circumstances subprime market arose.

Due to the high risks that these questionable loans were hiding, borrowers did not keep them into their portfolio, but sold them to financial entities that were specialized in high-risk operations ("hedge funds"⁵). The "placement" of these mortgages was made in chain, and investors did not know what they were buying. The fact is that these mortgages were promising high returns so they attracted more investors and more on the market. "The housing bubble was running on autopilot now, and as a snowball, was gaining in intensity" (Financial Week, 2009), but no one had awareness of it.

Warnings of some economists on the existence of a speculative real estate bubble were useless. Alan Greenspan was no longer in charge at FED. Even if he recognized the existence of a "speculative foam" on the real estate market, he has ignored the possibility of bubbles bursting and the possible disastrous effects on the entire world. Indeed, Mr. Greenspan was wrong again, so that

⁴ Dot.com crisis - crisis caused by informational technology development, especially internet

⁵ hedge funds – speculative funds

the speculative bubble burst out in 2006 and in 2007 it triggered, as we all know - the global financial and economic crisis.

If we are to look from outside, this crisis flowed as in **“the handbook”** because facts have developed according to Minsky's model. The exogenous shocks on the economy was, the development of a favorable environment for housing construction and a relaxed financial framework which offered access to credit to low-income population, when the crisis has burst out. The market reached to saturation, so that interest rates began to increase, and house prices to decrease. So when it came for the low-income population to pay the rent.....where is the money? The signals of alert on the credit market were perceived as a threat by banking companies which have bought financial products. These companies have tried to capitalize their shares by selling them on the stock market, but the large number of real estate securities lowered the price. Many banks, investment funds, insurance companies were forced to close their doors.

When "giants" such as Lehman Brothers, Bear Stearns, Merrill Lynch and AIG are on the verge of bankruptcy then panic occurs: "when Lehman Brothers has announced that they are bankrupted, everyone understood that crisis has burst out in the United States. Intervention of the Federal Reserve to rescue the insurance giant American International Group, also near to collapse, has failed to calm global fears. The prices of shares have fallen in the entire world, while customers were preparing to withdraw their policies" (Money Express, 2008). It did not take long until the panic extended in the entire world.

Injections of liquidity in the economy were considered the best solution for saving a part of insurance or financial companies such as AIG, under the pretext that they are "too big to be left to fall." The Bank of England's Governor, Mervyn King was "booed" when he intervened on the financial market to support the mortgage bank Northern Rock, although he opposed to financial injections to save those firms and banks that have shown imprudence when coming to lending. The fact that FED, ECB and other major central banks have decreased interest rates, had no relevance to market loans. What did central banks do, is linked to the desire of avoiding recession in the U.S.A., in order to prevent the damaging of the financial systems" (Dăianu, 2009, p.152). If it was wrong or not when these decisions have been taken, is too late for something to be done.

So what did this crisis actually caused? If we had to analysis what happened until now, we can observe easily that population has lost her trust, her confidence in banks, confidence in job securities, and has lost confidence in the financial systems. Developing countries that have began to be familiar with economical growth, were the most affected. People who thought their lives have changed in better, had a shock when they saw themselves in debt or homeless.

According to Minsky's model, we can say that now we are in the final stage of crisis, when panic has dissipated, the consequences of disaster are evaluated and reconstruction measures are taken. We are now trying to find the guilty ones just to exonerate ourselves. It is said that we are now recovering, maybe yes ... but with the cost of a contagion that has spread throughout the international financial sector, packed with "financial security packages" and caused by mortgages.

Let's be honest: **to no one has crossed his mind that a financial** - economic crisis will burst out in 2007. Actually, there were enlightened voices which have warned about this, and yet we did not prepare for it. We should have learned from the old crisis that occurred since Great Depression. These crises have occurred like flu symptoms and we ignored that: Headaches - Japan 1990, running nose - Mexico in 1955, fever - Thailand, Malaysia, Indonesia, and Korea in 1997, muscle pain - Argentina in 2002, until it puts you into bed - everyone in 2008. It's time for those people responsible for the political governance around the world to take the necessary and fair measures, to save us, because this flu will not pass so easily.

Lending is the first thing that should be considered. If at the beginning you were taking credit to buy a house even if you were working at a store as a seller, now are needed much more guarantees. People and institutions have withdrawn in their "shells" and refuse to do business with anyone. Capital reserves have disappeared. Now, debates among economists that we need our state that do not need our state or a well set monetary policy, have no sense. Now, are necessary those discussions regarding measures to stimulate individuals demand. But how can create sufficient demand using the economy as it is now? As Krugman says the decline of economy returned.

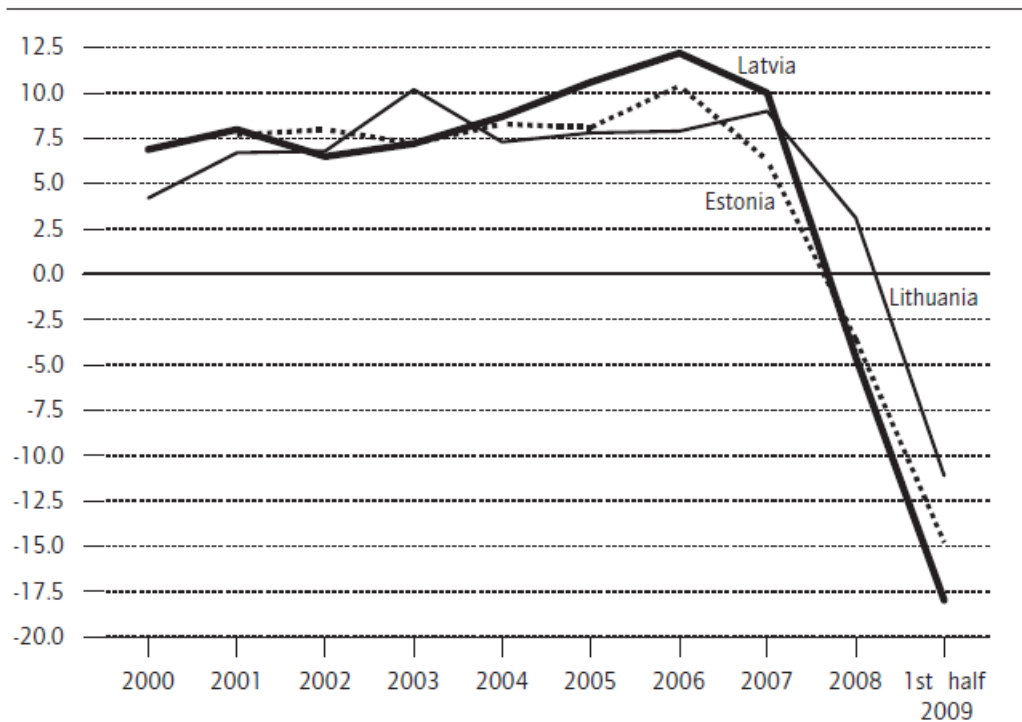
2. THE FINANCIAL CRISIS AFFECTED AND THE BALTIC COUNTRIES

Of all the E.U. countries, the countries that were hit the hardest by the economical financial crisis are the Baltic countries. After years of purchasing homes, cars, and lands consumers had realized that they have no money to pay their rates. It's hilarious because, shortly before the economical - financial storm, the Baltic countries have seen an economical increase. Between the years 2001 - 2007, GDP has maintained at an average of 7-8%, even higher than the GDP of some of the new European Union countries.

But the global crisis covered quickly the Baltic countries, so that in the year 2008 Latvia's GDP decreased with 4,6% and Estonia's with 3,6%. The economies of these countries virtually collapsed and continued to collapse in first half of 2009, Estonian's GDP reducing with 15.7%, Lithuania's with 11%, and Latvia's with 18.8%. These countries did not have the chance to enjoy

their economic growth because they were hit by the wave of a full economic - financial crisis, which soon enveloped all the world states.

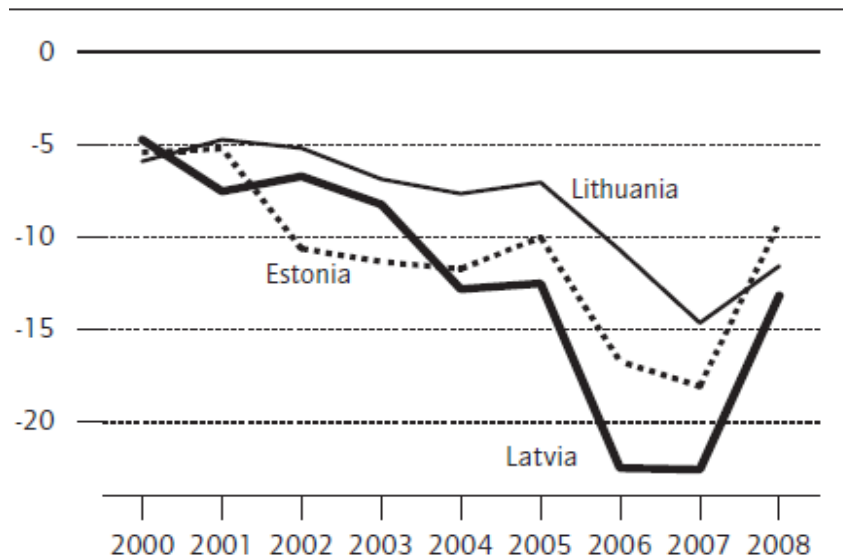
Graphic 1 Real gross domestic product in the Baltic States



Source: Alvarez and Engerer, 2009, p. 232

The increase of the strong demand in these countries, which followed the outbreak of the crisis, has been accompanied by an increase in the current account deficit, being largely financed by foreign banks as Sweden, Germany and Scandinavian countries, which owned important shares from the credit market. Their branches took loans from the mother companies and they oriented them to households and companies.

Graphic 2 Current account deficits in the Baltic States

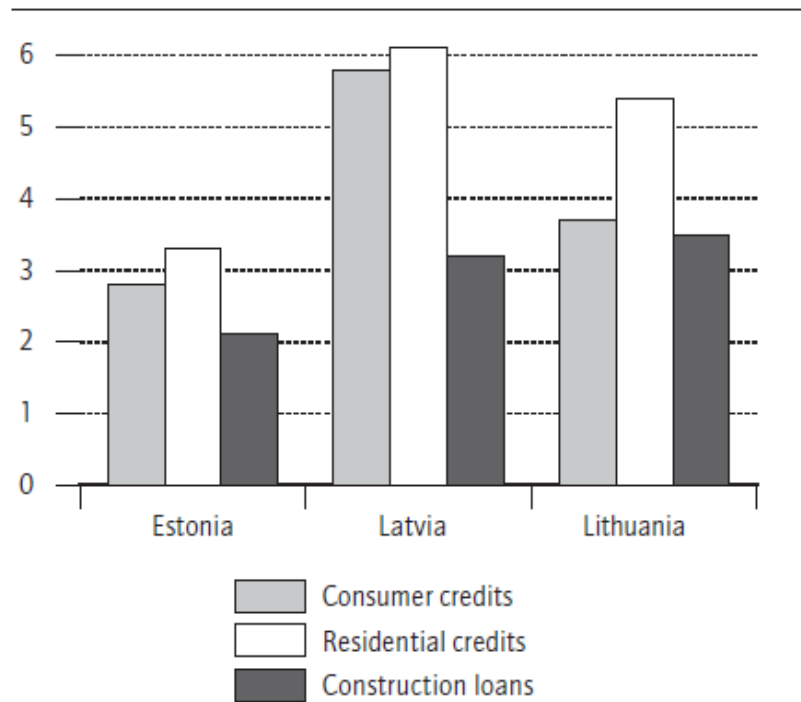


Source: Alvarez and Engerer, 2009, p. 232

The loans for householders grew faster than those granted to companies, but once with the increase in the mortgage lending's, the return rate increased in the same measure, even more. A big share of credits were given in euro, even if householders and companies that didn't had incomes in foreign currencies, and these led to a big collapse of the housing market. The payment of the credits in national currency it became more expensive for local loaners. As regards of the credits in foreign currencies, at the end of the year 2008, Latvia estimated a percentage of 88, 4%, Estonia 85, 1% and Lithuania 60%.

From this point of view, Baltic countries were disadvantaged, because the economical – financial crisis led to the national currency devaluation, and precisely in the period of pre – accession to the Euro Zone. Practicing an exchange rate rigidly anchored to the euro, led to artificial increase in assets prices, and lower ranges of variation of the exchange rate made much more pressure on fiscal policy, the main tool for protecting economies from imbalances. Strict fiscal measures for exchange rate support from government's side are necessary as a repetition of the cycle grows- decline could not be supported by the Baltic countries.

Graphic 3 Corporate credits, residential construction loans and consumer credits in the Baltic States



Source: Alvarez and Engerer, 2009, p. 232

External debt was also affected by the economical – financial crisis in the Baltic countries, reaching at the end of 2008, in Latvia to reach at 42 billiard American dollars (124%), to 32, 5 billiard American dollars (118%) in Lithuania, and 27, 4% billiard American dollars (68%) in Estonia.

3. CONCLUSIONS

The financial – economic crisis affected countries around the world, but severe effects were felt in countries that have given credits way to easy. The Baltic countries choose to exceed the transition to capitalism through an easy credit policy. Compared with other European countries, the prospects of the Baltic countries for the next years are bleak. The chances of economic recovery in these countries will reduce a lot in the case of another economic crisis or in the case that it would be proved that the actual crisis is in W.

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ANNEX 1

Country	GDP (millions of USD)	Coverage in DRB (km²)	Transport fuel consumption in 1000 t	GDP achieved with 1000 t fuel consumed for transportation (million of USD) Col2/Col4
Austria	374.400	80.423	7994	46.835
Bosnia-Herzegovina	16.960	36.636	1122	15.115
Bulgaria	44.780	47.413	2560	17.492
Croatia	61.720	34.965	1902	32.450
Czech Republic	189.700	21.688	6569	28.878
Germany	3.235.000	56.184	61958	52.212
Hungary	124.200	93.030	4175	29.748
Montenegro	4.444	7.075	830	5.354
Republic of Moldova	5.328	12.834	1049	5.079
Romania	160.700	232.193	4204	38.225
Serbia	42.390	81.560	1790	23.681
Slovakia	88.300	47.084	1805	48.919
Slovenia	49.550	16.422	1469	33.730
Ukraine	115.700	30.520	2445	47.321

THE COMPATIBILITY OF ROMANIA'S INDUSTRIAL POLICY WITH THAT OF THE EUROPEAN UNION

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Abstract: *Romania's position as one of the EU member states brought new challenges in terms of industrial policy, in order to respond to the necessity of bringing the competitiveness level of the Romanian economy close to the average level of the European states, by respecting the free trade principles of the European Union. Furthermore, in the near future Romania should be able to contribute to the achievement of the objective of transforming EU in the most competitive economy of the world. In this order, a market – oriented industrial policy is necessary, following the European industrial policy and the sustainable development concepts adopted by the European Commission, and based on the concept of competitiveness. The general purpose of a balanced economic growth, sustainable development and improvement of the economic competitiveness requires industrial policies created and implemented in tight connection with other relevant economic policies, such as the competition policies, those aiming for a functional business environment and those encouraging the SME development and attracting FDE, the policies in the education and research and development fields, the structural and regional policies, the commercial policies, the sustainable development and environment protection policies and those regarding employment and social cohesion.*

Key words: Industrial policy, competitiveness, European Union, competition policy, structural policy, regional policy, sustainable development

JEL Classification: L52, F02, F15

For Romania, becoming a member of the European Union involved not only benefits and opportunities, but also obligations related to the supplementary efforts required for economic development and enhancement of the industrial production competitiveness in order to reach a level comparable to the European average and contributing to the achievement of the European objective as set in the Lisbon Agenda: transforming EU in the most competitive economy of the world. In this order, a market – oriented industrial policy is necessary, following the European industrial policy and the sustainable development concepts adopted by the European Commission, and based on the concept of competitiveness. The European Union adopted a coherent attitude related to the

competitiveness policies, by grouping the Internal Market, Industry and Research in one single council, through a decision of the Council from Seville in June 2002.

In Romania, as consequence of the integration and adaptation of the economic policies to those of the European Union in view of enhancing the economic performances at a national level, the necessity of a coherent industrial policy became obvious. Therefore, in 2004, the document titled “Industrial Policy of Romania 2005 – 2008” was issued, establishing the main directions for action for the industrial policy for this period. The fundamentals of the industrial policy were based on encouraging the horizontal factors determining competitiveness: human capital, research, innovation, entrepreneurship, preservation the environment.

The industrial policy objectives for the determined period were established in correlation with the stipulations of other national economic policies and with the European guidelines. The main objectives of the Romanian industrial policy were defined as followig (Croitoru, Russu and Tarhoaca, 2002, p. 2):

- Enhancing competitiveness;
- Increasing the role of research, development and innovation;
- Promoting a sustainable management of natural resources and environment protection;
- Improving professional training and employment;
- Developing the cooperation and industrial services as well as the public – private partnership.

In the same time, the industrial policy priorities on medium term were defined (Croitoru, Russu and Tarhoaca, 2002): applying the industrial policy according to the specific necessities of each sector, improving the legislative frame favoring industry as well as the synergy of the different policies with direct impact on industrial competitiveness.

The same document established the economic policies’ program for the period of time taken into consideration, which assumed the legislative adaptation and creation of the institutions compatible with those of the EU, implementing and monitoring the harmonized legislation, improving the business environment, diversifying and modernizing the bank services, reducing taxation related to labor costs, moving forward to the informational society, adopting a coherent package of policies aiming to continue structural adjustments and improve competitiveness, creating an integrated system for controlling the industrial pollution, starting the main infrastructure projects and adapting the research and development system to the European operational structures.

The structural adjustments taken into consideration concerned the development of the industrial sectors insuring high added values, the development of industrial clusters, technologic

parks, regional development and SME encouragement, the modernization of the organizational structure of the companies as well as that of the management, environment rehabilitation, the stimulation of the cooperation between the local companies, increasing the role of innovation and technological research and starting some programs for producing and utilizing energy from renewable resources.

The general purpose of a balanced economic growth, sustainable development and improvement of the economic competitiveness requires industrial policies created and implemented in tight connection with other relevant economic policies, such as the competition policies, those aiming for a functional business environment and those encouraging the SME development and attracting FDI, the policies in the education and research and development fields, the structural and regional policies, the commercial policies, the sustainable development and environment protection policies and those regarding employment and social cohesion.

The competition policy “concerns those instruments that insure the market’s fundamentals and facilitate the development of efficient and competitive companies”(Negrescu and Oprescu, 2004, p. 4). Succeeding in such policies is one of the main factors of a functional market economy and a strong internal market. The competition policy must take into consideration the regulations concerning the incentives granted by the state in conformity with the European Acquis, as well as the provisions of the Law of Competition no. 21/1996 and the secondary legislation, following the European guidelines and must insure the necessary support for the Competition Council.

The competition policy objectives (Croitoru, Russu and Tarhoaca, 2002) concern the following aspects:

- strengthening the authority of the Competition Council and that of the Competition Office, in the purpose of increasing the capacity of these organisms to issue and implement the specific regulations;
- improving the legislation concerning the state incentives, according to the European Acquis;
- revising the legislation regarding the industrial parks, in conformity with the competition regulations.

The actions meant to encourage competition concern the limitation of the action area of the monopolies, continuing the pricing liberalization and avoiding anti-competition practices and economic concentrations.

One of the main factors acting in a decisive manner over the growth potential of industrial competitiveness is a viable and friendly business environment. Insuring a stable business environment, favoring a functional market economy, is one of the obligations that Romania assumed

during the integration process. Important steps have been made in this sense, by improving the legislative and institutional frame, increasing the investment flow, reducing bureaucracy and fighting corruption. However, Romania is still far from having a transparent, predictable and attractive business environment.

Developing a stable business environment is an objective that assumes a series of measures for increasing transparency and improving the Government – business environment – civil society dialogue, estimating the regulations' impact over the business climate, simplifying the administrative procedures, implementing a coherent system to monitor the foreign direct investments volume, implementing the corporate governance principles and strengthening the involved institutions.

One of the policies with major impact over the industrial policy actions is that of Small and Medium Enterprises encouragement, this sector having a special significance for the market economy development. SME are characterized by an enhanced capacity of reaction faced to the market stimuli and of adaptation to the economic structural changes. The Romanian authorities' policy in this field, so far, lacked coherence, the supportive periods being followed by those of total lapse.

A coherent strategy on the SME encouragement was adopted by the Government in 2001 only, through the "Action Plan to Eliminate Certain Barriers in front of Small and Medium Enterprises". The plan's objectives aimed to simplify the registration and licensing procedures for new SME, to improve the legal environment, to reduce and simplify the taxation system, to promote the access to financing resources and public contracts and to supply an informational system for SME.

The priorities (*Industrial Policy of Romania 2005 – 2008*, 2004, p. 8) for SME encouragement concern the creation of a favorable business environment, the development of the competitive capacities of SME, improving SME's access to financing resources and to the external markets and promoting the entrepreneurship and increasing management performances.

For implementing the SME encouragement measures the National Agency for Small and Medium Enterprises and Cooperation was created (ANIMMC), acting as national coordinator for implementing in Romania the European Book for Small Enterprises and the European multi-annual program for enterprises and entrepreneurship, particularly for SME.

Another factor influencing the industrial policy concerned the privatization and restructuration measures, which concerned completing the privatization processes for the state-owned companies, monitoring the privatization contracts, restructuring the activities for maximizing

their efficiency and modernizing and optimizing the technologic facilities from the potentially competitive industrial units.

In connection with the industrial policy and that for improving the business environment is the FDI promotion policy. Attracting foreign capital is possible by promoting Romania's image as a destination for foreign investors and assisting the foreign partners in the initial phases of FDI. The Romanian Agency for FDI was created with the purpose of issuing the FDI promotion strategy and an adequate legislation, and acting as a contact point for the new-coming and existing investors.

The development of education, human resources and social cohesion policies plays an important role within the industrial policy efforts. The main measures concern encouraging workers mobility, insuring a balance between the offer and demand of labor, developing the human resources management and, finally, insuring specialized training by a tight cooperation between the educational system and the business environment. The strategy for increasing the employment rate concerns the human capital development, creating new working places, encouraging both workers and companies' adaptability to the economic changes.

The social cohesion strategy involves actions aimed to attract social partners in the process of elaboration and implementation of the policies, by permanently consulting the economic operators and social dialogue partners, obtaining their support for implementing the structural adjustments and insuring an efficient active social protection system.

One of the politics with a considerable influence over the industrial policy is that encouraging research – development – innovation activities and infrastructure's development in order to evaluate the conformity of the industrial products. This factor is determinant in the efforts of reducing the development gap between Romania and EU and one of the main factors in increasing productivity and competitiveness.

An evaluation report (*Policies in the fields of Research, Technologic Development, Innovation. Romania's RDI policies in the attention of the EU member states (II) – the final evaluation report from the evaluators team from EU member states, 2005*) from a delegation of European experts concerning the research and development policies in Romania compared to Lisbon Agenda underlined the challenges related to the insufficient human resources basis for scientific and technologic research, the lack of adequate infrastructure, the insignificant connection between industry and R&D activities and the absence of a functional institutional and legislative frame. The same report underlined the necessity of identifying some main directions in the research activity and the main development channels, of structural improvement and increased concern over academic research.

The specific priorities (Croitoru, Russu and Tarhoaca, 2002) in the R&D field concern the capacity of defining and implementing coherent policy measures, finding the appropriate mechanisms for projects' identification, evaluating and granting the necessary funds, harmonizing the legal, institutional and procedural frame according to the European regulations and stimulating the modernization of the technical and informational infrastructure for research and development.

Sector assistance and regional policies are some other factors influencing the industrial policy and one of the most sensitive fields. Sector policy is defined and implemented by the Ministry of Economy and Commerce and concerns the encouragement of the strategic alliances with technologic, industrial, economic and financial basis, the industrial clusters based on international specialization and complementarities with the European countries, the development of the internal market for industrial products, sector assistance for high added value products benefiting from internal resources (IT, electro-technical industry, auto components, pharmaceutical industry, furniture industry, technology and equipments for the food industry and forest industry).

The process of defining the sector policy must take into consideration the comparative advantages of Romania from the time being and the possibility of developing new comparative advantages in fields with a high added value. Romania detains comparative advantage in the labor field, some exploitable natural resources with competitive costs as well as in the agricultural and forest potential, in the existent industrial infrastructure and in the geographic position.

The regional policy priorities (Croitoru, Russu and Tarhoaca, 2002) concern the improvement of the institutional frame at national and regional levels, improving the management capacities of the institutions involved in the regional development products, increasing the absorption capacity for structural funds and the correlation between the legislations regarding industrial parks, disadvantaged regions, free areas and special regions.

Accomplishing the industrial policy objectives is directly related to the commercial policy for exports encouragement without breaching the international agreements on free trade. The specific measures (*Industrial Policy of Romania 2005 – 2008*, 2004, p. 10) concern the extensive use of the facilities granted in the free trade arrangements and participating at the WTO negotiations for free trade, identifying the niches in the international market for the enhancement of Romanian exports, insuring the necessary support by extending the consultancy offer, offering training in the international trade field and insuring guaranties against commercial and non-commercial risks.

Finally, another factor influencing the industrial policy objectives regards the environment protection and the concern for sustainable development, according to the requirements of the European Union in this field. The specific objectives (*Industrial Policy of Romania 2005 – 2008*, 2004, p. 11) in this direction concern the integration of the environment protection requirements and

natural resources control in the sector and regional strategies and at company level, implementing the best available technologies and the “clean technologies”, rehabilitating the areas affected by historic pollution and creating and developing a market for the services and technologies for waste treatment and efficient use of energy.

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INCREASING THE EFFICIENCY OF THE EUROPEAN INSTITUTIONS: A HISTORICAL PERSPECTIVE

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Abstract: *The view that European institutions do not operate with maximum efficiency, that they are not yet able to cope with all major economic and social problems, to fully meet the basic functions, that cannot adapt to rapidly changing world has not emerged in recent years. In this paper we try to clarify the concept of institutional efficiency, and try to follow from a chronological perspective the main events that led to the more or less efficient European institutions.*

Keywords: Institutions, efficiency, European Union

JEL Classification: N24, H11

The problem of assessing „efficiency” in the realm of institutions stirs many controversies (note that the actual "efficiency” criterion is a controversial topic among economists).

If efficiency is defined in terms of an objective value indicator, identifiable and measurable, then maximizing this indicator requires the existence of a unique arrangement of market outcomes.

This understanding is the core of the welfare economy built around the Pareto static efficiency criterion. According to Pareto, an arrangement is efficient if there are other arrangements possible that could benefit a person, without disadvantaging another. Paretian criterion for assessing the efficiency is proved, however, unrealistic and impractical in the terms of the dynamic market process, as a constantly changing reality with many changes in the expectations of participants. *In the real world, which is governed by the policies and too often subject to government intervention, it is almost impossible to conceive Pareto-optimal solutions.*

Changing institutions determine, necessarily, a change in the allocation of resources, which is equivalent to saying that individuals behave differently in a different institutional framework. Modifying the constraints and incentives within which human action takes place means changing opportunity costs and relative prices in the entire spectrum of human action. This entails, in essence, changing the preferences and the economic and ethical nature of people. Therefore, any allocation of resources that can be classified as "effective" depends, necessarily, on the institutional framework in which decisions on the use of resources are evaluated and adopted. If efficiency is

determined by what results from voluntary agreements, then we will have to accept the non-uniqueness set of rules and institutions that can satisfy the "criterion of efficiency."

In a set of rules and institutions, Buchanan and Tullock (1962, p. 84) states that "what is effective is the result of voluntary agreements and not vice versa." Non-reciprocity clause would mean that not every state of things resulting from voluntary exchange process is effective. This approach is subject to the general equilibrium vision, the market situation in which, ex post, no person shall obtain suboptimal results in relation to its plans and expectations. However, only ex ante human action is always optimal. The existence of an entrepreneurial error makes that, ex post, the state of things always be suboptimal to an ex ante economic configuration. Hülsmann (2000) shows, that the development of a realistic analysis on the 'equilibrium' and 'efficiency', starts from the comparison of every choice (action) to its counterfactual alternatives (in terms of success and failure).

The problem of institutional change makes it necessary to explain the relationship between survival of certain institutions, institutional arrangements and efficiency. As Douglass North's (1990, p. 25) states, social institutions reduce uncertainty in human interactions, which does not necessarily imply that all these institutions are effective.

In an institutional analysis, efficiency indicates the conditions and framework of constraints and incentives that will produce the highest growth.

Uncertainty reduction does not require the existence of a single institutional structure and the capacity of these institutions in facilitating similar production of material wealth. Thus, the issue of explaining the survival of institutions and institutional arrangements consistent with reduced economic performance. Olson (1984) uses the concept of "institutional sclerosis" for the emergence and persistence of dysfunctional and ineffective institutions

The history of European integration after the Second World War was marked by phases of dynamic growth, stagnation and reorientation attempts. Successful implementation of the customs union in the period 1957 - 1968 was followed by a phase of disorientation and increased heterogeneity in the 1970s and early 1980s. Similarly, completing the single market from 1985 to 1992 was followed by a period of silence. Efforts to introduce the single currency did not led to a new dynamic of integration.

In the early 1980s, "eurosclerosis" had two different meanings: it described the difficulty of European countries to deal with their internal problems, but also the difficulty of European states to overcome the European integration. Two cases have resulted in overcoming the difficulties of European integration.

In 1974, the European Court of Justice decision on the „Dassonville" case, determined that all regulations acting as non-tariff trade barriers must be removed. By this decision, the Court allowed the competition between different national rules and pointed out how Member States can overcome future barriers to the flow of production factors by mutual recognition of standards.

The second case to overcome "eurosclerosis" was the program for establishing the Common Market in 1985 in order to overcome the economic and political problems of integration. 279 proposals have been adopted for the abandonment of non-tariff barriers, protection and control of national borders. Mutual recognition of standards, based on the minimum level of European harmonization, has been characterized as a "new approach" of the EU. Single Market Plan, aimed at reducing at the same time, hundreds of protectionist legislation in all Member States, was a success. In the years that followed, the EEC had regained optimism and went from "eurosclerosis" to "europhoria", an ebullient optimism regarding the dynamics of integration.

The prolonged recession in the early 1990s in Western Europe and increasing unemployment to record levels, starting from the already high level since 1980, did not help to promote a positive image of the successes of European integration. So a new discussion about eurosclerosis began.

EU institutions have also suffered from multiple sclerosis: The Commission, headed by Jacques Santer, had to resign following allegations of corruption. Commission led by Romano Prodi failed the institutional reform. Many authors believe that the Commission, as the engine of European integration, has lost its dignity as the two summits in Nice and Stockholm have shown. Governments have dominated the agenda of these meetings and the role of the Commission to arbitrate the negotiations between the governments in antagonistic positions was played without success. At the same time, governments have done nothing to obstacles encountered in the transition to EMU.

The functioning of European institutions have made numerous faults, that have sent clear signals that mechanisms should be reviewed, made more flexible and equipped with levers that it can overcome conflict situations. Often, the Commission has not made the most appropriate proposals in connection with major decisions on the EU agenda. The collegial nature of its operation and the autonomous decision of the Commissioners have eroded over time. Decision procedures were unduly prolonged and became cumbersome and inefficient.

Council of Ministers is defined by a sporadic character of its meetings, which have so far only found a place, in the national political agendas that allow consensus. The Parliament was in the paradox situation, of not having the mechanisms of dissolution and calling early elections, which had lessened its functionality.

Moreover, on 16 March 1999, European Commission resigned following the accusations of fraud, mismanagement and nepotism in the publication on March 15 report, by an independent Committee. This required rapid reform of the Commission, and emphasized the general need for internal reform to make EU institutions more democratic, transparent and respectable. European Parliament and Council have been equally criticized for their lack of openness and democracy. Internal reforms have been proposed just to be able to address these short-circuits in all three institutions.

The new European institutional project (The Constitutional Treaty, Lisbon Treaty) attempted to define political and legal principles in a form "understandable" to everyone, able to guarantee - at the same time - the interests of the Union's key components:

- Member;
- People;
- Regions.

The choice would be the federal, decentralized, based on the double democratic legitimacy:

- the people versus the states and regions;
- the federal versus intergovernmental.

The Council) would participate in decision-making on equal terms with the institution representative of the people (EP), the execution of decisions remaining primarily at the state level. Let's hope that this institutional project will make the EU politically effective, economically efficient and more open with themselves and the world.

While not perfect, the Constitution and Lisbon Treaty are very important steps that increase the institutional efficiency and unlock the main themes of European integration creating also a new political model. EU is characterized by being a reality and not a static process thus, the treaties and his reform or results should not be considered as definitive.

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ANALYSIS ON THE RELATIONSHIP BETWEEN THE PROFIT TAX AND INVESTMENTS IN THE CONTEXT OF A GLOBALISED WORLD. CASE STUDY – ROMANIA

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Abstract: *Although it is a relative old concept, having roots in the writings of the late ‘60s, globalization has become in current times a cliché, being used in many parts of the world and in many languages but not having a specific definition. Financial globalization is considered to be the core element of the process of globalization and consists in a complex integration of financial markets through exchange and financial flows.*

In this context, the economic agents are considered to be important players, given the fact that for their investments they appeal to financial resources wherever they may be. However their investment behavior is greatly influenced by the state, through the fiscal policy, especially through a very important instrument at its disposal, the profit tax rate.

The aim of this paper is to emphasize the evolution of the relationship between the profit tax and investments, in the case of Romania from 1990 until 2008, trying to show particular developments of each of these two variables studied and the relations between them, the amplitude of influence exercised by them. The paper also focuses upon a better understanding of how the variables analyzed influence the real economy in this globalized environment.

Key words: globalization, economic policy, investment, profit tax rate, FDI

JEL Classification: C01, E22, F21, H32

1. Introduction

The performance of the economic activity in any country is directly dependent on the development capacity, on the profitability and return on economic activities of the enterprises, the basic economic links.

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The “survival” of an enterprise in a market based economy depends very much on the decisions and strategies adopted by the management with the purpose of enhancing the profitability and long term return rate.

However, the enterprises don't act in a chaotic manner because they have to play by some defined rules where the “referee” is the state. The state is the one that can sometimes help, but it also can constrain the sphere of an economic entity using various instruments at its disposal.

Thereby, the public authority has at its disposal a range of different instruments like the intervention of the political regime (the form of government), monetary policy, fiscal policy etc. As the practice has shown the *monetary* and *fiscal policy* are two very important means through which the state can influence the economy. In particular, the fiscal policy through a very specific tool (the Profit Tax) can exert an important influence upon the investment process of an economic agent.

These two elements in particular: the profit tax and investments – the first one being at the disposal of the state and the second one at the hand of the economic agents – present a particular and special relationship of mutual determination in the way that the size and the importance of one of them has repercussions on the other one, and vice versa.

2. Financial literature regarding the concept of *investment*

A special place in the decisions of a company is occupied by the investments decision, which is considered the most important financial decision. The importance of those decisions is evidenced by the direct influence they have on the degree of liquidity of the company, because investment decisions influence the way how available cash resources are allocated efficiently by a company to replace old equipment, technical modernization and improvement etc. to perform the better manner of functioning of the company to ensure the highest optimum parameters. The decision to invest, is an important decision, with which company is facing throughout the period of its existence, usually this kind of decision is irreversible (Gudji, 2001, p.273).

Seen through the prism of its complexity, the notion of investment has been defined in the literature in several ways, namely:

- **Financial** – investment is seen as an immediate payment in view of future earnings or capital immobilization, order to achieve a capital gain over several periods (Brezeanu, 2009, p.36);
- **Accountant** – represents the amounts allocated for investment of fixed assets such as land, buildings, industrial machinery, patents, licenses, equity and others, including all three categories of property: intangible, tangible and financial;

- **Legal** – the investments are represented of any acquisitions or investments cover the elements that constitute the subject of a property as a heritage elements: rural and urban households, productive equipment, vehicles, securities, money (Onofrei, 2003, p. 194);

- **Monetary** – investments are regarded as "all expenses incurred to obtain monetary income in the future" (Teodorescu and Vasile, 2005, p.208). Under this approach, all expenditure incurred within a business are included in investment, without taking account of their object, in this case the concept of investment is overlap over the notion of cost.

- **Psychological** – focuses on the ability of an individual or company to give up at money or goods in exchange for future assets, which will reward time period in which the person has gave up his resources , expected inflation and the risk (uncertainty of achieving future earnings).

By linking all meanings attributed to the concept of investment, we can define its scope, as *all action of long-term immobilization of all current resources: money, material and human resources in order to obtain in the future higher incomes than those which could be obtained today.*

3. Investment in Romania after the ‘90

In post-revolutionary Romania, where private property rights revert to its natural, people have been concerned with the development of activities generating tangible or intangible benefits. This has led to strong growth in the number of private economic entities, which have always been interested in increasing the profitability of their activities, goal they wanted to achieve by investing.

This trend of commercial activities development, which was undertaken in Romania, can be seen from the value and volume increase of investments from 1990 to 2008, how we can see from the following table:

**Table 1 Evolution of net investment (million current prices),
on structural elements during 1990 to 2008 in Romania**

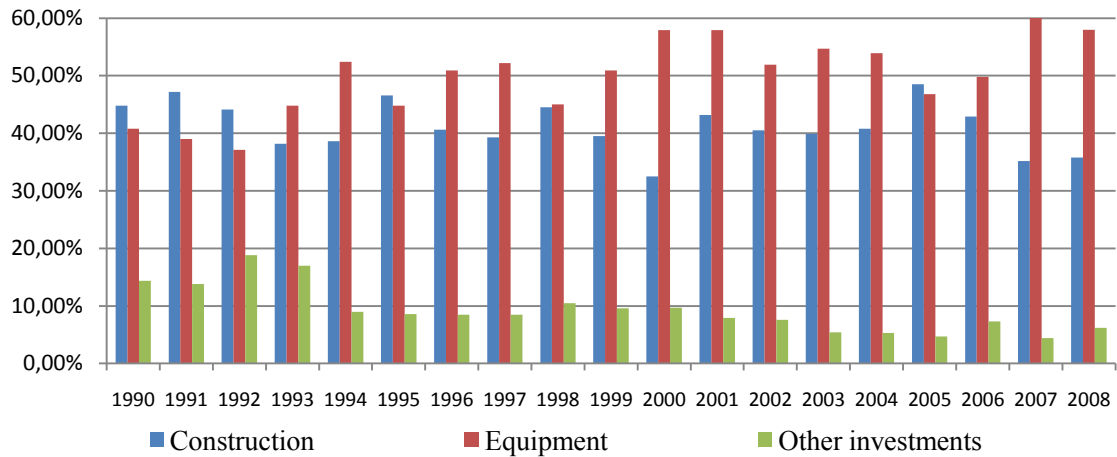
Year	Net investment -total-	Structural elements		
		Construction	Equipment	Other investments
1990	16,8 (100%)	7,5 (44,8%)	6,9 (40,8%)	2,4 (14,4%)
1991	31,4 (100%)	14,8 (47,2%)	12,2 (39,0%)	4,4 (13,8%)
1992	88,9 (100%)	39,2 (44,1%)	32,9 (37,1%)	16,8 (18,8%)
1993	282,2 (100%)	107,7 (38,2%)	126,4 (44,8%)	48,1 (17,0%)

1994	800,5 (100%)	308,7 (38,6%)	419,9 (52,4%)	71,9 (9,0%)
1995	1 299,6 (100%)	605,5 (46,6%)	581,8 (44,8%)	112,3 (8,6%)
1996	2 094,5 (100%)	850,7 (40,6%)	1065,8 (50,9)	178,0 (8,5%)
1997	4 413,5 (100%)	1 735,3 (39,3%)	2 304,2 (52,2)	374,0 (8,5%)
1998	6 051,5 (100%)	2 695,9 (44,5%)	2 722,9 (45,0%)	632,7 (10,5%)
1999	8 394,8 (100%)	3 313,3 (39,5%)	4 274,1 (50,9%)	807,4 (9,6%)
2000	12 498,7 (100%)	4 047,1 (50,9%)	7 237,2 (57,9%)	1 214,4 (9,7%)
2001	20 419,5 (100%)	6 979,6 (43,2%)	11 828,3 (57,9%)	1 611,6 (7,9%)
2002	27 173,5 (100%)	11 005,3 (40,5%)	14 092,6 (51,9%)	2 075,6 (7,6%)
2003	35 651,2 (100%)	14 220,0 (39,9%)	19 513,3 (54,7%)	1 881,9 (5,4%)
2004	44 869,9 (100%)	18 314,1 (40,8%)	24 176,0 (53,9%)	2 379,8 (5,3%)
2005	54 566,0 (100%)	26 482,3 (48,5%)	25 555,9 (46,8%)	2 527,8 (4,7%)
2006	73 891,0 (100%)	31 239,5 (42,9%)	36 287,6 (49,8%)	6 363,9 (7,3%)
2007	98 417,7 (100%)	34 666,2 (35,2%)	59 446,0 (60,4%)	4 305,5 (4,4%)
2008	123 022,1 (100%)	44 026,1 (35,8%)	71 335,2 (58,0%)	7 660,8 (6,2%)

Source: processed data accessed on 15.10.2010 at <http://www.insse.ro/cms/files/pdf/ro/cap12.pdf> and http://www.insse.ro/cms/files/arhiva_buletine2009/bsl_12.pdf

What is noteworthy is that in the early '90s, the biggest share of the investment was owned by construction, while the share of investments in various technological equipment, although not a very big difference, have a lower value. This would later change, because since 1993 the share of investment in construction and the share of investment in equipment has been reversed, as in Romania of that time showed a continuous increase in the share of investment in equipment, namely the productive capital, while the investment in construction was dropping, but there are two exceptions represented by the years 1995 and 2005, when the construction component had a high value than technological equipment.

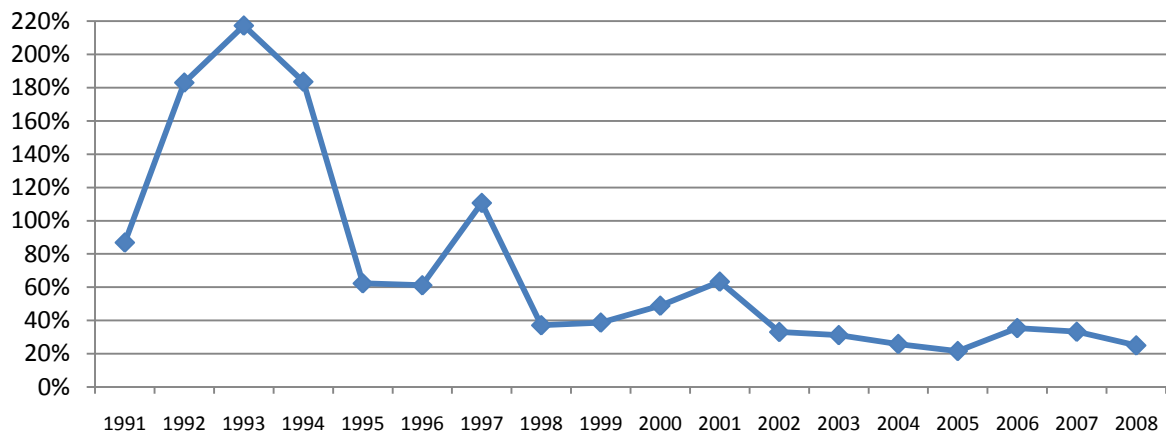
Graphic 1 An evolution of the share of investment components



Source: processed data from Table 1

Another important aspect that emerges from analysis of data from Table 1 is related to the dynamic performance of investments made in Romania. This element is highlighted in the following graphic:

Graphic 2 Evolution of the investment value from 1990 to 2008, from year to year



Source: processed data from Table 1

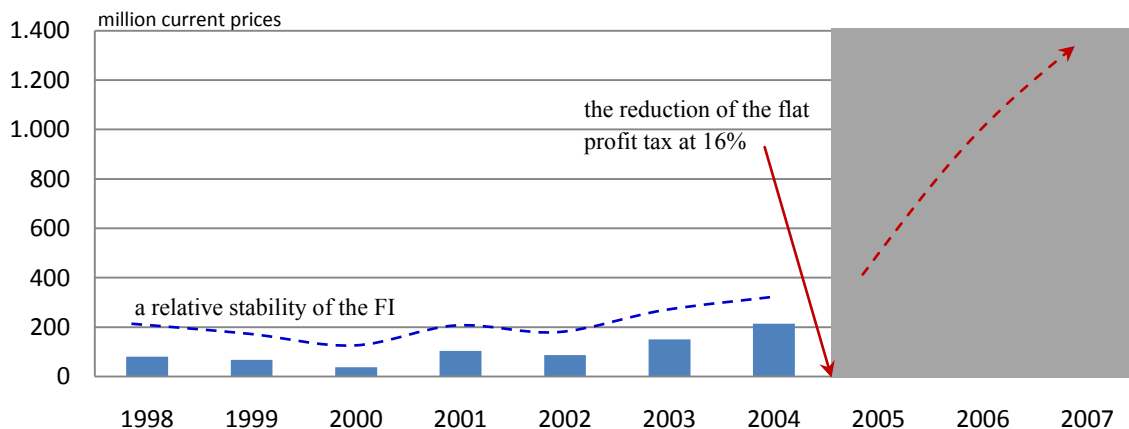
It can be seen, that investments have developed very quickly, especially in the period 1990 - 1994, a stage in which the investments made in Romania have increased from one year to another in the following way: the value of investments in 1991 were 80% higher than in 1990, while the next three years were characterized by an approximate tripling of the value of investments from one year to another. However, this growth seems to be considered taking into account the dramatic economic situation it was in Romania in the early 90s, a period characterized by an acute inflation which reached an average of over 256 percent in the period 1990 to 1994, according to the Report Inflation

issued by National Bank of Romania in the first half of 2001. Therefore, this massive increase in the amount of investment in Romania in the early years of the last decade, not due to an increase in real value but rather an artificial increase due to rampant inflation that characterized Romania from that time.

Concerning the last time, from 2000 until 2008, the value of investments increased from one year to another with an average of about 30%. This growth was sustained by the steady economic environment, characterized by an inflation rate reduced by an amount which has not exceeded 20 percent since early 2002.

Another element that should not be overlooked in the analysis of investment development in Romania is represented by the sources from which those investments were made, with emphasis on the evolution of foreign capital sources.

Graphic 3 Evolution of foreign investments value in Romania between 1998 and 2007



Source: processed data accessed on 15.10.2010 at <http://www.insse.ro/cms/files/pdf/ro/cap12.pdf>

As can be seen in the previous graphic, investments that have foreign capital as a source of funding, have increased since 2005, a trend which can be partially explained by the profit tax system, because from January 1, 2005 the current flat profit tax was reduced at 16% by the Government Emergency Ordinance no. 138/2004, amending the Tax Code, a development that was also anticipated in the economic literature (Martin, 2006, p.144).

4. Changes of the profit tax rate and their implications

The revolution from 1989 brought major changes at all levels of political, economical and social from Romania. This shift from a socialist state in which the central element was represented

by state property, to a democratic state, based on market economy, which gives people freedom to initiate profitable business, required significant changes in the Romanian legislation concerning the tax system.

The fact that, until 1990 was only one owner – the state, determined "subjective and automatically transfer of the benefits to the state budget" (Corduneanu, 1998, p.549), but once with the transition to a democratic society by redefining property rights and the establishment of economic agents who had private or mixed capital (public and private), the state had to create a legislative framework to govern the enterprises obligations on their profit.

No. 12/1991 Profit Tax Law, is one that opens the long and hard road of rules relating to taxable profit, these rules were constantly evolving in light of the real businesses life. All laws, ordinances and resolutions that have followed, tried to explain and to fill gaps in previous legislation or were made in order to facilitate the private sector in economic development and meet the requirements for Romania's accession to the European Union.

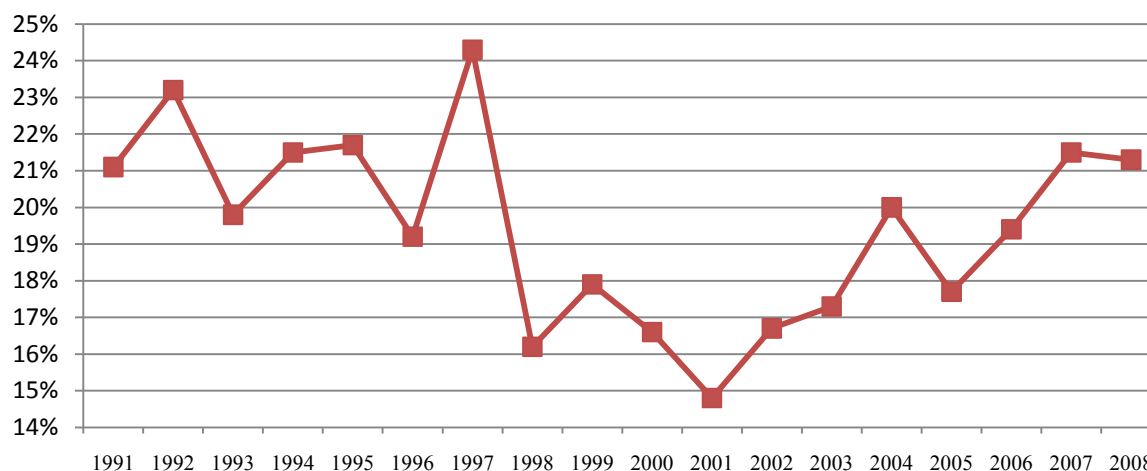
Initially, in 1991, Law no. 12 established progressive tax rates which ranged between 0% and 77%, who was applied only to fiscal year 1991, because at the end of the year, the Government Decision no. 804 imposed the use of progressive tax rates from 1st January 1992. But neither the adoption of this quota system has failed to achieve a legislative stability, because in 1994 a further amendment was decided by the Government Ordinance no. 70, which established transition to the flat tax system, at that time was of 38%.

Although, until present, the tax legislation remained constant, but about the tax system and profit tax rate we can't say the same thing. The flat tax level has varied in the sense of diminishing, leading now to a share 16%, effective from 1 January 2005.

Profit tax is one of the major revenue of the state budget, which has a relatively high share in total budgetary revenues.

By analyzing data obtained from the site of the National Institute of Statistics, we can observe the variation of participation the profit tax at forming the fiscal revenues from stat budget, so between 1991-1997 the participation in the state budget is an average rate of 21.5%, ranging from a minimum rate of 19.2%, in 1996, to a maximum rate of 24.3% recorded in 1997. In 1998 is recorded a fall in share of revenues from profit tax owned in the state budget revenues by 8 percentage points, which is shown in the graphic below.

Graphic 4 The evolution, in percentage points, of the profit tax in forming the budget revenues in Romania between 1991 and 2008



Source: processed data accessed on 15.10.2010 at <http://www.insse.ro/cms/files/pdf/ro/cap21.pdf>

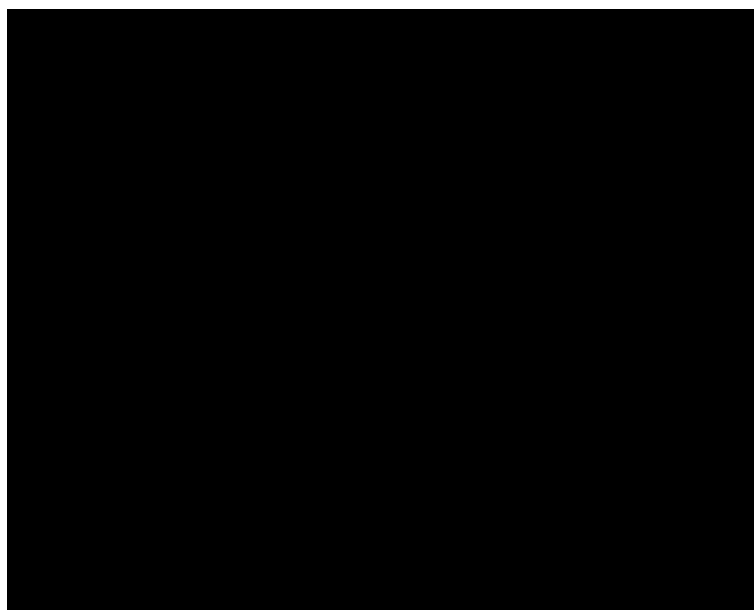
Since 1998, the share of revenues from profit tax in budget state revenues is relatively low, maintaining a downward trend between 1999 to 2001, when the share of profit tax reaches the minimum value recorded so far in post-revolutionary Romania namely 14.8% of total revenues. Thereafter, the rate of participation in forming the profit tax revenues has an upward trend, reaching 20% in 2004, and in the following year, 2005, to a further decrease, reaching 17.7 %.

Share declining of revenues from profit tax in budget state revenues in 2005, can be partially explained by approving the flat income tax of 16%, event which caused on short-term this decline, but had a long-term effect positive, whereas stimulated reinvestment of profits obtained by economic entities, increasing the productive activities, which in subsequent years was reflected in an increase in revenues generated by the economic agents and finally the taxable profit, resulting in an upward trend of revenues from profit tax in budget state revenues.

5. Statistical analysis of the correlation between investments and profit tax in Romania

The two variables, investments and profit tax, whose evolution has been previously analyzed, are not independent, because each exercise some influence over the other one.

Figure 1 The correlation between investments and profit tax

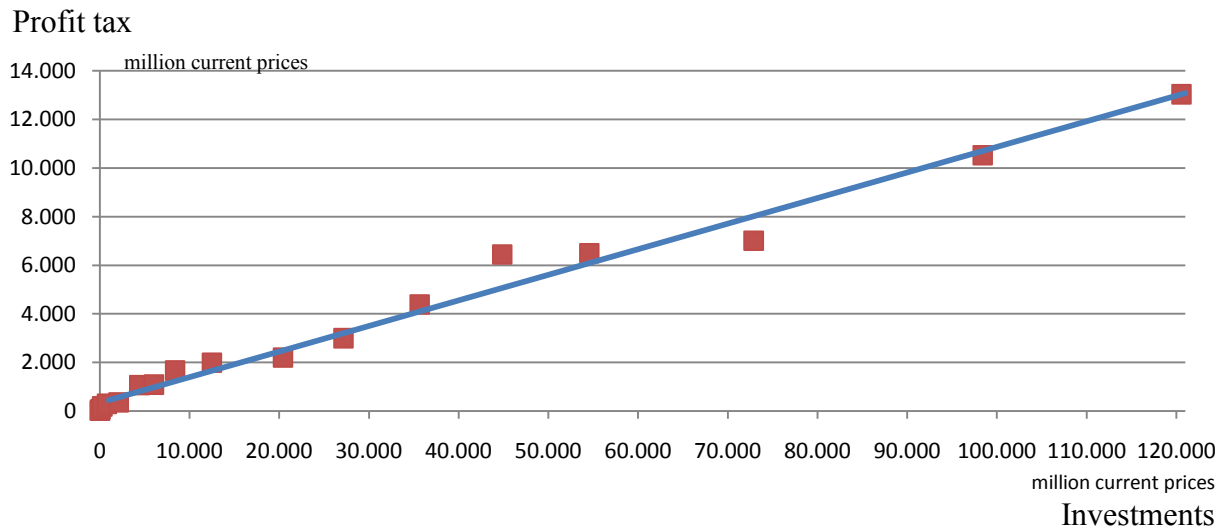


The state is one who, in different stages of economic development, acting through legislative acts issued in fiscal perspective it would follow, on this case the main instrument of action is represented by the profit tax rate, which directly affects the volume size of profit tax and the remaining amount to the company which can be used for different purposes, most important being represented by the investment.

The profit tax size influences the size of investment, investment which in turn leads to the creation of new value, which again is divided in several destinations, the two most important being represented by investments and profit tax. As a result, it is clear the multiplier effect of investments, which is closely related to the correlation with profit tax.

In trying to determine the correlation between investment and profit tax in Romania, I used as a sample, the value of investments and profit tax (million current prices) between 1995 and 2008, a period which includes a number of 14 years. In selecting this sample we left from premise of the existence in time of invariant features for the two variables, so we have chosen 1995 as base year because starting 1st January 1995 was introduced in Romania the rate proportional tax system, a system that remained until now, although the tax rate has varied over time and reduced the value of 38% to 16% (from 1 January 2005).

**Graphic 5 The relationship between investments and the profit tax
in Romania between 1995 and 2008**



Source: processed data from Table 1 and data accessed on 15.10.2010 at <http://www.insse.ro/cms/files/pdf/ro/cap21.pdf>

As it can be seen in the previous graphic, between profit tax and investment made in Romania during 1995 - 2008, there is a relationship of proportionality between changes in profit tax and changes in investment.

Based on the stated sample, the relationship between variables can be estimated by simple linear regression model equation of the form $Y = a + bX$, where Y will be variable profit tax, which I will note **Pt**, X will be variable *Investment*, noted by **I**, a and b are the values of model parameters of the regression estimators.

The two model parameters, a and b , are determined based on the following relationships, given the statistical literature (Jaba, 2002, pp.381-382), namely:

$$(1) \quad a = \frac{\sum_{i=1}^n y_i \cdot \sum_{i=1}^n x_i^2 - \sum_{i=1}^n x_i \cdot \sum_{i=1}^n x_i y_i}{n \cdot \sum_{i=1}^n x_i^2 - \left(\sum_{i=1}^n x_i\right)^2}$$

$$(2) \quad b = \frac{n \cdot \sum_{i=1}^n x_i y_i - \sum_{i=1}^n x_i \cdot \sum_{i=1}^n y_i}{n \cdot \sum_{i=1}^n x_i^2 - \left(\sum_{i=1}^n x_i\right)^2}$$

where: n - sample size (14 years);

x_i - the value of investments for the year i ;

y_i - Amount of income tax for the year i .

Using the program EViews program we calculated the estimated equation, which is synthesized in the following table:

Tabel 2. Regression model results

Dependent Variable: PROFIT_TAX				
Method: Least Squares				
Date: 10/27/10 Time: 21:55				
Sample: 1995 2008				
Included observations: 14				
Variable	Coefficient	Std. Error	t-Statistic	Prob. *
C	507.9921	205.4861	2.472148	0.0294
INVESTMENTS	0.103055	0.003984	25.86604	0.0000
R-squared	0.982380	Mean dependent var	4253.450	
Adjusted R-squared	0.980912	S.D. dependent var	3948.503	
S.E. of regression	545.5241	Akaike info criterion	15.57293	
Sum squared resid	3571159.	Schwarz criterion	15.66423	
Log likelihood	-107.0105	F-statistic	669.0522	
Durbin-Watson stat	1.649182	Prob(F-statistic)	0.000000	

Note: *Prob. Value<0,05 indicates a statistically significant coefficient for the level of 95% confidence

From this table we can express the regression equation as:

$$(3) \quad Pt = 507,9921 + 0,103 \cdot I$$

Equation (3) is plotted in Graphic 5 by the blue line, indicating that the evolution of the relationship between income and investments in Romania during 1995-2008 does not fluctuate very much from this landmark.

Along with defining the regression line, which showing the link between profit tax and investments, it should be measured and the intensity of this relationship, highlighting the degree of concentration or dispersion of the values on which profit tax has had in reality around the regression line, which consists of theoretical values.

Intensity relationship can be measured using the correlation coefficient (Jaba, 2002, pp.390-391), which may take a value between -1 and +1, if the correlation coefficient has a value closer to -1 or +1, the relationship between those two variables is closer, while its value is more close to 0, this indicates the absence of a link between the two variables.

The correlation coefficient value is determined using the following formula:

$$(4) \quad \rho(X, Y) = \frac{\sum_{i=1}^n (x_i - \bar{x})(y_i - \bar{y})}{n \cdot \frac{\sum_{i=1}^n (x_i - \bar{x})^2}{n-1} \cdot \frac{\sum_{i=1}^n (y_i - \bar{y})^2}{n-1}}$$

According to calculations made in EViews we obtained correlation coefficient value of 0.991151, between investments and profit tax, which shows that the two variables are directly linked very closely.

Tabel 3. Correlation matrix

Variable	Profit_tax	Investments
Profit_tax	1,000000	0,991151
Investments	0,991151	1,000000

Besides the foregoing, we can ask a question, namely: "In what proportion are influenced profit tax by investments?", To this questions, we can respond by estimating the ratio determination, which expresses the factor X influence the changes in variable Y and is calculated in case of a linear regression, as is the case at hand, the following formula:

$$(5) \quad \eta^2 = \frac{a \cdot \sum_{i=1}^n y_i + b \cdot \sum_{i=1}^n x_i y_i - \frac{1}{n} \cdot (\sum_{i=1}^n y_i)^2}{\sum_{i=1}^n y_i^2 - \frac{1}{n} \cdot (\sum_{i=1}^n y_i)^2}$$

Following the calculations for the regression model of investments and profit tax, we obtained a value $\eta^2 = 0.98238$, which shows that 98.238% of profit tax variation can be explained by of investments value made in Romania during 1995-2008.

6. Conclusions

Investments and profit tax are two macroeconomic variables that influence in a strongly way a country's economic life, how happened in Romania in the last 15 years. But these two variables do

not act in a haphazard and independent way, because the influence of one variable is conditioned by the other one, thing which was highlighted in this paper.

Following what we said above, we can see that after the transition to a market economy, the occurrence of private economic entities, there was a continued increase in investment in Romania, since 1990 until now.

An item that is noted in the study of the investments evolution in Romania is the accelerated development of foreign capital investments since 2005, when we can see that the value of foreign investments was 4 times higher in two years. This development can partly be explained in conjunction with the tax system, since the entry into force on 1 January 2005 a flat profit tax reduced at 16%. This has determinate increasing the value of foreign investments and the fact that foreign investors were attracted by the reduced rate of profit tax, which allowed them to obtain a high profit. At the same time it should be noted that foreign investments could be greater if the public authority would issued the laws that would ensure greater stability of the tax system.

The amount of profit tax collected at the state budget took an upward trend, each year recorded a higher value than that obtained in the previous year, although the proportion with increased amount of profit tax varied widely in last 15 years . Noteworthy is the maximum amount of growth, namely 24.3% in 1997 compared to 1996, the minimum value recorded in 2001, namely an increase in profit tax of only 14.8% compared with 2000.

The statistical analysis carried out previously shows us that the two variables analyzed are interconditioned and the values recorded in Romania from 1995 to 2008, forming a simple linear regression of the form $P_t = 507,9921 + 0,103 \cdot I$

Based on statistical calculations performed to determine the regression model of investment and profit tax, we obtained that the two variables are directly linked very closely, indicating that a change in a certain sense of the investments size will determine changes of profit tax in the same direction.

The close relationship between profit tax and investments, it's shown by determination's ratio calculation, whereby 98,238% of profit tax changes can be explained due to the influence of size of investments.

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FINANCING OF THE SMEs IN THE EUROPEAN UNION THROUGH CREDIT INSTITUTIONS

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Abstract: *It is widely acknowledge that financial constraints are the most visible problems of the SMEs. So through this paper we propose to analyze the main sources of financing that SMEs use to conduct their business. And, from these sources, we should focus on the ways of financing offered by credit institutions. Thus, we will identify the main sources of financing available to SMEs and offered by credit institutions. Banks are increasingly seeking to become facilitators and partners with their SME clients. In other words, they try to offer a broader range of products, better service quality and better prices. Through this paper we will see if the bank offers are truly advantageous for SMEs.*

Keywords: internal funds, bank loans, trade loans, European Investment Bank, subordinated loans

JEL Classification: F36, F33, F34

1. INTRODUCTION

An economic agent, who could not cover his full costs on his own resources, or through internal funding or self-financing, is forced to resort to external financing. From the analysis realised by the American economists John Gurley and Edward Shaw (developed in 1960 in their paper *Money in the Theory of Finance*), we extract two ways of external financing of the economic agents (Boariu, 2003, p. 12), namely:

- *The direct funding*, characterized by the fact that the agents that have available capital fund directly the agents that need financial resources. This direct financing is made by buying the securities issued by the agents that need capital on the financial market. This type of financing is done through the capital markets and the opened money markets.

- *The indirect funding* or "the intermediate funding" differs in that a financial intermediary is interposed between the agents in need of capital money and the agents who want to place their surplus cash capital. Intermediaries which made indirect financing are represented by banks and other financial authorized entities.

The indebtedness provides to the enterprise the possibility to obtain the necessary funding to conduct the business. This financing arrangement is indispensable for the proper functioning of the entire financial apparatus of the company, but its use must fall within certain limits to maintain the financial autonomy of the company.

The traditional instruments of indebtedness are the loans taken on different times and at different levels of interest.

2. THE EXTERNAL FINANCING OF THE SMES

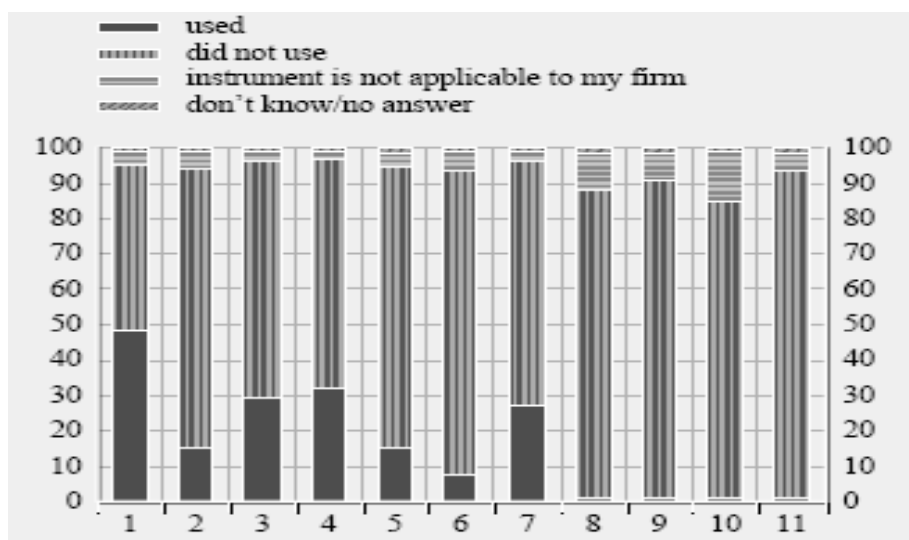
Traditionally, internal funding (from personal savings, retained profit and sales of assets) is an important source of financing for SMEs.

Bank loans (used by 32% of SMEs) and bank overdrafts, credit lines and credit card overdrafts (used by 30% of SMEs) had been the largest source of external financing for SMEs during the preceding six months. So we observe the traditionally important role of bank financing for SMEs in the euro area (see Figure no.1).

Indeed, bank loans, credit lines and overdrafts are not only used to finance investment but also as working capital. Leasing, hire purchase and factoring (27%) and trade credit (15%) had also played a relatively important role, while market based financing had been of minor importance to the financing of SMEs during the preceding six months (1% had issued debt securities and 1% had issued equity or relied on external equity investors).

Large firms had also barely relied on market-based financing (2% used either debt securities issuance or equity issuance or external equity investors) during the preceding six months, relying to a much greater extent on bank loans (used by 38% of the large firms) and on leasing, hire purchase or factoring (36%).

Figure 1 Financing structure of euro area SMEs over the preceding six months (%)



Source: European Central Bank, 2009, p. 10

Legend: 1= Internal funds; 2 = Grants or subsidised bank loan (involving support from public sources); 3 = Bank overdraft, credit line or credit card overdraft; 4= Bank loan (excluding overdraft); 5 = Trade credit; 6 = Other loan; 7 = Leasing, hire purchase or factoring; 8 = Debt securities issued; 9= Subordinated loans, participation loans or similar financing instruments; 10 = Equity issuance or external equity investors; 11 = Other.

Also from this study we observe that in all branches of economic activity, the net percentage of SMEs reporting an increase in their need for bank loans was positive (ranging from 10% in services and trade to 13% in construction). As regards trade credit, between 32% (in construction) and 42% (in services) of the SMEs replied that the instrument is not applicable to them. Among the SMEs to which this instrument was applicable, the majority reported an unchanged need.

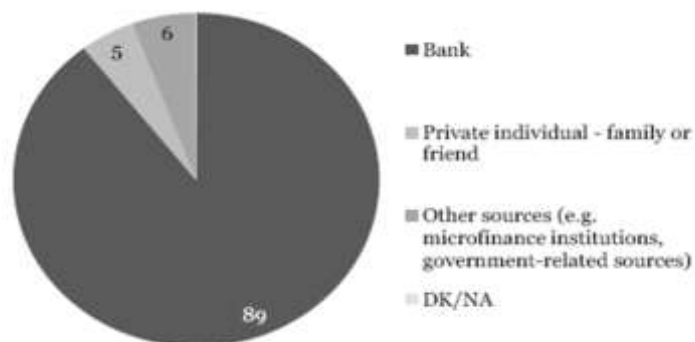
3. MOST POPULAR PROVIDERS OF LOANS

To see which were the main providers of loans to the SMEs in the last two years we will analyze the study made by the Flash Eurobarometer No. 271 about the Access to finance of the firms from the European Union in the past six months. This study was made on 9.063 companies from the European Union, Croatia, Iceland and Norway.

The study noted that the banks were the most popular providers of loans in the European Union; they were mentioned by 89% of companies that had obtained a loan in the past two years. One in 20 managers of such companies had received a loan from a private individual such as a family member or friend.

Other sources - such as micro-finance institutions or government-related sources - were mentioned by 6% of interviewees as the provider of their most recent loan, as can be seen and the figure no. 2, shown below.

Figure 2 Most popular providers of loans for the SMEs (percentages of firms)



Source: Flash EuroBarometer, 2009, p. 29

Banks were the most popular source for a loan in all countries in this study. Small businesses and their enormous development potential for the next years have attracted the attention of the commercial banks. Thus, ever more financial institutions have improved their credit supply.

The banks are increasingly seeking to become loan facilitators and partners to their SMEs customers. This requires more contact between banks and customers, greater commitment, trust and support from banks. Instead of taking in account the turnover, the number of employees of the company, etc., the banks now examine other characteristics of the firms such as:

- The market segment in which the company is operating;
- The Contractor (analyzing the age, the education, the experience);
- The age of the company;
- The target of the company.

In other words, banks try to offer a wider range of products, better service quality and better prices.

Indeed, the progress in many countries is facing the same direction. There is a clear and general trend favouring the financial liberalization across the Europe. Financial liberalization has a mixed impact on SMEs finance. First there is a trend to lower the interest rates due to competition between banks. Moreover, banks are becoming increasingly aware of the risk, which often leads to greater detaining in providing loans to customers who are considered to involve greater risks than the average. Here we speak of a paradox: although interest rates are more "friendly" for SMEs, the

increased risk and the banks attempt to minimize it determines that they are reluctant to provide credit to smaller applicants.

4. LOANS GRANTED BY THE EUROPEAN INVESTMENT BANK

The European Investment Bank is a European Union institution. The European Investment Bank task is to contribute to the integration, to the balanced development, to economic and social cohesion of the Member States by financing low-risk investments.

Through its credit lines for financial institutions, the European Investment Bank subsidizes usually the projects implemented by SMEs and by the municipalities. Since 1990, the European Investment Bank has signed loan agreements with Romania worth 6.6 billion euros, of which approximately 530 million euros (including current loans) were to support projects of the SMEs and the municipalities.

The European Investment Bank has granted to Romania in September this year two interim loans to support small and medium-sized projects: 80 million euros for Bancpost and 60 million for EFG Leasing (European Investment Bank). The loan for Bancpost is intended to finance small and medium-sized projects of SMEs in various sectors of industry, agriculture, tourism and services.

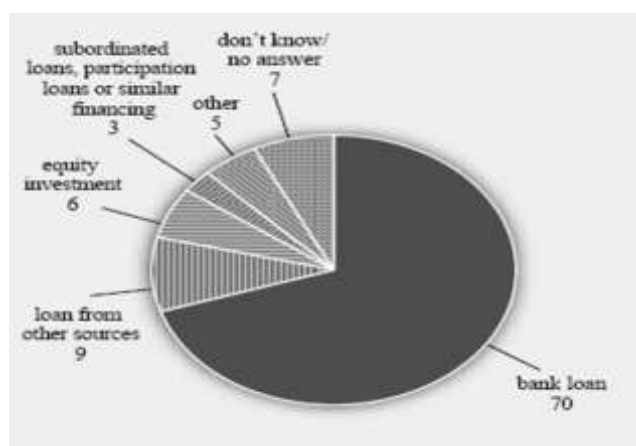
The loan for EFG Leasing aims to support up to 30% smaller projects of SMEs in Romania in the fields of industry, services including tourism, agriculture, health, energy and environmental protection. EFG Leasing will also benefit from facilities of financing of SMEs as a special aid scheme promoted by the European Community. This scheme is focused on continued and competitive growth of small and medium enterprises in Romania.

The European Investment Bank loans for SMEs are mainly for reduce the impact of the economic crisis. These loans are aimed at improving access to medium and long term funds that are financially benefit.

For this, the Bank has simplified the procedures and it also expands its scope of funding, covering the investments in intangible assets and in the working capital. In addition, the Bank is increasing its transparency, endeavouring to effectively transfer of the benefits of the EIB funds to the final beneficiaries.

The European Investment Bank, The World Bank and The European Bank for Reconstruction and Development (EBRD) pledged in February this year offer up to 24.5 billion euro for the banking system and the real economy form Central and Eastern Europe. European Investment Bank will provide almost half (11 billion) of the total amount.

Figure 3 Euro area SMEs' preferred sources of external financing for realising growth ambitions



Source: European Central Bank, 2009, p. 20

5. BANK LOANS FOR FUNDING SMES FUTURE GROWTH OPPORTUNITIES

It appears that bank loans are not only the most used source of external financing but also the preferred source for future use. 70% of all SMEs reported that they would prefer bank lending to finance their growth aspirations while 9% would use loans from other sources and 6% equity investment (see Figure no. 3). In addition, as in the actual use of financing sources the more sophisticated sources of financing, such as subordinated loans and other types of structured loans, were chosen only by a very small minority of SMEs (3%).

6. CONCLUSIONS

From the ones presented above we see that banks play a major role in financing of the SMEs in the European Union. The bank loans are used to supplement the internal funds use by the companies in financing their activity. It has not turned to bank loans only those SMEs which have funded their all activities through internal funds or a small proportion of the SMEs which felt that they would not get the required credits.

In the present the banks have a strong policy for financing the SMEs. In addition they provide and support assistance services, especially for the start-ups.

Currently the European Union promotes a whole program of support and financing the activity of SMEs, either through structural funds or through loans from the European Investment Bank for the credit institutions of member countries.

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SINGLE EURO PAYMENTS AREA AND ITS IMPLICATIONS ON THE EUROPEAN SMALL AND MEDIUM-SIZED ENTERPRISES

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Abstract: *The scope of this article is to discuss the implications of the Single Euro Payments Area from the perspective of the European SMEs. The current unpredictable and very challenging market situation has not fundamentally changed the fact that payment services need to continue modernization in order to become more flexible, agile and adapt in order to comply with its important purpose in society. SEPA is needed to ensure the new modern payment platform that can enable Europe to move beyond basic services, increase payments efficiency, embrace innovation and integrate further services in the trade process. European Small and Medium-sized Enterprises see SEPA as an important step towards the completion of the internal market, but such a major initiative has to be well planned, must meet the practical needs of enterprises and provide, at least in the long run, positive incentives for all market participants.*

Key words: Single Euro Payments Area, payments landscape, small users, Payment Services Directive.

JEL Classification: E42, F34, G12, G28.

INTRODUCTION

The European payments systems landscape is changing dramatically. Restructuring payments systems to meet European Union demands and the Single Euro Payments Area standards is a tremendous challenge and this is just the beginning of the move towards integration with an increasingly global payments environment.

In its premises, SEPA is an initiative of the aiming at harmonizing the system of cashless payments in the extended Euro zone, creating a coordinated environment of rules, standards and procedures, working as a single domestic payments market in which citizens and economics actors are able to make payments as easily and inexpensively as in their home countries.

The European Commission elaborated in parallel and presented in 2005 the Payment Services Directive-PSD, which has to be implemented into the national law until November 2009. The directive provides the necessary legislation for SEPA and at the same time insure a

liberalization of the European Market for payments services. The PSD is both a precondition for SEPA, especially as regards debt transfers, and an attempt to open the payment services market to operators other than banks.

SEPA is the largest payments initiative ever undertaken within Europe and possibly the world. A program of this size and scale cannot be implemented only by banks and public authorities. Bank customers including businesses of all sizes have the most important role to play, for SEPA will only succeed with their co-operation and commitment. One year and ten months after the successful launch of the first SEPA payment scheme, however, there remains room for improvement as regards SEPA market readiness. Additional efforts will be required to convince customers - in particular the small and medium-sized enterprises community and public administrations - of the benefits SEPA holds for them. Going forward it will therefore be necessary to increase communication efforts with a view to raise SEPA awareness and to get customers actively involved in SEPA implementation.

The creation of the Euro was a great achievement, but is it enough? SEPA is necessary if we wish to have a modern, sophisticated and efficient payment market for the Euro. Without SEPA, it will not be possible for the users of payment services to fully reap the benefits of a common currency and an integrated internal market.

The project's benefits are promoted by its initiators both from the political (European Commission) and the banking (European Payments Council) arenas. The European Association of Craft, Small and Medium-sized Enterprises (UEAPME) too has embraced the vision and acknowledged the potential benefits.

The article is structured to answer two research questions:

- A. *What does SEPA really mean for businesses as small and medium-sized enterprises and how should they prepare for implementing the project? How do they define the most important expectation as regards SEPA?*
- B. *What are the SEPA benefits, opportunities and costs for different SMEs?*

A. The European Payments landscape is changing and SEPA was and still is regarded as a major transformation of this landscape; its magnitude is sometimes compared to that of the Y2K project and the introduction of the Euro combined. In that sense, SEPA is a revolution. Customers, both SMEs and corporate bodies, banks, card schemes and processors, public administrations stand to benefit considerably from the wide range of new opportunities that have opened through the launch of SEPA, as it will promote efficiency, competition and innovation.

Small and medium-sized enterprises(SMEs) represent more than 995 of all European Union enterprises on a unit base (European Central Bank, 2009). Most EU SMEs conduct business locally

and expect financial institution to ensure a harmonization of the payments systems. In principle, generating competition and transparency, this initiative will have positive consequences for the various players in that market. SEPA will profoundly change the current systems of transfers, standing orders and card payments.

SMEs will benefit somewhat less. They have optimized their payments operations to deal with country-specific payments instruments and practices. Migration to SEPA instruments will bring clear benefits only in those countries where the quality of payments products is currently lower than the new European credit transfer or direct debit payments. In other countries, especially at the beginning, the SEPA instruments(developed for the euro market as a whole) might not match the rich domestic functionality developed in countries over the last 30 years. So SMEs will, on a country-by-country basis, be less prepared to invest in migration to SEPA standards. Attractive pricing would be an important driver in migration for adoption. Clearly this issue will complicate the transition process.

Transfers. Transfers within the euro area have been performed under the same conditions, stipulations and security as national transfers. The use of International Bank Account Numbers(IBANs) for all payments instructions also affect SMEs processing programs. The use of the Bank Identifier Code(BIC) also necessitates adjustments and requires a single investment from SMEs to adapt their software. This is comparable to the introduction of the euro and is a reminder that society, and the environment in which SMEs operate, is continuously evolving. Every SME, large or small, is expected to keep in step with these developments. The disappearance of the structured message that is the link between the bookkeeping and the transfers threatens to cause more problems. Transfers with a free message make automatic processing of transfers virtually impossible.

Direct debits. For payments by direct debit, an order is no longer given to the bank, but the contracting party, where debtors will be able to protest against such payments for a period of six weeks instead of four days. This implies longer-term uncertainty for the self-employed and SMEs that allow payments by standing order.

SEPA is not a question of yes or now, but rather a question of how? The changes described above can be implemented by every SME through effort and resources. From now on, SMEs will be able to execute and receive payments by means of transfer and standing order with virtually no problems within the euro area, Here, too, every SME has to keep in step with the changing environment in which they operates.

Card payments. SMEs will experience the most far-reaching SEPA changes in card payments. Until now, there has been too little competition in the area of terminals and none at all in

the field of transaction processing (for example, Banksys in the Belgian market of card payments). Opening up this market must lead to better prices for payments terminals as well as technical assistance. Increasing competition will not only have a positive effect on the price, market players will also start to look for more attractive formulas and new ideas in other fields in order to differentiate themselves.

Many companies are small users, for example, SMEs who have a few transactions a month and therefore significant fees per transaction, so that competition may reduce costs for this category of SMEs. Since price policy is only one way to convince them to take their chance with a particular market player, service and security will increasingly be leveraged post-SEPA. One single large European market should stimulate innovation in the field of technology, security and service. Thanks to a harmonized European payments infrastructure, it will be possible to implement efficient e-solutions. By 2010-2012, e-payments will account for 95-99% (Eetvelt, 2006) of the total of volume and there will be a common data formats, identifiers and references. For SMEs that rarely have treasury systems or sufficient resources to be able to have real-time visibility, these new e-solutions could be a real help and enable better financial reporting and planning. Cash flow data now outrank profits and loss data as lending criteria, so access to finances could be improved because banks could manage this data as value-added service.

A lot of SMEs do not charge interest for late payments or grant longer credit terms for fear of losing their customers. Corporate bodies benefit from this free financing compared to the conditions they would be granted by a bank, perhaps more automated e-payments will change this. A lot of SMEs cannot pay their suppliers before they have been paid by their customers and it remains to be seen if customers will be able to pay on time, in particular those who have no or bad access to finance. It is a vicious circle.

Furthermore, the standardization and automation of invoices might reduce the number of mistakes they contain. According to a study by Atradius, in the United Kingdom, 82% of invoices include an incorrect address. Two-thirds of companies send the wrong invoice back to the supplier and one-tenth refuse to pay them. As a result, invoices with mistakes are paid on average 15 to 30 days later.

It is essential that SMEs inform themselves and take part in the debate through various associations, institutions or websites and thus lead the final decisions regarding SEPA in such a way that their interests are not left out: they should not be passive. Then being aware of what could be possible with SEPA, SMEs could make it happen by expressing their needs and expectations to the banking industry. If there is a demand, supply should follow.

The most important expectations of European small and medium-sized enterprises as regards SEPA are:

- + cross-border payments services in general must become cheaper and more cost effective without increasing the costs for national payments in general. This must go beyond Regulation 2560/2001 (European Association of Craft, Small and Medium-sized Enterprises, 2007), which regulates the price for smaller amounts of cross-border payments independently from the real cost, stating that the price for cross-border payments must not increase the price for similar national payments. Most of Europe's SMEs would not support a new system otherwise;

- + SEPA must provide the same level and quality of services than the existing national systems as regards credit and debt transfers as well as payments cards. This includes features like security, user friendliness;

- + SEPA users should get basic service level on basic price and there should be open competition for extra services and the choice between different level of services.

B. Small and medium-sized companies are following in the wake of large companies, in taking advantage of the possibilities offered by the Single Euro Payments Area, but still too slowly. All over Europe, corporate bodies are relatively well prepared for the transfer to SEPA, but SMEs are providing cause for concern. They often lack the resources and expertise for mapping out what the transfer to SEPA might offer (Zago, 2007).

Figure 1 SEPA: a facilitator for optimization around the payment

Opportunities	Challenges
<ul style="list-style-type: none"> • optimization of in-/external processes based on uniform structures and standards in Europe; • less dependence on local partner banks and thus lower costs; • greater competition among providers- especially countries with low volume or with less developed payment landscape; • possibly higher „straight-through processing“ rate in cross-border business through standardization; • larger product offering, e.g. in the area of e-invoicing. 	<ul style="list-style-type: none"> • operative risk of switchover of customer relationship to SEPA-compliant products; • customer loss during switchover to SEPA-compliant products; • necessity to create new processes, e. g. mandate management; • conversion of IT platforms and systems required.

SEPA will also offer benefits to SMEs and retail banking customers by using the new instruments:

- ✚ Processing of SEPA transactions domestic and international at the same favorable terms and conditions as in the domestic market;
- ✚ Simplifying of purchase of goods and services within European countries;
- ✚ Increasing financial control through transparency and common procedures;
- ✚ Opportunities for the enlargement of business segments for SMEs because of common secure and pan-European direct debit procedures.

But with the new opportunities come also the threats for SMEs. Most of Europe's SMEs, especially small and micro enterprises, act mainly on local and regional markets and typically process only a few cross-border payments. These companies are accustomed to their national payments systems and will not opt for SEPA, if SEPA will end-up providing better and cheaper services for cross-border payments, but increasing the costs for purely national payments (Bartelt, 2007). The banking sector must make sure that SEPA offers as well some added value to consumers that act only or mainly at domestic level.

Some features for payments services, like the extension of the period for re-calling debt transfers or missing possibility to send structured remittance information with transfers, will make SEPA less attractive than the existing payments systems. Such steps back must be avoided, if SMEs are expected to opt voluntarily for SEPA.

As regards payments cards SMEs suffer from very little competition between operators and terminal providers and technical assistance. SEPA will only be accepted by the market if it contributes to more competition, better offers and lower prices for these services. If SEPA is to create a European monopoly for card operators, the regulators and competition authorities should take all the necessary steps to avoid market restrictions and overpricing.

CONCLUSION

Following the introduction of the euro, the creation of the Single Euro Payments Area is a natural progression within the payments market. However, in spite of its obvious goals, SEPA is still shrouded in mystery. After almost two years since the first deadline for SEPA instruments (1 January 2008) only a few SMEs really understand this project and its likely impact on Europe. According to the European Association of Craft, Small and Medium-sized Enterprises-UEAPME, the reason behind the very low number of SMEs switching to SEPA features is not the lack of information, but rather the lack of attractive and competitive offers from banks.

It is clear that SEPA is a massive undertaking with immense political and economic implications, huge potential and customer benefits and with the capability of delivering a shake-up

in the European banking industry. It is equally clear that there is a correspondingly high risk of failure, poor benefit realization and a lack of urgency.

SEPA success largely depends on whether it will deliver a quantitatively equivalent or better product in the field of electronic payment-at the same time or lower price-not only for consumers but also entrepreneurs. This should be valid for all types of entrepreneurs, large or small, operating in the international or domestic market.

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