STUDIA UNIVERSITATIS
BABEŞ-BOLYAI

EUROPAEA

3/2013

STUDIA
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STUDIA EUROPAEA

3 / 2013

July – September

STUDIA
UNIVERSITATIS BABEŞ-BOLYAI
STUDIA EUROPAEA

YEAR (LVIII) 2013
MONTH SEPTEMBER
ISSUE 3

S T U D I A

UNIVERSITATIS BABEŞ-BOLYAI

STUDIA EUROPAEA

3

EDITORIAL OFFICE: Hasdeu no. 51, 400015 Cluj-Napoca, ROMANIA
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DEVELOPMENT REFRAMED: COMMENTS ON THE 2013 ROMANIAN REGIONALIZATION APPROACH

Mircea Teodor Maniu*

Abstract
The present political juncture in Romania implies adopting sharp administrative measures in order to comply with both EU's tough requirements, well encapsulated in the Fiscal Compact, as well as with IMF's July 31, 2013 stand-by agreement clauses. In terms of governmental policies meant to boost the growth of the economy, for a third year in a row, such an option cannot be fully operational but with full societal support. It is my point that regionalization, as observed in nowadays Romania, represents much more than the exogenously, EU generated process of the last decade, largely a political concession to the intense need to absorb structural funds. In my view the regional approach truly represents today a one of the kind "vehicle" of development that could trigger much more energy and positive entropy than any other policy in present day Romania. The critical mass of success in this respect implies proper balancing of administrative, fiscal and economic interests, balance that could be reached only through political consensus.
Keywords: regionalization, growth and development, EU and Romania, regional governance

General Outlook

Soon after the 2005 reconsideration of the *Lisbon Strategy*, a process mainly aiming to improve the competitive position of EU's regions in a more and more competitive world economy by fostering growth, employment and

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overall competitiveness, the crisis was already a widespread phenomenon. Looking back in the 2007–2013 EU budget, we can notice that Romania has been allocated almost 20 billion Euros under the *Convergence Objective 1* and more than 450 million Euros under the *European Territorial Cooperation Objective,* while the very *Regional Operational Program* amounts to 3.7 million Euros. In EU's planning the bulk of these funds, actually more than 80%, was supposed to contribute to the so called *Convergence Regions*, defined as those territorial units situated under 75% of EU's average income, which will obviously depict the situation of Romania. Only the less than 20% rest was supposed to finance European competitiveness. But if we adjust these figures with the degree of absorption[1] of EU funds in Romania, we will suddenly become much less optimistic for the overall evolution of the regionalization approach.

Nevertheless, interpreting recent data we can state that *EU Cohesion Policy Programs* in Romania could contribute to at least an increase of 15% in GDP, as computed for the whole 2007 – 2013 budget period. Such a vision was definitely tributary to the largely overrated absorption capacity of the country, in connection with the lack of proper econometric means in order to assess the amplitude of the crisis.[2] Since one cannot judge without significant political bias what worked, falling right in place, and what was spent inefficiently in this process, I favor a procedure that could embed all the measurable inputs, and to a large extent also outputs, at regional level. Let's assume that such an approach would necessarily be a "smart", innovative, regional pattern for development. This could work for Romania, for reasons to be elaborated below, on the long run, just as the administrative reform initiated in Poland (Petrakas, Maier and Gorzelak, 2001) in 1999 was proven successful and fruitful only a decade later, and even more relevant, this happened in harsh crisis conditions.[3]

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[1] Romanian Prime Minister Victor Ponta assesses that while at the end of 2012 Romania could not reach more than 12% of the allocated funds, in July 2013 this figure significantly improved but it will not exceed 20% in the first half of 2013. (Romanian Academy, Debate about Regionalization, Bucharest, April 2, 2013)

[2] See in this respect Gh. Zaman, G. Georgescu, "Structural fund absorption: a new challenge for Romania?", in *Romanian Journal of Economic Forecasting*, Nr. 1/2009

[3] G. Petrakas, G. Maier, G. Gorzelak, *Integration and Transition in Europe: Economic Geography of Interaction*, London: Routlegde, 2001

So, my point is that any growth engine that worked in various moments for Romania (domestic consumption, exports) cannot make the difference on the short run as a politically induced "push-up" process that would build the necessary entropy for the next EU budgetary cycle. Making viable the Romanian regions among the 273 *NUTS II*[4] type of regions does not mean only updating a task that was embedded in the *Romania's Accession Treaty* and should have occurred anyway long time ago. In a juncture when it is obvious that the regions of Europe become increasingly quasi-independent players, EU or even world scale, doing this means only to play the game of the moment. As the regions are motivated by the increased challenges that derive today from global economic perspectives, and various and complex exogenous factors tend to re-shape even less opened economies, the managerial layer of governance of the regions turns to be a proper decisional step.[5]

Romania on the Regionalization Track

EU inspired approaches towards regional development and consequent regionalization occurred in most *Central and Eastern European* (CEE) countries during the 90s. At this stage Romania's regionalization policy has been described in numerous sources as a classical effect of "*Europeanization*"[6] bluntly meaning the chase for pre-accession funds. Following preliminary results in respect to EU funding a *Green Card* concerning regional development and the *Law of Regional Development* (151/1998 – modified in 2004) were passed. Almost on the spot, Romania was "divided" into 8 development regions (DR).

[4] The Nomenclature of Territorial Units for Statistics (NUTS) is an Eurostat device providing a single "uniform breakdown of territorial units for the production of regional statistics"; although NUTS has no legal value *per se* throughout EU, NUTS was effectively in place since 1988, the reviewed 1999 version indicating five territorial levels, for the Romanian case (2011) these are: NUTS I: the whole country; NUTS II: 8 development regions; NUTS III: 42 counties); NUTS IV: not applicable (EU pattern indicates territorial associations, mainly big cities); NUTS V: 323 municipalities and towns and 2859 rural communities (consisting of approximately 13.000 villages).

[5] John Peterson, M. Shackleton, *The Institutions of the European Union*, Oxford: Oxford University Press, 2002, pp. 326 – 346.

[6] Daniel Dăianu, *Încotro se îndreaptă ţările postcomuniste?*, Iaşi: Polirom, 2000; J. Bukovski, S. Piattoni, M. Smyrl, *Between Europeanization and Local Societies, The Space for Territorial Governance*, Lanham, Boulder: Rowman and Littlefield Publishers, 2003, pp. 2 – 7.

True, the law was conceived in such a manner that the counties in place would negotiate and later on join a certain development region on volunteer basis, according to the results of negotiations, public consultations and feasibility studies. But it was clear that the priority task of the Government, namely to create a territorial frame of NUTS II type in Romania, implicitly designed in order to absorb EU money, was accomplished.

It is not beyond discussion the fact that such a scheme was drawing upon the 1976 *National Territorial Plan*, a politically driven plan that imposed on Romania a development model having as main target diminishing of the economic imbalances between counties and historical provinces but purposely ignoring the past and the historical peculiarities of those territories.[7] While keeping in place the 1968 administrative grid (actually still valid in 2013), regions, in the sense we are branding them today, were inexistent during the communist regime, though the very name of region, used in the sense of county, was in legal use between 1951 - 1968. Such an approach, fully consistent with the communist obsession of even industrialization throughout the country, and the fact that the overall development should be nothing but a consequence of industrialization, led to the situation that practically all the Romanian macro-regions (historical provinces) developed heavy industries, obviously redundant, while inter-regional linking infrastructure was the least priority of the regime. Not to mention that significant developmental discrepancies were still to be observed during the late 80s.[8]

There is no wonder that building on such grounds and mechanically conceiving the regional framework in order comply with EU funding procedures has been branded as strongly artificial and ultimately conceived as nothing more than "another transitional tool" of regionalization, subject to change as soon as the economic geography will start to matter in terms of transactions' costs.[9] It is exactly what is invoked by those willing to approach the issue in a *top-down* manner, through major legal administrative changes, including the Constitution. Namely the Government decided to launch a

[7] E. Popa, *Autonomia locală în România*, Bucureşti: Editura ALL BECK, 1999.

[8] W. Patterson, *Rebuilding Romania, Energy, Efficiency and the Economics of Transition*, London: Earthscan, 1994

[9] Iulia Trăistaru, Carmen Păuna, "The Emerging Economic Geography in Romania", in Iulia Trăistaru, Peter Nijkamp, Laura Resmini (Eds.), *The Emerging Economic Geography in EU Accession Countries*, Aldershot: Ashgate, 2003, pp. 242 – 283.

campaign in order to familiarize the society with the fact that the very core of the process of regionalization should be the economic optimality and cohesion only a subsidiary effect, to be boosted mainly through EU platforms. It is empirically proven (in other countries) that any decent SWOT analysis would indicate the cost effectiveness of this approach. The opponents of this view are favoring a *bottom-up* approach which implies the "natural" non political creation of regions on dual basis: a decent macro PEST (Political, Economic, Social, Technological) investigation, conducted country wide along with general public consultations in order to determine precisely the state of the public opinion concerning the issue. The non political trade-off would be definitely the timing of the operation, the second implying a much longer period till in place, while the first would inevitably trigger public unrest concerning decisions that would influence the destiny of common people simply by political will.

Main Rationale for Regionalization: Diminishing Transactions Costs

While some sources point out to the fact that the term European regionalism refers to the emergence of overtly political regional pressures across Europe, mainly due to the resurrection of multilayered identity, most of them consider that economic competitiveness would be the capital driving force behind regionalism.[10] From an economist's point of view, the territorial evolution of the geographic areas of Romania has been traditionally conducted through factorial analysis. Interpreting the factors one can explain the various correlations of demographic, social, business, infrastructural, etc. - features that illustrate the process of territorial economic growth and development. But this traditional framework was developed in a lesser opened economy than today's world and became obviously obsolete from many standpoints. Building primarily on factor endowment and trading based on a *Hecksher-Ohlin-Samuelson* factorial case seem irrelevant for so many developed countries. Therefore, "clustered development" (Rostow, 1971) points towards comparable territorial meaningful structures, stable over time and also flexible enough to adapt to the present day technological

[10] T. Herschel, P. Newman, *Governance and Europe's City Regions*, London/New York: Routledge, 2002, pp. 25 – 28.

rapid changes.[11] Territorial clustering means more than analyzing the inputs, outputs and business environment, it deals with infrastructure, security, social life culture and identity and overall living standards.

As the main (political) deciding factors in EU as well as relevant stakeholders become aware of the benefits of increased competitiveness of European regions from the viewpoint of the clustered development, regional, national and European frameworks of development are today under scrutiny. Regions as territorial-geographic concentrations of not only demographic communities, but also firms, NGOs, infrastructure, public and private services. Clusters of regional consistence usually take advantage commercially of the specific bond that is more or less generated throughout history, to a far larger extent than countries as a whole. This is also the case of Romania, let's face it. But can they become really functional unless the triad of micro, intermediate (dedicated to a specific branch of the economy) and macro levels of policies would be effectively in place for that purpose?[12] Regionalization, no matter if we are dealing the Romanian case or else, should tackle the issue of "creating" a territorial unit with a specific morphology and also a structural dynamic of governance that could push evolutionary processes in a more vivid manner than government proved to be able. It is precisely this "centripetal regional dynamics" that generates cohesion, the feeling of belonging to the core instead of periphery, and generating action consequently.

If one can identify a location share differential, forcing regions to be different and actually get more different as benchmarked to national or international territorial entities, mainly for trading reasons, this cannot be valid unless the difference translates into diminishing the costs of transactions, not only for commodities and common services, but also for peculiar services such as the cost of investing, within that specific territorial unit, as opposed to the country wide determined cost. Of course, elaborating at this crossroad of the issue, I would say this is not feasible without a proper (regional) institutional framework, fully operational, able to implement and make fully functional several layers of governance, situation which brings to surface the issue of evaluation. Because it is obvious that regionalization

[11] Michale Porter, "Clusters and the New Economics of Competition", in *Harvard Business Review*, November/December, 1998

[12] B. Martins-Rodriguez, J.M. Viedma-Marti, "The Region's Intellectual Capital Benchmarking System: Enabling Economic Growth through Evaluation", in *Journal of Knowledge Management*, Vol. 10, No. 5, 2006

seen exclusively from an administrative standpoint (as the Romanian case appears, at least from a PR perspective) implies plenty of political interface, which due to the lack of popularity of the domain, could and probably would reverberate negatively over the whole process.

What I have in mind in this respect is the fact that the potential burst of bargaining concerning the potential limits of the regions, the status of regional capital cities, governors, appropriate institutional bodies, inevitably re-considering the administrative status of various communities are painful and time consuming processes, that could easily jeopardize the regionalization process at this stage, due mostly to the wrong public perception. But if the civil society's perspective could be somehow switched from the present day "administrative blueprint" and the emphasis could fall on clustering local businesses following a process of technological and even social networking, and therefore giving territorial consistency to a certain output, this would be a meaningful approach indeed. Putting the accent on proper regional diffusion of knowledge, transfer of good practices and emphasizing success stories, could work much better in my opinion in the case of Romania. Combining various layers of expertise (research units and higher education institutions, innovative companies and, why not, pilot administrative units of governmental bodies) to a degree that was never functional in Romania, though theoretically existent, would probably make those entities gather momentum for more sharing of their assets to the benefit of the whole region, just as this format of sharing is documented of not being operational countrywide.

Moreover, if a regionally administered conglomerate of fiscal contributors are "glued" by the same giving-receiving pecuniary interests, and the process is supplemented by "local pride", branding, and provided there is in place a preliminary scheme of contractual consistence targeting this limited associative pattern regulating the process, the chances to register positive outcomes of regionalization seem increasingly decent. I see this pattern of clustering more or less as a must adopt "risk minimizing tool" for both the business environment and regional communities. Such an approach could enforce, to a much larger degree than free market can do, and actually did in Romania, that in a certain area all the needed inputs are available in place, but also the necessary infrastructure and even supra-structural regulations and institutions are available for the business environment and citizens. Bottom line, the idea that transaction costs diminishing has as a prerequisite a public layer of governance that would be the guarantor of evolution in terms of secure sustainable development in a friendly environment.

Strongly believing that a region, as depicted above, has the potential to eliminate most of the intermediate levels of decision and therefore enable a more efficient development of all social and economic processes that occur in that region, some extra-economic details should be enhanced. Transactions as dealt in this paper are exceeding by far pecuniary transactions, and the issue of diminishing costs is definitely applicable to a larger extent in this respect. The region should extract assets from a multilayered type of cohesion, historically generating networking of various consistencies. If that breeds social identity on the one hand, economic links that forge peculiar coordinates of economic life on the other hand, all these scripts cannot be put at test on the short run but through the emergence of "pools of regionalization". Just as the economic clustering process is illustrated by the emergence of the alpha-clusters,[13] industrial type of structures that are characterized by innovation above all, regionalization should cover a far larger landscape, including the inherent sprawl that comes with the urbanization process, the territorial agglomerations of factors (IT, education, health, but also some public services) designed from scratch for the reduction of the transactions' costs. Last but not least, a true region in a multilaterally developed society offers not only higher incomes and material compensations, but also more important, increasingly higher quality of life.

Top-down Regional Approach

Much energy was dedicated throughout EU towards the so called political regionalization[14] or the granting of significant legislative power to regional representative bodies (Catalonia and Basque country in Spain, Flanders in Belgium, Scotland in UK and even in the archetypal model of a centralized state, France, for the case of Corsica) usually having in mind historically delicate, to say the least, ethnic specificities. Though the model appealed to many political forces in the ethnic mosaic of Central and Eastern Europe, not a single country decided yet for such a radical model,

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[13] J. Schoales, "Alpha Clusters: Creative Innovation in Local Economies", in *Economic Development Quarterly*, SAGE, No. 20, 2006.

[14] Several authors point out to the fact that the term regionalism refers first of all to the emergence of overtly political regional pressures across Europe, due to the inadequacies of the present day state; others consider that economic competitiveness is by far the major driving force of regionalism (see in this respect T. Herschel, P. Newman, *op.cit.*, pp. 25 – 28.)

encapsulating too many (previously) seen and unforeseen dangers. But this random example only illustrates the fact that the most publicized bottom-up case of regionalization turned (at least for the time being) unsuccessful. Could it work, again bottom-up, on different coordinates, such as purely administrative ones? It is my strong opinion that no matter how relevant would be the effort to convince the public opinion to back a certain pattern or to debate mass scale concurrent models of regionalization, whatever that could be accomplished would be further dividing the society when it comes to this matter. I will try to insert a couple of argumentative facts illustrating this view.

Despite the fact that quasi-liberal measures were undertaken all over the communist at the time Central and Eastern Europe starting with the 70s, Romania adopted a radically different path. While the Hungarian patterned "goulash communism" took off as early as 1968, Yugoslavia already experimented self-management and private entrepreneurship. Poland was definitely an "out of the box" case by communist standards. Not to mention the fact that China moved towards "one country two systems" in the early 80s, a time that witnessed also the Soviet *glassnost and perestroika*. Though, in line with international developments, Romania formally adopted a so-called *New Economic Mechanism* in 1978, allegedly giving more decision power to lower levels of the economy, this was by far only a propaganda tool. The short and even long run implications of this oxymoronic situation was a false perception of the mechanisms that govern the economy and the market, situation which was fully visible in the early 90s, when Romania took such a divergent path from the bulk of the comparable countries.

So, on these grounds of knowledge concerning the basics of free market, supplemented with the exacerbated *mimesis* in mocking EU procedures which could not be assimilated rationally, regionalization consonant with the rest of Europe seemed a far cry for Romania. Not quite the same situation throughout CEE. As the Report on Economic and Social Cohesion, determined by the assessment of EU's regional policy, having in view the new geo-political realities of Europe, was published in 1996 and clearly pointed there is no direct link between the type of regionalization[15], as observed in the 12 member

[15] Five main types of regionalization could be identified in the legal (constitutional and administrative) domain of most EU countries in the early 90s: administrative regionalization; regionalization through the local authorities already in place; political regionalization; regional decentralization; federalization.

states of the moment, and the peculiarities of the economic development in those countries. Soon after joining EU, most if not all CEE countries adopted coordinates of regionalization that suited better their interest. While Bulgaria, Estonia, Lithuania, Slovakia and Slovenia created an administrative frame entirely subordinated to the central government, but acting on regional basis, other countries, such as Hungary and Romania, implement regional policy mainly through the existing local authorities, obviously created for other ends in the previous regime, but mandated specifically for this task. On the other hand Poland and Czech Republic[16] effectively adopted regional decentralization, consisting in the creation of specific decentralized structures, new categories of territorial authorities, in larger constituencies, obviously targeted towards growth and development.

If we interpret empirically the path and the accomplishments of CEE countries it seems evident that early in terms of timing and top-down in a procedural perspective are the winning cards. Evidently diversity and initial differences are assets for a successful regionalization track, but EU offers sufficient conditions in order to assess that initial conditions could not matter less, if a "smart" policy framework is put in place (Hilpert (2003). In the case of Romania that evidently means to the re-interpretation of the administrative decisional levels. Conferring powers to regions would actually mean de-periphery-zation of at least the most competitive regions of the country with potential significant "locomotive" effects. Facing the fact that the Romanian economy is peripheral within the overall economy of the EU full integration at this stage (i.e. within Eurozone) cannot but enhance the scale of becoming more peripheral. It is difficult to assess at this stage if factual de-periphery-zation could be accomplished at regional level, but there are sufficient examples in this world that could prove the contrary.

Let's add one more important argument, illustrating the top-down case. It is a fact that development is interpreted in most sources as a phenomenon which is definitely more related to the territory where it occurs, that simple growth. While overall development grounded on high value added output represents the ideal approach in the present day

[16] Actually the former Czechoslovakia was the only CEE to have in place a regional form of territorial unit comparable with NUTS II. The Polish *voivodships* also matched several criteria of regional framework, as present throughout EU.

economy, there are no significant examples that such a framework could be operational from start countrywide. The empirical evaluations of high-tech mono industries located at regional level are definitely better, and more important, less prone to collapse under crisis conditions, than any development scheme conceived for the whole country *ab initio*. Of course the *Achilles's heel* in this case would be the potential inadequacy to the juncture of the world, continental or national markets, inducing severe recession in that mono industrialized region. But it seems that nowadays it is more important and more convenient to undertake the risk of acquiring top class technology that would put a region I another technological league, at all risks than simply evolve in full synergy with the past of that particular territory.[17]

Another supplementary argument pleading in favor of the idea that regionalization is today one of the most important triggering factors for development in Romania would be, paradoxically, the assessment of the growth and development in connection with the accumulated experience of transition and joining EU. While the process of transition occurred evidently spontaneous and falls into the "stop and go" pattern, it definitely could be branded as mostly endogenous, while joining the EU was obviously an exogenous process that change the coordinates of evolution, up to the point of distortion (Mattli and Pluemper, 2004). If there is a point in considering that the heavily political exogenous process of acceding to EU, inevitably forged "aggregated identity" sometime ignoring lessons derived from centuries of peculiar evolution, regionalization simply might be the answer. The deeper implications of moving from traditionally organized national frameworks to regional ones could be interpreted in this view as the *de facto* empowerment of the endogenous dimension of the economy. The trajectory of Poland during the crisis, a country that really took into consideration the endogenous growth perspective, is a relevant indeed example in this respect.

Admitting the fact that such a perspective actually leads to the conclusion that regional integration mainly targets lowering different economic and social transaction costs between participants, as opposed to non-participants, we should take into consideration other kinds of possible

[17] A. Nagarajan, W. Mitchell, "Evolutionary Diffusion: Internal and External Methods Used to Acquire Encompassing, Complementary and Incremental Technological Changes in the Lithotripsy Industry", in *Strategic Management Journal*, Wiley Inter Science, No. 19, 1998

interpretations. For instance, beyond the already discussed ethnical regionalization, exclusively building upon the dichotomy endogenously/ exogenously driven type of growth, could make us end up in interpretations of regionalism as "postmodern feudalism" (Siebert, 2002) therefore encapsulating much of the liabilities this epoch is associated with, autarchy coming first. But we should acknowledge that in a more and more competitive environment, in a world infested by so many non-tariff types of barriers, bringing competition towards lower and informal levels of PR manipulation, there is nothing wrong if EU tries to bring to life patterns that are deeply rooted in its own history. Therefore at first glance, and this time strictly form an economist's perspective, the "Union of the Regions" mainly appears to be a federalist approach, especially designed for a better specification of the division of powers between central and regional administrative levels. Such a scenario could not be, in my opinion, anything but benefic for a country like Romania.

I put on paper these comments exactly at a time when it became public the official announcement that the revision of the *Constitution* and consequently the regionalization process are "regrettably" postponed for 2014, exclusively for political reasons. Correlating the dimensions of the process with the constraints of the new EU budgetary cycle starting in 2014, the news cannot be worse for Romania's developmental perspectives. But the public debate conducted in such a manner that everybody should be aware of the negative consequences of indefinite postponement, should start on the spot. *Dixit et salvavi animam meam.*

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CITIES; BETWEEN ENGINES FOR GROWTH, AND DEVELOPMENT

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Abstract

Due to the advantages offered by agglomerations, human activities have always concentrated, and cities have become multifunctional places: living places, places where goods and services are produced, socializing places, etc. Nowadays however, the negative effects produced by agglomerations often get to overbalance the positive effects and to repel people and activities. Agglomerations often become impersonal and unfamiliar. They are no longer a "lived space" and people can hardly wait to "evade" at least during the weekend. On the other hand, cities are producing the most part of the added value in the EU; they are, in many aspects, the engines of the European economy, but also forerunners in the production of ideas and behaviors. In this context, the dynamics of some cities is different, mainly due to a false competition between the city as a production space and the city as living space for people. Our analysis will focus on the way in which cities use and transfer these resources, adding or destroying energies, materials, values and lives. We will underline the complementarities of the various societal areas as engines for development, so as to be able to reinforce the assumption that economic, political and social domains cannot evolve separately if a smart, sustainable and inclusive growth is to be considered.

Keywords: city growth, development, quality of life

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Cities in the XXIst century

The territory is a major factor in the political, social and economic life, based on the role it has to social transactions and market structures. Spatial proximity encourages exchanges, facilitates communications and generates complementary activities. The access to raw materials and inputs is, in the same time, conditioned by territorial factors. The territory is also important for the development of culture and for stimulating the innovation and the education, being the basis of the individual identity and the collective representation[1]. The concentration of the population is a basic indicator of the attractiveness of a place, the power to attract people and ideas being one of the characteristics of the cities throughout the history[2]. The population decreases in some cities and increases in others, but, in addition to the natural dynamics, there are many migratory flows. Some people migrate in order to look for employment, some others in order to look for a better living place. In the same time, cities have lost their uniqueness because of globalization; therefore, they got to compete on a global market in order to attract and to maintain resources. To do this, cities have to offer such conditions so the internal resources to remain and develop in place, and the external resources to settle down. Generally speaking, these resources are investments, qualified workforce and tourists. These three categories bring money, activities and dynamism in the region and pay taxes, which the public authorities can work with in order to further improve the urban attractiveness. Cities where life is more pleasant are also economically successful[3]. The aesthetic qualities of a city are functioning as catalysers for the economic growth; that is why cities invest in culture, leisure, shopping, mobility and environment. *"A city is not only a geographical concept, a spatial determination, an agglomeration of buildings and offices. A city breathes the urban atmosphere. Traditionally, cities are centers of trade, activities, art, culture, past and future. The urban atmosphere is determined*

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[1] Stein Rokkan, Derek Urwin, *The politics of territorial identity: Studies in European Regionalism*, London: Sage Publications, 1982, p. 7.

[2] Teodora Brandmuller & Berthold Feldmann, *The Urban Audit – measuring the quality of life in European Cities*, IAOS Conference, 2008.

[3] Dominic Tremblay, Mark-Urbain Proulx, *Le Positionnement de Saguenay*, Promotion Saguenay et CLD, October 2004.

by a labyrinth of dynamic changes between all these functions, between work and leisure, individuality and collectivity, public and private services".[4] That is why, the more people, companies and tourists become mobile, due to the technological, social and political development, the larger the scale, at which the competition is played between cities, is. *„The city is in fact a collection of locations"*[5] because people, companies and tourists take into consideration a large number of factors in order to settle down in a city, factors that influence one another. That is why every city needs a balance between its diverse functions (living place, place to be visited or place for economic activities), especially that monofunctionality has proved its limits particularly in the case of economic fluctuations or of exogenous changes.[6] And this harmony should be completed by the social one, because problems in the neighborhood can have negative effects on the activities and on the image of the city; both the social and the physical environment influence people's life.

"When urban conditions are right, people can be inspired to think, plan and act creatively".[7] They will get involved in the life of their city and they will be motivated to take part in problem solving. That is why creativity, motivation and involvement of people become one of the main resources for the development of a city, replacing the old ones, such as natural resources or access to the market. *"We now know how to build roads, bridges and sewing systems... Today the challenge is how to understand the city as a «synthetic whole»; to see it as a living organism and so being able to bring the seemingly disparate together"*.[8] That is why priorities come from democracy and governance, from social capital and from the quality of life. *"Building civic capacity and leadership is a software infrastructure as essential as roads and airports"*.[9]

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[4] Van Baxtel, cit. Vincent Vles (coord.), *Attractivité et recomposition des territoires touristiques*, Projet du contrat MSHA 2011-2014, p. 6.
[5] *Ibidem*.
[6] *Ibidem*, p. 8.
[7] Charles Landry, *Urban Vitality: a new source of Urban Competitiveness*, [www.princeclausfund.nl/urbanheroes/abert/texto3.htm], 23 April 2013.
[8] *Ibidem*.
[9] *Ibidem*.

The city as engine for growth

„The economic profitability of urban space – whether in the form of business districts, shopping centres, hotel complexes, or tourist sites – is patently dependent on it being maintained as clean, secure and attractive".[10] The economic relevance of the territory is given by the terms of exchanges within the territory, the relationship between people and the interrelationships existing in production and marketing; it is also influenced by coalitions of interests involved.[11] In a simple analysis of the economic process, those inputs that enter into the equation to produce the goods are labor, natural resources and capital. The higher their quality, the more increased the production will be. Compared to classical theories, however, a factor that becomes increasingly important in the production process is how resources are used.[12] The efficiency is measured through the productivity, which in relation to production costs becomes the main determinant of the attractiveness of a region.

A city is rich if it has certain resources (human, natural and material), but more important is that it can become rich if it knows how to combine those resources in an optimal manner. Natural resource endowment is initially a comparative advantage and therefore the concept of wealth is relative and depends on the reference to other regions. But the knowledge of the optimal combination of resources can give a competitive advantage, acquired in time. This is the reason why those institutions that coordinate the economy play such an important role, as they establish the rights and obligations of all local actors, so that they are compatible with long-term objectives. Therefore, the regions can keep their welfare only if they can adapt their institutions and equipments to the new conditions of competition. It follows that the economic development of a city is a dynamic process in which the future can be influenced.[13]

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[10] Gesa Helms, Rowland Atkinson, Gordon MacLeod, "Securing the City: Urban Renaissance, Policing and Social Regulation", in *European Urban and Regional Studies* 14(4), Ed. Sage Publications, 2007, p. 271.

[11] Stein Rokkan, "Territories, Centres and Peripheries", in Jean Gottman (ed.), *Centre and Periphery. Spatial variations in Politics*, Beverly Hills: Sage, 1980, pp. 163-204.

[12] Radu Barna, *Economie Regională*, Cluj-Napoca: EFES, 2008, p. 24.

[13] Stein Rokkan, Derek Urwin, *op. cit.*, p. 96.

The construction of a flexible, innovative and effective town must be based on a society in which the transaction costs are minimal and the use of endogenous potential is maximized.[14] In such a city, the development and the competitiveness are based on a number of factors, among which the most important ones are the specialized ones. They make the difference in today's competitive world, only that they must be continually renewed. Generally speaking, these factors are the result of cooperation among political, social and economic actors, and represent actually the benefit of a given location.[15] So, the city's chances towards development and growth depend heavily on its capacity for cooperation, on establishing networks and on the learning capacity of various actors, from their own experience or other's. H. Bratl and M. Trippl claim that *"the region has to become global"*,[16] which means the capacity of building internal networks, in order to take advantage of the benefits of proximity, but also external networks that enables the access to know-how and global markets.

"The city – as an economic and social phenomenon – acts as a multiplier of alternatives".[17] The city is the place of high-tech production, but also of cultural, behavioral and societal values. This is why it must be understood in an integrated way and to become, as I. Baran underlines:[18]

- a centre that imprint dynamism to the whole region;
- a place where public interest must prevail, due to the strong external effects the centre is capable of;
- a place for harmonious development of the various communities;
- a place which stimulates the social and physical changes;
- a place which prevent conflicts of interests;
- a place that indicate the better use of resources.

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[14] *Ibidem*, p. 53.

[15] *Ibidem.*

[16] Harald Bratl, Michaela Trippl, *Systematische Entwicklung regionaler Wirtschaften. Überprüfung der Leistungsfähigkeit der Neueren Systemtheorie am Beispiel der Industrieregion Obersteiermark*, Studie im Auftrag des Bundeskanzleramtes, Institut für regionale Innovationen GmbH, Wien, 2001, p. 30, [http://www.austria.gv.at/2004/4/15/bratl_trippl.pdf], 4 October 2012.

[17] Irina Baran, *Architectural and Urban Planning Elements*, Iaşi: Ed. Societăţii Academice "Matei-Teiu Botez", 2009, p. 128.

[18] *Ibidem*, p. 129.

Growth, however, is not enough to be created, but it should also last and should be able to transform itself into development. Therefore, knowledge must be expanded continuously, the organization must be improved, and the resources must be better used. Various investment projects must be framed by rules of general interest and guided by the principle of sustainable, human and endogenous development. Growth can not be done without the use of resources,[19] but territorial planning activities may take account of their scarcity.

Endogenous growth models differ from traditional neo-classical scheme in that they internalize the dynamics of growth. In the neo-classical model of R.M. Solow[20], the decreasing productivity of the capital for the long term cancels per capita growth, at least if there is no exogenous technical progress to increase the productivity of factors of production. Endogenous growth models, on the one hand, put the basis of economic growth on the choice made by the economic actors, which can stimulate productivity, and, on the other hand, on the inexistence of productivity losses due to the recognition of externalities.[21] Accumulation could represent the quantitative character of growth, while the qualitative character is represented by the improving efficiency of the productive combination. By means of these mechanisms, a city can create a self-sustaining growth process, while taking into account the spatial specificities of the process. Decreasing marginal efficiency of capital which leads, on long term, to the cancellation of the growth, in Solow's model, is compensated in the endogenous growth models by the existence of positive externalities related to the accumulation of factors such as human capital, research, and public infrastructure. Here, the source of external scale effects comes from the actions of the community, because businesses always act in a universe with decreasing marginal returns.[22]

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[19] Vasile Cristea et al., *Ocrotirea naturii şi protecţia mediului în România,* Cluj-Napoca: Ed. Presa Universitară Clujeană, 1996, p. 231.

[20] [http://cepa.newschool.edu/het/essays/growth/neoclass/solowcont.htm], 22 April 2008.

[21] Catherine Baumont, "Croissance endogène et espace", in Fred Céliméne, Claude Lacour (eds.), *L'intégration régionale des espaces,* Paris: Ed. Economica, 1997, pp. 93-112.

[22] *Ibidem.*

The concept of externality used by the endogenous growth theories is a-spatial.[23] However, the definition given by A. Marshall shows that economic thinking has taken into account the existence of privileged spaces, that can lead to improved productivity and can foster development and growth.[24] Externalities of this model are actually investments in human or material capital, know-how, innovation, and research. The territorial nature of the endogenous growth model can be inferred from the territoriality of these externalities, from the location of production factors and from the proximity of the economic actors in relation to these factors. The qualitative dimension of certain factors must always be placed next to other growth factors, including the capacity planning to use these factors, which should not be forgotten. B. Amable and D. Guellec are distinguishing several such models, which are based on:[25]

- Physical capital. The definition of physical capital is the same as in the neo-classical model, the existence of positive technological externalities arising from the accumulation of capital. The individual production function has decreasing returns, but each output depends also on the level of the global capital induced by externalities. At the origin of these externalities would be the effects of the accumulation of experience due to practice or to capital accumulation. Furthermore, investments that are incorporating technical progress in upstream intermediate production sectors may have favorable effects on productivity in downstream sectors.
- Technological innovation. Gains in productivity are due to the introduction into the production chain of a new technology based on research. Either there will be more specialized inputs, which will lead to a greater labor division, or more efficient inputs.
- Human capital. The growth rate of human capital acquisition for an individual is proportional with the time of formation and stock of knowledge accumulated (an individual well trained may progress

[23] Harald Bratl, Michaela Trippl, *op. cit.*, p. 15.

[24] Alfred Marshall, apud Wladimir Andreff, *Economie Internationale et Industries*, course notes taken by R. Barna in classes at MSTCE, University Paris I Sorbonne, 2002.

[25] Bruno Amable, Dominique Guellec, "Les Theories de la croissance endogene", in *Revue d'Economie Politique*, 102(3), 1992, pp. 313-377.

more rapidly in his formation). A firm production depends on how much physical and human capital has at its disposal, but also on the general human capital available on the market. The effectiveness of human capital depends on its general level in the territory, as an individual is more effective when the general level is high, and when he is surrounded by efficiency. For R. Lucas, urban agglomerations would be favorable for the accumulation of human capital due to the diffusion and exchange of possible information that are offered by the proximity.[26]

- Public capital. Private actors evolve in a competitive environment with decreasing returns, but which may become increasing returns, thanks to the public factors. Among the public factors that may increase private returns are public infrastructure, health spending, education, and research. The difference from previous models is to consider these factors as public goods, goods whose production would not be profitable for private actors. On the one hand, their accumulation is different, and, on the other hand, the interaction between these factors is different. Investment in fundamental research has particularly positive effects on research and development in the private sector. General schooling effects are beneficial in general but also in particular over the innovation capabilities of agents. Innovation is thus progressively incorporated in physical capital, investment in public capital leading to new learning effects and the birth of new skills.

Improving the productivity of factors of production and growth depends, in the above models, on the investment decision regarding the factors of endogenous growth and the production of positive externalities. Thus, the power of growth is not exogenous any more. It is caused especially by the choice of inputs (production factors) allocation.

Deterioration of the urban territory

Cities are privileged places for economic and technological innovation, but also places of high social stratification. Also, cities bring together diverse

[26] Robert Lucas, "On the Mechanics of Economic Development", in *Journal of Monetary Economics*, 22(1), 1988, pp. 3-42.

elements of the workforce in various fields, the interdependencies that are being created establishing some of the urban characteristics. The power of proximity interactions and daily exchanges of information give coherence to the urban territory, moreover that cities represent privileged places for cultural diversity. But at the same time, the urban area is the place in which the strongest processes of differentiation and social exclusion are generated. The city is the place for fragmentations, in which rich neighborhoods, well-equipped in services, are evolving along some poorest ones in which a lot of services are lacking, and that tends to further deepen the existing separation between different social groups.

Strengths and advantages, disadvantages and problems generated by urban agglomerations cause this area to be extremely complex. The analysis must therefore consider multiple aspects, find causes and penetrate their essence, and especially it must take into account all the factors and actors involved in urban development. *"Encounter, assembly (density), polarization and succession are the elements which define a territorial unity, which is at once functional, social, political and which symbolizes the city"*.[27] A. Cunha and J-B. Racine explained, on this basis, the possibility of deterioration of the urban space as the engine of development and growth, through three simple findings:[28]

- The limiting of proximity exchanges and social rifts could determine the disappearance of the assembly: *„urban space becomes more and more characterized by circulation and mobility rather than assembly"*;
- Although there may still exist specific networks, proximity becomes increasingly individualized and do not create social unity anymore;
- The regression of complementarity generates flexible diversities, on the one hand strengthening the society individualization, and on the other hand forming more volatile social groups than before.

Lack of democracy and weak possibilities of participation weaken the essence of urbanity, grow discontinuities and decontextualize the urban areas. They lead to mental and behavioral changes, and the emergence of

[27] Antonio Da Cunha, Jean-Bernard Racine, "Sustainable Development, The Quality of the Urban Environment and Governance", in Ioan Ionas, Denise Pumain, Jean-Bernard Racine, *Integrated Urban Systems and sustainability of urban life*, Bucharest: Ed. Tehnica, 2000, p. 83.
[28] *Ibidem*.

extra-regional centers such as some commercial suburbs or new centers, such as Silicon Valley.

In time, it became obvious that in order to run as an engine for the region, without being held back or prevented from operating, the city must act unitary; its various components should have the same goals and the one's needs should be therefore perceived as the needs of the whole. That is why the social equity, environmental protection, and democracy are just as important elements in the functioning of the city as engine for growth as the other factors.

Quality of Life and development

Pollution and agglomeration affect the city's quality of life. This has consequences on attracting managerial expertise and, in general, qualified workforce, which, being mobile at global level, has many possibilities available. The image of a city, which is first of all conditioned by the quality of life, plays an important role in the process of location. It can reduce the uncertainty and risk levels and can have a positive effect on trademarks.[29] The best example in this direction can be offered by the large number of Romanian doctors who emigrate because of the general offer of other regions, although they have a very good material status.

In their study, D. Lambrini, B. Biagi and V. Royuela support the idea according to which the quality of life is a public good, to which it should be allocated community resources.[30] The individual satisfaction comes from the consumption of public or private goods and services, from the consumption of leisure, clean air, a safe and healthy environment, which represent together the physical and social characteristics of the location. That is why the quality of life is more and more associated to the social welfare concept, although traditionally this was especially associated with some financial factors linked to the level of prices or to the cost of living. It is also the reason why for A. Sen the quality of life becomes "*the real possibilities*

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[29] Hubert Brossard, *Agence de promotion et Investisseurs étrangers: Processus de collecte d'information et services aux investisseurs,* Université de Neuchatel, Thèse présentée à la Faculté de Droit et des Sciences Economiques, 1996, p. 211.

[30] *Ibidem.*

you have regarding the life you lead".[31] Thus, all equipments, services, goods and characteristics that a city offers represent the advantage of the location or *"the packet of goods that is necessary for the «consumer» of urban space"*.[32] Quality of life is dependent on the economic stability and on the social justice. *„Choosing the location in the 21st century is governed by a set of rules that are different from those of the 20th century. In the past century the location possibilities were first optimized according to the company needs. In the knowledge-based economy of the 21st century, where the comparative advantage of the company is predominantly determined by the creativity of the workforce, the people's location preferences, especially the preferences of the qualified people, come to the fore"*.[33]

The institutional structure of an economy can be defined as *"rules of the game of a society"*[34] or, more formally, as *"man-made constraints in order to model interactions between people"*.[35] The institutional structure frames the social, political and economic transactions and incorporates businesses, trade unions, public power and inhabitants; determines the institutional framework in which these transactions occur, framework that includes culture, historical traditions, social and behavioral norms, the legal system etc.. Institutions thus play a fundamental role in social, economic, and political behavior and in the way a society is functioning because:

- The market can not function without private property and free trade, the fundamental institutions of capitalism, which can not exist without adequate legislation and without respect for social norms. Where these do not protect the property, like in the case of disadvantaged districts or areas dominated by organized crime, the development can not be achieved;
- The institutional framework carries out the monetary policy and determines the trust in the currency;

[31] Amartia Sen, cit. Dionysia Lambrini, Bianca Biagi, Vicente Royuela, "Quality of Life in the Economic and Urban Economic Literature", in *Social Indicators Research*, 84, 2007, p. 4.
[32] *Ibidem.*
[33] Charles Landry, *op. cit*.
[34] Arthur Ash, *An Institutionalist Perspective on Regional Economic Development,* Paper presented at the Economic Geography Research Group Seminar "Institutions and Governance", 1998, p. 23.
[35] *Ibidem.*

- Decisions in firms are increasingly decentralized, managers being judged by the results on the market, but at the same time, the emphasis is on cooperation and links between businesses;
- Labor market structure affects the behavior and attitude of people, and the structure of society determines the rate of different social groups or women activity.

The efficiency of institutional structure is an increasingly important factor for development.[36] The institutional framework, composed by administration and social capital, represents the framework of the economic policy. This framework shapes and is shaped by local specificities, some of their main features being the particular values, norms, and behaviors. Culture is an important part of creating identity, which in turn is an essential element of building the social, political, and economic space. Given that culture generally encompasses a large number of components, among which the culture of seriousness, of hard work or fairness, some regions tend to individualize. A very good example is Italy, where the Northern part seeks separation from the South not only for economic reasons: *"Increasing competition pressure in Europe drives the competition of localization passing through the competition of reputation and identity. The regional policies mission should therefore be based on creating a regional reputation and make the region known in direct correlation with its reputation"*.[37]

Conclusions

The city is an open system and the result of the relationship between culture and nature. It is an expression of the division of labor, but does not produce raw materials or energy needed for its functioning. In fact, cities exist only due to intense exchange relationship with their hinterland, which are not always equal or fair. The attractiveness of the centers being strong, they have plenty of opportunities to channel toward themselves the material, human, and informational resources. They produce goods and services for the whole territory, but also waste. In turn, cities are the market for the goods produced in the periphery, especially in agriculture and

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[36] Radu Barna, Cristina Dobrotă, "L`impacte du développement touristique sur l`environnement", in *Revista Transilvană de studii administrative*, Nr.1(10)/2004, Cluj-Napoca, pp. 9-13.
[37] Eugen Buss, *Regionale Identitaetsbildung*, Münster: Ed. LIT Verlag, 2002, p. 44.

tourism. Therefore, the major problems with spatial effects of urban growth may find sustainable solutions for development, primarily by maintaining the balance in the three types of networks in which the cities are involved:[38]

1. networks between urban and rural areas: rethinking solidarity with rural areas, even if economic activities continue to concentrate in cities;
2. social networks: the wealth created by the cities has to be used by all, as poverty degrades social networks and involve high costs for the society;
3. links with the nature: cities are the places where nature is valued, but one have to take into account the upstream and downstream transformations in the natural potential and its regenerative capabilities.

From these three directions we can conclude in what regard the actions that should be undertaken to ensure the sustainability of urban development. The neoclassical model asserts the convergence of economies in the long-term, which the endogenous models do not. The marginal returns of physical capital are canceling along with their accumulation, so the growth rate will not be determined solely by the population growth and the technical progress. In the endogenous models, based on investment in specific factors, the rate of economic growth may be different from one economy to another. It is therefore possible for an economy to find itself in a vicious circle of underdevelopment, when the marginal efficiency of endogenous growth factors (human capital, etc.) is low, due to their poor accumulation. In this case, a poor economy might not be able to get out of this state.

The development of cities is more and more closely linked to their attractiveness because regions and cities are playing now in an open competition on a free market. Attractiveness however should not be taken for competitiveness, because competitiveness regards especially the economic, quantitative aspect, while the urban attractiveness includes the first aspect but goes on further, towards qualitative aspects, such as the quality of life. That is why development strategies should concentrate on both the economic aspects and on the cultural, social, and environmental

[38] Antonio Da Cunha, Jean-Bernard Racine, *op. cit.*, p. 85.

aspects in order to create a welcoming and safe climate for people, since it is through them that the economic stability and the success of the city are guaranteed for the future. And we should not forget that this depends on the political will, in order to form and improve the three types of networks in an inclusive format. It is the reason why for shaping a smart, sustainable, and inclusive growth, above all in a country like Romania, consolidating democracy becomes a duty for all members of the community.

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22. [http://cepa.newschool.edu/het/essays/growth/neoclass/solowcont.htm] 22 April 2008.

STUDIA UBB. EUROPAEA, LVIII, 3, 2013, 35-58

THE COMPETITIVENESS OF SMEs IN THE EU MEMBER STATES. CHALLENGES AND LESSONS AHEAD FOR ROMANIA

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Abstract
The competitiveness of the SME sector is one of the key factors of development in the current context. The primary aim of our research is to analyse the strengths of the SMEs in the EU from the perspective of their competitiveness and to formulate some practices and strategies to be applied by Romanian SMEs to reach an improved level of competitiveness. A theoretical perspective of competitiveness of SME is presented as well as several proofs for a set of three directions for gaining and enhancing SMEs competitiveness: the adoption of e-business, the internationalisation process and the adoption of innovation.
Keywords: SMEs, competitiveness, EU, Romania.

1. Introduction

The term *competitiveness* is analysed with reference to firms, industrial sectors, regions, nations and supranational entities[1]. In fact, the two main reference levels of competitiveness are the firm and the nation, both with

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[1] Thomas Hatzichronoglou, "Globalisation and Competitiveness: Relevant Indicators", in *OECD Science, Technology and Industry Working Papers*, 1996/05, OECD Publishing, p. 3, 10 December 2012.

different objectives: “while for a nation the aim is to maintain and improve its citizens’ living standards, for a firm the object is to deal successfully with international competition by making profits and increasing its market shares”.[2] Nevertheless, the World Competitive Yearbook released by the prestigious Swiss business school The Institute of Management Development (IMD), is based on the assumption that wealth creation takes place primarily at enterprise level (whether private or state owned) and on the idea that enterprises operate in a national environment which enhances or hinders their ability to compete domestically or internationally.[3] Hence, we remark the interdependence relation between competitiveness of enterprises and competitiveness of economies.

Our main interest is the small and medium enterprises (SMEs) sector, because of its importance in the EU economy. Throughout the challenging economic conditions of the past five years, “SMEs have retained their position as the backbone of the European economy, with some 20.7 million firms accounting for more than 98 per cent of all enterprises, of which the lion’s share (92.2 per cent) are firms with fewer than ten employees. For 2012 it is estimated that SMEs accounted for 67 per cent of total employment and 58 per cent of gross value added (GVA)”.[4] Moreover, the SMEs are important to national economies, they are “the ones on which one country can rely, also in bad times, because they will not move to another country when the state advantages are over, when the salaries increase, when the demand decreases or for other reasons”.[5]

Within this framework, the primary aim of our research is to analyse the strengths of the SMEs in EU member states from the perspective of their

[2] *Ibidem*.

[3] World Competitiveness Center (WCC), Methodology, [http://www.imd.org/wcc/research-methodology/], 5 June 2013.

[4] ECORYS, *EU SMEs in 2012: at the crossroads. Annual Report on Small and Medium-Sized Enterprises in the EU*, 2011/12, Rotterdam, p. 9, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2012/annual-report_en.pdf], 10 January 2013.

[5] Florin Duma, “Developments and Constraints for the Romanian Small and Medium-Sized Enterprises”, in *Proceedings- 10th International Conference on Management, Enterprise and Benchmarking* (MEB 2012), Budapest, Hungary, 2012, p. 140, [http://kgk.uni-obuda.hu/sites/ default/files/09_Duma%20Florin.pdf], 10 March 2013.

competitiveness and to formulate some practices and strategies to be applied by Romanian SMEs to reach an improved level of competitiveness.

The structure of this paper is as follows. In Section 2, we present a theoretical perspective of competitiveness of SMEs, a special attention being given to the impact of specific characteristics of SMEs well-known approaches "competitiveness as a driver" and "competitiveness as an outcome". In Section 3, we propose an overview of the SMEs sector in Romania, the data referring to the Romanian entrepreneurs' profile, employment, sectors of activity, productivity, contribution to gross value added and so on. In Section 4, we propose a set of three directions for gaining and enhancing SMEs competitiveness: the adoption of e-business, the internationalisation process and the adoption of innovation. We bring proofs that once adopted, these directions help the SMEs to reach an improved level of competitiveness. These three directions are illustrated with data for the EU SMEs, a special attention being paid to the Romanian SMEs. In the final part of Section 4, we made some remarks related to the competitiveness of the Romanian SMEs. In the final part of this paper, we draw some conclusions and propose some practices and strategies to be applied by Romanian SMEs to reach an improved level of competitiveness.

2. The competitiveness of SMEs – a theoretical perspective

In a classic approach, the competitiveness of firms is defined as the capacity to achieve a greater than average improvement in the quality of goods and services and/or a reduction in their relative costs that enable them to increase their profits (revenues-costs) and/or market share[6]. Measures of competitiveness of firms include financial or market-based indicators as well as other variables such as innovativeness, quality, ethical standing, social responsibility, working conditions of employees and so on.[7]

[6] Michael Dunford; Helen Louri; Manfred Rosenstock, "Competition, Competitiveness, and Enterprise Policies", in R. Hall, A. Smith, L. Tsoukalis (editors), *Competitiveness and cohesion in EU policies*, Oxford: Oxford University Press, 2001, p. 109.

[7] Donatella Depperu, Daniele Cerrato, "Analyzing International Competitiveness at the firm level: concepts and measures", *Working Paper no. 32*, Universita Cattolica Del Sacro Cuore, Piacenza, 2005, p. 5, [http://dipartimenti.unicatt.it/dises_wp_azzurra_05_32.pdf], 10 December 2012.

The competitiveness of the SMEs has gained a specific interest because of the following two main reasons: the specific characteristics of the SMEs compared with larger firms and the importance of this sector in the economy. We consider that the specific characteristics of SMEs heavily influence both in a positive and negative manner the competitiveness of this type of enterprises. Thereby, the flexibility of SMEs, their openness to change, quick reaction to the market changes and a fast decision-making process are seen as having an important role in enhancing the competitiveness of SMEs.[8] Moreover, we consider cannot be ignored those specific characteristics of SMEs that make it more difficult for them to be competitive; characteristics such as limited human and capital resources, reactive approach, misconception of performance measurement and informal strategies.

An adaptation of the approach of Depperu and Cerrato[9] to the topic of competitiveness of SMEs reveals the following:

A) The view of "competitiveness as a driver" might be adopted taking into account the specific characteristics of SMEs. This view points out the sources of a firm's competitive advantage, both internal (resources, capabilities and knowledge) and external (such current competition within the industry, bargaining power of suppliers, bargaining power of buyers, threat of new entrants, threat of substitute products or services[10]). In the case of internal sources of a firm's competitive advantage, there are two main approaches: the resource-based view and the competence-based view.[11]

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[8] Nicoleta Dorina Racolţa-Paina, "Analiza competitivităţii IMM_urilor din Uniunea Europeană (2007-2011). Proces şi măsurare", in Liviu C. Ţîrău, Ştefan Melancu (editors), *Interferenţe Euro-Atlantice. 20 de ani de Studii Europene la Universitatea „Babeş-Bolyai"*, Cluj-Napoca: EFES, 2013, p. 275.

[9] Donatella Depperu, Daniele Cerrato, "Analyzing International Competitiveness at the firm level: concepts and measures", *Working Paper no. 32*, Universita Cattolica Del Sacro Cuore, Piacenza, 2005, pp. 7-9, [http://dipartimenti.unicatt.it/dises_wp_azzurra_05_32.pdf], 10 December 2012.

[10] Michael Porter, *Competitive Advantage: Creating and sustaining superior performance*, The Free Press Edition, 1998, p. 12.

[11] Donatella Depperu, Daniele Cerrato, "Analyzing International Competitiveness at the firm level: concepts and measures", *Working Paper no. 32*, Universita Cattolica Del Sacro Cuore, Piacenza, 2005, p. 7, [http://dipartimenti.unicatt.it/dises_wp_azzurra_05_32.pdf], 10 December 2012.

From the perspective of resource-based view (with a static approach of the internal sources of competitive advantage) most of SMEs, especially micro and small enterprises might be characterised by a low competitive potential, due to some of their specific characteristics, such as: lack of human resource; managerial capacity; limited capital resources; reactive approach; tacit knowledge and little attention given to the formalisation of processes; misconception of performance measurement.[12]

From the perspective of competence-based view (that refers to management processes that transform the sources of a firm's competitive advantage to achieved performance), one weak point of SMEs might be the high dependence on one person (entrepreneur/manager of the business). The entrepreneur's demographic, psychological and behavioral characteristics as well as his or her managerial skills and technical know-how are seen as influential factors related to the performance of SMEs.[13]

We consider that in the case of external sources of a firm's competitive advantage, SMEs might rely more on to network resources (that involve the relationship with partners, suppliers, distributors, customers and so on) than to other sources, such as: favorable market structure, access to financial capital, brand recognition, and so on.

B) The view of "competitiveness as an outcome" (that assumes a wide range of performance indicators) might be adapted to the SMEs, due to their specific characteristics, such as: tacit knowledge and little attention given to the formalisation of processes and misconception of performance measurement.[14]

We believe that a static analysis of SMEs profitability take precedence over the dynamic approach because of their main financing constraints related to: limited capital resources[15] and difficult access to finance.

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[12] Stefano Biazzo; Patrizia Garengo, *Performance Measurement with the Balanced Scorecard. A Practical Approach to Implementation within SMEs*, Springer-Verlag Berlin Heidelberg, 2012, pp. 55-56.

[13] Thomas W.Y Man; Theresa Lau; K.F., Chan, "Conceptualisation of SMEs' Competitiveness: a Focus on Entrepreneurial Competencies", 1998, p. 1, [http://www.sbaer.uca.edu/research/ icsb/1998/27.pdf], 10 December 2012.

[14] Stefano Biazzo; Patrizia Garengo, *Performance Measurement with the Balanced Scorecard. A Practical Approach to Implementation within SMEs*, Springer-Verlag Berlin Heidelberg, 2012, pp. 55-56.

[15] *Ibidem*.

3. The development of the SMEs sector in Romania

Taking into account the fact that currently the SME sector contributes with 65% of Romania's GDP,[16] we can consider the analysis of the current development of this type of enterprises and the future prospects of this segment as an essential element for generating a correct and coherent assessment of the long-term evolution trends in our country.

After a short overview of the statistical data concerning the evolution of the Romanian SMEs we can summarise by presenting the following facts:

- Entrepreneurs' profile –using the data provided by the *Amway European Entrepreneurship report 2012. The unleashed potential of entrepreneurship in times of Crisis* a GFK research, we can state that 66% of the Romanians have positive attitude about self – employment.[17] In Romania, the vast majority of entrepreneurs are men, under 40 years old, high school and university graduates.[18] Between 2007 and 2010 the number of the Romanian young entrepreneurs aged between 18 and 24 has increased five times (reaching 29%), but the dominant age was still between 25-34 (31.2%) and the broad majority 49.3% were high school graduates (university graduates – 27.5% as in comparison with the 2007 figures – 52.1%).[19]

Employment - the level of employment for the local Romanian SMEs (estimates for 2011) is close to the European average share of about two-thirds

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[16]Agerpress, *ONRC: 951.803 firme erau active la finele anului 2011*, 13 March 2012, [http://www.agerpres.ro/media/index.php/economic/item/110779-ONRC-951803-firme-erau-active-la-finele-anului-2011.html], 28 April 2013.

[17] GfK, *Amway European Entrepreneurship report 2012. The unleashed potential of entrepreneurship in times of Crisis*, Amway European Entrepreneurship Report 2012, Nuremberg, Germany, p. 5, [http://www.entrepreneurship-center.uni-muenchen.de/aktuelles/amway-report-2012/amway_broschuere_2609_click.pdf], 24 April 2013.

[18] Péter Barta, Ileana Modreanu, Nina Spirea, Marius Piti, *Promovarea antreprenoriatului ca factor cheie pentru dezvoltarea economică*, Fundația post-privatizare, octombrie 2012, pp. 28-30, [http://www.postprivatizare.ro/romana/wp-content/uploads/2012/10/Studiu-Antreprenoriat.pdf], 24 April 2013.

[19] Cristina Negraru, "Profilul antreprenorului român. Cum s-a schimbat în criză", *in Wall-Street*, 13 february 2012, [http://www.wall-street.ro/articol/Start-Up/116542/profilul-antreprenorul-roman-cum-s-a-schimbat-in-criza.html#ixzz2aU9HpxOW], 23 April 2013.

of the total (67,2% RO; 67,4% EU-27)[20]. We can also mention an important fact reflecting the average labor productivity for the Romanian SMEs, which represents 72% of large companies' labor productivity.[21]

Sectors of activity – According to the statistical data provided by the National Institute of Statistics, in 2010 most of the Romanian SMEs were operating in the service sector - 39.5%, followed by sectors like: trade - 38.8%, industry - 11.2% and construction - 10 5%.[22]

- Productivity - low productivity and profitability of this sector for which the international trade data also shows that most local Romanian SMEs depend only on the domestic market.[23]
- Contribution to gross value added - the SMEs contribution to gross value added, which in Romania for the total of 529.015 SMEs enterprises (representing 99,7% of the total Romanian companies) is about 52,7%, while for the EU-27 countries is around 58,1% (estimates for 2011).[24]

Analysing the annual growth percentage of growth value added and employment of SMEs and share of High + Medium High Tech SMEs by Member State, (2011 estimates) we can see that in Romania's case we rank below the EU average percentage with only one exception – the percentage of growth of real value added of all SMEs (2.2 – EU-27 and 2.6 – Romania).

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[20] EC, *SBA Fact Sheet 2012 – Romania*, 2012, p. 1, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2012/romania_en.pdf], 23 April 2013.

[21] Péter Barta, Ileana Modreanu, Nina Spirea, Marius Piti, *Raportul fundației post-privatizare privind sectorul IMM din România*, Fundația post-privatizare, colaboratori: Alexandru Dinu, Carmen Prosan, Roxana Sescioreanu, Adam Tănase, 2013, p. 71, [http://www.postprivatizare.ro/ romana/wp-content/uploads/2013/06/Raport-IMM-2013.pdf], 24 May 2013.

[22] Péter Barta, Ileana Modreanu, Nina Spirea, Marius Piti, *Situația curentă a întreprinderilor mici și mijlocii din România*, Fundația post-privatizare, 2012, pp. 4-25, [http://www.postprivatizare.ro/romana/wp-content/uploads/2012/06/studiu-IMM_2012.pdf], 24 April 2013.

[23] Dragoș Pîslaru, Ileana Modreanu, *Contribuţia IMM-urilor la creşterea economică – prezent şi perspective*, București, Editura Economică, 2012, p. 13, [http://facultateademanagement.ro/wp-content/uploads/Studiu_Contributia-IMM-urilor-la-cresterea-ec.-DP.pdf], 24 April 2013.

[24] EC, *SBA Fact Sheet 2012 – Romania*, 2012, p. 1, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2012/romania_en.pdf], 23 April 2013.

Following the data presented by the same report, we can conclude by presenting the figures below:[25]

- Romania is found in the EU-27 average in terms of percentage of the High-tech companies (1124 enterprises representing 0.2% - of the total companies);
- Romania is also close but under the EU-27 average in terms of high + medium high tech, medium-low tech, Knowledge intensive services (KIS), Knowledge-intensive market services / KIMS, or High-tech knowledge intensive services / HKIS companies;
- Also we are classified above the European average in terms of low-tech companies (6.6% - 34 924 enterprises, 5.1 EU-27 average), other knowledge intensive services enterprises and less knowledge-intensive services enterprises.

Trying to describe the evolution of the Romanian SMEs during the past 5 years, we can state the following facts: [26]

- partially as a result of the introduction of the OU Nr. 34/2009, in 2010, the number of companies that have closed their activity and have been removed from the Register of Trade data reached a historical number of 171.146 companies, an increase from the previous year by almost 400%;
- in 2011 there were 467833 Romanian SMEs companies,[27] in 2012 the number of new registrations followed a negative trend over the period 2011 with only 125.603 new entries;
- taking the same reference year, 2010, SMEs enterprises accounted in Romania for 61% of the total turnover of the non-financial sectors and 40% to the total turnover of the Romanian industry;

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[25] ECORYS, E*U SMEs in 2012: at the crossroads. Annual Report on Small and Medium-Sized Enterprises in the EU,* 2011/12, Rotterdam, Tabel A2, p. 72 and Tabel A8, p. 79, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2012/annual-report_en.pdf], 10 January 2013.

[26] Péter Barta, Ileana Modreanu, Nina Spirea, Marius Piti, *Situația curentă a întreprinderilor mici și mijlocii din România*, Fundația post-privatizare, 2012, pp. 4-25, [http://www.postprivatizare.ro/romana/wp-content/uploads/2012/06/studiu-IMM_2012.pdf], 24 April 2013.

[27] CNIPMMR, *Strategia consiliului naţional al întreprinderilor private mici şi mijlocii din România 2012-2016*, project, p. 10, [http://www.cnipmmr.ro/CNIPMMR-Despre-Noi/STRATEGIE-CNIPMMR-2012-2016.pdf], 29 April 2013.

- as a relevant example, the SMEs in the services sector contributed with 19.3% of the total turnover, and the most important representatives were the information and communication enterprises that have had a positive evolution even in the economic crisis period, the share of turnover generated by those companies constantly increasing even during the 2008 – 2009 period.

The Small Business Act for Europe (SBA) reflects the Commission's political will to recognise the central role of SMEs in the EU economy and for the first time puts into place a comprehensive SME policy framework for the EU and its Member States."[28] The ten principles governing SBA (entrepreneurship, second chance, think small first, responsive administration, state aid and public procurement, access to finance,[29] single market, skills and innovation,[30] environment, internalisation[31])[32] are analysed through the evaluation of a few indicators by trying to reveal how well the member states perform in the specified fields.

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[28] Michaela Saisana, *Monitoring SMEs' performance in Europe Indicators fit for purpose,* Methodological note, JRC Scientific and Policy Report, Report EUR 25577 EN, Luxembourg, Publications Office of the European Union 2012, p. 3, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/saisana_jrc_sbamethodology_eur25577.pdf], 24 April 2013.

[29] the nine criteria measured for this indicator are: *rejected loan applications and loan offers, access to public financial support including guarantees, willingness of banks to provide a loan, relative difference in interest rate levels between loans up to EUR 1 million and loans over EUR 1 million, total duration to get paid, lost payments, venture capital investments - early stage, strength of legal rights, depth of credit information index.*

[30] skills and innovation measures ten criteria: *introducing product or process innovations, introducing marketing or organizational, innovations, innovating in-house, innovative collaborating with others, sales of new-to-market and new-to-firm innovations turnover, participating in EU funded research, selling online, purchasing online, enterprises providing training to their employees , employees' participation rate in education and training.*

[31] for the internalization indicator we have eight criteria evaluated: *importing from outside the EU, exporting outside the EU, cost required to import, time required to import, number of documents required to import, cost required to export, time required to export, number of documents required to export.*

[32] Michaela Saisana, *Monitoring SMEs' performance in Europe Indicators fit for purpose,* Methodological note, JRC Scientific and Policy report, Report EUR 25577 EN, Luxembourg, Publications Office of the European Union 2012, pp. 9-12, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/saisana_jrc_sbamethodology_ eur25577.pdf], 24 April 2013.

Romania registers a high score only for the first criteria – entrepreneurship but has very low estimations for all the other nine indicators.[33]

4. The Competitiveness of SMEs in the EU Member States – Challenges and Facts

In order to reveal the main challenges and facts regarding the competitiveness of SMEs in the EU member states and taking into consideration the above-mentioned approaches of competitiveness (see Section 3), we analyse three directions for gaining and enhancing competitiveness: the adoption of e-business, the internationalisation process and the adoption of innovation. We believe that all of these three directions are interconnected in the case of SMEs. Therefore, two of the main drivers of internationalisation of firms are e-business[34] and innovation.[35] The Internet is a tool for SMEs of all sizes that helps them to overcome some of the barriers to internationalisation.[36]

4.1. The adoption of e-business by SMEs

E-business implies "the conducting of business on the Internet, not only buying and selling, but also serving customers and collaborating with business partners".[37] The current economy, characterised by two interconnected

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[33] EC, *SBA Fact Sheet - Romania*, 2012, pp. 1-14, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2012/romania_en.pdf], 30 April 2013.

[34] Kim Dung Le; Franz Rothlauf, "Foreign market entry of e-business companies and implications for theories of internationalization", Working Paper 4, 2008, Johannes Gutenberg-University Mainz, p. 1, [http://wi.bwl.uni-mainz.de/publikationen/Working_Paper_04_08_KL.pdf], 10 December 2012.

[35] Austrian Institute of Economic Research (WIFO), Fraunhofer Institut für System- und Innovationsforschung (ISI), *Barriers to internationalisation and growth of EU's innovative companies, Final Report*, Viena, 2010, p. v, [http://ec.europa.eu/enterprise/policies/innovation/files/ proinno/innovation-intelligence-study-1_en.pdf], 10 December 2013.

[36] EIM Business & Policy Research, *Internationalization of European SMEs*, Zoetermeer, 2010, p. 7, [http://ec.europa.eu/enterprise/policies/sme/market-access/files/internationalisation_of_european_smes_final_en.pdf], 10 January 2013.

[37] Paige Baltzan, *Business Driven Information Systems*, 3rd Edition, Mc-Graw Hill/Irvin, 2011, p. 65.

events: the globalisation of markets, firms and activities, and the diffusion of information and communication technologies (ICTs) and the Internet has conducted to this practice.[38] The main benefits of adopting ICTs by SMEs are: increased productivity in the production processes, increased efficiency of internal business operation and connection of SMEs to external contacts whether locally or globally, more easily and cheaply.[39] Moreover, primary business areas taking advantage of e-business include marketing/sales, financial services, procurement, customer service, and intermediaries.[40]

The adoption of the Internet by European SMEs is having a positive impact on the grow of companies; "European SMEs grow two-three times faster when they embrace the Internet".[41] Moreover, an increasing number of European SMEs are aiming to exploit the benefits of enterprise software and services.[42] This fact might be seen as a result of the European e-Business Support Network for SMEs (eBSN), an initiative of the European Commission to foster the adaptation and innovative use of ICTs by SMEs, established in 2003.[43] Within this initiative, six actions have been developed; each of these projects targeting e-business in different industries, such as textile, clothing and fashion industry, automotive industry and transport and logistics industry, the tourism industry, the agro-food supply-chain and construction sector.[44] Even if there is evidence that there is currently a good range of suitable ICT solutions available to SMEs

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[38] Lorna, Uden, "How to Promote Competitive Advantages for SMEs: Issues, Ideas and Innovation", in *Journal of Business Systems, Governance and Ethics*, Vol. 2, No. 2, 2007, p. 1.

[39] UNDP-APDIP- e note (2005) Why Should Countries Embed ICTs into SME Policy, [http://www.apdip.net/apdipenote/4.pdf], 10 December 2012.

[40] Paige Baltzan, *op.cit.*, pp. 79-80.

[41] EC, Enterprise and Industry, "Integration of SMEs in global digital value chains", [http://ec.europa.eu/enterprise/sectors/ict/ebsn/digital_supply_chains/index_en.htm], 10 March 2013.

[42] EC, *eBusiness Guide for SMEs. eBusiness Software and Services in the European Market*, 2008, p. 10, [http://ec.europa.eu/enterprise/e-bsn/ebusiness-solutions-guide/docs/eBusiness_Guide_for_SMEs.pdf], 29 July 2013.

[43] EC, Enterprise and Industry,, „What is eBSN?', [http://ec.europa.eu/enterprise/sectors/ict/ebsn/what/index_en.htm], 10 March 2013.

[44]EC, Enterprise and Industry, „Integration of SMEs in global digital value chains", [http://ec.europa.eu/enterprise/sectors/ict/ebsn/digital_supply_chains/index_en.htm], 10 March 2013.

there are significant challenges to SMEs that plan to introduce and use e-business, such as lack of time and skills for an informed decision-making on ICT strategies.[45]

The data generated on the Information Technology market show that at the EU level the first three countries that are leading this group are Germany, UK and France (representing 60% of the European figures).[46]

In the case of Romania, the level of adoption of ICTs by SMEs (at the level of 2011) is the following:[47] 77.09% of the SMEs have computers; the Internet is accessed in 73.22% of the SMEs; the email is used in 69.93% of the SMEs; 33.26% of the SMEs own a proper website; 5.69% of the SMEs use an Intranet system; 14.21% of the SMEs carry out online transactions; IT facilities do not exist in 14.16% of the SMEs.[48]

In Romania, in 2010 the share of SMEs that were purchasing online reached only 7% (EU-27 average 28%). If we continue this reasoning, we find that the figures showing the percentage of SMEs enterprises that were selling online are less favorable than the previous ones, in 2011 in this case; the data indicated only 4% of the companies (EU-27 average 13%).[49]

4.2. Internationalisation of SMEs

We consider internationalisation as "all activities that put SMEs into a meaningful business relationship with a foreign partner: exports, imports, foreign direct investment, international subcontracting and international

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[45] GmbH, Technopolis Group Ltd. and iCons srl, *Evaluation of the EU Initiative "Stimulating Innovation for European Enterprises through smart use of ICT"*, Final Report, 2012, p. 209, [http://ec.europa.eu/enterprise/sectors/ict/files/ebsn/best-practices/ebsn-study_final-report_en.pdf], 10 March 2013.

[46] EC, *eBusiness Guide for SMEs. eBusiness Software and Services in the European Market*, 2008, p.18, [http://ec.europa.eu/enterprise/e-bsn/ebusiness-solutions-guide/docs/eBusiness_Guide_for_SMEs.pdf], 29 April 2013.

[47] According to the data offered by a national survey carried out by the CNIPMMR (the National Council of Small and Medium-Sized Private Enterprises in Romania) on a sample of 1.723 Romanian SMEs.

[48] Ovidiu Nicolescu et al. (coord.), *Carta Albă a IMM-urilor din România*, 2011, Bucureşti: Editura Sigma, p. 267.

[49] EC, *SBA Fact Sheet - Romania*, 2012, p. 12, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2012/romania_en.pdf], 30 April 2013.

technical cooperation".[50] In the context of economic environment heavily influenced by globalisation, internationalisation should be "fully integrated into the SME as a core part of the company's long term strategy".[51] The main drivers of SMEs internationalisation are exposure to internationalisation (either because the sector is particularly exposed or because of the personal and professional experience of the owner/manager)[52] and owner/manager's international orientation, globalisation of SMEs' industry, SMEs established international network and foreign market potential.[53]

From the 25% of the EU-27 - SMEs companies that have export activities 50% succeed in going beyond the Internal Market (and here we must underline the fact that usually the size of the company influences the internationalisation process – large companies are more inclined to internationalise). If we try to make the same assessment for the importing enterprises, we see that only 29% of the EU-27 are engaged in import activities from which 50% import products from outside the Internal Market borders.[54] Moreover we can add the fact that 7% of the SMEs enterprises are involved in technical cooperation with foreign partners, 7% are subcontractors of a foreign company, the same percentage of enterprises are subcontractors of foreign partners and only 2% are active in FDI. Trade, communications, manufacturing, transport and research are the more internationalised sectors in the EU.[55]

In the case of Romania, we can mention the following facts: the share of the Romanian SMEs enterprises importing from outside the EU in 2009 was around 3% (as in comparison with the EU average of 5%). The share

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[50] EIM Business & Policy Research, *Internationalization of European SMEs,* Zoetermeer, 2010, p. 5, [http://ec.europa.eu/enterprise/policies/sme/market-access/files/internationalisation_of_european_smes_final_en.pdf], 10 January 2013.

[51] EC, *Supporting the internalization of SMEs*, Final Report of the Expert Group, 2007, p. 4, [http://ec.europa.eu/enterprise/policies/sme/files/support_measures/internationalisation/report_internat_en.pdf], 10 December 2012.

[52] *Ibidem*, p. 9.

[53] Cranmer Rutihinda, "Factors Influencing the Internationalization of Small and Medium Size Enterprises", in *International Business & Economics Research Journal*, Vol. 7, No. 12, 2008, p. 52.

[54] EC, *Internationalisation of European SMEs*, 2010, p. 5, [http://ec.europa.eu/enterprise/policies/sme/market-access/files/internationalisation_of_european_smes_final_en.pdf], 30 April 2013.

[55] *Ibidem*, pp. 5-6.

of SMEs companies exporting outside the EU registered only 1% (EU average – 3%). For Romania in 2012 the cost required to import was 1500USD (EU average – 1101 USD and the time needed to import was 13 days (EU average – 11 days). For the exports, the figures indicated 1490 USD (EU average 1032) and 12 days (EU average 11 days).[56]

4.3. The adoption of innovation by SMEs

Innovation is "the renewal and enlargement of the range of products and services and the associated markets; the establishment of new methods of production, supply and distribution; the introduction of changes in management, work organisation, and the working conditions and skills of the workforce".[57] According to the same European Commission document quoted above, there are two broad senses of innovation: the innovation process (it relates to mechanisms for interaction within the firms as well as with networks that link the firm to its environment) and the result of the innovation (it is counted in new product, process or service). One of the main conditions of innovation is the existence of "a strong, shared culture which is clearly innovation-oriented".[58] In the case of SMEs, characteristics such as flexibility, their simple organisational structure, their low risk and receptivity are seen as innovation facilitators.[59]

In 2008 the share of the Romanian SMEs introducing product or process innovations reached 18% (EU average, 34%), the figures also indicated that SMEs introducing marketing or organisational innovations represented 26% (EU average 39%), also the SMEs innovating in-house represented 17%

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[56] EC, *SBA Fact Sheet - Romania*, 2012, p. 14, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2012/romania_en.pdf], 30 April 2013.

[57] EC, *Green Paper on Innovation*, 1995, p. 1, [http://europa.eu/documents/comm/green_papers/pdf/com95_688_en.pdf], 10 December 2012.

[58] R. Deshpandé; J. U. Farley; F. E.Webster, Jr., "Corporate culture, customer orientation, and innovativeness in Japanese firms: a quadrad analysis", in *Journal of Marketing*, Volume 57, 1993, p. 24.

[59] Harrison and Watson, 1998, quoted by ECORYS, *EU SMEs in 2012: at the crossroads. Annual Report on Small and Medium-Sized Enterprises in the EU*, 2011/12, Rotterdam, p. 47, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/supporting-documents/2012/annual-report_en.pdf], 10 January 2013.

(EU average 30%).[60] The data provided by the same source also indicates that the share of innovative SMEs collaborating with others in 2008 was quite low, only 2% (EU average 11%). What really should worry us is the reduced percentage of SMEs participating in EU funded research (number per 100.000 SMEs) in 2011, 7 in Romania (EU average 23).

The EIS (European Scoreboard Indicators) 2008 includes innovation indicators and trend analyses for the EU-27 Member States. This data shows that on the first positions, above the EU average levels we find countries like: Denmark, Germany, Finland, Sweden, and the UK followed by Belgium, Ireland, France, Luxembourg, the Netherlands and Austria. Czech Republic, Estonia, Greece, Spain, Italy, Cyprus, Portugal and Slovenia are the so called *moderate innovators,* positioned bellow the EU average and followed by the next country group: Bulgaria, Latvia, Lithuania, Hungary, Malta, Poland, Romania and Slovakia which are the *catching-up countries*.[61]

We must underline the fact that 35.53% of the Romanian SMEs[62] do not perform any innovation activities.[63] The data provided by the same source also indicates that in the case of 64.47% Romanian SMEs, the innovation activities are linked to new products (32.01% of the analysed SMEs), new technologies (20.24%), new approaches to management and marketing (15.07%), information system (10.29%) and human resources (7.79%).

Overall, from the perspective of the above-mentioned directions of competitiveness of the SMEs in the EU member states, the Romanian SMEs do not perform very well, the presented data indicating values more under the level of European figures. Therefore, we consider that the SMEs in Romania ought to adopt or to improve these three directions in order to gain and/or enhance the competitiveness.

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[60] EC, *SBA Fact Sheet - Romania*, 2012, p. 12, [http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/files/countries-sheets/2012/romania_en.pdf], 30 April 2013.

[61] Hugo Hollanders, "Measuring innovation: the European Innovation Scoreboard", in: E. Villalba (ed.), *Measuring Creativity*, Proceedings from the conference, 'Can creativity be measured?', Luxembourg: Publications Office of the European Union, 2009, pp.32-33, [http://ec.europa.eu/education/lifelong-learning-policy/doc/creativity/report/measure.pdf], 30 April 2013.

[62] The data results from a 2011 national survey carried out by the CNIPMMR on a sample of 1.723 Romanian SMEs.

[63] Ovidiu Nicolescu et al. (coord.), *op.cit.*, p. 257.

Romanian SMEs should increase their efforts to adopt e-business, the benefits being considerable on the long run. In this regard, the entrepreneur/owner plays the vital role; his/her openness to and knowledge of information and communication technologies having a great influence on the decision to adopt e-business. The known internal constrains in the case of this type of firms, such as the lack of financial and managerial resources, are the main challenges in the process of the adoption of e-business. We consider that a prioritisation of the budget expenses, a special attention being paid to e-business adoptions and/or development, might be a strategic decision in the case of Romanian SMEs.

The process of internationalisation of the Romanian SMEs should be adopted or continued, as a core part of company's long-term strategy, even if the specific characteristics of this type of firms might be seen as the challenges for internationalisation process. From this regard, the Romanian SMEs managed by owners/managers with an international personal and professional experience might be highly competitive on international markets compared with an average SME. Furthermore, the Romanian SMEs should be aware of all form of internationalisation, such as technical cooperation with foreign partners, subcontracts of a foreign company or partner or even foreign direct investments.

The adoption of innovation by SMEs is a reality in the current economic and business environment. The Romanian SMEs should take immediate actions in order to adopt innovation, starting with the understanding of the large meaning of innovation. Those SMEs that have already adopted innovation activities should maintain this direction and take important steps toward the improvement of innovation activities (in terms of both innovation process and the result of innovation). Moreover, an innovation culture should be fostered at the level of the Romanian SMEs, a crucial role being played by the company's owner/manager.

5. Conclusions

In order to formulate some practices and strategies to be applied by the Romanian SMEs to reach an improved level of competitiveness we followed several stages, the main conclusions being the following.

1. At a theoretical level, there are proofs that the competitiveness of SMEs is heavily influenced by the specific characteristics of this type of firms.

2. In the case of SMEs, both approaches “competitiveness as a driver” and “competitiveness as an outcome” might be used to analyse the competitiveness of SMEs, being necessary an adaptation to the specific characteristics of SMEs.

3. From the perspective of “competitiveness as a driver”, most SMEs, especially micro enterprises, might be characterised by a low competitiveness level, due to their limited resources as well as the high dependence on one person (entrepreneur/manager of the business).

4. From the perspective of “competitiveness as an outcome” a static analysis of SMEs profitability take precedence over the dynamic approach because of their main financing constraints.

5. The SMEs sector in Romania is characterised by a low level of profitability and productivity and most SMEs depend on the domestic market. That is why we consider that the main factor influencing this reality is the competitiveness level of the Romanian SMEs for which the three directions proposed by this research could contribute on medium term to an improvement of the situation.

6. The 2012 SBA data show that the employment and the value added have stabilised in 2010-2011 and that Romania has registered a high score only for the first criteria proposed by the evaluation – entrepreneurship. Moreover, our country had very low estimations for all the other nine indicators used to elaborate SBA fact sheets (between which we find criteria taken into discussion by us along this insight, such as access to finance, single market, skills and innovation, or internalisation).

7. The High-tech and the knowledge-intensive sectors are considered at the EU level drivers of competitiveness, situation that cannot have the same relevance at this moment for Romania where the share of this type of companies is still under the EU average.

8. There are proofs that once adopted, the proposed directions for gaining and enhancing SMEs competitiveness (the adoption of e-business, the internationalisation process and the adoption of innovation) will bring SMEs to reach an improved level of competitiveness.

9. The proposed directions for gaining and enhancing SMEs competitiveness (the adoption of e-business, the internationalisation process and the adoption of innovation) are well performed at the level of European SMEs. In the case of Romanian SMEs immediate actions should be taken to improve the e-business adoption, the internationalisation process and the adoption of innovation

Taking into consideration these aspects, we made some proposals regarding practices and strategies to be applied the Romanian SMEs to reach an improved level of competitiveness:

1. Romania should develop policies in the direction of promoting the internationalisation of SMEs by facilitating a better informational flow for entrepreneurs in order to respond and better personalise their offer to the exigencies, standards required and necessities of the foreign markets.

2. The promotion of partnerships between Romanian SMEs and R&D resources (such as: universities, public or private institutions and other organizations) should encourage and support the companies to develop and apply an increased level of innovation.

3. The facilitation of Romanian SMEs' access to funding sources: through information, mainly on European funds or internal or external partnering, foreign investments, etc.

4. Romanian SMEs should adopt the market-driven strategy; strategic alliances and integrative university collaborations, as innovation strategies, to develop and enhance their competitiveness on national and international markets.

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STUDIA UBB. EUROPAEA, LVIII, 3, 2013, 59-74

THE REFORM OF THE ECONOMIC AND MONETARY UNION. THREE VISIONS FOR THE ADVANCE OF EUROPEAN INTEGRATION

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Abstract
As the latest crisis has laid bare the flaws in the design of the economic and monetary union, a profound restructuring of the architecture of the EU's economic governance became inevitable. However, the measures already taken and those under consideration tend to deepen an already clear cleavage between Euro and non-Euro Member States. The discussions on this topic are not entirely new. They are connected to a wider discussion on flexible integration that has paved its way in reaction to the increasing heterogeneity of the preferences and capabilities of the Member States. Inevitable, any decision on the reform of the economic and monetary union will have a direct impact on the future advance of European integration and its political outcome. The present article analyses the most important tenets of the upcoming reform of the economic and monetary union through the visions expressed by three of the most powerful leaders of the present day European Union.
Keywords: flexible integration, EU reform, economic and monetary union

The need for restoring the credibility and integrity of the economic and monetary union has brought already in sight a number of reform measures. They concern both the viability of the economic and monetary union and the political finality of the whole process of European integration. That is why they have drawn considerable attention among the experts and

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received ample spaces in the public interventions of the European leaders. These two lines of discussion converge when it comes to ponder on the prospect of a future flexible or differentiated integration as the cleavage between Euro and non-Euro area Member States tends to lose its provisional character and become more entrenched. It is feared that this can have implications with regard to the voting power and the influence of non-Euro countries in the structures of the economic and monetary union, especially those that assumed the obligation of adhering to the Euro zone. There are also fears as for instance those expressed by Great Britain that the deeper the division between Euro and non-Euro Member States grows, the greater becomes the risk of undermining the single market.

Flexible integration generates anxiety as it opens a line of fracture with a long-established EU principle, namely, that of solidarity, which was part and parcel of the European project ever since its launch. European solidarity can be read in many keys, but the most relevant for the present discussion is the one of constructing a lasting cross-national sense of unity. In this respect, the common policies, which lie at the heart of the European policy-making, are bound to 'give substance to the solidarity' that binds Member States' economies and currencies[1]. Nevertheless, the discussion on flexible integration is far from novel. Various modes of flexible integration have gained over time considerable prominence in the political debate. Alexander Stubb divided the existing political conceptions of differentiated integration into three principal categories: 1./multi-speed, 2./ variable geometry and 3./ *à la carte*, by using three variables - time, space and matter.[2] Although each of the proposed models conveys a series of often subtle distinctions and implies different strategies for action,[3] all stem from a similar diagnosis of the EU's malady: namely, that of seeking to apply excessively strict common goals and disciplines to countries, which in fact are strikingly diverse. According to Alex Warleigh,[4] one can sense a certain

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[1] Leo Tindemans, *Report on the European Union*, Bulletin of the European Communities Supplement, 1/1976, [http://aei.pitt.edu/942/1/political_tindemans_report.pdf], 21 July 2013.

[2] Alexander C.-G. Stubb, "A categorization of differentiated integration", in *Journal of Common Market Studies*, No. 2, Vol. 34, 1996, pp. 283–295.

[3] Georgiana Ciceo, „The Multispeed Integration and the Future Inner Borders of the EU. What are the Challenges for those Remaining Outside the Hard Core?" in: *Eurolimes - Journal of the Institute for Euroregional Studies*, Vol. 14, 2012, pp. 15-29.

[4] Alex Warleigh, *Flexible integration. Which Model for the European Union?*, New York: Sheffield Academic Press, 2002, p. 12.

preference for the multi-speed model when it comes to policies with a predominant Community method of policy making because of the significant powers of the Commission and European Parliament, who tend to protect both small states and 'the general European interest' by preventing the emergence of a 'hard core'. At the other end of the spectrum there are the transgovernmental policies in the classification of Helen Wallace[5] in which case the preferences have a tendency towards the *à la carte* model as usually clusters of Member States agree to cooperate on various policy issues.

Economic and monetary union can advance on a double track as Art. 20(1) of the Treaty on the European Union (TEU) states that 'Member States which wish to establish enhanced cooperation between themselves within the framework of the Union's non-exclusive competences may make use of its institutions and exercise those competences by applying the relevant provisions of the Treaties'. Especially this future institutional setup for handling the economic and monetary union has generated anxieties among the non-Euro members of the European Union. Martin Schultz, the President of the European Parliament, was insisting that 'there is no need whatsoever to create new, parallel Unions and new, parallel institutions'. In the context of Euro zone governance as well, 'the integrity of the Community institutions must be safeguarded'. When it comes to reforms, these will have to enable 'the 25 Member States which are keen to take part in all EU policies to do just that'.[6] His views are reinforced by the Thyssen Report, which considers it necessary 'to place the governance of the EMU within the institutional framework of the Union' and 'to proceed swiftly by maximizing the possibilities given by the existing Treaties and their elements of flexibility'.[7]

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[5] Helen Wallace, "An Institutional Anatomy and Five Policy Modes", in Helen Wallace, Mark A. Pollack and Alasdair Young (eds.), *Policy-Making in the European Union*, 6-th ed., Oxford: Oxford University Press, 2010, pp. 90-107.

[6] Martin Schulz, *Speech to the European Council*, 18 October 2012, [http://www.socialistsanddemocrats.eu/gpes/media3/documents/4057_EN_schulz_council_en_121018.pdf], 21 July 2013.

[7] Marianne Thyssen, *Report with recommendations to the Commission on the report of the Presidents of the European Council, the European Commission, the European Central Bank and the Eurogroup "Towards a genuine Economic and Monetary Union"*, A7-0339/2012, October 24, 2012, [http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A7-2012-0339+0+DOC+PDF+V0//EN&language=EN], 21 July 2013, p. 18.

As already mentioned, another anxiety is generated by the impact of the cleavage between Euro and non-Euro members on the stability of the single market. In this respect, Great Britain appears to be the most vexed by the influence of the future reforms. In a report summarizing a long series of debates on the future of the economic and monetary integration, the House of Lords acknowledged that '[w]e are deeply concerned that closer integration of an inner core of Member States could threaten the integrity of the single market'.[8] As it is evident that the Euro area would remain one of its key trading partners, the members of the UK Parliament could not afford to remain complacent with the current events and ignore the many legal and political intricacies of the project. The fear is that a certain 'degree of marginalization will be inevitable as the Euro area (and possibly other Member States) take steps towards deeper integration'.[9] This feeling might be reinforced by the prospect that 'Euro area countries and other participating Member States will converge towards common positions in a number of areas. This may place an EU-27 single market under severe strain, in particular if a majority of non-Euro Member States chooses to participate in banking union'[10].

Given the sensitivity and complexity of the problems under consideration, it is not surprising that the opinions of the European leaders are split. As customary in the history of the European Union, the result of the ongoing discussions on the reform of the economic and monetary union will be a compromise that will have to accommodate Angela Merkel's perceived need for greater 'Europeanization of national powers', David Cameron's aspiration towards denationalization of European powers, and François Hollande's vision of a stronger political union[11]. In order to offer a clearer blueprint of the subtleties of the most important issues at stake in these negotiations, we intend to take a closer look to these three visions on the future of Europe.

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[8] House of Lords, European Union Committee, *European Banking Union: Key issues and challenges*, 7th Report of Session 2012–13, 12 December 2012, [http://www.publications.parliament.uk/pa/ld201213/ldselect/ldeucom/88/88.pdf], 21 July 2013, p. 42.
[9] *Ibidem*, p. 41.
[10] *Ibidem*, p. 42.
[11] ***, "Charlemagne: Europe à l'Hollandaise. François Hollande's flawed vision for Europe" in *The Economist*, 9-15 February 2013, p. 27.

From a multispeed Europe towards an EU of various strengths? The vision of Angela Merkel

When analyzing the German proposals for the future reform of the economic and monetary union we should bear in mind the importance that Germany attaches to this project, on the one hand, and how Germany relates this particular reform to the overall conception for the future of the European integration, on the other. So, firstly, without entering into the history behind the Economic and Monetary Union as a political project for advancing the European integration, we can state that ever since its official launching with the Treaty of Maastricht of 1992, Germany was one of its staunchest supporters. Back then, German chancellor Helmut Kohl 'framed the single currency as the symbol of European integration'[12] and this idea has been maintained as a core assumption for shaping the European policy of successive German governments. Although in Germany, as in other member countries the support for the EU is decreasing as more Member States join[13], it remains at the elite level a broad consensus in favor of the European integration. Secondly, from a German standpoint, the reform of the economic and monetary union represents just a significant milestone on the road towards political integration.

When speaking about the reform of the Economic and Monetary Union, the German chancellor proceeds from these two basic assumptions.[14] There are however some other traditional features of the German position that can be detected in her discourse, as for instance the importance that 'one important aspect of German European identity, the 'Europeanized Germany through EMU' should not contradict any other aspect of Germany's

[12] Thomas Risse et al, "To Euro or Not to Euro?" The Euro and the Identity Politics of the European Union", in *European Journal of International Relations*, Vol. 5, No. 2, 1999, p. 166.

[13] Gesa-Stefanie Brincker and Max Conzemius, "The modulation of the German *Leitbild* of a federal Europe" in Gesa-Stefanie Brincker, Mathias Jopp and Lenka Anna Rovná (eds.), *Leitbilder for the Future of the European Union. Dissenting Promoters of Unity*, Baden-Baden: Nomos, 2011, p. 177.

[14] Angela Merkel, *Speech by Federal Chancellor Angela Merkel in the European Parliament*, Brussels, 07 November 2012, [http://www.bundesregierung.de/Content/EN/Reden/2012/2012-11-07-merkel-eu.html], 15 July 2013.

European identity such as the *Stabilitätspolitik* and the social market economy'.[15] As a result, with regard to the economic and monetary union, Germany focused primarily on price stability and the independence of the monetary policy. Taking into consideration that the German economic governance system is relatively resistant to changes, Germany was keen to maintain economic, social and employment policy as much as possible at the national level.[16] Nowadays, Angela Merkel acknowledges that the design flaws in the architecture of the economic and monetary union, especially, the weak structure of the economic union, need to be addressed. The economic policy coordination is necessary to tap also into the sensitive realms of labor market or tax policy. Nevertheless, the 'principle of subsidiarity and national democratic processes must be respected' by striking a sensible balance between 'new intervention rights at European level and the scope for action of Member States and their parliaments'. Without entering into too many details, the German chancellor mentions her preference for a 'layered and differentiated procedure' that will enable Member States to conclude 'binding and feasible agreements' with the European institutions.[17]

One of the most sensitive issues triggered by the prospect of the reforming of the economic and monetary union concerns of a possible division between a Europe of the 17 and of the 28. These concerns have been addressed by Angela Merkel without compromising in any way the imperative of reform proving once again her political shrewdness. In order to dissipate the fears of those concerned by the prospect of a possible. She stresses that the renewed economic and monetary union is 'no closed club of Euro countries' and 'does not lead to a two-speed Europe but, rather, creates a double-strength European Union'. However, she considers that there is necessary to decide 'whether only parliamentarians from the Euro countries should be allowed to vote on such matters', but 'without establishing an additional parliamentary institution'.[18] This is in many respects a more inclusive perspective than those of other prominent German

[15] Martin Marcussen, *Ideas and Elites: The Social Construction of Economic and Monetary Union*, Aalborg Oest: Aalborg University Press, 2000, p. 130.
[16] G.-S. Brincker and M. Conzemius, „The modulation of the German *Leitbild*", pp. 201-202.
[17] A. Merkel, *Speech in the European Parliament*.
[18] *Ibidem*.

politicians like Wolfgang Schäuble and Karl Lamers or Joschka Fischer who openly advocated the idea of a core Europe.[19] The German chancellor's concern with lending the project greater diplomatic legitimacy and diplomatic standing is also obvious. As such, Mrs. Merkel looks much more favorable to the idea of a 'vanguard' group of states that would 'shape and set the agenda for the future direction of the European Union as a whole'[20] than to a 'core' group that will pursue the European and their own integration.[21]

Last, but not least, the chancellor's discourse on the future of Europe touches upon the issue of the political finality of the process of European integration. In this respect, Angela Merkel decided once again not to edge away from the well-known German thinking on the future structure of the European Union, namely, an essentially federalist one with some intergovernmentalist overtones. Her insistence on the democratic legitimacy and oversight of the process of deepening the economic and monetary union, for instance, reminds in many respects the similar pleas made by respected representatives of the German political elite at other milestones along the way towards the European Union.

In brief, the present German conception on reform remains entrenched in the country's traditional standpoints on European integration. Although aware of the need and urgency for renewing 'the political shape of economic and monetary union in keeping with the times', the German chancellor decided to go along a very cautious path last but not least because of the forthcoming German elections. There are however high expectations that in the aftermath of the elections Angela Merkel will alter to a certain extent this position and become more responsive to the appeals for painstaking reforms of her European partners.

The British preference for an à-la-carte Europe and the perspective of David Cameron

Generally speaking, British attitudes toward the economic and monetary union 'reflect collectively held beliefs about English identity' that

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[19] G. Ciceo, „The Multispeed Integration", pp. 17-18.

[20] Stephen Wall et al, *Flexibility and the future of the European Union*, London: Federal Trust, 2005, p. 8.

[21] *Ibidem*.

comprises specific meanings attached to national 'institutions, historical memory and symbols'. Each of these particular elements and all together render any attempt aimed at accommodating a 'European political order that goes beyond intergovernmentalism' difficult.[22] These identity arguments are usually played hard by the opponents of the economic and monetary union. What is also worth being mentioned is the fact that any discourse on this issue is framed essentially in economic terms, whereas the political arguments come only on a second place.[23]

While mulling over the alternatives available for shaping the future of the economic and monetary union, David Cameron has come to the conclusion that any discussion will need to have as starting point the observation that 'we are a family of democratic nations, all members of one European Union, whose essential foundation is the single market rather than the single currency'. He agrees that at some stage in the next few years 'some big institutional changes' will become a must for 'the long term future of the Euro'. Yet, these will have to work fairly for both those inside and outside the Euro zone, as it is 'a vital interest for us to protect the integrity and fairness of the single market for all its members'. The structure to be created will need to 'accommodate the diversity of its members' and to enable Europe 'to act with the speed and flexibility of a network, not the cumbersome rigidity of a bloc'.[24]

After being opposed to any form of differentiated integration for the most part of the 1980s out of conviction that by preserving uniformity it could determine the speed of the entire integration process and would prevent it to 'spillover' into sensitive policy areas, UK shifted towards an *à la carte* model against the background of the negotiations on the Maastricht Treaty, not because it had completely abandoned its fears of losing influence if flexibility was to be considered a principle of EU governance, but because it wanted to counter the German concept of 'hard core' and the French one of 'concentric circles'.[25] Based on the principles of intergovernmentalism, the

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[22] T. Risse et al, „To Euro or Not to Euro?", pp. 161-162.
[23] Claudia Ehmke, „*Leitbilder* for the Future of the European Union: United Kingdom" in: Gesa-Stefanie Brincker, Mathias Jopp and Lenka Anna Rovná (eds.), *op.cit.*, p. 364.
[24] David Cameron, *EU Speech at Bloomberg*, 23 January 2013, [www.number10.gov.uk/news/eu-speech-at-bloomberg], 15 July 2013.
[25] A. Warleigh, *Flexible integration*, p. 15.

model, as the metaphor of the menu of a restaurant from where it derives its name might suggest, considers that the Member States should be given the possibility of choosing from a variety of policy areas the ones in which they wish to participate (the matter of integration) by preserving a minimum of common goals[26] - ‘that is common policies where there are common interests without any constraint on those who cannot, at a given point of time, join them’.[27]

The vision on the future of Europe expressed by the British Prime Minister preserves the most important elements of this model. He makes a powerful case in favor of a, flexible union of free Member States that share treaties and institutions and pursue together the ideal of cooperation’. Moreover, he acknowledges that even though his ‚vision of flexibility and cooperation is not the same as those who want to build an ever closer political union – but it is just as valid’. It is in the interest of his country not to be ‘weighed down by an insistence on a one size fits all approach’,[28] proceeding from the assumption that all countries crave for the same level of integration.

With regard to the future shape of the European Union, the British remain favorable to a Union of sovereign nation states that cooperate when it is in their national interest. From a British perspective, a far greater importance is attached to the output legitimacy of the future construction, which basically means that the institutional setup will need to be configured in ways that allow them to better deliver policies. The most sensitive issue concerns the sovereignty of Parliament that is still held high and remains central to the British political system. Under these circumstances, any transfer of competences to supranational institutions that lack democratic accountability is difficult to be accepted by the British. Consequently, protecting the

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[26] Under the minimum of common goals, an institutionalized economic cooperation (e.g. the common market) is mostly understood.

[27] Ralf Dahrendorf, *A Third Europe?*, Third Jean Monnet Lecture, Florence: European University Institute, November 26, 1979, [http://aei.pitt.edu/11346/2/11346.pdf], 21 July 2013, pp. 20-21.

[28] David Cameron, *EU Speech at Bloomberg.*

Parliament, the nation state and the national political system have become core issues on the European agenda of the United Kingdom.[29]

In his speech, David Cameron proceeds from the assumption that the 'European Union that emerges from the Euro zone crisis is going to be a very different body', 'transformed perhaps beyond recognition by the measures needed to save the Euro zone'. That is why he has decided to throw his political weight behind a proposal, which is not entirely new for him. This concerns the organization of an referendum in which the British to be asked to decide between 'leaving or being part of a new settlement', that will be 'subject to the democratic legitimacy and accountability of national parliaments, where Member States combine in flexible cooperation, respecting national differences not always trying to eliminate them and in which we have proved that some powers can in fact be returned to Member States'.[30]

Considering the positions expressed by the British Prime Minister, we can conclude that sovereignty has remained a central theme in the British discourse and that this will not alter in the near future. As a result, United Kingdom is likely to maintain its positions on the economic and monetary union and the outlook of European integration in the years to come. Although conceding on the need for the reform of the economic and monetary union, United Kingdom will have to decide on its future in the new structure. The decisive moment will, as in case of Germany, be the next general elections.

A Europe with a variable geometry? How much of this is still valid in the vision of François Hollande?

Ever since the launch of the European integration, the French positions with regard to it where shaped by national interests and needed to be legitimized domestically.[31] Yet, in opposition to United Kingdom, France managed to Europeanize its own identity and accommodate European values

[29] Claudia Ehmke, "*Leitbilder* for the Future of the European Union: United Kingdom", p. 337.

[30] David Cameron, *EU Speech at Bloomberg.*

[31] Gesa-Stefanie Brincker and Anne Schmidt, „A European Union designed for the sake of France? French *Leitbilder* for the enlarged European Union" in: Gesa-Stefanie Brincker, Mathias Jopp and Lenka Anna Rovná (eds.), *op.cit.*, p. 130.

to the extent to which these would not challenge its own conception of a nation-state.[32] This was also the case with the economic and monetary union. Faithful to the principles of economic dirigisme and eager to counterbalance the German proclivity towards a strong monetary policy, France advanced the idea of an economic government without unambiguously expliciting its ideas. Any attempt to shed light on this topic exposed the difficulties generated by the attempt to find common gound between economic patriotism and a European economic governance.[33]

The crisis has proved that France's insistence on the need for economic governance in the economic and monetary union has been correct. International Monetary Fund has also signaled repeteadly the need for this economic governance. However, it is still not clear what France means by this economic governance. The speech of François Hollande, has done little for spelling out the necessary clarifications. For him, Europe 'cannot be limited to a market, a budget, a currency, irrespective of their value', in the very same manner as it cannot be equated with a 'sum of treatises' or a 'compound of rules'. Neither can Europe survive as an 'accumulation of nations in which each of these comes to seek what is useful for itself and only for itself'. His solution lies in a 'differentiated Europe' which by no means is either a 'two speed Europe', because this would swiftly become imbalanced, or an *à la carte* Europe, because this would mean a divided Europe. With regard to the future institutional setting, the French vision is also relatively blurred. It is ready to accept the Euro governance, new financial instruments and under certain conditions a budget for the Euro zone, that will need to be connected to the budget of the European Union.[34]

Without being very specific, François Hollande laid down a vision on the future construction of the European edifice that accomodates in as much as possible the French positions on the current issues under consideration. As a result his discourse showcases an old French dilemma concerning the

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[32] T. Risse et al, „To Euro or Not to Euro?", p. 171.

[33] G.-S. Brincker and A. Schmidt, „A European Union designed for the sake of France?", p. 149.

[34] François Hollande, *Intervention devant le Parlement Européen*, Strasbourg, 5 February 2013, [http://www.relaunchingeurope.eu/sites/default/files/05%2002%2013%20Discours%20du%20pr%C3%A9sident%20de%20la%20R%C3%A9publique%20au%20Parlement%20europ%C3%A9en%20de%20Strasbourg.pdf], 15 July 2013, p. 5.

European integration – to what extent it is adequate to transfer competences to the European level and what is the point from where it is better to maintain them at the national level.

Conclusions

As such, the British vision exposes little overlapping with both the German and in particular the French ones. However, it is obvious that all the three leaders agree that a new blueprint of the institutional framework is necessary. Moreover, they find common ground with respect to the need for a democratic scrutiny of the institutions and decision-making processes by the European and national parliaments depending on the level of decision. In addition they favor a more efficient use of the mechanisms for enhanced cooperation already existing in the treaties as these perceived as tools for effective policy-making rather than tools for building a 'core Europe'.[35] The overall decisions taking by now with regard to the banking union with its joint banking supervision and the and enhanced cooperation in fiscal and budgetary policy seem to reinforce this trend and add credibility to the political discourse on future reform irrespective of how elusive this might be right now.

None of the three leaders has come up yet with an inspiring vision on either the reform of the economic and monetary union or the future of European integration. It is all the same true that deepening the cooperation in the Euro area is not likely to break ground for the creation of a federal state in the traditional sense of the term in the near future.[36] What is to be expected is the fact that the European construction will advance in small steps just as its founding fathers have envisaged. For the time being though, the good intentions seem to be 'thwarted by the timidity and lack of independence of the national governments', by diverging apprehensions

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[35] Funda Tekin and Wolfgang Wessels, *Flexibility within the Lisbon Treaty: Trademark or Empty Promise?*, EIPASCOPE, no. 1, 2008, p. 27.

[36] Francesco Paolo Mongelli, *The Mutating Euro Area Crisis. Is The Balance Between "Sceptics'' and "Advocates" Shifting?*, European Central Bank Occasional Paper 144, February 2013, [http://www.ecb.int/pub/pdf/scpops/ecbocp144.pdf], 15 July 2013.

on the need to build 'political capacities for joint action that we lack'.[37] But with a modest 'political backbone', the crisis of the single currency can bring about a 'cross-border awareness of a shared European destiny'.[38]

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[37] Jürgen Habermas, *The crisis of the European Union. A Response*, Cambridge: Polity Press, 2012, p. 126.
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STUDIA UBB. EUROPAEA, LVIII, 3, 2013, 75-92

THE CREATIVE ECONOMY. FROM CONCEPT TO CREATIVE ENVIRONMENT. CHALLENGES FOR ROMANIA

Nadia Valentina Ivanova,* Elena Marinela Porumb**

Abstract
The economic crisis contested the known economic growth models, in both their being and the way they are measured. While providing economic growth and competitiveness encouraging are still the main priorities on the agenda, the prompt attention has shifted on creating jobs, raising salaries, addressing problems of inequality and promoting long term sustainable prosperity. This study aims to show the importance of the Romanian human capital's creative potential through the Global Creativity Index. The Global Creativity Index evaluates the perspectives of sustainable prosperity of 82 nations according to a series of economic, social and cultural factors which form the base of the 3Ts of economic development- Technology, Talent and Tolerance. Although a novelty approach, from the lack of necessary data to calculate the European Creativity Index, we used just the data from the Global Creativity Index ranking from which we selected the E.U. member states, and on this bases we tried to couture an, clear as possible, image of the impact of creativity and culture over Romania and its potential to develop through exploiting the creative industries.

Keywords: creative economy, creative environment, creative cluster, creativity index

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Introduction

The study's objectives will cover a logical sequence. There for we will fallow some conceptual and methodological aspects and then we will add a certain theoretical and practical tools (Creativity Index) for the Romanian creative economy.

The creative industries, despite being an emerging field of study, have already come to constitute an important sphere of practice, representing an important sector of the 'new economy'.

"Adequately nurtured, creativity fuels culture, infuses a human-centred development and constitutes the key ingredient for job creation, innovation and trade while contributing to social inclusion, cultural diversity and environmental sustainability."[1]

The array of artistic and cultural production and distribution enterprises that constitute the creative industries has come to be consolidated under an umbrella that bridges the nexus between culture and economy. On the one hand, the human capital can harness the individual talent, and on the other hand so can the organizational practices.

1. The Creative Economy Concept-The Creative Industries

Background Review of the Creative Economy Concept

There are many creative economy concepts, but some of the most notable are those developed by John Howkins in 2001, by UNCTAD in 2004, by NESTA in 2007 through which to the previous model of the Department of Culture, Media and Sport (UK) was improved, and the 7Cs model developed by us.

The concept model was proposed and developed by authors, institutions and organizations in order to create a frame for practical implementation steps. See the table 1.

[1] United Nations, *Creative Economy Report 2010*, UNCTAD, 2010 [http://unctad.org/en/Docs/ditctab20103_en.pdf], 3 July 2013.

John Howkins, 2001	**UNCTAD, 2004**	**NESTA, 2007 (Refined DCMS model)**	**The 7 Cs Model, 2012**
Advertising Architecture Art Crafts Design Fashion Film Music Performing arts Publishing Software Toys and games Television and radio Video games	**Heritage** Traditional cultural expressions (e.g. art crafts, festivals and celebrations) Cultural sites (e.g. archaeological sites, museums, libraries) **Arts** Visual arts Performing arts **Media** Publishing and print Audiovisual **Functional creations** Design (e.g. fashion, graphic) New media (e.g. video games, software) Creative Services (e.g. architecture, advertising, creative R&D)	**Core creative fields** Commercial outputs that possess a high degree of expressive value and invoke copyright protection. **Cultural industries** Activities involving mass reproduction of expressive outputs (based on copyright). **Creative industries and activities** The use of expressive value is essential to the performance of these sectors. **The rest of the economy** Manufacturing and service sectors benefit from and exploit the expressive outputs generated by the creative industries.	**Creative capital** (manifestations of creativity) Knowledge management **Creative industries** Creative industries with artistic content and of media content **Creative businesses** Creative industries producing active intangibles **Cultural industries** Creative industries with preponderant cultural content **Creative environment** Knowledge capital Human Capital Social Capital Structural and Institutional Capital Cultural Capital Natural Capital

Bobirca and Draghici in the study "The measuring of creative economy –Case study Romania"[2] define the creative economy through the creative industries assembly, which in their turn have certain characteristics:

[2] Ana Bobircă, Alina Drăghici, "The Measuring of the Creative Economy – Case Study", in Romania Economic Journal, Year XXI, no. 34, 2009.

A. they represent a set of intensive activities in knowledge, part of the economy based on knowing;
B. they include activities of conception, production and distribution of intensive goods and services in artistic or scientific creativeness, respectively in cultural or informational intangible assets (as intellectual property);
C. they have the capacity to generate income from the creative products and services commercialization, as well as from the exploitation of intellectual property rights;
D. they have the potential to generate sustainable economic growth, promoting the social inclusion, cultural variety and human development.[3]

Hereby, starting with these classification models of the creative industries, as well as from the classification made by the UNCTAD.[4]

The creative industries:

- *Are the cycles of creation, production and distribution of goods and services that use creativity and intellectual capital as primary inputs;*
- *Constitute a set of knowledge-based activities, focused on but not limited to arts, potentially generating revenues from trade and intellectual property rights;*
- *Comprise tangible products and intangible intellectual or artistic services with creative content, economic value and market objectives;*
- *Are at the cross-road among the artisan, services and industrial sectors; and*
- *Constitute a new dynamic sector in the world trade.*[5]

2. Measuring the Creative Economy

For some time now, researchers have been dedicating many pages to the measurement if the creative economy. But, because the creative economy's definition is broad, standards for measurement are still under development. For example, the DCMS[6] is working on a new set of standards

[3] *Ibidem*, p. 119.
[4] UNCTAD = *United Nations Conference on Trade and Development.*
[5] United Nations, *op. cit.*, p. 7.
[6] Department of Culture, Media and Sport (UK).

for measuring the creative industries. Meanwhile, the classification of the creative industries is a mean through with the creative economy can be delimitated and measured.

Bobircă and Draghici proposed the following classification of the creative industries, and as it can be seen in the 7Cs model above, we agree with the fallowing classification:

- creative industries with preponderant artistic content: visual arts - painting, sculpture, antiquities, photograph; interpretative arts - music, theatre, opera, dance, circus spectacles;
- creative industries with preponderant cultural content: cultural patrimony – historical monuments, museums and collections, archaeology; immaterial patrimony - traditions, handicraft, festivals, traditional holidays, local arts; other cultural institutions/activities -libraries, archives, exhibitions;
- producing creative industries of media content: traditional (printing: books and pamphlets, manuals, courses, newspapers and other publications; movies, television programmes, radio); digitized: software, information games, other categories with creative digitized content;
- producing creative industries of active intangibles (intermediate inputs): design (interior, graphic, vestiary, industrial); publicity; architecture; creative research-development;
- connected industries: hardware producers; producers of support equipment and devices; other sub-sectors of the information technology and communications industry with support roll for creative industries.[7]

Another approach consists in considering the creativity as being a measurable social process. Economically, however, a relation between creativity and economical-social development is not apparent, especially the assumption that, creativity contributes to the economic growth. In this case it is important to measure not only the economic results of the creativity, but the cycle of the creative activity through the interaction of four capital forms - social, cultural, human and structural or institutional - as determinants of the creative growth - the creative capital.

The accumulated effects of these determinants are called "creativity results".[8] This represents the cadre of determination of the creativity index,

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[7] Ana Bobircă, Alina Drăghici, "The Measuring of ...", pp. 117-120.

[8] Creative economy report 2008, UNCTD, 2008 [http://unctad.org/en/Docs/ditc20082cer_en.pdf], 3 July 2013.

also known under the name of *the 5Cs model.*[9]

"Creativity can also be defined as the process by which ideas are generated, connected and transformed into things that are valued. *Originality* means creating something from nothing or reworking something that already exists."[10]

In the context of the new era, an era in which much emphasis is put on innovation, on developing a sustainable economy, developing new way of life, creative ways, I think that it is only right the further enlarge the concept, and by default the definition of creative economy.

In our opinion, as part of the creative economy should also be include the concept of smart city. Thus, it is properly to further enlarge the UNCTAD definitions of the creative industries, by adding several more components, as follows:

The creative industries:

- are the cycles of creation, production and distribution of goods and services that use creativity and intellectual capital as primary inputs; and should also include high-tech industries, medical, education, culture and art, tourism and leisure-which are part of the compact city;
- constitute a set of knowledge-based activities, focused on but not limited to arts, potentially generating revenues from trade and intellectual property rights. Here can be included all activities related to intelligent city, compact city.
- correlate sustainable, green activities and practices which are included in concepts such as green city-green urbanism, LEED development,[11] eco-rural development, eco-farm development;
- comprise tangible products and intangible intellectual or artistic services with creative content, economic value and market objectives. To which are added all services and products included in the business, logistic and IT hubs.
- are at the cross-road among the artisan, services and industrial sectors;
- constitute a new dynamic sector in world trade.

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[9] This model was developed by the research team of the Hong-Kong University lead by Prof. Desmond Hui. See *A Study on Creativity Index*, 2005 [http://www.uis.unesco.org/culture/Documents/Hui.pdf], 3 July 2013.

[10] UNCTD, *Op. cit.*, p. 10.

[11] Leadership in Energy and Environmental Design.

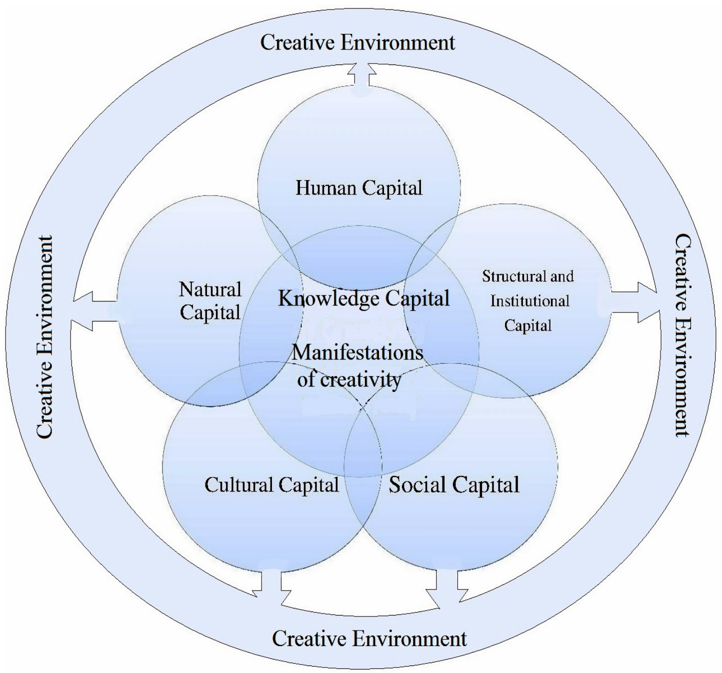
Similar to other markers, the creativity index measures the performance of a phenomenon, using a set of markers that highlight its certain key features. It is inspired from the existent indices relative to creativity, innovation and economic performance, but introduces new elements, especially from art and culture.

The accent applied to the creativity dimension implies considering some series of factors. These include, but don't limit to: education in art schools, the occupancy of the workforce in the culture domain, the new technologies, the economic contribution of the creative industries.

These markers are gathered in six pillars of creativity, in which it can be noticed the bond between the human capital and the creative results correlated with the social, institutional, technological and cultural environment.

Moreover, this type of bonding among all types of capital should be completed by further integrating the natural capital as a variable of creative development, therefore resulting in the creation of a network, in which they are totally interrelated and connected to one another through the continuous flow of the knowledge capital, as illustrated bellow.

Fig. 1. The 7Cs model.



3. Creative Indexes

The Global Index of Creativity

The current study considers the determination and the analysing of an index of creativity through the application of the 3Ts model, developed by Richard Florida, in Romania's case, based on the given data by *Martin Prosperity Institute* in the ***Creativity and Prosperity: The 2010 Global Creativity Index-January 2011*** study and, also, the ranking of the European Union member states according to the creativity index.

Richard Florida, created a number of indexes to measure the creativity of places, based on his work focused on the creative class, which he presents in the book *Who's Your City*. These include the:

- Talent Index. The proportion of the population 18 years and older with a bachelor's degree or higher;
- Bohemian Index. The proportion of the population employed in artistic and creative occupations;
- Mosaic Index. The proportion of the population that is foreign born;[12]
- Tech Pole Index. The proportion of the population employed in high-tech jobs.

Richard Florida and the Martin Prosperity Institute has developed a number of measures that comprise the "3Ts" - technology, talent and tolerance - and has established that they affect or are associated with economic development (the 3Ts include the four creativity indexes mentioned above.)

a. Talent Index – TLI is a compound index, having in its structure three sub indices, respectively the Creative Class Index - CCI, the Human Capital Index – HCI and the Scientific Talent Index - STI.

b. Technology Index – TI also a compound index which is based on a system of three markers, respectively innovation index – II, technology innovation index – TII and R&D index – RDI.

c. Tolerance Index – TI is, in its turn, a compound index which has in its structure three other indices respectively tourism openness index – TOI, the number of foreign students or who are studying abroad index (Students

[12] CNSLC, Creative Economy Literature Review, 2012 [http://www.gov.ns.ca/cch/department/docs/ CreativeEconomyLiteratureReview.pdf], 5 July 2013.

Index - TSI) and the international trade of creative goods and services index (Creative Trade Index – CTI).

To measure the Global Creativity Index, Richard Florida and the Martin Prosperity Institute use the fallowing "formula":

"To create the final Global Creativity Index, we constructed the talent, technology and tolerance variable based on principle component analysis. In other words, each of the scores are based on the actual performance and not the rank of each individual variable. We thereafter ranked each of the 3 T variables, with the highest number to the best performer. We added the ranks together and divided by three. In the case where we had a value for just two of the three variables, these two were added and divided by two. To get the Global Creativity Index score, the average score of the 3 Ts were divided by the number of observations overall."[13]

4. Case Study. Measuring the index of creativity for the EU countries

The European creativity index[14] respects the three dimension construction of the Florida's index. The methodology for calculating of the 3 compound annual indices aforementioned, respectively Talent Index, Technology Index and Tolerance Index, according to ***Creativity and Prosperity: The 2010 Global Creativity Index***, is the following.

In order to calculate the final value of the Global Creativity Index, at European level there were built the variables related to the technology, the talent and the tolerance based on the component analysis. In other words, each of scores is based on the actual performance, and not on the rank of each individual variable. Subsequently, were ranked the variables of each of the 3T, offering the largest number to the state with the best performances. Then are gathering the variables and it shall be divided into three. In case they could be calculated only two of the three variables, these are summed and the result was divided at two. To obtain the Global Creativity Index score,

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[13] Richard Florida, *Creativity and Prosperity: The Global Creativity Index*, Martin Prosperity Institutte, 2011 [http://www.martinprosperity.org/media/GCI%20Report%20Sep%202011.pdf], 5 July 2013

[14] It is important to mention that index definitions and classification were reproduce as they written in Ana Bobircă, *op. cit.*

the average score of the 3T was divided by the total number of observations. Thus, the ranking of European countries is presented in Appendix 1.

4.1 The analysis and the comments of the results

a) Talent Index:

Following the analysis of the data relating to the talent index, there is a grouping of the Nordic countries with consistently high scores, such as Sweden, Finland, Denmark, the Netherlands and Belgium, and at the other extreme countries such as Portugal, Czech Republic, Bulgaria and Cyprus, having relatively low score. Countries like Germany, France and the United Kingdom continue to have a good position, but compared to 2007, register a decrease of a few percents.

As for Romania, this is located on the last position in the ranking of European countries, registering low values, especially for scientific talent index, having the lowest number of researchers in Europe. However, from the point of view of the growth rate, Romania occupies a leading position, caused by the growth of the Human Capital index. In Romania it should be increased the efforts and achieved the converged policies of development of the talent and the human capital that will certainly lead to the increase of the creative capital, of the intellectual that belongs to both the individual as well the organization with beneficial effects on the development of the society.

b) Technology Index:

Following the data collection and analysis, it appears the maintaining at the top ranking of the Nordic countries, Sweden, Finland, Denmark and Germany.

With regard to Romania, it occupies the last but one place in the ranking of European countries, positioning determined by the low number of patents applications submitted (13), but also by the percentage of research-development expenses from the GDP (about 0.58%, compared to 3.57% of Sweden).

Therefore a direct recommendation is obviously the one related to the increased spending with the research-development, the general tendency being the increasing expenses related to knowledge which are being imported more and more in order to remain competitive.

c) *Tolerance Index:*

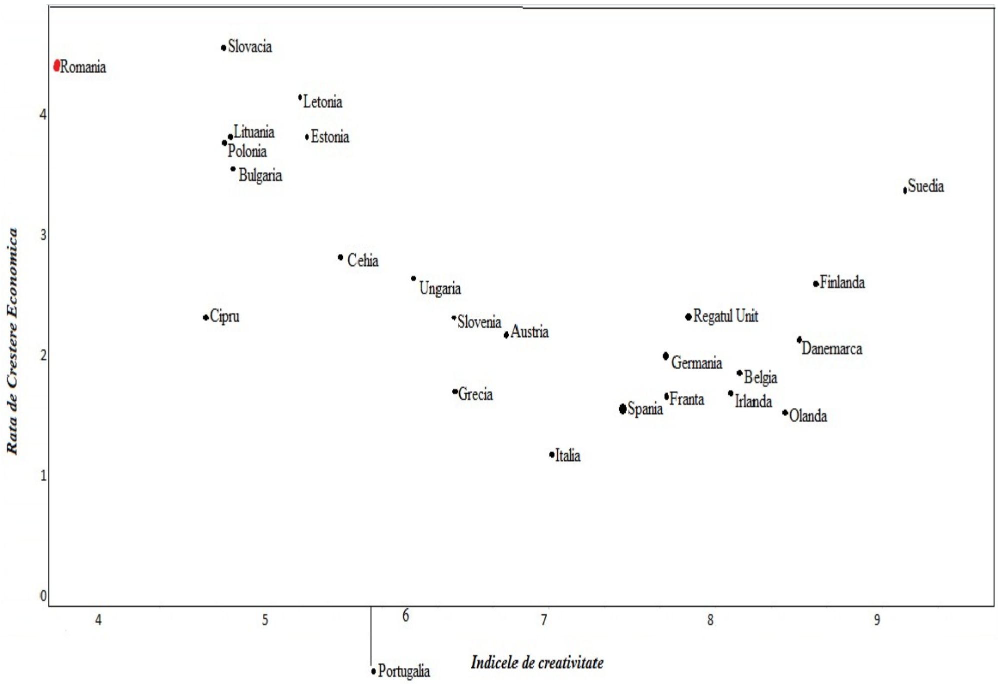
From the data analysis it is noted a modification of the ranking in favour of countries such as Ireland, the Netherlands and Spain that occupies the first positions.

Romania has a better positioning within this index, placing it in the middle of the ranking, perhaps due to a tolerant behaviour at the society level, but that could be related to the beneficial effects of bohemian, creative, multicultural, multi-religious communities and therefore with a very important creative potential for economical and social development.

4.2. Determination of the correlations

It can be observed a direct correlation between the index of creativity level and the economic growth confirming the hypothesis of the study, respectively that the high levels of creativity and high rhythm of development of the creative activities can lead to economic growth (see fig. 2). For Romania this correlation is among the strongest.

Fig. 2. The correlation between the Creativity Index and the economic growth. Source: own calculations.



5. Final conclusions

5.1. Releasing Passion and Talent and Path Finding

The study fallows the adaptation of the system of markers used by Richard Florida to calculate the creativity euro-index by collecting data and correlating them at European level, thus resulting in the creativity index of Romania.

Thus, we determined and analyzed the creativity index by applying the 3Ts model - talent, technology, tolerance, on Romania, based on the data provided by the Martin Prosperity Institute in the study of ***Creativity and Prosperity: The 2010 Global Creativity Index-January 2011*** and, also, we classified the member states of the European Union depending on the creativity index. The objective was to evaluate the creative potential of the country and to determine its capacity to attract and develop creative human capital.

The talent, technology and tolerance indices were built on the basis of a system of 9 indicators (Creative Class Index, Human Capital Index, Scientific Talent Index, Innovation Index, High-Tech Index, R&D Index, Tourism Openness Index, Students Index, Creative Trade Index) calculated globally for 82 countries in 2010.

As resulting from the research of Florida, the competitive epicentre of Europe is transferred from the powers like France, Germany, Great Britain, towards the creative countries located in Northern Europe, respectively Sweden, Finland, Denmark and the Netherlands.

Sweden occupies the first place in the creativity index ranking, both at European level as well globally. Finland, Denmark and the Netherlands also register very high values pointing out that the Europe's creativity "centre" is in the north. All these countries have a high level of technological development and they consistently invested in the further development of their creative talent.

Even if it is situated on the last positions of the ranking, Romania, along with other European states such as Bulgaria, Latvia, Poland, Lithuania records high growth rates of their creative potential.

5.2. Developing a consciousness for creative actors

Even though Romania registers low values for the first two indicators, according to some other studies, it is seen that Romania finds itself, among other 28 countries, in the second stage of development, the efficiency one, compared to the country taken as an example of best practice, Japan, which is already in the third stage of development, being an economy based on innovation.

5.3. National and local authorities

With a common e-government framework, EU countries are encouraged to deploy advanced technologies, institute better governance and provide expanded services with concomitant pursuit of greater transparency, efficiency and inclusion. Notwithstanding, differences remain between regions and within them.

We all know that the bureaucratic system in Romania can be very complicated. Beside this, the low segment of founding coming from the government further complicates the situation.

In Romania, according to the National Institute of Statistics, during 2004-2006 the intensity of innovation was two times higher in industry (1.93%) than services (0.90%)[15]. The enterprises in Romania tend to innovate new products for the company and less new products for the market. The share of new or significantly improved products in the total turnover of the enterprises was 18.6%. Enterprises with new products for the firm had a share of 13.7%, compared to the ones with new products for the market with a share of 4.9%.

In 2006, three quarters of the expense of the innovation was used for the purchase of machinery, equipment and software. The total value of expenses allocated to innovation in that year was 6.4217 billion lei. Both in industry as well in services the highest share of the innovation expenses is held by the purchase of machinery, equipment and software. The services companies have spent more on research-development than those in the industry field.

[15] The National Institute of Statistics, "The Innovation in Industry and Services during 2004-2006" in Press Release No. 124 of June 30, 2008 [http://www.insse.ro/cms/files/statistici/comunicate/com_trim/Inov_ind/inov_ind_serv_08e.pdf], 28 June 2013.

5.4. Developing a broad education system that encourages creativity

For example, regarding the expenses for innovation, according to the World Bank data, in Romania, in 2008 only 0.59% and in lowered in 2011 to only 0.47% of GDP was allocated on research and development in order to increase knowledge, unlike Japan which assigned 3.47%, respectively 3.36% of its GDP.[16]

5.5. Invest and Promote incentives in human potential in order to raise creativity

The creative class represents on average about 30% of employment in the EU, registering an annual growth rate of 8%, higher in particular for countries with low index values.[17] The creative class represents only 17% of the working class in Romania; therefore the 30% target of employment in the creative sector should be set to be reached in the fallowing years.

Summing what we have shown above, as Romania strongest point from the perspective of innovation is to remember that it is at a medium level of development, a fact which allows the advancement, and also the fact that it has formulated innovation strategies and sustainable development.

On the other hand, however, its weakest points, there can be observed a very low orientation of the companies to produce new products for the firm or for the market, investing in research and development, the acquisitions of know-how are also very low, a weak guidance in attracting external knowledge (such as know-how), it is the country that has, after Russia, the lowest degree of total distrust in major companies.

5.6. Promoting Creative Places. Building Creative Clusters

Romania should focus on developing and building structures such as IT Clusters, and not only, which represents associations of organizations active in the information technology field, comprising software developers and solution providers, academic institutions, public bodies and other catalyst organizations.[18]

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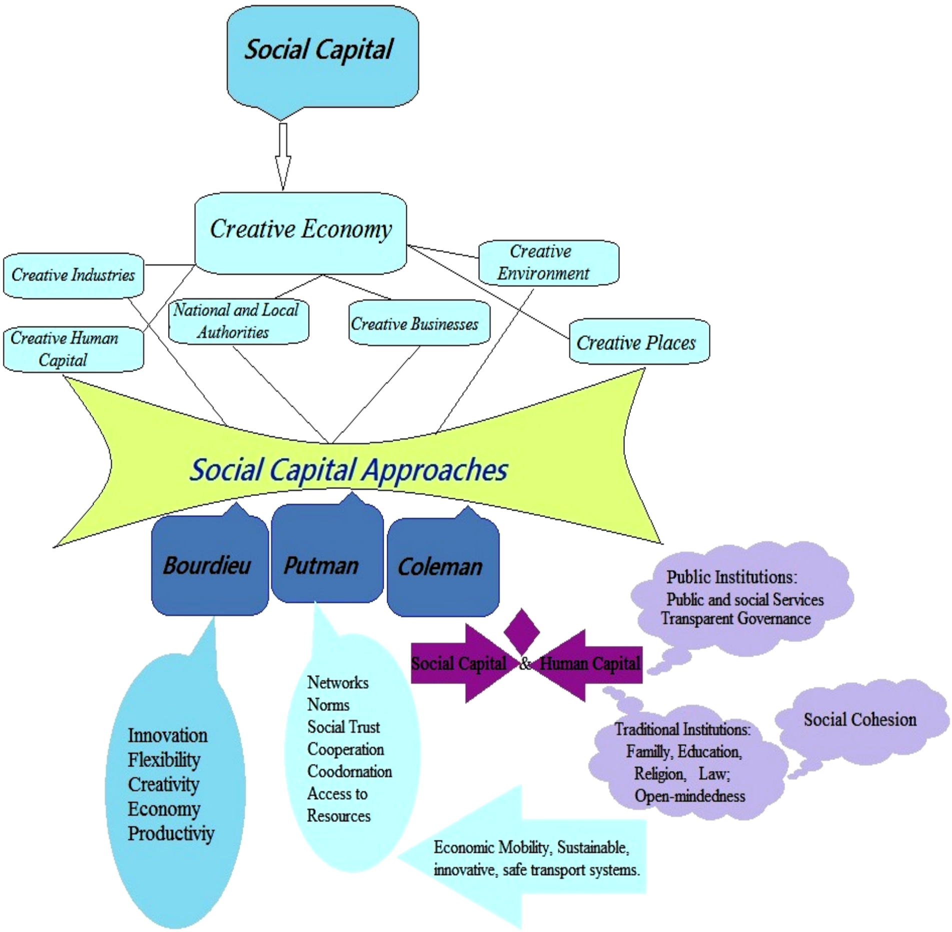
[16] World Bank, Research and development expenditure (% of GDP), 2013 [http://data.worldbank.org/indicator/GB.XPD.RSDV.GD.ZS], 28 June 2013.

[17] Ana Bobirca, Alina Draghici, "Creativity and Economic Development" in *World Academy of Science, Engineering and Technology*, no. 59, 2011 [http://www.waset.org/journals/waset/v59/v59-171.pdf], 9 July 2013.

[18] ***, *Cluj IT*, 2013, [http://www.clujit.ro/en/about/], 29 June 2013.

This kind of constructions aim to create "an auspicious ecosystem for the development and commercialization of innovative, value-adding software services and products, through:

- strong cooperation between the cluster members,
- exchange of knowledge and ideas,
- public-private partnership, and
- fostering of research - for the benefit of all cluster entities and with impact on the society at large.



Social Capital - Mind Map

Maybe Romania should fallow the "Trust and creativity" (Trustworthiness and Creativity) slogan which was use by Nikon. The Nikon Corporation has structured policies that correspond to this philosophy, which were shared with all the employees and then put into practice. In other words, the company places at the centre of its activities the importance of social capital (trust) and the knowledge management and innovation (creativity).

The potential for development is a dynamic process and it largely depends on the policies used by the states to encourage the development of this sector. The ability to attract, retain and develop the creative capital is therefore directly proportional to the state's ability to adapt its development strategies so that it also incorporates this new field of economy.

Appendix 1.

Table No. 2. The ranking of the European countries after the IGC. Source: ***Creativity and Prosperity: The 2010 Global Creativity Index***

Country	*Technology Index*	*Talent Index*	*Tolerance Index*	*Creativity Index*
1. Sweden	5	2	7	0.923
2. Finland	1	1	19	0.894
3. Denmark	7	4	14	0.878
4. Netherlands	17	11	3	0,854
5. Belgium	16	12	13	0.813
6. Ireland	20	21	2	0.805
7. United Kingdom	18	19	10	0.789
8. France	14	23	16	0.764
9. Germany	9	26	18	0.764
10. Spain	24	28	6	0.744
11. Italy	26	18	23	0.707
12. Austria	13	30	35	0.663
13. Greece	38	9	37	0.638
14. Slovenia	23	10	51	0.638
15. Hungary	33	25	34	0.606
16. Portugal	31	34	33	0.577
17. Czech Republic	25	31	49	0.553

Country	*Technology Index*	*Talent Index*	*Tolerance Index*	*Creativity Index*
18. Estonia	27	15	69	0.528
19. Latvia	39	14	60	0.520
20. Lithuania	31	16	75	0.484
21. Bulgaria	40	38	45	0.480
22. Slovakia	36	33	55	0.476
23. Poland	37	29	58	0.476
24. Cyprus	59	43	25	0.463
25. Romania	49	63	44	0.346

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STUDIA UBB. EUROPAEA, LVIII, 3, 2013, 93-106

THE STATE OF THE ROMANIAN STOCK MARKET CHALLENGES AND PERSPECTIVES

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Abstract:
Almost five years after the 2008 global financial shock, the Romanian stock market is still struggling to find a way to get out of its profound crisis. Meanwhile, the US and most of the Western European exchanges fully recovered and some of them even exceeded the pre- 2008 crisis levels. In this paper we attempt to analyze why the Romanian stock market has ended up in its current condition, what the implications are and what steps can be taken in the future.
Keywords: capital market, Bucharest Stock Exchange, RASDAQ, securities, investors

1. Introduction

During the recent financial and economic crisis, the Romanian stock market suffered a collapse (in many cases the stock quotations depreciated more than 90% compared to the 2007 levels). Moreover, while during the last couple of years, the most important stock markets fully recovered to pre-crisis levels and some of them (like the US stock market) currently surpassed the 2007 quotations. Actually, some major indexes like DJIA, S&P 500 or DAX,[1] recently reached the all-time high level. For example before the 2008 crisis,

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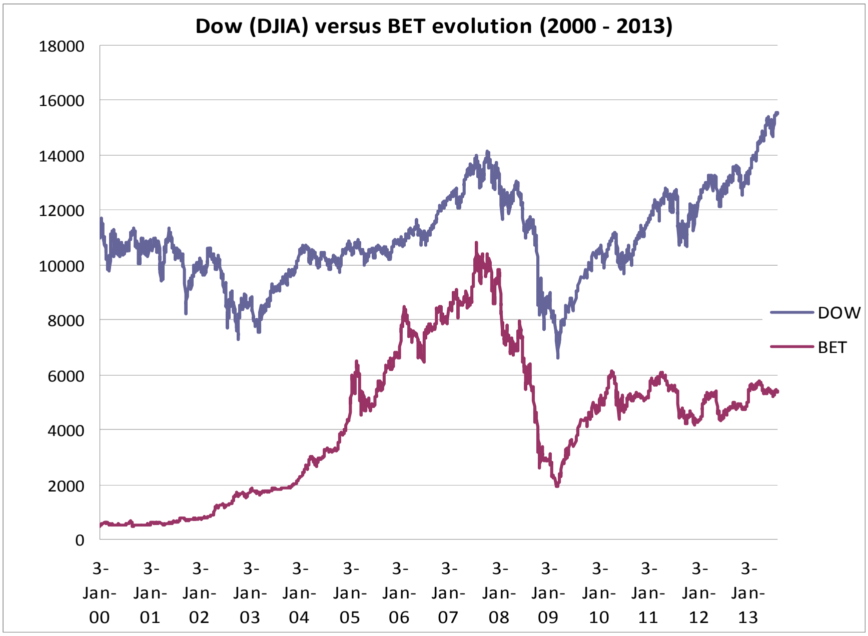
[1] DJIA – Dow Jones Industrial Average (index that reflects the evolution of the most important 30 stocks on the US market), S&P 500 – Standard and Poor's 500 (reflects the evolution of the most important 500 stocks on the US market), DAX – Deutcher Aktien Index (reflects the evolution of the most important 30 stocks on the German market)

the DJIA reached its peak on October 11, 2007 at 14.198 points. Today, July 18, 2013 the DJIA index largely surpassed that level, hitting a new historical maximum at 15.548 points.

Meanwhile, the Romanian stock market is still struggling to find a way out of its profound crisis. In order to compare it with the US stock market, let's take a look at the major Romanian stock index: BET.[2] This index reached the historical highest level, previous the crisis, on July 24, 2007 at 10.813 points. Today, July 18, 2013 the BET index is just 5.420 points, only at the half way mark compared to the 2007 maximum. The same is true or even worse for the other Romanian stock market indexes like, BET-C, BET-FI or BET-NG.[3] Actually, among the stocks listed on the main market of the Bucharest Stock Exchange (BSE), not a single one managed to surpass the 2007 quotation, even if we take in account the dividends!

Chart 1. The evolution of the DJIA versus BET index



Source: author calculations using data from Bloomberg, BSE.

[2] BET – Bucharest Exchange Index (reflects the evolution of the most important 10 stocks on the Romanian market)

[3] BET-C - Bucharest Exchange Index Composite (reflects the evolution of all the stocks from Bucharest Stock Exchange), BET-FI (reflects the evolution of the investment funds from the BSE), BET-NG (reflects the evolution energy sector from BSE)

Is this paper we attempt to find some answers to the following questions: why is the Romanian stock market confronted with this recovery gap against the major markets and what are its challenges and perspectives?

2. The current condition of the Romanian stock market

Why did a necessary correction on the Romanian stock market in 2008 transform into a collapse from which it has not recovered even after almost five years? There are several reasons for the current situation and we will attempt to identify and explain the factors leading up to it.

In retrospect, we can say that by the end of 2007 Romania experienced a bubble on the Romanian stock market (if we were looking only at PE ratios of some companies), as well as in the real estate market. The situation was pretty much similar with the US and Europe. There were symptoms of irrational exuberance on the capital markets in 2007 (especially during spring and summer) with a frenzy of share capital increase through secondary public offers and stocks traded at prices that lost any connection with the company fundamentals, due also to an overheating in the whole economy.

Nevertheless, the stock market bubble is not the only cause for this collapse. When the foreign investors realized that, the crisis would be very serious, they started to disinvest firstly from the emerging and frontier markets, like Romania. There was a huge sell-off during the end of 2008 and beginning of 2009, which was reflected also on the depreciation of the local currency exchange. Actually, during that difficult period, the Romanian central bank together with the IMF, World Bank and European Commission reached an agreement (in March 2009) with the most important foreign bank present here to maintain their financial exposure, in other words not to retire capital from Romania. This was not the case on the stock market, but rather only for the banking system. Moreover, not only was virtually nobody to buy what the foreign investors were selling, but the local investors started to panic as well and to sell at any price, ignoring once again the fundamentals.

Another reason is that the Romanian stock market is small and the majority of the stocks are illiquid, making it very difficult for somebody to sell significant packages without completely crashing that stock price. In many cases of some companies listed on the RASDAQ market, it was actually impossible for investors to sell their participations because there were virtually no counterparts.

The trough of the collapse was reached in March 2009, in synk with all the important stock markets. Since then, the US and most of the European markets started a gradual, but strong, process of recovery. The come-back was completed this year and in some cases the indices are reaching all-time record high closing levels (July 2013).

The explanation is based on a mix of factors:

1. several rounds of quantitative easing programs done by the Federal Reserve (Fed) and some similar programs implemented by the European Central Bank (ECB), Bank of England and so on;
2. continued cuttings of the interest rates by Fed, ECB, Bank of England and so on, to levels almost close to zero;
3. good fundamentals for many companies, both because of the 2009 severe correction and also due to their positive results;
4. economic growth still weak, but, with few exceptions, back to positive territory.

The situation on the Romanian stock market is very different. The major index BET is only at the halfway mark compared to the 2007 peak and the financial index BET-FI reached only one third compared to the maximum before the crisis.

From the mix of factors which led to the complete recovery on the US and Western European markets, only the last two are partial valid for Romania.

There was not a quantitative easing program or something similar, but rather heasvy austerity measures in the summer of 2010 (cutting the public sector wages by 25%, increasing the VAT rate with 5%, cutting the social benefits by 15% and so on). No inflow of cash in the country, but rather cash-out (heavy adjustment of the current account deficit). No steady reduction of the interest rate, but even nowadays the interest rate of the Romanian central bank is still high at 5%. Therefore the growth rate of the economy was much bellow potential, though became positive in the past two years.

In brief, the macroeconomic environment was not helping at all the recovery on the stock market. But more than that, we can identify also some specific factors for the Romanian market, responsible for its disappointing condition:

1. a very small and decreasing number of investors on the Stock market;
2. not a single Initial Public Offer (IPO) after 2008;
3. lack of involvement of the authorities in supporting the stock market (see the case Poland for best practices);
4. poorly trained market actors employees;
5. poor diversification of the tradable instruments
6. poor corporate governance and transparency.

Now, let us take a closer look to each of these factors.

The number of investors on the Romanian stock market is very low compared to the population (78.253[4] investors compared to a population of 20 millions). This number was decreasing in the past five years from the maximum reached in 2008 (about 100.000 investors). Moreover, only a small percent of this number are active investors. This low number of investors can be explained by a lack of investment culture in the country, low saving rate (the average bank deposit per capita is around 2.000 euro in Romania), but also a lack of trust and disappointment regarding the stock market.

Besides the reduced number of investors, we have a very "shy" presence of the local institutional investors like the pension funds or insurance companies (one of the explanations for the Warsaw stock market success was the Polish pension funds huge and constant investments – currently their share is about one third of this market capitalization). As a result, the Romanian stock market is very depended on foreign capitals and foreign investors' mood.

Everywhere in the world, the development of a stock market is very difficult, if not impossible, without IPOs (Initial Public Offers). The last successful IPO was more than five years ago, in 2007: Transgaz raised 65m euros from the BSE. Despite this very successful IPO, since then there were

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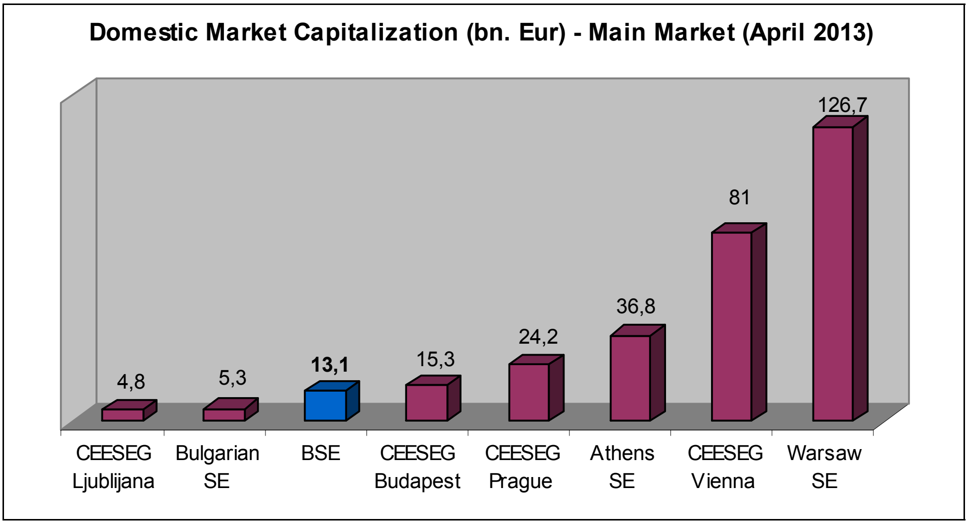
[4] As of Mach 2013, http://www.fond-fci.ro/docs/Comunicat%20de%20presa%20martie%202013.pdf

many talks, promises from the Government to privatize the state companies' trough IPOs on the stock market (important companies like Romgaz, Hidroelectrica, Nuclearelectrica, Tarom and so on), but nothing has happened. By contrast, most of the privatizations in Poland were made trough the stock market with the full support of the Government. On the other hand, the private companies are reluctant to go public or if they do it, some of them consider foreign markets (like London –see the A&D Pharma case). Even some listed companies are considering a quotation on another exchange (for example Fondul Proprietatea, the most important company on BSE, intends to have a secondary listing on the Warsaw Stock Exchange). As a result, the domestic market capitalization is one of the lowest in the region as we can see in the chart bellow (chart 2).

Chart 2. Domestic markets capitalizations in the Central and Eastern Europe



Source: BSE, June 2013[5]

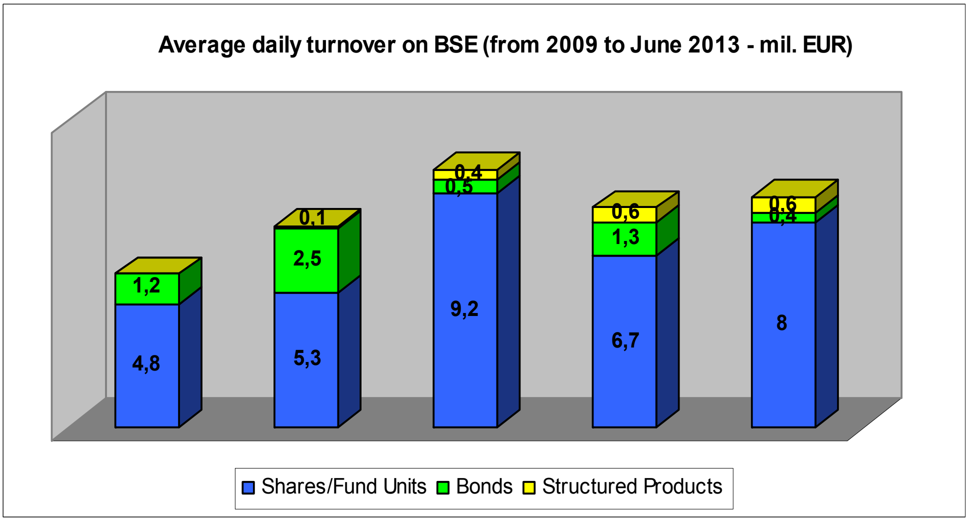
Besides the lack of support from the authorities, there is also a lack of professionalism or involvement among most of the stock market actors in developing the market. From the stock exchange to the intermediaries and all the way up to supervisory authorities we can find poorly trained

[5] Bucharest Stock Exchange Presentation, June 2003, http://bvb.ro/info/2013_06_03_BVB_IR_presentation_en.pdf, p.8

employees or with little motivation concerning the improvement of this dramatic situation. Actually, due to the market collapse and poor liquidity, the number of intermediaries decreased dramatically after the crisis because of bankruptcy or simply because lack of activity (from 76 brokerage houses in 2008 to only 46 today).[6]

Another factor for this evolution was the poor diversification of the tradable instruments: the bonds (state or corporate) were listed on the exchange very late; the short selling was regulated only recently and is almost inexistent, while the structured products market is incipient. As we can see from the chart bellow (chart 3) BSE is mostly an exchange for shares. True, there is another exchange, Sibex[7] which is mostly for derivatives, but also very small.

Chart 3. BSE - Exchange for shares



Source: BSE, June 2013[8]

Last but not least, current and potential investors (both foreign and local) on the Romanian stock market are reluctant to invest and point to the lack of transparency among the companies and especially among those listed

[6] BSE Statistics, http://www.bvb.ro/TradingAndStatistics/GeneralStatistics.aspx
[7] Sibex - Sibiu Stock Exchange, http://www.sibex.ro
[8] Bucharest Stock Exchange Presentation, June 2003, http://bvb.ro/info/2013_06_03_BVB_IR_presentation_en.pdf, p.8

on the RASDAQ segment of the BSE. There is also poor corporate governance and weak protection for the minority shareholders.

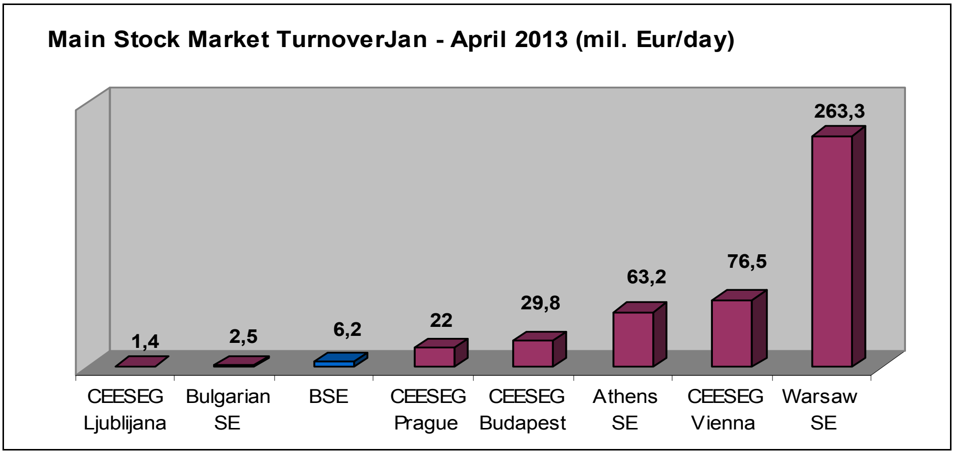
Therefore, feeling disappointed and seeing no hope for improvements, many active investors liquidated their portfolios (usually taking big losses), closed their accounts and stopped trading, probably forever.

3. Challenges and perspectives for the Romanian stock market

The main challenge for the Romanian stock market is to re-establish trust in the market and become more attractive, primarily for investors, but also for its client companies. Another challenge is the recovery race to reach its pre-crisis level and, on the other hand, the competition with the stock exchanges from the region.

These goals can be achieved mainly by developing the market. Romanian stock market is small even by regional standards. If we compare with a smaller former communist country, like the Czech Republic, the BSE capitalization is only half of the Prague Stock Exchange. If we compare with Poland, BSE is just about tenth in capitalization (see Chart 2). In terms of stock market turnovers, the situation is even worse: about one third of the volume traded on Prague and about forty times less than the volume on Warsaw (see Chart 4).

Chart 4. Stock markets daily turnover in CEE



Source: BSE, June 2013[9]

[9] Bucharest Stock Exchange Presentation, June 2003, http://bvb.ro/info/2013_06_03_BVB_IR_presentation_en.pdf, p.8

Potential solutions to this critical situation of the Romanian stock market resides in solving the difficult problems raised before: new IPOs (both from privatizations, but also form local private companies), attracting investors (foreign investors, but also locals – like the pension funds), public authorities involvement and support, financial education among the investors and the companies, new trading instruments (short selling) and improved transparency and corporate governance.

In perspective, the development of the Romanian stock market can be boosted by passing from the frontier market status to the emergent market one. This status will bring more visibility and access to a larger category of foreign investors. According to the well-known international equity index provider MSCI (Morgan Stanley Capital International), currently Romania is a "frontier market".

Table 1. Frontier and Emerging Markets

Frontier Markets						**Emerging Markets**		
Americas	**Europe & CSI**	**Africa**	**Middle East**	**Asia**		**America**	**Europe, M. East & Africa**	**Asia**
Argentina	Bosnia Herzegovina	Botswana	Bahrain	Bangladesh		Brazil	Czech Republic	China
Jamaica	Bulgaria	Ghana	Jordan	Pakistan		Chile	Egypt	India
Trinidad & Tobago	Croatia	Kenya	Kuwait	Sri Lanka		Colombia	Greece	Indonesia
	Estonia	Morocco	Lebanon	Vietnam		Mexico	Hungary	Korea
	Lithuania	Mauritius	Oman			Peru	Poland	Malaysia
	Kazakhstan	Nigeria	Saudi Arabia				Qatar	Philippines
	Romania	Tunisia	Palestine				Russia	Taiwan
	Serbia	Zimbabwe					South Africa	Thailand
	Slovenia						Turkey	
	Ukraine						United Arab Emirates	

Source: MSCI

MSCI divides the stock market of the countries around the world in three groups: developed, emerging and frontier markets. As we can see from the table bellow (table 1), Romania is classified in the weakest group among some of the most economically undeveloped countries in the world. Among European Union countries, we can only find five countries in this category: Bulgaria, Slovenia, Estonia, Lithuania and Croatia. Some of them, like Slovenia or Estonia are belonging to this group mostly because they are small countries.

For its classifications, MSCI is using three main criteria: economic development, market size and liquidity and, the last one, market accessibility.

Romania meets the first and the last criteria: economic development (in fact, here are requirements only for promotion to the developed markets group) and market accessibility.

Table 2. The MSCI Market Classification Framework

Criteria	**Frontier**	**Emerging**	**Developed**
A Economic development A1 Sustainability of the economic development	No requirements	No requirements	Country GNI per capita 25% above the World Bank high income threshold* for 3 consecutive years
B Size and Liquidity Requirements			
B.1 Number of companies meeting the following Standard Index criteria	2	3	5
Company size (full market cap) **	USD 516 mm[10]	USD 1032 mm	USD 2065 mm
Security size (float market cap) **	USD 37 mm	USD 516 mm	USD 1032 mm
Security liquidity	2.5% ATVR	15% ATVR	20% ATVR
C Market accessibility criteria			
C1 Openness to foreign ownership	At least some	Significant	Very high
C2 Ease of capital inflows/outflows	At least partial	Significant	Very high
C3 Efficiency of the operational framework	Modest	Good and tested	Very high
C4 Stability of the institutional framework	Modest	Modest	Very high

* High income threshold for 2011:GNI per capita of USD 12,475 (World Bank, Atlas method)
** Minimum in use for the May 2013 Semi-annual Index Review, updated on semi-annual basis
Source: MSCI[11]

[10] MSCI uses 'mm' as an abbreviation for 'millions'.
[11] MSCI Market Classification Framework, available at http://www.msci.com/resources/products/indices/global_equity_indices/gimi/stdindex/MSCI_Market_Classification_Framework.pdf

Solutions have to be found for the third criteria market size and liquidity. The size and liquidity criteria are based on the minimum investability requirements[12]. Investability mostly shows what the return potential of a company is on the long term.

Concerning the first sub-criterion 'company size', we can find on the BSE three companies who have a capitalization over the minimum required:[13]

1. SNP – Petrom OMV market capitalization: 7.721 mm USD
2. FP – Fondul Proprietatea: 2.661 mm USD
3. BRD – Groupe Societe Generale: 1.600 mm USD

Just two more companies from BSE have some chances to meet this criterion in the near future: TLV – Banca Transilvania (810 mm USD) and TGN – Transgaz (674 mm USD).

Concerning the free-float market capitalization criterion the same three companies meet also this one, plus Banca Transilvania[14]: SNP – 636 mm USD, FP – 2.288 mm USD, BRD – 637 mm USD and TLV – 689 mm USD.

The last sub-criterion, the security liquidity is only met by one company which is FP, which has an ATVR (annualized traded value ratio) more than 15% situated around 41%. Actually, FP trading is about fifty percent of the daily turnover on BVB.

As we can see from this analysis, BSE is only one sub-criterion away from the status of emergent market, but this one is hard to meet as long as the liquidity on the BVB remains so low and half of it is dependent on one company (FP). Some possible solutions can be increasing of the free float of Petrom trough a state secondary public offer, which will considerably increase the ATVR.[15] Another solution can be the listing of some important state owned companies. With regards to the latter, the listing of Romgaz, which has a market value of about 3 - 4 billion dollars, would be most effective.

[12] *Ibidem*, p. 1

[13] As of July 24, 2013

[14] While Banca Transilvania has a free-float of more than 85%, there is a limitation for buying stocks to maximum 5% of the share capital. Though, exceptions to this rule were made in the past: for EBRD in 2001 to acquire 15% or for Bank of Ciprus in 2009 to acquire almost 10%.

[15] "BVB de piata de frontiera la bursa emergenta", March 2011, http://www.bvb.ro/info/2011_03_30_BVB_Frontier_Emerging_ro.pdf

But also, listing Hidroelectrica or convincing some private companies to list on the BSE like BCR or RCS-RDS can help to reach this goal.

Conclusions

The potential of the Romanian stock market is important and there is enough room for growth. We are considering here the big potential IPOs for the state companies in their process of privatization (Romgaz, Hidroelectrica, Nuclearelectrica and so on). In addition, from the private sector, some of the fastest growing sectors of the economy are almost unrepresented yet on the BSE: like the IT&C sector or the agriculture. The BSE and the intermediaries should get more involved in presenting the benefits of going public for these companies, as well educating the local investors.

Anyhow, new listings alone will not help too much, if the other problems that we identified are not addressed. We are referring here to the diversification of financial instruments, improvement of transparency and better protection for minority shareholders, better education of the market actors, more governmental support of the stock market and so on.

If these things are not happening and, on the other hand, if the Romanian stock market does not succeed to evolve from frontier status to emerging market level, a possible last resort way out of this critical situation can be an alliance with another stock exchange(s) from the region. Today there is a strong competition for capital among the Central and Eastern European exchanges (and also at global level) and alliances like the one made by the exchanges from Budapest, Prague and Ljubljana under the Vienna Stock Exchange patronage (CEESEG),[16] might be a last resort solution for BSE. Even an important and respectable market, like the Vienna Stock Exchange, understood that nowadays it cannot accomplish much alone, against the Warsaw or Istanbul fast growing stock markets.

Unless serious (positive) steps are taken, unlike the period of inertia of the past years, most probably, the Romanian stock market will be just an "experimental" one.

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[16] CEESEG – Central and Eastern Europe Stock Exchanges Group

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8. Federation of European Securities Exchanges, [http://www.fese.eu/en/], 24 July 2013

9. Morgan Stanley Capital International, [http://www.msci.com/resources/products/indices/global_equity_indices/gimi/stdindex/MSCI_Market_Classification_Framework.pdf], 25 July 2013

STUDIA UBB. EUROPAEA, LVIII, 3, 2013, 107-132

THE IMPACT OF THE EURO IN THE MODERN ECONOMY CONTEXT

Dragoș Păun*

Abstract
The following paper presents the role that the Euro took after its introduction. The paper presents some of the key features that have led to the strengthening of the euro prior to the debt crisis. In the article the author will present some of the implications of the introduction of the euro in the new member states as well as the role of the euro in third countries. The paper presents the factors that make a currency international and the causes for which the euro is seen as an international currency. The paper also introduces some of the recent changes in the EMU and the need for change in the monetary union. The article also argues that there is a need for a stronger cooperation and cohesion in the fiscal policy.
Keywords: Euro, Eurozone, Banking union, monetary policy

Implications of the Enlargement of the Eurozone

In the process of the EU enlargement, each new state is subjected to a clause through which euro adoption is mandatory when the state in question meets the convergence criteria of the Maastricht Treaty. After the accession wave of 2004 the new member states have set diferent target years for the accession into the Eurozone according to each country profile

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as they were obliged to do so, unlike Great Britain and Denmark, who have the opt out option.[1] Slovenia became a member of the eurozone in January 1, 2007, followed by Malta and Cyprus in January 1, 2008, Slovakia in January 1, 2009 and Estonia in January 1, 2011.

Some of the states with a better evolution of fixed exchange rates and better fiscal policy indicators intended to adopt the euro faster. We must mention that EU member states from Central and Eastern Europe apply different exchange rate regimes, introduced through reforms from the first half of the '90s. For example, Poland and the Czech Republic have floating exchange rates, thus the fluctuations have to be limited to the levels established through the ERM II. Lithuania has a currency board monetary system, in which the monetary authority ensures fixed rates for the exchange rate[2]. The monetary regime of a state determines the necessary adjustment degree required for entering the eurozone. Unlike the states participating in the eurozone, who limited the liberty of their monetary institutions during the creation of the EMU, the states that hold currency board monetary systems, which imply the existence of strict fiscal discipline, must assign more space for maneuvers to the institutions managing the monetary policy. The possibility of maintaining the currency board regime during the participation to the ERM II was accepted by the ECB and was used by Estonia and Lithuania, who entered the ERM II in 2004 and Latvia, which joined in 2005.

All new EU member states have a public debt below 60% of the GDP, Estonia even 10.1%. Instead, some countries in the eurozone exceed government debt with 70% of the GDP.

The budget deficit criterion is met especially by the Baltic States. In part, reducing the budget deficit is a result of dynamic economic growth in these countries in recent years, fact which is reflected in increased revenues. Long-term interest rates have decreased due to economic policy reforms, competition in the banking sector and increased credibility of public policies

[1] K. Liebscher (Ed.), *Financial Development, Integration and Stability, Evidence from Central, Eastern and South Eastern Europe*, Edward Elgar Publishing Limited, 2006, p. 56

[2] M.S. Allam, A. Goerres, *Adopting the Euro în Post-Communist Countries, An Analysis of the Attitudes toward the Single Currency*, Koln: Max-Planck Institut für Gesellschaftsforschung, 2008, p. 6

in these countries, especially thanks to joining the EU. In this context, the states offered confidence to international investors, leading to lower interest rates. Although this has not led to a massive increase in direct investment,[3] opportunities for low-cost loans were created. Regarding inflation rate as a convergence criterion, it varies according to each state's economy.[4]

The European Commission assesses developments in each member state in the process of meeting the convergence criteria. In this technical process, single currency introduction holds political symbolism. The case of Lithuania, which was not considered fit to become a member of the EMU because of exceeding the inflation rate by 0.1%[5], may cause a debate on the significance of the convergence criteria, the concept of sustainability and equal treatment all EU member states, whatever their size and economic power. In addition, a strict interpretation of the criteria applied to new member states in the context in which the founder states violated the SGP rules may raise questions on the application of unequal treatment within the EU-28.

One of the most important consequences of EU enlargement is the increased economic and social diversity. The new member states have realised, until the economic and financial crisis of 2008-2009, a faster economic growth compared to eurozone members. The economic development of these countries is the result of economic integration between economies with different degrees of development. Even if this process depends on national policies, economic integration involves processes such as capital flows and labor migration in the more developed member states. Even in the favorable conditions in which the new member states have reached a share of services in their GDP comparable to the EU average, there are still important differences to be noticed.

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[3] J. Roy & P. Gomis-Porqueras, *The Euro and the Dollar in a Globalized Economy*, Ashgate Publishing Limited, 2007, p. 152

[4] Margarida Duarte, "The Euro and Inflation Divergence în Europe," in *Federal Reserve Bank of Richmond, Economic Quarterly Journal*, 2003, p. 54 [http://www.richmondfed.org/publications/research/economic_quarterly/2003/summer/pdf/duartesummer03.pdf.], 15 March 2010.

[5] Willem Buiter, *The Inflation Criterion for Eurozone Membership: What to do when you fail to meet it?*, European Institute, London School of Economics, 2006, p. 3, [http://www.nber.org/~wbuiter/crash.pdf], 10 March 2010.

Gaps show differences in productivity and at the level of economic structures, and stress the importance of flexibility of the new member states' economies. This is a decisive factor when facing economic shocks and for sustainable development. Flexibility can be assessed by analysing the labour market, wages and other variables.[6]

The Euro. Impact in the current monetary system context

In normal circumstances, the function of a currency is limited to the area in which it is issued. The currency becomes international when it holds a significant role outside the original jurisdiction and it is used by foreign agents. The factors that contributed to the consecration of the international status of the euro were the stability and reliability, the size and strength of the euro economy and its integration in international terms.[7] The role that the euro plays internationally is that of an investment, reserve, anchor, transaction currency and invoice type of currency.[8]

The advantages of a currency's international status include: implicit transfer of resources equivalent to interest-free loans, stimulating the macroeconomic policy flexibility thanks to the ability to rely on own currency to finance the external deficit of payments. We also mention the status and prestige that the global market dominance involves and an increased influence derived from other economic agents' monetary dependence.

The option to call for a particular currency, which internationalises its role, is based on three levels. First of all, in the initial phase of internationalisation, a decisive role is played by the confidence in the currency's value and the stability of the home economy. Then, an important attribute is the degree of liquidity, which in turn is based on a large financial market, characterised by diversity and flexibility. Thirdly, the currency must be based on an extensive trading network, i.e. it has to be widely accepted and traded. Thus, the higher the volume of transactions taking place in and with an economy, the higher the positive effect of increasing the size and reducing costs from using that currency. This aspect is defined as the

[6] J. Roy & P. Gomis-Porqueras, *op.cit.*, p. 158.

[7] Ottmar Issing, *The Birth of the Euro*, Cambridge University Press, 2008, p. 177.

[8] Wolfgang Mückl (Ed.), *Die Europäische Währungsunion*, Paderborn: Ferdinand Schöeningh, 2000, p. 84.

network effect and it refers to the fact that the behavior of an economic agent depends on strategic practices adopted by other agents in the same network.

Ever since its introduction, it was estimated that the euro would gradually acquire an international role. The extent of this role remained to be seen. The transition from the pound to the dollar as an international currency used predominantly took place gradually during the interwar period, the dollar supremacy culminating at the end of the Second World War. In 1973, through the collapse of the Bretton Woods system, the first signs of the weakness of the dollar appeared. With the end the dollar supremacy, the demand for dollar reserves decreased, and states opted for other anchor currencies. By introducing the EMS in Europe, the international profile of the German mark increased. However, many countries continued to relate to the dollar and the rapid growth of global trade and financial markets as a result of globalisation and liberalisation in recent decades led to an extensive use of the dollar in foreign exchange markets.[9] Discussions referring to a strong currency gave off the idea that this currency must acquire an international status. Some countries, however, such as Germany and Japan, deliberately discouraged the international role of the national currency, especially as a reserve currency, which suggests that it is not a decisive factor[10]. Factors to be taken into account in this context are the impact on financial markets, commodity prices and the monetary policy. Financial benefits may come from two sources: increased volume of trade implies lower costs of trading on financial and foreign exchange markets. Since these factors imply lower costs for goods, services and financial instruments, positive effects for the demand are taken into account. Secondly, states that issue currency that has an international role enjoy certain advantages. Thus, economic agents in that country, both public and private, which take loans, shall enjoy lower funding costs due to the international demand for their bonds. A state with an international currency has the ability to finance the budget deficit through

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[9] J. Roy & P. Gomis-Porqueras, *op.cit.*, p. 59

[10] Richard Portes, "The role of the euro în the world: past developments and future perspectives", in *London Bussiness School*, [http://www.europarl.europa.eu/comparl/econ/pdf/emu/speeches/20001123/portes/default_en.pdf], 20 April 2010

bonds denominated in its own currency, since other countries are willing to accept a large amount of debt at low cost to the issuer. This "exorbitant privilege"[11] is considered one of the reasons why the US current deficit has grown without coercive measures. Since this privilege destabilises financial discipline and allows the accumulation of financial imbalances, its importance is relative.

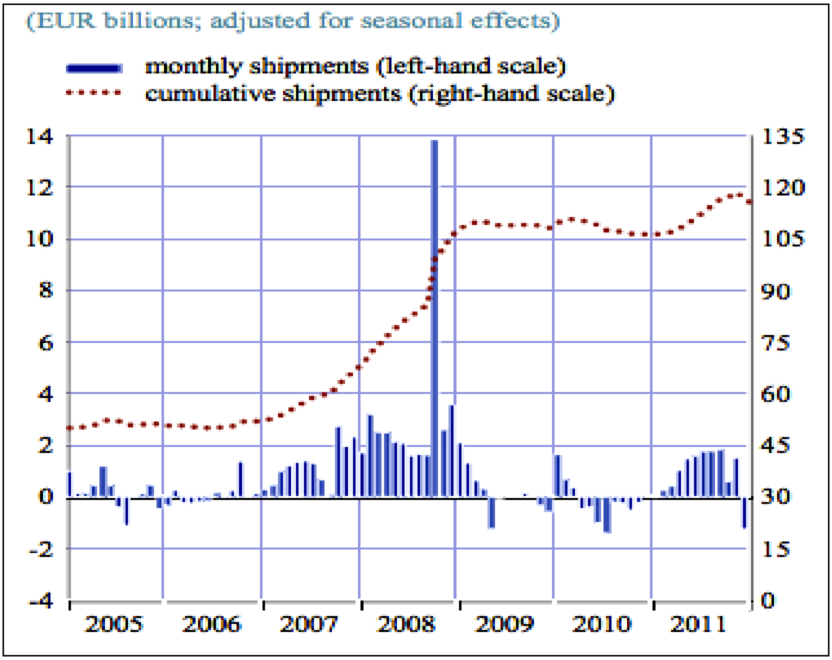
Besides financial implications, the international role of a currency has a symbolic value; thus, strong currencies are seen as a manifestation of power.[12] Regarding the euro, this symbolism is relative, given that this was not the motivation for introducing the single currency. The euro is a currency used by many states, involving a growing awareness and contributing to the supranational European identity. The euro was introduced to promote integration and economic welfare in the member states. With this aim, the mandate of the European System of Central Banks (Eurosystem) is to maintain stability in the euro area. Regarding the euro's international role, the ECB has adopted a neutral position, arguing that encourage or disruption of the euro's international status directly is not feasible nor desirable. This role must be the result of market forces acting on the basis of economic and financial developments. The fact that the ECB carries out the mandate to maintain price stability in the euro area contributes indirectly to the use of the euro internationally.

Another aspect of the international role of the euro is its use in third party countries for its purchase power. The residents of several developing countries with transition economies have a part of their finances in foreign currencies or foreign currency bank deposits. After the introduction of the euro, the monetary and financial institutions of the eurozone issued significant quantities of bills outside the eurozone. This figure is probably even bigger in reality, taking into account other transfer channels, such as tourism or the black market.

[11] John Freivalds, "Is the dollar's exorbitant privilege as the global standard at risk?," in *World Trade Magazine*, [http://www.worldtrademag.com/Articles/Column/BNP_GUID_9-5-2006_A_100 00000000000497000], 23 April 2010.

[12] R. Mundell, & P.J. Zak, *International Monetary Politics after the Euro*, Cheltenham: Mass Edward Elgar Publishing, Inc., 2005, p. 24, [http://www.netlibrary.com/Reader/], 15 June 2010.

Figure 1. Net shipments of euro banknotes to destinations outside the euro area (million EURO)



(Source: ECB, The International Role of the euro, 2012 [13]*)*

The contribution of the official sector to the international use of foreign currency consists in using it as anchor currency, intervention currency or for denominating exchange reserves in that currency. These three roles are related also because the euro indicates a geographical concentration in European countries that are not part of the eurozone. The option for a particular currency as anchor currency is important and involves a spillover effect on the use of the same coin for currency reserves and as intervention currency. Reporting national currency to another currency reduces costs and risks of using that currency and acts as an incentive for its internationalisation. For the countries of Central and Eastern Europe, the option for reporting their currency to the euro was something to be expected.[14] In contrast, the euro is

[13] https://www.ecb.int/pub/pdf/other/euro-international-role201207en.pdf, 01 June 2013.
[14] M. Baimbridge, & P. Whyman, *Economic and Monetary Union în Europe, Theory Evidence and Practice*, Edward Elgar Publishing, 2003, p. 133.

not the best option for Asian economies, mainly because the eurozone is not their main trading partner, and the dollar already held this position.

Table 1. International reserves

percentage		Dec. 2005	Dec. 2006	Mar. 2007	Jun. 2007	Sept. 2007	Dec. 2007
global	USD	66.9	65.5	65.0	65.0	63.8	63.9
	EUR	24.1	25.1	25.4	25.5	26.4	26.5
	JPY	3.6	3.1	3.0	2.8	2.7	2.9
	GBP	3.6	4.4	4.5	4.6	4.7	4.7
	other	1.9	2.0	2.1	2.1	2.3	2.0
industrialised countries	USD	73.0	71.3	71.4	71.2	69.6	69.4
	EUR	19.6	21.0	21.1	21.2	22.5	23.1
	JPY	3.4	3.5	3.2	3.1	3.1	3.1
	GBP	2.2	2.6	2.6	2.8	3.0	2.8
	other	1.8	1.6	1.6	1.7	1.9	1.6
developing countries	USD	61.7	61.2	60.5	61.0	60.2	60.7
	EUR	27.8	28.1	28.4	28.2	28.9	28.4
	JPY	3.7	2.8	2.8	2.6	2.5	2.8
	GBP	4.8	5.7	5.8	5.8	5.9	5.8
	other	1.9	2.2	2.5	2.4	2.6	2.2

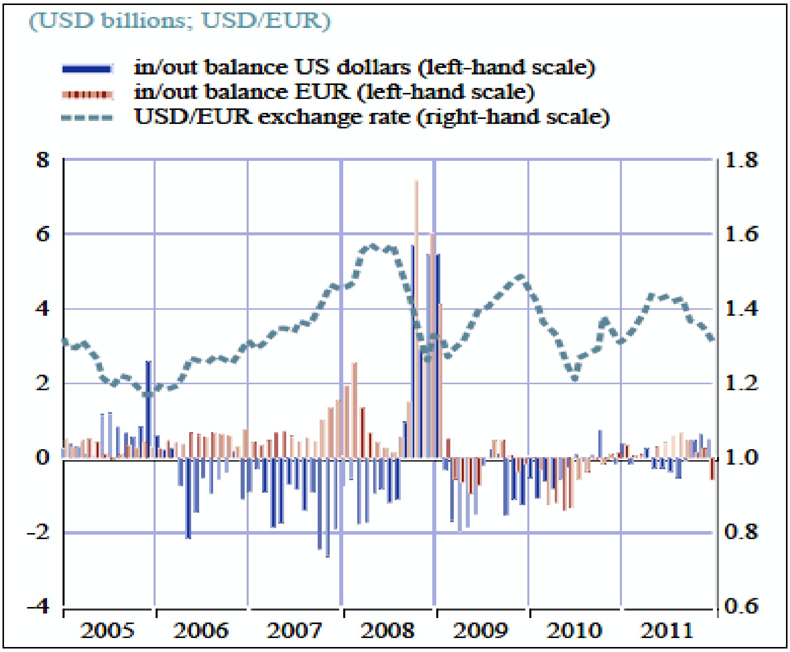
(Source: ECB 2008:47)

The above table shows a geographical preference of states partially or totally reporting their currency to the euro. Starting with December 2005, 40 out of 150 countries using the system have used the euro as a partial reference point or as a pegging currency. 18 of these countries are in Europe and 14 in the French franc zone.[15] For countries not participating in the ERM II, reporting their currency to the euro is a unilateral decision and does not imply any obligation from the Eurosystem. Instead, for countries participating in the ERM II, currencies are maintained between the fluctuation lines previously established, of 15%, around a predetermined parity between the euro and

[15] Anne Marie Gulde (Hrsg.), *The CFA Franc Zone*, International Monetary Fund, 2008, p. 6.

the currency in question. Two of the ERM II states, Latvia and Malta, have established a margin lower by only 1%, respectively 0 (Malta adopted the euro in January 2008).

Figure 2. Foreign currency exchanges in Russia by authorized banks



(Source: ECB, The International Role of the euro, 2012)

In what concerns the use of the euro for reserves, the states in question have considered several factors: the pegging currency, the direction of commercial flows and the invoice type of currency used, the denominated currency for loans, strategies to avoid risks, and political considerations. If we take a look at the states that use the euro for reserves, we notice a preference of developing countries 21% higher than that of developed countries. In analogy with the case of the euro as pegging currency, we notice a regional preference for the euro in Eastern Europe countries. It is considered that Russia has one of the largest foreign exchange reserves denominated in euros, about one third of the total foreign exchange reserves, fact reflected in the commercial relations report.[16]

[16] J. Roy & P. Gomis-Porqueras, *op.cit.*, p. 78

Moreover, some countries in South America hold a significant part of their reserves in euros. This option is motivated by commercial flows and financial links with the euro area. On the other hand, oil-exporting countries in the Middle East hold a small share of their reserves in euros, although the idea of diversification is taken into consideration. The functions of the euro as a pegging and reserve currency are related to the intervention function. While few central banks make their intervention currency known, statements of the authorities show a preference for the euro in European countries.[17]

Table 2. Importance of the euro in the international financial system

International debt titles (generic definition), in billion USD			
1995			
all currencies		EUR	USD
2.846,8		777.7	1.104,1
in percentages, all currencies		27.3	38.8
2007			
22.713,5		11.008,5	7.921,8
in percentages, all currencies		48.5	
all bonds, in billion USD			
1995			
all currencies		EUR	USD
international	2.846,8	777.7	1.1 HI
national	24.825,1	6.319,3	10.510,4
Total	27.671,9	7.097,1	H. 614,5
total in percentages, all currencies		25.6	42.0
2007			
international	22.713,5	11.008,5	7.921,8
national	57.173,0	12.735,3	24.429,0
Total	79.886,5	23.743,8	32.350,8
total in percentages, all currencies		29.7	40.5

(Source: IdW 2008:80)

[17] Jurgen van Hagen (Hrsg.), *Monetary and Fiscal Policy în an Integrated Europe*, Berlin: Springer Verlag, 1995, p. 202

Euro – dollar relationship

We have analysed the euro-dollar relationship from the moment of the de facto introduction of the euro in 2002. As stated in the previously, the international role of a currency is based on several basic factors. Firstly, the economic strength and stability of the currency in the country of origin play an important role in the emergence process of a currency on an international level. In a position which states that the value of a remains the same or increases, the currency is preferred as a reserve currency. It is also used as a measurement unit and exchange tool if the currency remain stable. Thus, currency stability, i.e. a low and stable inflation rate, is relevant to its international status, while a sustainable economic policy is essential for achieving this goal.

The second important factor for the emergence of a currency is the size of the home economy. Size gives other positive effects besides the advantage of reduced susceptibility in the case of external shocks. The larger the economy, the greater the absolute flows of private investments, the emissions of government bonds and trade. These large flows exert pressure on international transactions to be denominated in local currency. This context has a spillover effect, emphasising the role of international currency: if trade is invoiced mainly in a certain currency, that state may decide to report its own currency to that currency and to create reserves. For example, the US dollar became the main billing currency for goods trade, becoming the most effective exchange option, widely accepted and with low transaction costs.

However, the size of the economy is not a sufficient condition for a currency to gain an important international role, an example being China, which became in 2010 the second economy in the world. One relevant reason is the immaturity of local financial markets and the lack of capital convertibility.[18] In view of the international acceptability of a currency, foreign residents must be able to acquire, store and dispose of financial instruments denominated in that currency. This requires capital and accessible financial markets, which shows the third factor necessary for the international status of a particular currency: a broad, solid and properly regulated local financial system.

[18] J. Roy & P. Gomis-Porqueras, *op.cit.*, p. 63

Even in the conditions of a stable value, a broad economy and strong financial markets, a currency requires considerable time to be accepted internationally. For example, it took the US dollar several years to surpass the pound. This is because the internationalization of a currency does not occur simultaneously in all its aspects. The reserve currency function is developed in the beginning, alternative currency being then used in other areas as well. Thus, the currency must overcome inertia and modify already established practices on externalities and functional synergies related to them.[19]

Externalities refer to the convenience and cost advantage to make use of a currency widely used by other economic agents. Therefore, the more widespread the currency, the more attractive it is. Functional synergy refers to the advantage of using for a function already a currency already employed in a related function. Thus, if a currency is accepted as payment, motivation to use it as a reserve currency increases. In order for a currency to achieve international recognition, it is necessary to destabilise the currency already holding an international status, given that in equal conditions it is considered that the already accepted currency will have a decisive advantage.

After the introduction of the single currency, some analysts affirmed that the euro has a significant potential to play an international role.[20] The euro was expected to be welcomed on the international scene, even if it had to demonstrate a certain level of stability, a condition made possible through the independent mandate of the ECB to maintain price stability with a positive effect on currency stability. After the introduction of the euro, economic forecasts attributed to the US a faster and more favorable growth trend due to low unemployment and favorable framework. At the same time, it was predicted that failure to achieve structural reforms in the eurozone in due time could reverberate negatively on economic performance.[21] On the other hand, forecasts showed that the euro area would enjoy greater stability, while the US government debt would increase and the budget

[19] Onno de Beaufouert Wijnolds, "Living up to expectations? Taking stock of the international role of the euro", *Conference Paper, University of Miami, Washington*, 2006, p. 6, [http://www6.miami.edu/eucenter/conf/Wijnolds_euro06final.pdf], 10 June 2010.

[20] Ottmar Issing, *op.cit.*, p. 177

[21] IMF, Regional Economic Outlook, International Monetary Fund, 2008 [http://www.imf.org/external/Pubs/FT/REO/2008/EUR/ENG/ereo0408.pdf], 10 June 2010

deficit would raise question marks regarding the dollar's stability.[22] In conclusion, there were sufficient signals meant to show that the euro would be well received internationally, that it would gradually develop to that level but without putting the dollar supremacy at risk.

Official use of an international currency is dictated by the private sector. When the euro was introduced, financial markets were fragmented. The euro exerted the necessary pressure to harmonies them. Moreover, in 1999 the Financial Services Action Plan was introduced,[23] a legislative program largely completed in 2004 with the purpose of removing the obstacles that stood in the way of financial market integration.

In what concerns exports outside the euro area, the predicted figure was 58% after the creation of the EMU. This was based on invoice operations in currency of the EMU participating states in the ‘90s. In 2004 this figure was confirmed, the role of the other currencies being taken over by the euro. The use of the single currency has also increased in the case of imports, where it is still lower compared with exports. Although initially the use of the euro in the service area proved to be slow, its share has gradually increased, at the same time with the share in the goods area. The exception was Greece, where service exports with invoice currency in euros remained limited, given that most of these services included shipping, which traditionally used the dollar.

Among the countries outside the eurozone, new EU member states have intensified the use of the euro as invoice currency. It was expected that the new EU members would make transactions in euros, given that the currency would be used in the future in these countries. Thus, transaction costs are handled by both countries equally and are not exposed to fluctuations of national currencies. Outside Europe, the euro is used as invoice currency on Asian markets, but this use remains minor. Euro performance from the perspective of the exchange rate shows that the currency started from an initial value of $1.17, dropped to $0.83 at the half of 2000, and continued until 2002 at a level below the euro-dollar parity. This situation changed in 2004 when the euro went back to $1.35 while maintaining above the dollar level.[24]

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[22] J. Roy & P. Gomis-Porqueras, *op.cit.*, p. 65

[23] EC, Introduction of the euro in Slovakia. Analytical report, 2009 [http://ec.europa.eu/public_opinion/flash/fl_214_en.pdf], 10 September 2010

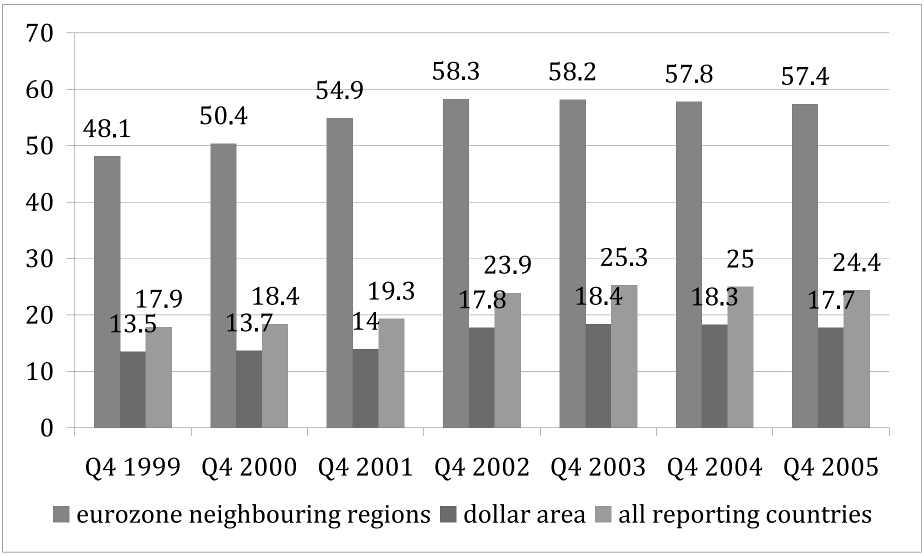
[24] John Williamson, "The dollar euro exchange rate", *Economie Internationale*, nr. 100, 4/2004, pp. 51-60, [http://www.cairn.info/revue-economie-internationale-2004-4-page-51.htm], 21 September 2010

In analysing the international role of a currency we should consider, in addition to the exchange rate, the currency's use by public and private economic agents. Central banks have adopted the euro for the intervention policy as pegging currency or as part of foreign reserves. In the absence of political pressure, banks choose the currency that had the largest contribution to managing exchange rates and the monetary policy.

Romanian to English translation

According to the ECB, the euro's international role is characterised by regional dispersion. The dollar holds supremacy as the global transaction currency. This is due to the large size of the US economy and low transaction costs. The dollar is the preferred currency in invoice operations, representing about half of the total exports worldwide and thus doubling the total US exports. The German mark used to cover 15% before the introduction of the euro. This role was taken over by the euro after 1999. Through the EU enlargement in 2004 and 2007, the new member states were obliged to adopt the euro in the future. The moment of adopting the single currency depends on the ability of meeting the convergence criteria set by the Maastricht Treaty.

Figure 3. Euro share in global reserves by region (percentage)



(Source: ECB 2008:63)

Euro supporters affirm that the trajectory of the euro is favourable thanks to the EU enlargement in Central and Eastern Europe, a process through which the single currency will have a trading area larger than that of the dollar.[25]

When the single currency was introduced, it was expected that it would occupy the second position internationally, after the dollar, fact that was confirmed. The euro surpassed the role played by the German mark in the '90s and in some sectors it surpassed the combined role of the currencies it replaced. Its influence is more pronounced in the region close to the euro area, according to a geographical preference. Therefore, the prediction that the euro does not destabilise the dollar supremacy is correct[26] but we cannot eliminate the idea that in the future the euro may gain a position equal to that of the dollar. Some analysts suggest creating an international monetary balance between the euro and the dollar, in which each currency will have a share equal to 40% in a period of five to ten years.

The European Banking Union

The European Union and the European Economic and Monetary Union have been suffering in the last years from a major crisis, which has affected the image of the Euro. The countries that are part of the EMU have realized that the currency is going through a crisis and have tried to find solutions. At the very creation of the EMU there have been voices that argued the fact that the EMU has limited mechanisms and that the fiscal policy can not work with any cohesion to the monetary policy.

The EMU has reached one its goals, the strengthening of the common market and has led to multi-national corporations that extend beyond national borders. Foreign Direct Investments have increased among the member states. But 11 years after the introduction of the euro it was also proved that the Growth and Stability Pact and other mechanisms that were in place did not work. One of the answers to the question of what

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[25] Hans Joachim Tesmer, *The Euro under American attack? The development of the Euro since its January 1999 Debut*, Hamburg: Mauke Verlag, 2001, p. 42

[26] D. Sumual, "Is it the end of US Dollar Supremacy?", *The Jakarta Post*, October 2003, [http://www.thejakartapost.com/news/2003/10/23/it-end-us-dollar-supremacy.html.], 10 March 2010

went wrong, especially after the Crisis in Cyprus, 2012, was the lack of overseeing the banking sector, which is one the keys in a strong economy.

European leaders have assumed this issue and as solution they are working towards a banking union, which would regulate and supervise the trouble banks and also major financial institutions at a supranational level. Currently, the banking union refers only to the euro area, but the main aim is to include all Member States.

The creation of a banking union favors the Member States from two points of view. First of all it provides stability by weakening the link between heavily indebted governments and troubled banks, secondly, in the long term, the European banking system will become more sustainable. Having a strong banking system to support the currency could lead in the long run to a situation where crisis such as the last could be avoided.

Unfortunately, the creation and implementation of a banking union is much more difficult than its conceptualization. The European financial system, the banks have a central role as providers of about three quarters of total loans, with a very large influence on the national economy. Thus, their supervision involves technical problems, due to differences in national banking procedures from state to state and the area that it has to cover (the euro area/EU). Besides technical difficulties, their supervision may be complicated by the degree of subjectivity in this area, affecting the loan mechanism, which affect growth and jobs. Due to this, Member States have so far avoided the creation of such a union, but the main reason behind this decision is the severity of the euro crisis and the pressure on the Euro.

As already mentioned, the proposed banking union, currently covers only the euro area, although it is desirable that in the future it would include all EU member states. But at the moment this is impossible because of political implications, see the position of Britain. This decision is currently the best option and can solve the euro crisis. However, the disadvantage is the difficulty of coordinating the relationship between the euro area and the outside area and the relationship between central banks.

Although this option seems the most optimal, Britain’s "opt out" raised many questions, since the decision to leave aside the financial center of Europe, London, could have negative effects on bank union. In this way, there is a risk of two centers of financial supervision, leading inevitably to poor regulation, which would opt for the more flexible rules available. From another perspective, the creation of a single supervision throughout the Union can be considered a sensitive element. For the success of this project there is a necessity to have a proper structure and to avoid "desire" of an entity of the Euro zone to exercise control over the entire EU.[27]

The financial crisis has shown that an extremely interconnected and integrated area, such as the Euro zone, and the European Union requires a strong institutional framework. An extremely important element for strengthening of the institutional framework is creating financial banking union, and the first step is the implementation of the Single Supervisory Mechanism (SSM).

This mechanism consists of competent national authorities and the European Central Bank, but there is also the possibility for countries outside the euro area to take part in this new concept. SSM will be implemented in 2014 and will operate as a system that assists national supervisory authorities, but at the same time possesses a powerful decision-making center. Through this mechanism all banks in the euro area will fall within SSM, meaning about 6,000 banks. However, the fact that all banks in the euro area will fall under SSM, does not imply that the ECB will conduct direct supervision of all banks. This system is highly decentralized, as knowing the competent national authorities operating environment, but the ECB shall define provisions and surveillance system, and most importantly will have the power to initiate direct supervision of any bank or group of banks, when deemed necessary.[28]

The way the powers between the European Central Bank and national authorities will be divided not yet fully determined, but the fact is that the ECB will have powers to conduct investigative activities and authority to order and apply corrective measures, fines and including the possibility of closing a bank request. However, national authorities will continue to have a role in monitoring.[29]

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[27] D. J. Elliot, „Key Issues on European Banking Union", in *Global Economy and Development*, November 2012, p. 10.

[28] Banca Centrală Europeană, *Stabilirea Mecanismului de Supraveghere Unic, primul pilon al Uniunii bancare*, [http://www.ecb.int], 10 April 2013

[29] D. J. Elliot, „Key Issues on European Banking Union", in *Global Economy and Development*, 2012, p. 20

Fiscal Integration – a possibility?

The European Union is seen by some critics as an unusual entity, as monetary policy is decided at European level, while fiscal policy is left to the national states. We have argued in this article about the controversial decision to split the two policies. Until recently, the idea of a fiscal integration was discussed only in academics and "think tank" sites, without having a major effect on the process of developing policies. But the financial crisis has forced European countries to turn the idea of a fiscal union into a goal. But there are also conflicting visions, Steve McKay believes that fiscal policy must fall within the exclusive competence of national states, arguing the lack of support from citizens which could bring long-term damage Monetary Union.[30]

Clemens Fuest and Andreas Peichl proposed five main elements of a possible fiscal integration: 1. fiscal rules for member states, as well as rules on the coordination and supervision policies; 2. crisis resolution mechanism; 3. joint guarantee for debt; 4. fiscal equalization and / or other mechanisms. However, the idea of a fiscal integration is far from being defined what it means or how it should be done, raised a number of questions and discussion, without giving a clear idea of the direction and sure to be adopted in this matter.

The ability to transfer part of European financial responsibility has raised a number of questions, however, most Member States of the European Union considers that the need for budgetary oversight and financial default is necessary for the success of the euro area. By 2008, countries have accumulated significant private and public debt, thus affecting the entire euro area. This vulnerability has been based on the following reasons. First EU monetary policy combines centralized policy with decentralized responsibility for the majority of economic policies (the responsibility of national states), and there is no centralized policy based on budget or centralized budgetary capacity. Secondly, the Member States did not respect the provisions of the GSP. Moreover, the coordination of national policies was based on coercive instruments with limited impact. Third, the failure of financial institutions had an extremely negative effect on public finances, as these institutions play an important role in stimulating an economy and the sustainability of

[30] B. M., Markiewicz, A., Jonung, L., "A fiscal union for the euro: Some lessons from history", in *NBER Working Paper*, No. 17380, 2011, p. 3.

public finances. Central banks increase money supply in 90 years, and new approaches to risk assessment led to an excess of global liquidity on an incorrect assessment of the risks to public and private documents and credit expansion, thus fueling the already existing property bubble.

In the last four years the EU has adopted a number of decisions on the supervision and regulation of financial institutions, but it has also developed an ambitious project for financial reform in order to strengthen and stabilize institutions that have proved particularly vulnerable during the economic crisis. The financial reform program is based on a report prepared at the request of the European Commission, by Jacques de Larosière, former managing director of the IMF and Governor of the Banque de France[31]. In the report, it was proposed a new system of financial supervision, complemented by an Early Warning Mechanism (EWM), led by the European Central Bank. EWM can be an added value to the policy process, since its purpose is to detect vulnerabilities and risks to avoid potential crises.

Another important element for strengthening the financial institutions of the European System of Financial Supervisors, it is composed of three European Supervisory Authorities "European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets (ESMA) - and from a macro-prudential supervisory body, the European Systemic Risk Board (ESRB)."[32] one of the problems faced by EU financial policy refers to the differences in the financial rules and enforcement methods the supranational provisions in this area. The purpose of this system is to supervise, in cooperation with national authorities, harmonization and ensure proper performance and strict new requirements.

In the last four years the EU has implemented a series of tools to strengthen financial institutions and create a stable environment, however, a classic fiscal integration can not yet be applied to the euro area. At the same time, we must recognize that European countries have taken important steps to ensure economic and financial stability. One of the elements is important to the economic stability of the European Semester, the annual

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[31] Comisia Europeană, *Proiect pentru o uniune economică și monetară profundă și veritabilă, Lansarea unei dezbateri la nivel european*, 28 noiembrie 2012, p. 7, [http://ec.europa.eu,] 10 May 2013

[32] *Ibidem*, p. 8.

cycle of economic policy coordination. The European Semester focuses on the first six months of the period in which European states coordinate their Budget and economic policy objectives according to European standards. The first step is when the Commission adopts the Annual Increases in Growth, usually at the end of the year, and it establishes priorities for public finances and economic growth. Even if the initial report is based on general recommendations for all states in the final phase, the Commission shall prepare specific recommendations for each of them, over which nation states give their acceptance and the Council approves them.

To address shortcomings fiscal coordination, the European states have adopted two complex projects Two Pack and the Treaty on Stability, Coordination and Governance in the EU.

Two Pack will come into force in 2014, and the first drafts of the national budget will be delivered to the Commission on October 15, 2013. Transposition of provisions will be made easier, since it applies directly, and therefore does not need to be transposed into national law. The two regulations are based on Six Pack and apply only to the euro area, the first regulation refers to strengthen coordination of national budgets, and the second regulation to improve fiscal oversight. More specifically, the first regulation refers to the direct supervision of national budgets.

Due to the "spill-over" effects of national fiscal policies in times of crisis, risks are shared in a significant extent. The Member States shall provide the Commission budget together with the macro-economic forecasts on which the plan is based on. An independent institution will oversee the fulfillment of common regulations. This regulation is considered to be a preventive tool of the Growth and Stability Pact, because if the Commission considers that the budget plan does not meet the provisions of the GSP, it may request review of the plan and provide recommendations that nation states must take into account. The second regulation concerns the strengthening of financial supervision under which the Commission can decide, if need, a stricter supervision of states considered financially vulnerable. Also, this regulation provides for stricter supervision States receiving precautionary financial assistance.

Treaty on Stability, Coordination and Governance in Economic and Monetary Union, known as the 'fiscal compact' came into force on 1 January 2013, and aims to strengthen fiscal discipline in the eurozone. This treaty is based on three main elements fiscal stability, coordination and governance in the EU economy euro area. With regard to fiscal stability, the requirements are similar to those of the GSP deficit below 0.5 % and debt below 60%. The main change is the method of punishment, which is simplified and temporary deviations are allowed only under special circumstances (eg financial crisis). To ensure compliance with these provisions will be a national supervisory authority, and in case of deviation, it may refer to the European Court of Justice, having the right to amend to 0.1% of GDP. The provisions relating to the coordination of EU economies require a partnership between the EU members, through which the exchange of information and discussion about the reforms to be implemented at national level. This news is extremely important because of experiences during the financial crisis of 2007-2008, when the Member States have implemented different provisions to tackle the crisis, but without analyzing their effect in Europe.

This pact is believed to be essential for completing economic and monetary union, and may be the necessary step to save the euro and at the same time strengthen its position in the global market.

We strongly believe that EMU will not be complete without fiscal integration, but at the same time, the question arises, how democratic is a fiscal integration without political base. At the moment the EU is trying to establish some common fiscal rules for the eurozone and a common tool for crisis resolution.

Conclusions

The euro proves to be an instrument of full economic integration of the community space and also an accelerator of the political one. The importance of the euro is also relevant for other regions, the currency having received an international position along with the dollar.

Among the future challenges for the euro we can list the implementation of macroeconomic policy at the EU level, review of the Stability and Growth Pact, the EMU economic governance effectiveness, competitiveness and flexibility of the European economic and social model.[33]

[33] Mark Townsend, *The Euro and Economic and Monetary Union*, John Harper Publishing, 2007, p. 267

The Eurobarometer shows that the euro has become a symbol for EU citizens.[34] After its effective introduction in 2002, the euro began to be perceived as part of the European identity. Thus, in a study by Eurobarometer on EU citizens regarding the meaning of the EU for the citizens, the first place was represented by the freedom of movement, with 50% of the respondents, followed by the euro, with 49% of the respondents. Relations within the EMU regarding economic growth are complex and varied. We can differentiate direct and indirect effects that overlap or influence each other. Since the period of time that was analysed covers only 10 years, and economic growth is a lengthy process, market research demonstrates only empirically the general phenomenon of economic growth. Some indicators, such as the decrease of transaction costs, have a positive effect measured at 0.3 to 0.5% of the GDP. Then, eliminating the exchange rate risk encourages investment and economic growth. In 1997 studies forecasted an economic growth of up to 3% in the euro area in the first 5 years. The EMU has been shown to contribute to a real budget discipline in the member states. Through institutional reforms such as the SGP, member states entering the EU adopt financial policies aimed towards fulfiling the ECB mandate of financial stability and social systems reform.

Financial market integration is carried out on the money market or in the process of harmonisation on the government bonds market.[35] The EMU has allowed the creation of this large financial market in participating countries. These issues are particularly relevant for financing companies on the financial market.

The future role of the euro – as we have stated in this chapter – depends on its function as an anchor, reserve and intervention currency. Also defining is the process of integrating financial markets in the EMU and expanding the euro influence by EMU enlargement with new members, notably Great Britain. Denmark could join the euro area after experiencing the economic and financial crisis.

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[34] R. Fishman, A. Messina, *The Year of the Euro, The cultural, social and political import of Europe's common policy*, University of Notre Dame Press, 2006, p. 69

[35] K. Liebscher, (Ed.), *Financial Development, Integration and Stability, Evidence from Central, Eastern and South Eastern Europe*, Edward Elgar Publishing Limited, UK, 2006, p. 436

The international role of the euro also depends on the evolution of economic performances in the eurozone compared with the US. The eurozone has to increase its economic growth rates by increasing structural flexibility, according to the Lisbon Agenda. The perception regarding a possible devaluation of the dollar in relation to the euro may favour an increased international role of the euro.

The ECB mandate explicitly guarantees the internal stability of the single currency and in this sense, it has established a positive development in ensuring price stability. The ECB will continue its policy to refrain, to encourage or to inhibit the direct use of the euro outside the eurozone. Thus, market forces will decide the international role of the euro.

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STUDIA UBB. EUROPAEA, LVIII, 3, 2013, 133-148

THE EXCHANGE RATE CHANNEL AND ITS ROLE WITHIN THE MONETARY POLICY TRANSMISSION MECHANISM

Horațiu Dan*

Abstract
This paper addresses the subject of the monetary policy transmission by focusing on the exchange rate channel, the channel responsible for the propagation via exchange rates of the effects induced by the central bank's monetary policy decisions. These effects target variables such as the levels of output and consumption, the unemployment rate or inflation. The purposes of the study are of achieving a deeper understanding of the processes within the exchange rate channel and providing with a general framework describing how the channel may function depending on the economic environment.
Keywords: exchange rate channel; monetary transmission; monetary policy; central bank decisions; inflation

1. Introduction

The monetary policy transmission mechanism is defined in several ways, which we hold as being complementary in offering a detailed picture of the mechanism's functions and structure. According to Taylor, the monetary policy transmission mechanism is defined as the process through which monetary policy decisions are transmitted, with effects on the real gross

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domestic product and inflation.[1] Ireland provides with a more detailed definition. In his paper, he regards the transmission mechanism as describing "how policy-induced changes in the nominal money stock or the short-term nominal interest rate impact real variables such as aggregate output and employment". He also notes that "specific channels of monetary transmission operate through the effects that monetary policy has on interest rates, exchange rates, equity and real estate prices, bank lending, and firm balance sheets".[2] The European Central Bank's insight completes the picture: "The transmission mechanism is characterized by long, variable and uncertain time lags. Thus it is difficult to predict the precise effect of monetary policy actions on the economy and price level".[3]

The monetary policy transmission mechanism is comprised by a series of five channels, each governing a specific cause-effect structure: the expectations channel, the interest rate channel, the asset price channel, the credit channel and the exchange rate channel.[4] This paper will focus on analyzing the processes that take place within the exchange rate channel, which describes how the exchange rate influences key economic variables such as the output level, employment or inflation. The channel becomes more important in the context of the high degree of economic and financial globalization, as well as that of the stronger interdependencies that are being established between the world's economies. This dynamics sheds a new light on the exchange rate channel and its role within the monetary policy transmission mechanism, as its effects are without doubt augmented by the socio-economic evolution of the new millennium.

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[1] John Taylor, "The Monetary Transmission Mechanism: An Empirical Framework", in *The Journal of Economic Perspectives*, Vol. 9, No. 4., 1995, pp. 11-26

[2] Peter Ireland, "The Monetary Transmission Mechanism", in Federal Reserve Bank of Boston, *Working Paper 06-1*, 2005, [http://www.bos.frb.org/economic/wp/wp2006/wp0601.pdf], accessed 1 May 2013

[3] European Central Bank, *Transmission Mechanism of Monetary Policy*, [http://www.ecb.europa.eu/mopo/intro/transmission/html/index.en.html], accessed 15 February 2013

[4] Norman Loayza, Klaus Schmidt-Hebbel, "Monetary Policy Functions and Transmission Mechanisms: An Overview", in Norman Loayza, Klaus Schmidt-Hebbel (eds.), *Monetary Policy: Rules and Transmission Mechanisms*, Santiago: Central Bank of Chile, 2002

2. The Exchange Rate Channel and the Interest Rates: the Interest Rate Parity

As a first consideration in our analysis regarding the exchange rate channel, we need to underline the strong connection between the exchange rate and the interest rates.

Changes in interest rates for pair currencies influence the value of exchange, both in the spot and in the forward market. Although the way in which these values are altered constitutes, if not a veritable controversy among economists, at least a lack of consensus regarding the correct answer, we consider that this debate generates valid solutions to the question, which we will present in the following paragraphs. Also, we consider that these answers, although not able to provide with generally valid certainties, which would without any doubt be preferable, can successfully be used in outlining the way in which key economic mechanisms operate and for this reason we will employ them in our study of the functioning of the exchange rate channel.

One of the traditional economic theories in this field, known as the interest rate parity, states that the currency with a risen interest rate will depreciate with regard with its pair and vice versa, the currency which has a relatively smaller interest rate is prone to appreciate[5]. Although it's an affect that might seem counter-intuitive at the first glance, this process takes place, as the theory states, because otherwise market players will benefit *ad infinitum* from arbitrage by borrowing in the cheaper currency and investing in the one which just experienced a rise in the interest rate, seeking to enter in a reverse transaction at a future moment in time, pay the debt and record a risk free profit due to the difference in interest rates. The theory presents two subcomponents, thus referring to both possible situations, more precisely the one in which market players enter into forward contracts in an attempt to lock their profits and the one they don't. The two situations are described by:

- the covered interest rate parity for the case in which a futures contract is entered into;

[5] Francis Breedon, Dagfinn Rime, Paolo Vitale, *A Transaction Data Study of the Forward Bias Puzzle*, Discussion Paper 7791, CEPR, 2010, p. 3

and

- the uncovered interest rate parity, for the situations where futures contracts are not used, in which case expectations come into play and predict a future spot value that will allow for profit to arise.

Both these subcomponents of the interest rate parity theory state that, in a context characterized by a free flow of capital, it's impossible to make profits by following the above mentioned strategies, as the offer and demand mechanism will ensure that the forward or future spot quotations will imply an appreciation of the currency with a relatively smaller interest rate, appreciation that, *ceteris paribus*, will be equal to the difference between the initial and the modified levels of the interest rate[6], thus annulling any potential profits and delivering an equivalence between investments made in one currency or another. At the same time, the capital flows that migrate away from investments denominated in the more expensive currency will affect the balance between offer and demand, thus putting pressure on interest rates for both currencies by raising the interest rate for the initially cheaper currency and lowering them for the initially more expensive one. These to processes will continue until parity is reached again.

However, taking into consideration that there is a single spot valuation and a multitude of forward rates (for different maturities), without entering into any conflicts with the main principle behind the interest rate parity theory, it can be argued that there is another possible outcome of a change in the interest rate. Because of the superior demand for the currency that pays a higher interest, the spot price of the exchange rate will move in the favor of this higher paying currency, while the forward price, regardless of the maturity date, will show a depreciation of the same currency. This depreciation will be equal with the sum of the absolute value of the difference in the spot exchange rate and the extra interest which triggered the adjustment process in the first place.

Also, it is important to mention that the fluctuations in the exchange rate triggered by changes in interest will take place only until the exchange rate and the interest rate reach a new point of equilibrium. Once the new

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[6] Robert Feenstra, Alan Taylor, *International Macroeconomics,* New York: Worth Publishers, 2008.

level of the interest rate is reflected in the exchange rate, future fluctuations, in the absence of a new change in interest for one of the two currencies, will represent the consequence of other causes. Similarly, other causes (for example changes in the fundamental structure of the economy) can affect the exchange rate, overlapping their effects with the one generated by the change in the real interest rate.

Once past the border of the strictly theoretical zone, the concept of interest rate parity must confront the observations highlighted by the empirical literature, which, from a certain point, invalidate the theory.

Regarding the covered interest rate parity, the theory holds pretty well, as a cvasi-consensus is present among economists. The majority of the empirical studies, from which we nominate the ones developed by Bahmani-Oskooee and Das,[7] Clinton,[8] and Thornton,[9] is confirming the theory's validity, obtaining results that, even if not unanimous, represent statistic relevance and thus can be interpreted as an empirical proof.

Things are however different when it comes to the uncovered interest rate parity theory, the more important subcomponent as it refers only to spot market values, which have a greater effect on the economy than forward prices, which are nothing more than derivative financial instruments. In this sense, we consider relevant the empirical studies conducted Bilson[10], Fama[11], Froot and Frankel[12], Lewis[13], Engel[14] or Burnside,

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[7] Mohsen Bahmani-Oskooee, and Satya Das, "Transaction Costs and the Interest Parity Theorem", in *Journal of Political Economy*, August 1985, pp. 793-99.

[8] Kevin Clinton, "Transactions Costs and Covered Interest Arbitrage: Theory and Evidence", in *Journal of Political Economy*, April 1988, pp. 358-370

[9] Daniel Thornton, "Tests of Covered Interest Rate Parity", in *Federal Reserve Bank of St. Louis Review*, July/August 1989 , pp. 55-66

[10] John Bilson, *The Speculative Efficiency Hypothesis*, in Journal of Business, vol. 54, no. 3, 1981, pp. 435-451

[11] Eugene Fama, "Forward and Spot Exchange Rates", in *Journal of Monetary Economics*, vol. 14, 1984, pp. 319-338

[12] Kenneth Froot, Jeffrey Frankel, "Forward Discount Bias: Is it an Exchange Risk Premium?", in *Quarterly Journal of Economics*, 1989, pp.139-161

[13] Lewis, Karen, "Puzzles in International Financial Markets", in G.M. Grossman, Kenneth Rogoff, *Handbook of International Economics,* Amsterdam: North Holland, vol. 3, 1995, pp. 1913-1971

[14] Charles Engel, "The Forward Discount Anomaly and the Risk Premium: A Survey of Recent Evidence", in *Journal of Empirical Finance*, vol. 3, no. 2, 1996, pp. 123-191

Eichenbaum, and Rebelo[15] [16], which bring conclusive evidence against the theory. However, it's important to underline that such an invalidation is not necessarily the product of an error in reasoning, but can be caused by subtle, yet determinant, differences in the premises that the theory is based on and the aspects of a highly complex reality which cannot be simulated within the model. In this sense, Ranaldo and Sarkar[17] find that responsible for the theory's empiric failure lies in the phenomena of volatility and lack of liquidity, Burnside, Eichenbaum and Rebelo[18] point out the transaction costs, while Iluț considers that the interest rate parity theory fails in practice because economic agents often deviate from the rational behavior implied by the theory, more precisely they exhibit aversion towards the ambiguity of an uncertain situation.[19]

The controversy does not mean that the uncovered interest rate parity should be completely discarded just because it doesn't provide a generally valid prediction model. On the contrary, the rationale behind it, adjusted by taking into consideration a series of factors that are identifiable and quantifiable locally, can prove to be very helpful in evaluating the effects that changes in the real interest rate have on the future evolution of the exchange rate. Such an approach will be useful also for market agents, but mainly for the central bank in its mission to achieve the proposed macroeconomic objectives.

Once these notions are clarified, we can continue by concentrating on key aspects of the impact which relative prices have on exports and imports.

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[15] Craig Burnside, Martin Eichenbaum, Sergio Rebelo, "The Returns to Currency Speculation in Emerging Markets", in *American Economic Review Papers and Proceedings*, vol. 97, no. 2, 2007, pp. 333-338

[16] Craig Burnside, Martin Eichenbaum, Sergio Rebelo, "Understanding the Forward Premium Puzzle: A Microstructure Approach", in *American Economic Journal: Macroeconomics*, vol. 1, no. 2, 2009, pp. 127-154

[17] Angelo Ranaldo, Asani Sarkar, *Exchange rate risk, transactions costs and the forward bias puzzle*, Swiss National Bank, 2008, [http://www.hkimr.org/uploads/conference_detail/521/con_paper_0_510_session-7-3_sarkarranaldo_1sep08.pdf], accessed 12 May 2012

[18] Craig Burnside, Martin Eichenbaum, Sergio Rebelo, *Op. cit.*, 2009

[19] Cosmin Iluț, *Ambiguity aversion: implications for the uncovered interest rate parity puzzle*, 2009 [http://www.stanford.edu/group/SITE/archive/SITE_2009/segment_3/segment_3_papers/ilut.pdf], accessed 19 March 2013

3. Effects on the Current Account and Output

The appreciation of the national currency implies the relative growth in prices of internally produced goods with regard to foreign goods, leading to a decreased international competitiveness of internal goods, correlated with a relative decrease in prices of foreign goods. This dynamics will exert a negative pressure on the current account due to increased imports and lower export levels. Inevitably, this situation will trigger a decrease in the output level, as a direct consequence of the diminished demand.

Similarly, in the scenario of the depreciation of the national currency, internal products become cheaper when compared to foreign ones, a fact that will lead to a decrease in imports and increase in exports, resulting in pressure towards a higher output level due to the superior demand.

However, we need to mention that these affects are partially cancelled in the probable situation in which part of the raw materials used in the output process are imported. In this case, the appreciation or the depreciation of the national currency will make these raw materials of foreign origin, relatively cheaper, respectively relatively more expensive. In such situations, the effects on the production costs are of an opposite sign to the effects induced by the changes in the relative prices of the final internal or foreign products, thus reducing the intensity of exchange rate fluctuations of the national currency. This reduction is determined by the weight that imports of raw materials (denominated in foreign currency) have in the total production costs of internal goods (expressed in national currency).

As it results also from our previous remarks regarding the exchange rate channel and its way of functioning, the weight it has in the entire monetary policy transmission process for a certain economic zone is given by the exchange rate sensitivity to a series of factors. These factors are exogenous to the exchange rate channel and among them we can indentify:

- the way in which the interest rate channel functions, as the intensity of the relationship that is being established between the exchange rate and the interest rate is dependent on the real value of the latter, a value that is not being directly controlled by the central bank, but is formed in the market. It is true that the starting point in this formation process is the nominal interest rate (which is directly and completely under central bank control), but the real interest rates available in the market are being formed by term structure mechanism specific to the interest rate channel and

- the local validity or invalidity of the uncovered interest rate parity theory.

Another exchange rate channel related tool which the central bank can use in order to influence the macroeconomic climate is represented by the direct participation to the foreign exchange market. In this way, the monetary authority has the possibility to correct what it considers to be a deficit in either offer or demand for the national currency, aiming either at smoothing the market volatility or at altering the long-term level of the exchange rate.

The first strategy has obvious advantages due to the elimination of negative effects which a high degree of short-term volatility induces in financial markets, thus preventing a loss of efficiency in the functioning of the asset price and expectations channels.

The second strategy poses somewhat more complex problems. It is true that the level of economic competitiveness, with positive effects on output and employment, exhibits a component linked to the exchange rate. However, the important distinction which has to be made is weather the altering of the freely formed market exchange rate is being performed as a response to weaken an objectively strong currency or it's a move aiming at canceling a disadvantage generated by an overvalued national currency. In the first case (the one of manipulating the exchange rate in order to obtain an artificially weaker currency and the advantages on external markets that this brings), the strategy can prove to be wasteful, as the transfer of competitiveness deficit, and implicitly of the cost that it generates, from producers towards the national bank, means that the latter uses its foreign currency reserves by selling at an undervalued rate, thus most probably generating costs which are superior to the gains reported by the producing companies. In this context, Porter sustains that the artificial weakening of the national currency does not generate real competitiveness, capable to bring economic benefits. More, it can be argued that such a policy will only encourage the lack of competitiveness, delaying microeconomic adjustments and thus constituting a competitive disadvantage in the moment the exchange rate will no longer be sustained by the central bank[20]. Isărescu shares this

[20] Michael Porter, *The Competitive Advantage of Nations*, New York: Free Press, 1990

view: "It is true that the exchange rate depreciation offers a bubble of oxygen to producers who are uncompetitive in a fundamental sense. However, it is also true that the oxygen bubble will be in place only on the short-term. The excesses of depreciation aimed at maintaining or increasing international competitiveness are as harmful as excesses of appreciation aiming at controlling inflation. With regards to both international competitiveness and inflation, the exchange rate cannot substitute structural reforms."[21]

Having cleared these aspects, we still need to evaluate the situation in which the central bank does not target its market intervention towards creating a competitive advantage which, as we have seen, is a fragile one, but aims at eliminating a commercial disadvantage generated by the overvaluation of the national currency. Such an overvaluation can arise due to the way in which market participants form their perception on risk and the occurrence probability of future events. These kind of perceptions and the resulting predictions often prove to be false,[22] which does not mean that they don't alter the demand/offer balance point for a given bundle of exchange rate pairs. However, for a central bank intervention to be justifiable, it's important that the overvaluation is a real one, a fact that can be verified only if over time the appreciation pressures present in the market disappear and the central bank can withdraw its participation without consequences on the exchange rate.

A concrete case in this sense is the one of the Swiss Central Bank, who in September 2011 decided to introduce a threshold beyond which not to permit the appreciation of the Swiss Franc versus the Euro. The Swiss Central Bank governor motivated the decision in a press release dedicated to this event by stating that international events have determined the strong appreciation of the Swiss Franc over a short period of time, bringing it to an overvalued level which threatens the Swiss economy with recession and the appearance of a deflation.[23] While this paper is being written, at

[21] Mugur Isărescu, *Reflecții economice: piețe, bani, bănci, vol. 1*, București: Academia Română, Centrul Român de Economie Comparată și Consens, 2006, pp. 86

[22] Daniel Kahneman, *Gândire rapidă, gândire lentă*, București: Publica, 2012

[23] Phillip Hildebrand, Short statement by Philipp Hildebrand on 6 September 2011 with regard to the introduction of a minimum Swiss franc exchange rate against the euro, 2011 [http://www.snb.ch/en/mmr/speeches/id/ref_20110906_pmh/source/ref_20110906_pmh.en.pdf], accessed 25 March 2013

less than a year and a half after the Swiss Central Bank decision to intervene in the market and limit the Swiss Franc's appreciation, the exchange rate is 1.24 EUR/CHF, revealing a Swiss Franc which is weaker than the level of 1.20 EUR/CHF that the central bank pledged to defend. All this while Switzerland's economy has kept growing, proving that the central bank's actions were correct, representing an example of good practice for any monetary authority dealing with a similar situation.

4. Effects on Inflation

After having discussed the relationship between exchange rates and output, the next step is to explore the processes within the monetary policy transmission mechanisms through which exchange rates influence inflation.

The first type of interaction between exchange rates and inflation is being carried out in connection with the output level and the influences which exchange rates exhibit, as we have just seen, over it. From here there is only one step left, provided by the way in which the market adapts to the output deficit or surplus. The subject is of interest even if the change in output that we are referring to is derived from the change in demand (which means that the level of the offer of goods and services is the one that adapts to the new demand). The reason is that, especially in the presence of strong shocks induced by changes in exchange rates, this adaptation of offer to demand could not be a perfect one, leaving space for a further adjustment in price, with consequences on the inflation level.

The second type of interaction is materialized through the commercial balance, as the induced changes in the exchange rate by the levels of imports and exports transcend the quantitative aspect. A stronger currency will induce lower import real prices, while a weaker currency will determine these goods to become more expensive. However, at this stage the key factor represented by the structure of the national output steps in, as competitiveness of exports is in an opposite relationship with the attractiveness of imported goods. For this reason, a pressure made by the national output on domestic prices of an opposite sign as that exerted by imports will be in place. More precisely, in the presence of rigidities in adapting the output level, national producers will shift the sale of a part of the available quantity of goods towards the market (foreign or domestic) where they can obtain a higher price, thus influencing domestic prices by either diminishing or boosting domestic offer. The result of these antagonistic pressures on the output level is given by the structure of the national aggregate output, more precisely the level of substitutability between imports and internally produced goods.

5. The Exchange Rate Channel and the Openness of the Economy

The importance of the exchange rate channel depends highly on the degree of openness of the economy and on the economic interactions (mainly of commercial and of investment capital nature) between the economy (or the monetary zone) and the exterior. This is because of the relationship between these interactions and key economic indicators linked to the output level, product competitiveness, investment level and, indirectly, the unemployment rate.

Rodriguez[24] draws the conclusion that the optimum degree of economic openness is in an inverse relationship with the size of that economy, so that the bigger the economy, the less open does it need to be and vice versa. The argument is sustained by empirical data also. The 2013 KOF Economic Globalization Index is more than relevant in this sense, exhibiting a strong link between the openness and size of the economy[25]. The explanation lies in the fact that a smaller economy is more dependent on external markets for both imports/exports and the capital needed for its development. In such a relationship, the exchange rate constitutes a crucial factor, which leads to a higher functionality level of the exchange rate channel and, in consequence, to the central bank's need to grant it extra attention.

Relevant in this sense is the concrete case of Romania, an economy which is small, relatively open (situated in the first third of the ranking provided by the index referred to earlier) and highly dependent on its economic relationships with the exterior. In this context, a particularity of

[24] Carlos Rodriguez, *On the Degree of Openness of an Open Economy*, Universidad del CEMA Buenos Aires, Argentina, 2000, [http://www.ucema.edu.ar/u/car/Advantage.PDF], accessed 2 April 2013

[25] *KOF Economic Globalization Index 2013*, [http://globalization.kof.ethz.ch/static/pdf/rankings_2013.pdf], accessed 10 April 2013

the National Bank's of Romania mission is represented by the distinct enunciation of its attribution regarding the elaboration and application of the exchange rate policy,[26] the goal being the underlining of the importance of the exchange rate's transmission channel for the good functioning of the national economy. The effectiveness of the channel is confirmed by Cocriș and Nucu, who see it as growing.[27]

The discussion over differences in openness between large and small economies is however not intended to avert us from the general trend of the world economy, which is clearly heading towards a higher degree of openness, with commerce and flows of capital playing the lead roles. However, the fact that smaller economies have a greater need for openness does not mean that larger economies don't benefit from this process. In this context, it becomes clear that the sustained tendency for openness that characterizes most of the world's economies strengthens the role played by the exchange rate channel within the monetary policy transmission mechanism. A relevant example is that of the Euro Zone. The July 2000 European Central Bank Monthly Bulletin highlights a relatively economically closed Euro Zone and its consequences regarding the poor functioning of the exchange rate channel.[28] Twelve years later, statistic data provided by the same institution point out that the trade activity between the Euro Zone and the exterior has reached in 2011 at 37% of the Euro Zone gross domestic product (comparing to just 25% in 1999), shedding a new light on the exchange rate channel.[29] Beyond particular examples and cases, the figures provided by the World Trade Organization are more than clear: if in 1999 world aggregate trade was worth 5.712.000 Million USD, in 2011 it has reached the level of 18.255.000 Million USD.[30]

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[26] The Romanian Parliament, *Law no. 312/2004, art. 2*, [http://www.legex.ro/Legea-312-2004-43592.aspx], accessed 4 December 2012

[27] Vasile Cocriș, Anca Elena Nucu, "Interest rate channel in Romania: assessing the effectiveness transmission of monetary policy impulses to inflation and economic growth", in *Theoretical and Applied Economics*, vol. 20, no. 2, 2013, pp. 37-50

[28] European Central Bank, *Monthly Bulletin July 2000*, [http://www.ecb.int/pub/pdf/mobu/mb200007en.pdf], accessed 12 April 2013

[29] www.ecb.eu

[30] www.wto.org

6. Conclusion

The exchange rate channel is a key component of the monetary policy transmission mechanism as it governs the processes that involve interaction with factors that are external to the national economy. In the context of intense economic globalization, exchange rates play a crucial role in designing the internal economic environment by having strong effects on the output level (with consequences on employment) and on the inflation rate due to rigidities in offer and the potential shifts of offer between the domestic and the external market. Also, we identify that the strength of the exchange rate channel is dependent on the openness of the economy, due to its influences on traded volumes and capital flows.

Having this in mind, central banks need to take a close look at the exchange rate channel, as issues like the economic openness, the validity of the interest rate parity theory or the structure of the domestic demand and output represent local variables that greatly influence the processes that take place within the exchange rate channel. In these circumstances, the deep understanding of the exchange rate channel's functioning and role within the transmission mechanism is essential for conducting an efficient and effective monetary policy.

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28. www.ecb.eu

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STUDIA UBB. EUROPAEA, LVIII, 3, 2013, 149-158

EUROPE'S EUROPES IN THE INTERWAR PERIOD

Paula Mureșan*

Abstract
The aim of this paper is to present and analyse the economic disparities of the two Europes, Eastern and Western Europe, in the beginning of the 20th century. Therefore, we shall talk about industrial and agrarian countries. Romania is a case point in the present paper, due to its particularities.
Keywords: Industrial, agrarian countries, interwar period, economy, economic disparities.

The beginning of the 20th century provides the perspective of a European continent divided between nation states and the great empires which fell apart at the end of the First World War,[1] between developed countries and less developed ones, between powerful and weak states.

If one is to have an outlook on Europe, from its origins, it may be stated that the old continent has constantly been rattled by ideological, ethnical, social and political turmoil, which has practically led to two different faces of the continent: Western Europe and Eastern Europe. In order to provide some relevant data that can justify this separation, we shall turn to international historiography, which notes the decline of the Roman Empire, 395, the Great Schism, 1054, the attack of the crusaders on Constantinople, 1204 etc.

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[1] R. J. Crampton, *Eastern Europe in the Twentieth Century - and After*, Routledge, 1994, p.10.

Therefore, the disparities present at the beginning of the 20th century become much more obvious. All the causes and effects of a plethora of such actions as the ones stated above have taken their toll on the states' pattern of development and, implicitly, on mentalities.

Political life in European countries has proven to be particularly complex and diversified, tailoring itself according to the specific traits of each state or nation. The year 1918 was a turning point in the evolution of European states and Europe itself, taken as a whole. We are referring not only to the end of World War One, which led to numerous ideas aimed at unification, but also to the opportunity provided by this major event. Professor Vasile Pușcaș argues that in Central and South-Eastern Europe, the achievements span far beyond a mere territorial reorganisation. In his view, much more was accomplished, as nations in the area furthered their synchronisation endeavour to the general pace of European modernisation.[2]

The industrial revolution basically transformed countries from predominantly agricultural ones to industrial giants. This is chiefly encountered in Western Europe from the 18th-19th centuries, marking a period of economic growth. This revolution enabled western states to develop their economies by means of industrialisation and experience significant progress in agriculture, practically switching from manual labour to machine-driven one. The proximity of eastern countries to the oriental model explains why they would take the step towards industrialisation only later, after the mid-19th century.

Søren Kjeldsen-Kragh, in his book entitled *The Role of Agriculture in Economic Development: The Lessons of History*[3], brings into discussion a statistical view of European states at the beginning of the 20th century. The author proposes an indicator pertaining to the average European industrialisation level, which he marks at 100. Thus, first on the list comes Great Britain, with a value of 254, followed by Belgium with 230, Germany 177, Switzerland 150, France 140, Sweden 104, The Netherlands 97, Norway 93, Denmark 85, Austria-Hungary 82, Italy 71, Spain 52, Greece 48, Portugal 46, Serbia 39, Russia 34, Bulgaria 33, Finland 32 and Romania 13. For the entire Europe,

[2] Vasile Pușcaș, Marcel Știrban, *Perfecționare și atitudini critice în sistemul politic al României*, în *Dezvoltare și modernizare în România interbelică 1919-1939*, Ed. Politică, Bucharest, 1988, pp. 11-12.

[3] Søren Kjeldsen-Kragh, *The Role of Agriculture in Economic Development: The Lessons of History*, Copenhagen Business School Press, 2007, p. 27.

the author grants the value 100, whilst for continental Europe 83. Continental Europe minus Russia is represented by the value 109.

There are multiple relevant aspects deriving from the aforementioned study: Romania is last on the list, with 13 points, Britain has an indicator nearly 20 times higher than the last country on the list, namely Romania, whereas the gap between western and eastern states is extremely deep.

The same discrepancies are noticeable in the case of two relevant and prominent factors: agricultural productivity and industrial development. We shall make a brief presentation of Romania, in comparison with West-European countries, by stating that Romania's situation is close to that of East-European states, which is why any comparison is this area is fruitful and valid.

It has to be taken into account that Western Europe had already gone through two distinctive agricultural revolutions by the 19th century. [4] The first was chiefly aimed at the change to an intensive agricultural setting, with more extended crops and more reliance on the increase in quality of seeds and the integration of animal husbandry into farming. The second, which started in the 19th century and continued well into the 20th century, relied on the replacement of manual labour with mechanical one. Bogdan Murgescu believes that in Romania, the 19th century brought a merely partial first agricultural revolution, while the mechanisation process of agricultural activities was severely delayed. Hence, 19th century Romania underwent only a superficially modern agricultural revolution, which explains the low mechanisation later on.[5]

In interwar Romania, two major reforms were achieved from a social point of view. The first is the agricultural reform, through which nearly six million hectares of land, pastures and forests were removed from the large property and given to peasants, accounting for 1.400.000 individuals who received plots of land. The second is the political and constitutional reform of the state. The reform of the Romanian state's administrative structure was, in our view, of paramount importance, and was carried out firstly through the approval of the Law on Administrative

[4] Bogdan Murgescu, *Europa și România. Acumularea decalajelor economice (1500-2010)*, Ed. Polirom, Iași, p. 135.

[5] *Ibidem*, p. 135.

Unification of 1925, by the National Liberal Party (PNL).[6] Once these reforms had been implemented, a series of natural transformations arose in the social, political, economic and cultural life of the country.

The agricultural reform was accomplished by Garoflid Constantin, the minister of agriculture in Averescu's Government, and it came into force in 1921.[7] The law stipulated that peasants should be its main beneficiaries. Hence, the provisions of the agricultural reform prompted a significant transfer of land from the great landowners to small households: "Nearly 6 million hectares of land were expropriated so as to be given to peasants, while approximately 1.400.000 peasants were awarded land"[8]. Although the agricultural reform was meant to favour peasants, it proved to be unable to solve already deep-rooted problems, as it lacked the necessary means of implementation (equipment, credits, specialised consultancy). Population increase was perceived as a negative factor, putting pressure on the right to property of landowners: "Half of the agricultural population of the country exceeded the necessity of agricultural output."[9] Because of rudimentary techniques and equipment, the agricultural output decreased substantially.

Meanwhile, the promoters of the reform hoped that, in this way, rural education could be altered as well. The figures indicate, however, an entirely different reality: "At the beginning of the 20th century, over ¾ of the country's population was illiterate."[10]

From an economic standpoint, the country had not yet found a path to follow. The dilemma was germane to the choice of the means of development which were appropriate for the state and it gave rise to the following perspectives: either an exclusively agricultural one, or an industrial one. After World War One, whose consequences encompassed the unification of the country, politicians aimed to include the newly-acquired territories into the national economy. "From 137.000 sq. km, the surface of Old Romania,

[6] For further details, see: Nicolae Păun, *Viaţa economică a României 1918-1948*, Ed. Presa Universitară Clujeană, 2009, pp. 21-85.

[7] See: Stelian Saon, *Agricultura României în al doilea deceniu interbelic*, Braşov: Transylvania University Publishing, 1999.

[8] Keith Hitchins, *România 1866-1947*, Bucharest: Ed. Humanitas, 1996, p. 373.

[9] *Idibem*, p. 376.

[10] Eugen Weber, *Dreapta românească*, Cluj-Napoca: Ed. Dacia, 1999, p. 51.

the new one, after the Unification, reached 295.049 sq. km."[11] We are thus referring to an internal battle for the inclusion of these territories. The country began to show significant economic progress, due to large foreign investments and national entrepreneurs. Professor I. Scurtu assesses the situation, by stating that "at the end of the second decade, Romania presented a patrimony of human and material resources, production, transport and exchange capacities that had increased 2,2 to 2,5 times compared to the Romanian state before the war."[12]

Albeit the war caused widespread devastation to the economy, the rebuilding process in the 1920s was swift and meaningful. The merits can be attributed to the liberals, who ensured the leadership of the country in the third decade and led a policy of industrialisation throughout the country.

"The origins of Romanian liberalism can be traced back to its beginnings and to the development of the national bourgeoisie in the first half of the 19th century. As the Romanian capitalism and bourgeoisie developed and matured, economic liberalism formed, shaping itself as an economic doctrine with distinctive features, instilled by the particular traits of the Romanian economy and socio-economic structure."[13]

By stating that liberalism stood for progress, the liberals perceived "progress, in all areas of social life, only within the boundaries of private property."[14] This will ensure advancement, without confronting with incoherent leaps or twitches, through a steady movement that prevents misbalance.

The addition of Transylvania and Banat to the Old Kingdom increased the production capacity of the country: "The Dynamics of the '20s are suggested by the increase in the number of factories of various kinds, from 86.000 in 1918 to 273.000 in 1930 and the increase in mining output between 1924 and 1928 by 189 per cent, as well as the production of manufactured goods by 188 per cent."[15]

The oil and the metallurgical industries met with significant increase. In the case of oil, "production went up from 968.000 tonnes in 1918 to

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[11] Ion Bulei, *Românii în secolele XIX-XX, Europenizarea*, Bucharest: Ed. Litera, 2011, p. 202.
[12] Ion Scurtu (coord.), *Istoria românilor*, vol. VIII, Bucharest: Ed. Enciclopedică, 2003, p. 79.
[13] Toader Ionescu, *Istoria gândirii economice din România*, Ed Bucharest: Economică, 1996, p. 95.
[14] I.G. Duca, *Doctrina liberală*, Bucharest: Ed. Cultura Naţională, 1923, p. 103.
[15] Keith Hitchins, *op. cit.*, p. 384.

5.800.000 tonnes in 1930, placing Romania sixth among worldwide suppliers. The metallurgical industry had an impressive increase, as steel production went up from 38.000 tonnes in 1925 to 144.000 tonnes in 1928."[16]

Consequently, the effects of industrialisation were felt in the entire economy: transportation improved, the railway network was modernised and there were new opportunities for employment in the area of public services and state administration. Nevertheless, one weakness remained present in Romanian industry: the internal market was unable to absorb its products. This was mostly due to the state's intervention in the form of protectionist tariffs and restrictions imposed on transportation.

The national market was advancing slowly "because of the low standard of living of the masses – chiefly peasants, who lacked the means to purchase nationally-manufactured goods."[17]

Efforts made by liberals and the adoption of the "through ourselves" policy so as to maintain key segments of the national economy in the hands of Romanians did not prove to be entirely successful. "Prior to World War One, foreign capital accounted for almost 80% of the total capital invested in the Romanian industry. The national capital had the tendency of being directed to those areas which promised to yield quick benefits – land, transportation, banks. As a result of the liberal government's policies, national investments in the '20s became much more diverse, but, during this decade there was no spectacular change in the relation between international and national capital (…). Even though national investments started to increase in the period between 1925 and 1928, 65% of the capital of industrial joint-stock companies and 25% of that of banks was foreign."[18] Romania starts to position itself on the map of Europe and to become a factor which is worthy of being taken into account in the European circuit. Significant data on the economic growth of the Romanian industry is provided by Professor Nicolae Păun in his book, *The Economic Life of Romania 1918-1948*: "an increase in the number of enterprises in 1928, compared to 1923, by 35%; motive force utilised by 25%; value of production by 146%; fuel by 37%;

[16] *Ibidem*, p. 385.
[17] *Ibidem*, p. 387.
[18] *Ibidem*, p. 393.

employed personnel by 26%; raw materials utilised by 128%", all of which indicate the leap made by Romania as a consequence of liberal policies.[19]

The reputable Romanian historian and economist Virgil Madgearu, in his book *The Evolution of the Romanian Economy after World War One*[20], brings into the equation a key element so as to provide essential data: the participation ratio of the active population in industry and agriculture, in various countries. Moreover, the author mentions the year of the census. Bulgaria, registered in 1926, has 80% of its active population involved in agriculture and 9% in industry. Romania, according to the 1930 census, has 78,2% of its population active in agriculture and 10,2% in industry. Greece and Hungary, assessed in 1928 and 1930, respectively, have a ratio of 53,7% / 50,8%, respectively, in agriculture and 15,9% / 23,0% in industry. In Italy, France, Germany, Switzerland, The Netherlands and England, the percentage referring to agriculture drops below 50%, to 47,3%, 35,7%, 28,9%, 21,3%, 20,6% and 5.6%, respectively, whilst in industry, it varies between 29,5% for Italy and 42.3% for England.

Some conclusions can be drawn with regard to this information: in Bulgaria, Romania, Greece and Hungary, Central or South-East-European countries, the percentage of the population involved in agriculture is significantly higher than the one active in industry; Italy and France can be regarded as mainly agrarian, rather than industrial, whereas Germany, Switzerland, The Netherlands and England, where the proportion of the population active in industry is greater than the one in agriculture, are advanced countries from an industrial perspective. England has primacy in industrialisation, as the first country to have experienced the industrial revolution.

The national income per capita is another pertinent landmark, as it indicates the degree of development of the economy of a state. Gheorghe Dobre[21] conducts such a statistical analysis for the year 1938: Great Britain is in first place, with revenues of 378 dollars per capita, followed by Germany with 338, Denmark 318, France 237, Italy 127, Hungary 111, Greece 80,

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[19] Nicolae Păun, *op. cit.*, p. 197.

[20] Virgil N. Madgearu, *Evoluția economiei românești după primul război mondial*, Bucharest: Ed. Științifică, 1995, p. 155.

[21] Gheorghe Dobre, *Economia României în context european-1938*, Bucharest: Ed. Fundației Științifice Memoria Oeconomica, 1996, p. 138.

Romania 76, Bulgaria 68, Yugoslavia 68, while the European average stands at 222 dollars. The information provided enables us to emphasise several aspects: Central and South-East-European countries lie at the bottom of the hierarchy, whilst Western ones have primacy. Great Britain has the largest income per capital, almost five times greater than the last country on the list. Compared to the European average, the level of Romania is three times lower.

Historian Gheorghe Iacob states that in Romania's modernisation process we have to take into account several particularities of the Romanian space: the predominantly agrarian society was in fact a hindrance in the process of modernisation; the Balkanised elements specific to the East-European area were a disruptive factor in the process of adapting to European standards. In spite of these inconveniences, there was a political elite that assumed the process of modernisation (it is the liberals and the conservatives that should be given credit for this), and some segments of society adapted more quickly. "Only in the interwar period did the cultural level of the population manifest a significant increase and, only then was a balance reached between mentalities and the achievements of modernisation."[22]

To conclude, we are entitled to state that Europe at the beginning of the 20th century was divided in two: a predominantly agrarian one, composed of Central and East-European countries which, in their process of modernisation, attempted to take the step towards industrialisation, and an industrialised one, formed of western countries, which made essential progress, notably in the industrial sector, the agricultural one being also competitive, as a result of mechanisation.

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