ROMANIAN ECONOMIC AND BUSINESS REVIEW

Statement of Purpose

The *Romanian Economic and Business Review* is the first peer-reviewed Romanian journal in the field of economics and business. This journal intends to provide a forum for academic analysis of the economic phenomena and institutions affecting the world economy in general, and Romania, in particular. *REBE* examines a wide variety of phenomena related to economic growth and business development and attempts to publish high quality research focusing on the role of institutions and public policy, within both a national and international context. *REBE* encourages cross-disciplinary research work of Romanian and foreign scholars.

Author Information

The ROMANIAN ECONOMIC AND BUSINESS REVIEW (REBE) is a refereed journal published four times annually by the Romanian-American University. The editors invite submissions of articles that deal with important issues in economy and business. Papers that focus on specific phenomena and events affecting Romanian economy are particularly encouraged. Because REBE seeks a broad audience, papers should be comprehensible beyond narrow disciplinary bounds.

Manuscripts should not exceed 8,000 words and must conform to the REBE's style requirements, which are guided by The Chicago Manual of Style (14th edition). All submissions must include a cover sheet explaining the scope of the article, and including the authors' names and affiliations, telephone and e-mail address. The text should be single-spaced. References are cited with parentheses using the author/date/page style. *Example*: (Marcus, 2005, p. 74). Authors should use footnotes, not endnotes to add only short comments. Bibliography should include only references cited in the text, in the alphabetical order of authors. An abstract of no more than 200 words should be included.

Submission of a paper implies that the paper will not be submitted for publication to another journal unless rejected by the REBE editor or withdrawn by the author, and that it is an original work. All submissions should be sent to the journal Editor:

Dr. Bogdan Glăvan
Romanian-American University
Bulevardul Expoziției nr. 1
București
Telephone: 0723 177 820
E-mail: rebe@rau.ro

Subscription rates:
Institutions - $100/year
Individuals - $30/year

ROMANIAN ECONOMIC AND BUSINESS REVIEW

WINTER 2007 VOLUME 2 NUMBER 4

PUBLISHED BY THE SCIENTIFIC RESEARCH DEPARTMENT OF THE ROMANIAN-AMERICAN UNIVERSITY

PRO UNIVERSITARIA
BUCUREȘTI
2007

ISSN 1842 – 2497

CONTENTS

Romanian Economic and Business Review – Vol. 2, No. 4

THE POSITIVE SIDE OF LISBON TREATY

Florin Bonciu[*]

The Lisbon Treaty or Reform Treaty represent in brief the current position of the European Union member states towards the idea of European economic integration. One important characteristic of this Lisbon Treaty is the fact that it amends at the same time two previous treaties, namely the Treaty on European Union (the so-called Maastricht Treaty of 1992) and the Treaty establishing the European Communities (the so-called basic EEC Treaty of 1957).

During the history of European integration which is now more than 50 years old there were several significant changes in the treaties as result of new circumstances and new perspectives on integration. The previous amendments took usually one to two years from signing to entering into force while a notable difference in case of current treaty is the fact that it needed more than 7 years for preparation and one version although signed by the Euopean Union leaders at the end of 2004 was rejected by referendums in France and Netherlands.

In order to understand the place of Lisbon Treaty in the history of European Union we can say that before it there were two fundamental treaties:

- the Treaty of Rome (EEC Treaty, 1957);
- the Treaty of Maastricht (TEU, 1992).

EEC created the common market, the TEU set up the single currency and added “two pillars” (common foreign policy and common justice and home affairs). These treaties set out the unique EU structure, the one combining international agreement and a partial federal “super-state”. Repeated efforts since the TEU have been made to promote more federal inclination of the “federation”.

Due to the above mentioned characteristic the Lisbon Treaty will be an amending document. As result even its official title is: “the Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community”.

The main changes introduced by the Lisbon Treay can be summarized in two main categories: institutional changes and division of competence.

Institutional changes

1) There will be only two Community treaties to deal with:

---

[*] Florin Bonciu is Professor of Eorld Economics at the Romanian American University in Bucharest.

a) the TEU – Treaty on European Union, or the Maastricht Treaty (in force since 1 November 1993); main modifications here include the EU institutional system, enhanced cooperation, foreign and security policy, as well as defense policy.
b) European Economic Community Treaty (or Rome Treaty, in force from 1 January 1958), which concerns the EU and Member States division of competence in various economic policy fields. In the new draft it is called “the Treaty on the functioning of the EU”.
2) Ordinary legislative procedure: affirmation of co-decision rule, i.e. when the European Parliament and the Council participate in the EU legislation on equal footing.
3) The EU Presidency (i.e. that of the European Council’s presidency) with 2 and a half years duration, instead of presently half a year.
4) A new position is created: “High Representative of the Union for Foreign Affairs and Security Policy”.
5) Right of citizens is recognised with one million signatures in favour of a future proposal.
6) The Charter of Fundamental Rights is kept in the supplement to the treaty (the UK and Poland have already pronounced their reservations).
7) A special clause is included providing that the European Parliament and the Council of Ministers will decide on an equal footing the issues of the Union’s budget, both annual and multi-annual.
8) The Lisbon treaty enhances the Social dimension of Europe by connecting economic and social issues. However, the social policies remain mostly within the domain of the member states competences. The treaty includes (in the protocol attached to the treaty) the Charter of Fundamental rights and guaranties that these rights have a binding legal force, which means that any EU laws that are contrary to the Union’s social objectives can be declared void by the Court of Justice.
9) The European Union acquires a legal status which implies the EU ability to sign contracts, be part of international conventions and be member of international organisations. This will increase the role the EU plays in the international arena promoting European values and interests.
Regrading the institutional changes there are some practical issues worth mentioning: the first European Commission (to be sworn in 2009) will consist of one Commissioner from each member state. From 2014 the number of commissioners will be reduced to two-thirds, i.e. 18 of the present EU-27 and a special rotating system is envisaged.

Division of competence

For the first time in Community and Union’s history the Lisbon treaty has clarified the distribution of power between the Union and the member states.

The treaty underlined the basic principle in sharing these competences: the Union enjoys competence conferred on it by the member states; all other competences are in the realm of the states. The principle of "conferred powers" has formed the background of responsibility's division at various levels of power.

The following three main categories of competences have been mentioned:

1. The Union's exclusive competence, where the EU institutions can legislate alone. The areas covered by exclusive competences include six policy spheres among which are: Customs Union, Competition rules, monetary policy (for the states in the euro-zone), conservation of marine biological resources, Common commercial/trading policy and conclusion of international agreements.
2. The Union's shared competences between the EU and the member states where the latter exercise their competence if that is agreed upon with the EU. There are twelve following competences: Internal market issues, certain aspects of social policy; economic, social and territorial cohesion; agriculture, fisheries, environment, consumer protection, transport, trans-European networks (TEN), energy; area of freedom, security and justice; and joint civil protection measures regarding public health or natural disasters.
3. Areas where the Union can only provide support, assistance and coordination while the member states retain sole responsibility for the development on these areas, i.e. without any aspects of harmonisation of the member states' policies. There are 10 in total such spheres: industry and culture, tourism and public health; education, vocational training, youth and sport, civil protection and administrative cooperation. Besides, there are 3 specific coordination spheres in formulating guidelines for economic, employment and social policies.

Focus on the positives

The Treaty of Lisbon will be a big step forward because it gives the European Union much greater capacity for action, greater democracy and transparency, and therefore brings the EU closer to its citizens.

Greater capacity for action

The new Treaty offers the Union the possibility to enhance its capacity to act by increasing the efficiency and effectiveness of the institutions and decision-making mechanisms, especially in view of new global challenges- and issues which matter to citizens – such as climate change, energy, security, international terrorism, immigration, further enlargement and strengthening of the role of the EU at an international level, for example with a stronger focus on conflict prevention, etc.

Among the provisions that support the greater capacity for action we can mention:

- The legal personality of the EU , which allows it to sign the European Convention on Human Rights and other treaties has been recognized;
- Qualified Majority voting becomes the general rule in the Council;
- New possibilities are to be opened for enhanced cooperation;
- Increased efficiency of Commission by reduction of number of Commissioners;
- Increased competencies for EU including energy policy and climate change;

Greater democracy and transparency

The European Parliament will be the big beneificiary of this treaty because of Co-decision putting it on an equal footing with the Council of Ministers. Co-decision will be extended to virtually 100 per cent of all European legislation with only a few exceptions, like tax. That means that members of European Parliament elected by the people will gain more influence, and that will be in the people's interests. Thus Europe is becoming more parliamentary, more democratic and closer to its citizens.

At the same time serious steps have been taken to improve the democratic functioning of the EU, including more involvement of national parliaments. The capacity of the EU to take initiatives has been strengthened.

Among the provisions that support the greater capacity for action we can mention:

- Charter of Fundamental Rights becomes legally binding;
- Formal recognition of citizenship of the EU (in addition to that of member states);
- Citizens' initiative that enhances participatory democracy (Petition with 1 million signatures);
- Co-decision substantially expanded, giving new powers to the European Parliament, including budget;
- National Parliaments will be better involved in the EU decision making process (subsidiarity principle), giving them the right to show the Commission the “Orange Card”;
- Stronger role for European Parliament in election of the President of the Commission;
- Expansion of the jurisdiction of the /court of Justice to include all activities of the Union (except common foreign and security policy);
- Social market economy and full employment become Union objectives;
- New protocol recognizing general economic interest services;
- Exit clause is included so that any country can leave the EU when it decides to do so.

Some preliminary conclusions

Given the caracteristics briefly mentioned above the Lisbon Treaty is neither a kind of Nice-plus nor just a mini-Treaty or a completely new Treaty.

One may say that the draft for a Constitutional Treaty has been neither ignored nor forgotten. Anyway, it has been mentioned that in a rather poetical way, that even if the text of Lisbon Treaty reflects the draft Constitution it does not reflect the soul of the draft.

The main shortcomings related to the adopted text of Lisbon Treaty mentioned in this respect were:

- The term constitutional treaty has disappeared;
- Removal of European symbols: flag, anthem and motto, preventing closer emotional attachment of citizens to EU;
- Charter of Fundamental Rights, even if it has a binding character, is not given prominence;
- Provision of possibility of national opt-outs;
- Primacy of European law over National law no longer mentioned in the text;
- New voting system is to be postponed until 2014, with transitional process (Ioannina) in place until 2017;
- There is no agreement on a stronger EU-wide coordination of tax policy.

As a conclusion it is to be noticed that mostly the economic policy amendments and institutional ones have been the main driving force behind a new treaty.

This pragmatic approach was based on a general perception that EU could not continue to function in the old manner, without changes in the Union's integration efforts. These changes had to take into account the realities of an enlarged Union, the challenges of globalization and the political realities in the member states.

References

Main Communities and the EU Treaties: EEC Treaty (1957), TEU (1992), Nice Treaty (2001), the Constitutional Draft Treaty (2004) and Lisbon Treaty (2007).

Treaty Establishing a Constitution for Europe. 2005. Luxembourg: Office for Official Publications of the European Communities.

EU Enlargement: 120 myths and facts about enlargement. 2006. European Commission, DG for Enlargement.

Better off in Europe. How the EU single market benefits you (Europe on the move series). 2006. Luxembourg: Office for Official Publ.

The Lisbon Treaty. 10 easy-to-read fact sheets. 2007. Publ: Foundation Robert Schuman. December.

EUROPEAN FISCAL COORDINATION

Stela Aurelia Toader and Laurențiu Teodorescu*

Abstract

The existence of 27 different taxation systems in the European Union represents an obstacle against the good operation of the domestic market, generates significant extra costs for the trans-frontier trade and business on administrative plan and with regard to the observance thereof, it hinders the restructuration of societies, reduces competitiveness of European companies at world level and leads to double taxing situations. These are the main reasons for which, at present, at European level, the issue of coordinating the national fiscal systems is more current than ever.

Under conditions in which accurate measurement of the fiscal burden is given by the effective taxation level, which corresponds to a nominal taxation quota and a taxation basis, and under conditions in which European cooperation and coordination must not lead to the abandonment of the national autonomy in the fiscal field, if the sovereignty of the member states with regard to setting the taxation quotas, the solution would be the adoption of a common consolidated basis of taxation at European level.

Although there exists a unique market and an economic and monetary union, there still does not exist a genuine community fiscal policy, at the level of the European Union operating at present 27 different fiscal systems. More than that, the recent extensions of the European Union lead to a considerable increase of the differences between the fiscal regimes within the European Union, the new member states of the European Union being generally states with more reduced levels of taxation as compared to the old member states (UE-15), which are, at the same time, the most developed in the European Union.

The member state fiscal systems present major differences with regard to the level of the taxation quotas, which range between 10 and 50 percent in the case of income obtained by physical entities, between 10 and 35 percent in case of taxing companies and between 15 and 22 percent in case of VAT.

* Stela Toader is Associate Professor if Public Finance at the Romanian American University in Bucharest.
Laurențiu Teodorescu is Certified Internal Auditor – Constanta General Directorate of Public Finance.

The differences do not refer only to the taxation quotas, but address the assembly of the rules of seating the taxes, from the setting of the taxation basis up to the fiscal facilities granted.

Also, global fiscal pressure varies in the different member states between 28.4 and 50.5 percent from the GNP, this having from case to case a different impact on the economy.

The following table presents the taxation quotas applicable to the main composing taxes of the fiscal systems in the European Union member states.

Table 1: Tax Rates in European Union (18 member states)

Member states	Individual Income Tax	Corporate Tax	Capital Gains	Dividend	Interest	Royalties	VAT
Austria	4 tax bands (0%-50%)	25%	25%	25%	0%	20%	Standard rate 20% Reduced rate 10%
Bulgaria	10% flat tax	10%	Added to the regular income	7%	15%	15%	20%
Czech Rep.	15% flat tax	21%	Are taxed as income for companies and individuals	15%	15%	15%	Standard rate 19% Reduced rate 9%
Estonia	21% flat tax	22% applies to an actual distribution of the profits	Added to the regular income	0%/24%	0%	15%	Standard rate 18% Reduced rate 5%
Ireland	0-34.000 20% > 34.000 41%	12,5% for trading income reduced rate 10% 25% on passive income	20% for individuals	20%	20%	20%	Standard rate 21% Reduced rate 4,8% and 13,5%
Greece	4 tax bands (0%-40%)	25%	Added to the regular income	0%	29%	20%	Standard rate 19% Reduced rate 9% and 4,5%
Germany	Progressive from 15% to 45%	25%	25% for companies	21,1%	21,1%	0%	Standard rate19% Reduced rate 7%
Italy	Progressive from 23% to 43%	33%	12,5%	12,5%	12,5%/27%	22,5%	Standard rate 20% Reduced rate 4,5% and 10%
Cyprus	Progressive from 0%-30%	10%, 25% for corporated bodies, lower rates for shipping companies	20% for individuals 25% for corporation	0%	0%	0%	Strandard rate 15% Reduced rate 5% and 8%
Latvia	25%	12,5%	2% for companies	10%	10%	5%-15%	Standard rate 18%

			0% for individuals				Reduced rate 5% and 0%
Lithuania	15% and 24%	15%, 13% for small companies	For companies are added to the regular income 15% for individuals	15%	10%	10%	Standard rate 18% Reduced rate 9% and 5%
Hungary	Progressive from 18% to 36%	Progressive from 10% to 16%	For companies are added to the regular income 25% for individuals	0%	0%	0%	Standard rate 20% Reduced rate 15% and 5%
Malta	Progressive from 0% to 35%	35%		0%	0%	0%	Standard rate 18% Reduced rate 5%
Poland	Progressive from 19% to 40%	19%	Are added to the regular income	19%	20%	20%	Standard rate 22% Reduced rate 7% and 3%
Portugal	Progressive from 10,5% to 42%	25% with the addtion of a local tax of 2,5%	For companies are added to the regular income For individuals 10%	20%	20%	15%	Standard rate 21% Reduced rate 12%, 5%
Romania	16% flat tax	16%	16%	16%	16%	16%	Standard rate19% Reduced rate 9%
Slovenia	Progressive from 16%-50%	25%	For companies are added to the regular income For individuals 5%-20%	25%	25%	25%	Standard rate 20% Reduced rate 8,5%
Finland	Progressive from 0% to 32,5% - national tax Municipal tax – 16%-21%	26%	26% for companies 28% for individuals	28%	28%	28%	Standard rate 22% Reduced rate 17%, 8%

Source: www.worldwide-tax.com

The existence of 27 different taxation systems in the European Union represents an obstacle against the good operation of the domestic market, generates significant extra costs for the trans-frontier trade and business on administrative plan and with regard to the observance thereof, it hinders the restructuration of societies, reduces competitiveness of European companies at world level and leads to double taxing situations.

The differentiations regarding the fiscal regimes applicable in the European Union crate a strong fiscal competition between the member states, which competition distorts the character of the unique market, acting as a genuine obstacle for the free circulation of goods, services, labor force and capital.

Besides disadvantages in the field of European integration, fiscal competition presents a series of disadvantages in the field of economic efficiency and fiscal equity.

In the field of economic efficiency, when the decrease of the taxation of one country has as effect the decrease of the fiscal collections of other countries due to the trans-frontier mobility or to the reduction of the economic activity it provokes, the countries will set taxation quotas al lower levels than in the case of the existence of concentration, since, in case of fiscal competition, the negative externality on collective collections, collections directed to public goods and services will be neglected, which will lead to an under-dimensioning of the collective sector. As such, elimination of trans-frontier differences in matters of taxation will contribute to the reduction of the geographical distortions in investment, perception of income, etc., decision making, allowing creation of the Union efficiency.

In matters of equity, fiscal competition distorts both intra-territorial equity between the tax-payers of the same state, but also the equity between countries, since this encourages a speculative behavior at companies and particular entities, by use of the public services of a country or other but paying taxes in only one country.

This fragmentation of the taxation systems constitutes, in some of its elements, a way towards tax evasion, the loss of fiscal income following fraud and tax evasion being estimated only in the case of value added tax, between euro 200 and 250 bln.

Coordination of the fiscal regimes of member states could be a solution for the removal of the prejudices which competing national fiscal policies could bring to the domestic market and achievement of the European Union goals.

But, in matters of taxation, the decisional procedure requires unanimity in the European Union Council, which until now hindered the adoption of common rules in matters of direct and indirect taxation. The reason would be that, observing the fiscal sovereignty of each member state, it if not agreed to apply pressure in establishing fiscal regimes, which are influenced, besides other factors, by the politic and cultural ones.

Achievement of a genuine fiscal coordination in the 27 member states of the European Union is a difficult, costly and long-duration process.

Fiscal coordination at European level must consider the nature of taxes. Thus, while in case of indirect taxes it is imposed a high degree of harmonization, as these influence free circulation of goods and services, in case of direct taxes the harmonization has mainly as effect taxation of the income of large, trans-national companies and the income of persons with activities in several countries, regulation of the other categories of taxes being left in the responsibility of the member states.

Further on, the issue of European coordination will be approached exclusively from the point of view of direct taxes.

Thus, although in the field of direct taxes, the freedom of member states is as yet large enough, the domain of application thereof being less regulated at European Union level, there still exists a series of initiatives by which there is envisaged a better coordination aimed at eliminating double taxation to the benefit of persons and businesses as well as to fight tax evasion and conserve the taxation bases.

The main problem which could occur under conditions of a large freedom of the member states in seating the direct taxes appears in case of trans-frontier businesses. Thus, physical entities and companies which wish to work or invest in other member states can be affected by double taxation of certain income or the appearance of extra costs generated by the necessity of fiscal conformity.

Fiscal barriers in case of trans-frontier activity have constituted the subject of a large debate in the last years, by which there was pursued modification of the fiscal regimes of member states so that these do not hinder assurance of the four fundamental freedoms stipulated by the European Union Treaty (*free circulation of goods, services, persons and capitals*).

In the field of company taxation, at European Union level there are envisaged, on the one hand, prevention of fiscal competition harmful between member states and on the other hand, assurance of the free circulation of capitals.

As such, the possibility of occurrence of double taxation of profits in case of companies which carry out trans-frontier economic activities have imposed adoption of certain legislative measures common to all member states.

These were initiated in 1990 by two directives and a convention:

- “Parent Subsidiary” Directive (90/435/CEE), on the common fiscal regime applicable to parent-companies and their branches, which regards abolition of double taxation between various member states of the profit distributed between the parent-company situated in one country and its branches situated in other member states;
- “Merger” Directive (90/434/CEE), which has in view reduction of the fiscal burden which can hinder reorganization of companies;

- Convention 90/436/CEE, based on article 239 of the European Union Treaty and which introduces an arbitrary procedure of avoidance of double taxation regarding adjustment of the profit between associated companies situated in different member states.

In 1997 there was adopted a package of measures regarding direct taxation, whose scope is to fight harmful fiscal competition, with the intention to sustain a fiscal coordination in the European Union, applicable especially to companies.

Three domains were especially approached: company tax, taxation of income resulting from savings and taxation of royalties between companies.

The package of measures adopted on December 1, 1997, by the Council of Europe, also named "Package of measures regarding taxation" or "Monti Package", had in view:

- fighting competition in the field of taxation;
- elimination of distortions in the unique market;
- reorientation of the increasing tendency of taxing labor by a taxation system oriented towards the labor.

Within the frame of the "fiscal package" there were adopted:

- a code of behavior for business taxation, which represents the common wish of the member states, even though it is not a legal instrument. According to this code, the member states will fight competition in the field of taxation and will avoid introduction of measures having as effect competition in this sphere. There was also established a system of exchange of information on fiscal measures and an evaluation of this system;
- a normative instrument aimed at removing existing distortions in effective taxation of income resulting from savings, guaranteeing a minimum level of taxation of the income from interest obtained within the European Union (Directive 2003/48/CE, on saving operations);
- a legislative measure aimed at eliminating retentions at the source on trans-frontier payment of interest and royalties, made between associated companies (directive on payment of interest and royalties).

At present there exist ever more intense preoccupations to trigger a harmonization process of profit, unifying the taxation rules of corporations by a consolidated, common taxable basis.

Also, in the field of taxing physical entities, an European level preoccupation is that of preventing fiscal discrimination in case of taxing savings and pensions. Thus, the European Commission considers that the citizens of Europe must not be hindered in working in other member states by such issues as pension transfer and taxation.

In the field of savings, the citizens of Europe must be free to place them where they think they obtain the best income, the fiscal obligation remaining in the state of residence. On the other hand, the member state governments can record losses of income when their residents avoid declaring income from savings. An important step towards tax evasion avoidance in case of saving operations was achieved by coming into force, on July 1, 2005, of Directive 2003/48/CE, by which member states must introduce automatic exchange of information regarding payment of income by non-residents.

In December 2006, the European Commission presented three communications (COM 2006/823, COM 2006/824, COM 2006/825), regarding coordination of fiscal policies of member states, of which two approach specific issues such as trans-frontier losses and tax imposed in another country. These communications treat almost exclusively taxation of companies (only the communication regarding the tax imposed in another country makes reference to physical entities) and pursue more an improvement of interaction between various national fiscal systems than a harmonization in this field.

The communications were presented, on the one hand, in an attempt to find quick solutions to issues related to trans-frontier economic activities which, on a long term, can be solved by way of a common consolidate basis for company taxation (CCTB), and on the other hand, to solve any issue which could survive after introduction of such a consolidated taxation basis.

According to the European Commission (COM(2206)823), coordination of the fiscal systems is required to remove discrimination and double taxation, thus avoiding lack of taxation and reducing the costs related to the assurance of conformity for companies and physical entities which must apply several fiscal systems.

The European Economic and Social Committee supports[1] the European Commission proposal of elaboration of a common, consolidated basis for company taxation, one of the principles formulated in the CESE endorsement being that CCTB must be mandatory in order to be completely efficient.

Another issue under the attention of the European Commission is the fiscal treatment of trans-frontier losses[2]. It is taken into consideration the fact that, lacking a trans-frontier compensation of losses, a company with activities in several countries will pay greater taxes than a company carrying out its activity in only one country. Application of CCTB could solve this issue, but until its elaboration, the Commission suggests various trans-frontier compensation methods for the losses of a parent-company when the losses are covered by a branch and for companies with work points/branches in other countries.

In the majority of the member states, for groups there is possible a compensation of losses incurred inside the same state. If there are branches in

1 Opinion of the European Economic and Social Committee/2007/1264 on the COM(2006) 823, COM(2006)824 and COM (2006) 825

2 COM (2006) 824

other countries, compensation is possible only in exceptional cases. This was the situation in the *Marks and Spencer* case. According to the award pronounced by the European Court of Justice, the losses will be compensated at the parent-company only when there are no other possibilities to obtain compensation of the loss in the country where the branch has its headquarters.

The companies within a group are separate entities from the legal point of view and are taxed individually. In spite of that, 19 member states have opted for the introduction of national systems of collective taxation of the group inside the country. The majority have opted for accumulation of the total taxation, while other accept only the possibility of loss compensation. Under the circumstances in which national provisions regarding trans-frontier compensation of losses differs from one state to another, application of CCTB could be a solution for the companies which carry out activities in several countries.

In Communication COM(2006) 825, on the tax imposed in another state and the necessity of coordinating the fiscal policies of member states, the European Commission deems that, when income not achieved between companies are transferred, there must be applied the same rules regarding deferment of tax payment on the territory of one country or between different countries. In spite of that, issues occur because the provisions regarding income not achieved doffer one from another. Furthermore, the insufficient flux of information between fiscal authorities and companies or physical entities involved may lead to lack of taxation or double taxation.

By the Resolution of October 2007/2097(INI)[1], the European Parliament supports the efforts of the European Commission to create a common, consolidated basis of taxation of the companies (CCTB) and deems that this will lead to an increase of transparency, allowing the companies to operate overseas according to the same rules used in the country of origin, to the intensification of trans-frontier commercial exchange and investments and considerable reduction of administrative costs and possibilities of tax evasion and fraud.

It also reminds that CCTB will mean common norms regarding the taxation basis and will not affect in any way the freedom of member states to set further on their own taxation quotas.

In the opinion of the European Commission, CCTB must be uniform, to determine a simplification, at the same time establishing a framework of common standards, but in order to establish a genuine unified basis of common taxation, there must also be created a documentation comparable, or at best, common, in order to record trans-frontier economic activities.

---

[1] European Parliament resolution of 24 Octomber 2007 on the contribution of taxation and customs policies to the Lisbon Strategy (2007/2097(INI))

References

*** Communication from the Commision to the Council and the Parliament and the European Economic and Social Committee on Coordinating Member States' direct tax systems in the Internal Market (COM (2006) 0823)
*** Communication from the Commision to the Council and the Parliament and the European Economic and Social Committee on Exit taxation and the need for co-ordination of Member States' tax policies (COM(2006) 0825)
*** Communication from the Commision to the Council and the Parliament and the European Economic and Social Committee on Tax treatment of Losses in Cross-Border Situations (COM(2006)0824)
*** Opinion of the European Economic and Social Committee/2007/1264 on the COM(2006) 823, COM(2006)824 and COM (2006) 825
*** European Parliament resolution of 24 Octomber 2007 on the contribution of taxation and customs policies to the Lisbon Strategy (2007/2097(INI))
*** Activities of the European Union, Taxation, www. europa.eu
*** www.worldwide-tax.com

Romanian Economic and Business Review – Vol. 2, No. 4

DEFENDING CLUSTERS AGAINST CRITICS

Sarmiza Pencea*

Abstract

In recent years, almost everybody became interested in clusters. Companies, businessmen, scholars and policymakers alike seem to be fascinated by the clustering phenomenon and its potential to trigger, or to further stimulate, economic growth and development. This remarkably large interest seems to be entirely justified if we just overview some of the most important benefits clusters can generate.

In recent years, almost everybody became interested in clusters. Companies, businessmen, scholars and policymakers alike seem to be fascinated by the clustering phenomenon and its potential to trigger, or to further stimulate, economic growth and development.

This remarkably large interest seems to be entirely justified if we just overview some of *the most important benefits* clusters can generate:

- Clusters create agglomeration economies, economies of scale and scope, generating spill-over effects, reducing costs and increasing efficiency;
- They combine cooperation and competition in ways that improve performance and stimulate innovation;
- They improve access to resources, information, specialized infrastructure, institutions, services and financing;
- They encourage the birth of new companies (spin-offs and start-ups), which generates a dynamic and competitive environment, proper for economic growth, higher productivity and competitiveness;
- Clusters improve learning processes and fasten the diffusion of knowledge and best practice;
- They also help member companies to better identify and turn into account opportunities, and, on the other hand, to better face challenges and risks;
- Clusters make it easier for companies to export, to expand abroad, to cooperate internationally and to get global recognition;
- For the regions where they function and for the local communities in these regions, they bring more and better paid jobs, better opportunities for

* Sarmiza Pencea, Ph.D is researcher at the Institute for World Economy in Bucharest.

setting up businesses, higher investments, more efficient use of local resources, economic growth and higher living standards.

When studying the economic literature on clusters, one can notice that, just like any other concept, idea, or practice, besides positive attitudes, clusters also gave rise to some critical remarks and worries.

Speaking about positive attitudes, we should point out that, in spite of their numerous benefits (of which only some of the most important have been mentioned here), *clusters and cluster policies should not be seen as universal panaceas*, simply because they cannot solve each and every economic problem. Clusters and cluster policies should be seen only as what they really are: a potential means to improve the economic environment and to increase firm competitiveness. This is extremely important, but it surely doesn't cover all the range of questions related to economic development.

Speaking about critical remarks and worries, we come to the real focus of this paper, which is to look at the potential disadvantages clusters could create for the economy of the regions where they are located, or for the local communities in these regions.

1. One critical remark, which generated extensive debates in cluster literature,[1] is that *the deep specialization induced by clusters diminishes diversity* in the regions of their location.

We obviously cannot deny that clusters deepen specialization, but we must reassess the well-documented fact that *specialization is beneficial*, because it leads to better quality, economies of scale, higher efficiency and improved competitiveness in international markets.

On the other hand, in an encouraging business environment, well-performing clusters are able to determine the development of a whole range of different activities, which are either linked in the production chain of their core activity, or are complementary, or support activities. Also, powerful clusters normally generate the birth of new companies, of new fields of activity and of other new clusters in completely different categories. Therefore, it means that *clusters may contribute to economic diversification* and that *normally, market mechanisms enable clusters to strike the right balance between specialization and economic diversification.*

Finally, *if governments manage to treat all clusters equally,* irrespective of their category, size, age, performance or power, supporting projects on a competitive basis and not clusters selected in a discretionary manner, then diversity can be easily preserved.

2. Another critical remark is that *the presence of clusters could put the other industries in their region at disadvantage.* Companies functioning in a completely different field than the cluster located in their region, might

[1] Ammirato *et al* (2003).

feel that they are disadvantaged by its presence, especially because of the competition for labour and other inputs.

But, this phenomenon is part and parcel of the normal changes that occur in a market economy. Companies must face this sort of challenges. They must *learn to manage change*, to adapt to the new environment, to try to identify and use the opportunities created by, for instance, the birth of a cluster in their region, and to avoid or reduce the potential damages. The companies which prove themselves able to adapt, will survive, while the others will disappear, and although this might sound very drastic, *this is the market mechanism which leads to economic restructuring and upgrading and to better allocation of resources.* If the resources in one region are better turned into account by the cluster than by the other companies, it means that both the presence of the cluster, and the restructuring, or the disappearance of the other companies are beneficial, leading to superior economic performance in the region.

3. A further remark, connected to the previous one, is that clusters could have a negative impact on the local population if a *region becomes too dependant on the specific activities of clusters.*

Here we must underline that there is a great difference between the local dependence on a cluster, and the kind of dependence specific to mono-industrial regions. *A cluster is not mono-industrial.* Even if it has one core activity, *a cluster always develops, vertically and horizontally, many other different activities* and, additionally, because clusters relay heavily on innovation, they often become the *breeding place of many young companies*, *in newly born fields.*

Therefore, the local communities cannot not face the risks of a mono-industrial area, because in developing or mature clusters, innovation, efficiency, productivity and competitiveness increase constantly; this leads to higher wages and increased buying power for the local population, higher incomes for the local governments, better public services and investments, and all these allow for higher living standards. This is completely opposed to the situation in mono-industrial areas, where both the monopoly and the potential bankruptcy of the only industry in the region, leave employees without choices and bring unemployment and poverty.

4. Another worry expressed by theoreticians is that *clusters might become resistant to change.* [1] Geographic proximity in a cluster, they say, can be both an advantage and a disadvantage. The positive aspect is that proximity allows for faster progress along a given path, while the negative aspect is that the very success of the cluster might turn it resistant to change.

Clusters offer an environment which promotes learning, competitiveness and growth, but along the same path, of their core activity. The question is if such

---

[1] Lundvall (2003).

structures could accept a radical change, the switch to another path, required by the market when their core activity becomes obsolete.

In our opinion, the answer is quite obvious. What is obsolete disappears, sooner or later, irrespective of any opposition. Just like living beings, clusters are born, they grow, become mature, decay and die.

Indeed, considering their past success and the difficulties of switching to a new core activity, the companies in a cluster might show resistance to radical change. Still, their choice, at the right moment, could make the difference between survival and death, and therefore, they will normally fight to survive, switching to a new activity no matter how difficult this might be.

5. Finally, some critics consider that *cluster-based development cannot work in country X, because the companies in that country lack any propensity to cooperate with each other.*

But, numerous empirical studies show that clusters are functioning all over the world, irrespective of their cultural contexts. Companies willingly choose to make part of a cluster because they get the opportunity to become more profitable and competitive. When they have to cope with fierce competition and their survival comes to depend on their agglomeration in clusters, companies will make this choice naturally, and they will cooperate with each other.

The birth and proliferation of clusters is a natural stage in the evolution of companies and of the business environment, therefore they will appear sooner or later in every economy. "*The challenge for an economy is to move from isolated firms to an array of clusters, and then to upgrade the breadth and sophistication of clusters to more advanced activities.*"[1]

References

Ammirato, Pierro, Kulkarni, Anand, Latina, David . 2003. *Clusters - Victorian Businesses Working Together in a Global Economy*, Discussion Paper,

Cluster Working Group, Department of Innovation, Industry and Regional development, Melbourne, Australia, October.

Brusco, Sebastiano. 1983. The Emilian Model: Productive Descentralization and Social integration, *Cambridge Journal of Economics* 6, 1983, citat de Ammirato, P. et al.

Ketels, Christian, Lindquist, Goran, Solvel, Christian 2006. *Cluster Initiatives in Developing and Transition Economies*, Center for Strategy and Competitiveness, Stockholm.

Lundvall, Bengt-Ake. 2003. *Industrial Clusters and Competence Building in the Era of the Globalizing Learning Economy* - Aalborg University, Dept. Of

[1] Porter (2003).

Business Studies, Denmark, Lecture at the opening of the Thailand Science Park, June.

Porter, Michael E. 1990. *The Competitive Advantage of Nations*, The MacMillan Press Ltd., London and Basingtoke.

Porter, Michael E. 2003. "The Economic Performance of Regions," *Regional Studies*, vol. 37.

Porter, Michael E. 2003. "Building the Microeconomic Foundations of Competitiveness", in: *The Global Competitiveness Report 2002-2003*, World Economic Forum, New York, Oxford University Press.

Solvell, O., Lindqvist, G., Ketels, Ch. 2003. *The Cluster Initiative Greenbook, TCI Global Conference*, Gothenburg, Sweden, September 2003, 1st Edition August.

van der Linde, Claas. 2003. Findings from the Cluster Meta Study, www.isc.hbs.edu

Romanian Economic and Business Review – Vol. 2, No. 4

THE ROLE OF STRATEGIC ALLIANCES IN INTERNATIONAL BUSINESSES

Georgiana Cebuc*

Abstract

Market globalization and impressive market growth force a lot of companies to declare themselves in the position of not having the critical strategic dimension, necessary for a successful competition gigantic markets. As a consequence, companies may be forced to resort more and more, to newer cooperation types, which were inconceivable in traditional economic development and when national markets prevailed. Signing alliances among companies may change the force field on national and international markets and may profoundly reconfigure the respective markets.

1. The architecture of cooperation: managing coordination costs and appropriation concerns in strategic alliances

One of the fastest growing trends for business today is the increasing number of strategic alliances. According to Booz-Allen & Hamilton, strategic alliances are sweeping through nearly every industry and are becoming an essential driver of superior growth. Alliances range in scope from an informal business relationship based on a simple contract to a joint venture agreement in which for legal and tax purposes either a corporation or partnership is set up to manage the alliance

Corporations have increasingly seen alliances as attractive vehicles through which they can grow and expand their scope, and the rate at which interfirm alliances have been formed in the last two decades has been unprecedented. A notable characteristic of this growth has been the increasing diversity of interfirm alliances. The nationalities of partners, their motives and goals in entering alliances, and the formal structures used to organize the partnerships have all become increasingly varied. The variety of organizing structures implies that firms face numerous choices in structuring their alliances. This study examines why firms choose the specific governance structure they do

* Georgiana Cebuc is Assistant Professor of Economics and International Business at the Romanian American University in Bucharest.

in alliances. It explores some of the conditions at the inception of an alliance that influence the formal structure used to govern it.

Partners may provide the strategic alliance with resources such as products, distribution channels, manufacturing capability, project funding, capital equipment, knowledge, expertise, or intellectual property. The alliance is a cooperation or collaboration which aims for a synergy where each partner hopes that the benefits from the alliance will be greater than those from individual efforts. The alliance often involves technology transfer (access to knowledge and expertise), economic specialization, shared expenses and shared risk

The governance structure of the alliance is the formal contractual structure participants used to formalize it. Prior research has distinguished among such formal structures in terms of the degree of hierarchical elements they embody and the extent to which they replicate the control and coordination features associated with organizations, which are considered to be at the hierarchical end of the spectrum. At one end are joint ventures, which involve partners creating a new entity in which they share equity and that most closely replicate the hierarchical control features of organizations. At the other end are alliances with no sharing of equity that have few hierarchical controls built into them. Organizational scholars have long studied the basis for hierarchical controls within organizations and viewed them as a mechanism to manage uncertainty. Prior research on contract choices in alliances and the extent of hierarchical controls they embody has been influenced primarily by transaction cost economists, who have focused on the appropriation concerns in alliances, which originate from pervasive behavioral uncertainty and contracting problems. Following this perspective, scholars have suggested that hierarchical controls are an effective response to such concerns at the time the alliance is formed. Thus, the greater the appropriation concerns, the more hierarchical the likely governance structures for organizing the alliance. The logic for hierarchical controls as a response to appropriation concerns is based on their ability to assert control by fiat, provide monitoring, and align incentives. The operation of such a logic was originally examined in make-or-buy decisions. The same logic by which firms choose between the extremes of making or buying is also expected to operate, once firms have decided to form an alliance, in their choice of governance structure: when firms anticipate appropriation concerns, they are likely to organize alliances with more hierarchical contracts. While researchers have made significant advances in classifying alliance governance structures and in identifying their determinants, our understanding of alliances is limited by two factors inherent in much of that research. First, the research on alliances focuses on the anticipated appropriation concerns as the primary basis of the choice of governance structure. Building on the idea that an important feature of hierarchical controls is their ability to manage potential moral hazards, transaction cost economists suggest that hierarchical controls arise in alliances when participants anticipate such concerns. Even resource dependence theorists, who have looked primarily at the origin of ties rather than their structure, have suggested similar moral hazard concerns as a reason why firms may transform pure exchange relations into power relations.

While appropriation concerns originating from contracting obstacles, combined with pervasive behavioral uncertainty, can clearly be an important concern, once firms decide to enter an alliance, there is another set of concerns that arises from anticipated coordination costs. By coordination costs we mean the anticipated organizational complexity of decomposing tasks among partners along with ongoing coordination of activities to be completed jointly or individually across organizational boundaries and the related extent of communication and decisions that would be necessary. Coordination considerations are extensive in alliances. Litwak and Hylton noted that the specialized coordination in interorganizational relations is a challenge, "since there is both conflict and cooperation and formal authority structure is lacking." As a result, the anticipated interdependence resulting from the logistics of coordinating tasks can create considerable uncertainty at the outset of an alliance that is different from appropriation concerns. The uncertainty for participants concerns the way activities will be decomposed and integrated and the extent to which there is likely to be an ongoing need for mutual adaptation and adjustment.

The distinction between coordination costs and appropriation concerns can be understood with a hypothetical example. Imagine that an alliance is formed between two firms that have complete confidence in each other and face no appropriation concerns whatsoever. Despite this frictionless situation, they must still coordinate the division of labor and the interface of activities and products between them. This creates considerable uncertainty that alliance partners consider at the time they form an alliance and attempt to answer in structuring the relationship.

Hierarchical controls can be an effective solution in situations of high anticipated coordination costs. As noted by Barnard (1938), Chandler (1977), Thompson (1967), and others, an important basis for hierarchical controls is' their ability to provide superior task coordination, especially in situations involving high interdependence and coordination. For small businesses, strategic alliances are a way to work together with others towards a common goal while not losing their individuality.

Alliances are a way of reaping the rewards of team effort - and the gains from forming strategic alliances appear to be substantial. Companies participating in alliances report that at much as 18 percent of their revenues comes from their alliances. But it isn't just profit that is motivating this increase in alliances. Other factors include an increasing intensity of competition, a growing need to operate on a global scale, a fast changing marketplace, and industry convergence in many markets (for example, in the financial services industry, banks, investment firms, and insurance companies are overlapping more and more in the products they supply). Especially in a time when growing international marketing is becoming the norm, these partnerships can leverage your growth through alliances with international partners. Rather than take on the risk and expense that international expansion can demand, one can enter international markets by finding an appropriate alliance with a business operating in the marketplace you desire to enter.

Businesses use strategic alliances to:

- achieve advantages of scale, scope and speed
- increase market penetration
- enhance competitiveness in domestic and/or global markets
- enhance product development
- develop new business opportunities through new products and services
- expand market development
- increase exports
- diversify
- create new businesses
- reduce costs.

Strategic alliances are becoming a more and more common tool for expanding the reach of your company without committing yourself to expensive internal expansions beyond your core business

2. Stages of Alliance Formation

A typical strategic alliance formation process involves these steps:

- Strategy Development: Strategy development involves studying the alliance's feasibility, objectives and rationale, focusing on the major issues and challenges and development of resource strategies for production, technology, and people. It requires aligning alliance objectives with the overall corporate strategy.
- Partner Assessment: Partner assessment involves analyzing a potential partner's strengths and weaknesses, creating strategies for accommodating all partners' management styles, preparing appropriate partner selection criteria, understanding a partner's motives for joining the alliance and addressing resource capability gaps that may exist for a partner.
- Contract Negotiation: Contract negotiations involves determining whether all parties have realistic objectives, forming high calibre negotiating teams, defining each partner's contributions and rewards as well as protect any proprietary information, addressing termination clauses, penalties for poor performance, and highlighting the degree to which arbitration procedures are clearly stated and understood.

- Alliance Operation: Alliance operations involves addressing senior management's commitment, finding the calibre of resources devoted to the alliance, linking of budgets and resources with strategic priorities, measuring and rewarding alliance performance, and assessing the performance and results of the alliance.
- Alliance Termination: Alliance termination involves winding down the alliance, for instance when its objectives have been met or cannot be met, or when a partner adjusts priorities or re-allocated resources elsewhere..
- The advantages of strategic alliance includes 1)allowing each partner to concentrate on activities that best match their capabilities, 2)learning from partners & developing competences that may be more widely exploited elsewhere, 3) adequacy a suitability of the resources & competencies of an organization for it to survive.

3. Risks of Strategic Alliances

Strategic alliances can lead to competition rather than cooperation, to loss of competitive knowledge, to conflicts resulting from incompatible cultures and objectives, and to reduced management control. A study of almost 900 joint ventures found that less than half were mutually agreed to have been successful by all parties.

An alliance can fail for many reasons:

- failure to understand and adapt to a new style of management
- failure to learn and understand cultural differences between the organizations
- lack of commitment to succeed
- strategic goal divergence
- insufficient trust
- operational and geographical overlap
- unrealistic expectations

4. More and Bigger Alliances

The IT deals, in turn, are only part of the unstoppable trend in world business towards more and bigger alliances of all kinds. On the day that IBM and Toshiba unveiled their latest partnership, Wendy's, the fast food chain, announced a 400 million$ merger with a Canadian coffee and doughnuts chain, Hortons. The two have been allies for four years, coming together to build 'combo' units selling both hamburgers and doughnuts.

The reasons for the alliance are strikingly clear from the numbers.

The combos save about a quarter of the costs, and sell a fifth more than either a Wendy's or Hortons on its own. That's often the basis of an alliance: to reap the synergies of sharing capital and operating costs while tapping a bigger market than either partner could achieve independently. The word synergy (meaning that two plus two supposedly makes more than four) was once fulsomely used to justify takeovers and fell into disrepute when their promised payoffs didn't arrive. But in their quieter way, alliances seem to be delivering the goods.

That's after a discouraging start, when alliance results appeared to be no better than those of allegedly synergistic acquisitions. It isn't just that managements have become more adept at handling strategic alliances (though they plainly have). The improvement results, first, from necessity: and second, from intrinsic aspects of the alliance relationship. Necessity is the mother of more than invention. If a project is absolutely vital to your future, the incentive to make it work is absolutely compelling.

Even three-way partnerships can pay off where necessity rules. The PowerPC chip mentioned above has been widely hailed technically. Nobody noted the managerial achievement involved in bringing so complex a device into production and to market. But Motorola, Apple and IBM all had very powerful motives in their respective confrontations with Intel. Without an advanced microprocessor, Motorola would have been forced out of the market: Apple could never have competed with its MS/DOS rivals: and IBM would have been wholly at Intel's mercy.

As it happens, Apple has probably gained most of the trio and IBM least, because the latter found prohibitive the inherent disadvantages in offering two directly competing PC lines. That happens with alliances - they evolve over time as circumstances change, and may even develop (as with Hortons and Wendy's) into full-scale merger. So the partners have to be flexible for the alliance to work. That flexibility is one of the key, intrinsic characteristics that explain how so many alliances have resisted the inflexible forces that commonly mar straight amalgamations.

5. Focus and direction

Another powerful factor is that, for an alliance to be effective, each side must have a clear benefit in view and in realization. This clarity of purpose is linked with two other essentials of good management and winning strategy: focus and direction. The alliance is focused on a specific, uncluttered shared objective, and execution is placed firmly in the hands of an operating management whose task is equally clear. A clear line, moreover, is drawn between the operators and their overlords. There's no confusion between the two roles, as there is inside nearly all companies.

The good alliance in fact closely resembles a first-class piece of project management - the mode which is taking over much work inside large organizations. With external alliances also growing fast, the whole pattern of strategic formation and execution is plainly changing towards genuine partnership. That changes the nature of the corporation - every corporation. Consider the examples of the four major companies in quite different businesses mentioned above. Their alliances are so important that none of the four could now realize their ambitions without their many partners.

Smith Kline Beecham's necessities included tapping into drug-related research fields, like biotechnology, where it had no position itself. At Allied Domecq, plans for developing as a global force in spirits depended on continued success with partners in markets like Japan. For Pilkington, alliance with a Japanese competitor was the key to expanding in automotive glass in the US and other markets. At GKN, alliances were the foundation for its attack on global markets for automotive drive-trains.

In all these relationships, the most striking element is their durability and relative smoothness. They became taken for granted, but only because the respective partners had worked hard, and were still working, to ensure that the benefits were mutual and the management effective. Whether the lessons of allied success are being transferred into the internal management of the allies themselves is another matter. But that's the next logical step - and the next necessity.

Too many companies joke about the 'tubular bells' or 'silos' that characterize their organizations: separate compartments which never unite in the common cause of corporate success. Sheer difficulties in communication used to explain (though not justify) these harmful internal divisions. But Intranets and e-mail sweep away the difficulties. Departments, divisions and separate businesses can keep each other fully informed at all times and in real time. Nothing less makes any sense.

If companies genuinely want to grow, especially globally, the alliance route is sure to be required, both inside and outside. Externally, the approach is identical whether the partnership dynamic is all or any of these: scale, pooling expertise, cracking new markets, cost reduction, minimizing and optimizing investment, competitive advantage, or sharing technology, high or low.

In high-tech, especially in information and communications, alliances are indispensable, not least in developing and marketing the technology that binds customers with their allies and enables them to achieve genuine synergies. The old adage, 'if you can't beat 'em, join 'em', has a new and universal twist: 'join 'em, and you can beat anybody.'

I would say that this new concept will change the way that we do business.

References

David C. Mowery, Joanne E. Oxley, Brian S. Silverman, Strategic Alliances and Interfirm Knowledge Transfer. 1996. *Strategic Management Journal*, Vol.17

Yoshino and Rangan, Michael Y. and U. Srinivasa. 1995. *Strategic Alliances – An entrepreneurial approach to globalization, First Edition.*

Trott, Paul. 2005. *Innovation Management and New Product Development*, Third Edition. Pearson Limited Edition.

B. Barney. 2007. *Gaining and sustaining competitive advantage.*

Romanian Economic and Business Review – Vol. 2, No. 4

THE TIMETABLE FOR EURO ZONE ADMITTANCE

Simona Poladian and Eugen Andreescu*

Abstract

If several years ago we spoke about EU enlargement now we are talking about Euro Zone extension. The Euro Zone is preparing to receive more members. This aspect results from the political representatives from sides, Euro area and countries from outside. In spite of some postponements the next wave of Euro Zone enlargement is scheduled for January 2008 and includes Malta and Cyprus. That's why Euro Zone increases from 13 to 15 the number states that adopt Euro.

If several years ago we spoke about EU enlargement now we are talking about Euro Zone extension.

The Euro Zone is preparing to receive more members. This aspect results from the political representatives from sides, Euro area and countries from outside. After the Slovenian Euro adoption since January 2007, the number of Euro countries increased to 13. This is the first step to a greater enlargement after six years of break when Greece was accepted (2001).

The EU enlargement, by opening its borders since May 2004 to a more 10 countries, has initiated some kinds of euphoria atmosphere regarding Euro area admission in the following 2 or 3 years. But the practical integration process, namely the necessary conditions that should be implemented in society, has proved to create difficulties in these economies and has determined some countries such Czech Rep. Estonia, Latvia and Lithuania and Hungary to redraw the initial target established for entering into Euro Zone. The main cause of this postponement is the fulfilling of the Maastricht criteria.

In spite of some postponements the next wave of Euro Zone enlargement is scheduled for January 2008 and includes Malta and Cyprus. That's why Euro Zone increases from 13 to 15 the number states that adopt Euro.

The rest of the 12 EU countries is maintaining the status of "derogation member states" until they fulfill the necessary restrictions. Among these, only 10, namely, Sweden, Czech Rep., Estonia, Latvia, Lithuania, Poland, Hungary, Slovakia, Bulgaria and Romania have the obligations to adopt Euro when are

* Simona Poladian is researcher at the Institute for World Economy in Bucharest.
Eugen Andreescu is researcher at the Institute for World Economy in Bucharest.

ready. But only Slovakia (2009) and Romania (2014) has established target term for Euro adoption.

11 EU countries formed at 1 January 1999 the Euro Zone.

THE TIMETABLE OF EURO ADOPTION

EU members (since 1960)	Becoming EU Member	Becoming ERM member	Euro adoption	Currency	Currency regime	Central level of exchange
Denmark	1973	March 1979	-	Krona	ERM: between -2,25and +2,25%	7,46
Ireland	1973	March 1979	1999	Euro	-	-
UK	1973	October 1990-September 1992	-	Pound	Free floating	-
Greece	1981	March 1998	2001	Euro	-	-
Spain	1986	June 1989	1999	Euro	-	-
Portugal	1986	April 1992	1999	Euro	-	-
Austria	1995	January 1995	1999	Euro	-	-
Sweden	1995	-	2011	Krona	Free floating	-
Finland	1995	October 1998	1999	Euro	Euro	-

Greece has joined to the group since 2 Jan 2001. Next country that prefers Euro from Jan 2007 is Slovenia. Malta and Cyprus enlarged from the 1 Jan. 2008 the border of Euro Zone. Next is the turn of Slovakia for 2009, then it is estimated an enlargement with Lithuania, Latvia, Estonia; Bulgaria estimates the adoption of Euro for 2010, then Romania and Hungary in 2014).

Some postponements of these terms are possible. They depend on the respecting of the Maastricht restrictions. For example, Hungary is confronted with a very large budgetary deficit (10%) and a public debt that exceed 60% of the GDP. Baltic countries are fighting with a high inflation and Romania also. Slovakia is having problems with inflation and long term interest.

EU members (since 2004)	Becoming EU Member	Becoming ERM member	Euro adoption	Currency	Currency regime	Central level of exchange
Cyprus	2004	Since April 2005	2008	Pound	ERM between -15 and +15%	0,585
Czech Republic	2004	2008-2011	2011-2014	Krona	Free floating with Euro reference	-
Estonia	2004	June 2004	2009-2010	Krona	ERM between -15 and +15%; monetary board	15,65
Hungary	2004	2011	2014	Forint	Bilateral rates between -15 and +15%	282,0
Poland	2004	2010	2013	Zlot	Free floating	-
Slovenia	2004	June 2007	2007	Tolar	ERM between -15 and +15%	239,5
Malta	2004	April 2005	2009-2010	Lat	ERM between -15 and +15%	0,429
Latvia	2004	April 2005	2009-2010	Litas	ERM between -15 and +15%	0,703
Lithuania	2004	June 2004	2009	Krona	ERM between -15 and +15%; monetary board	3,45
Slovakia	2004	Nov. 2005	2009	Krona	ERM between -15 and +15%	38,45
Bulgaria	2007	2007	2010	Leva	Euro monetary board	1,96
Romania	2007	2010-2012	2012-2014	Leu	Floating	-

ERM II: The ERM is based on the concept of fixed currency exchange rate margins, but with currency fluctuations had to be contained within a margin of 15% on either side of the bilateral rates.

The Estonian kroon, Lithuanian litas, and Slovenian tolar were included in the ERM II on 28 June 2004; the Cypriot pound, the Latvian lats and the Maltese lira on 2 May 2005; the Slovak koruna on 28 November 2005.

The currencies of the three largest countries which joined the European Union on 1 May 2004 (the Polish zloty, the Czech koruna, and the Hungarian forint) are expected to follow eventually. Plans for Bulgaria are to apply for ERM membership in the beginning of 2007 and to commit to its rules regardless of the European Commission decision, while Romania plans to join ERM in 2010-2012.

EU countries that have not adopted the euro are expected to participate for at least two years in the ERM before joining the Euro zone. As Slovenia adopted the euro in 2007, the Slovenian tolar was removed from the ERM and from circulation.

Sweden is expected to participate in ERM in order to meet the convergence criteria required for switching currency, but has deliberately chosen to stay out of the mechanism, thus maintaining their currency Swedish krona. This choice is currently tolerated by the ECB, but it has been warned it won't be tolerated for newer union members.

The ERM member states are: Cyprus, Denmark, Estonia, Lithuania, Latvia, Malta and Slovakia.

The bilateral rates of the ERM members (22 march 2007)

Country/currency	Bilateral rates/Euro	Floating margin
Denmark/ Krona	7,46038	+ or – 2,25%
Estonia	15,6466	+ or – 15%
Lithuania	3,45280	+ or – 15%
Letonia	0,702804	+ or – 15%
Slovenia/talar[1]	239,640	+ or – 15%
Cyprus/pound	0,585274	+ or – 15%
Malta/ lira	0,429300	+ or – 15%
Slovakia/krona	35,4424	+ or – 15%

A very important aspect regarding the Euro adoption is its weight in export and import volumes.

-The highest-

Austria	63%
Italy	54%
Spain	54%
Nederland	53%
Belgium	50%

[1] Already Slovenia has entered into Euro Zone since 1 Jan 2007

-The lowest-

Greece	28%
Luxembourg	30%
France	43%
Finland	44%

-on the whole Euro area the weight of Euro in export volumes account for 49.7% versus $ that accounts for 44%-

As to the Euro weight in import volumes we could see:

-The highest-

Austria	61%
Belgium	46%
Spain	44%
Portugal	43%

-The lowest-

Greece	18%
Ireland	19%
Nederland	23%

-on the whole Euro area the weight of Euro in import volumes account for 35.2% versus $ that accounts for 55.7 %-

Among the newly EU countries the Euro weight in export volumes are:

-The highest-

Slovenia	88%
Czech Rep.	72%
Poland	70%
Romania	54%

-The lowest-

Cyprus	39%
Lithuania	51%

As to the Euro contribution in import values

-The highest-

Slovenia	82%
Romania	71%
Czech Rep.	71%
Poland	60%
Bulgaria	60%

-The lowest-

Lithuania	51%
Cyprus	58%

We could observe Slovenia having 88%, the highest weight of Euro in export volumes and 82% for import volumes. Austria is on the second place, at a large distance from the first position with a weight of 63% by exports and 61% by imports.

Generally speaking the newly EU countries are very tight by Euro in comparison with the former 15 EU countries. That's why we have reasons to believe that the way toward Euro Zone is not an easy one but is the right way.

Concerning the future EU enlargement we summarize in the following table countries that are willing to obtain full EU membership:

EU member (after 2011)	EU request	Negotiations process (since 2005)	EU member	ERM member	Euro adoption	Currency	Currency regime	Central level of exchange
In the process of negotiations								
Croatia	2003	2005	2011-2012	2011	2014	kuna	Limited floating with Euro reference	-
Turkey	1967	2005	2015 - ?	2015 - ?	2018 - ?	Turkish pound	Free floating	-
Outside negotiations								
Albania	2008	2012	2017	2017	2020	leka	Limited floating with Euro reference	-
Macedonia	2004	2008	2013	2013	2016	dinar	Limited floating with Euro reference	-
Bosnia	2009-2010	2015	2020	2020	2022	marka	Monetary Board with Euro reference	1,96
Serbia	2008	2011	2015	2015	2018	dinar	Free floating with Euro reference	-
Montenegro	2008	2011-2012	2015	2015	2018	Euro	German Mark adoption since Nov. 2000	-
Ukraine	2010	2012	2017	2017	2020	hrivna	Dolar Reference	5,0-5,1

Romanian Economic and Business Review – Vol. 2, No. 4

ELIMINATING ENVIRONMENTAL PROBLEMS: FROM DISCRETIONARY POLICY TO MARKET SOLUTIONS

Bogdan Glăvan*

Abstract

Environmental problems have become in the last decades a topic of large interest. Economists have analyzed the issue from different perspectives, in an attempt to find the most effective solution for the preservation of the environment. Although significant progress has been made, there is still much room left for further improvement both in the quality of the scientific debate and in the choice of practical policy tools.

1. Introduction

Environmental problems have become in the last decades a topic of large interest. Economists have analyzed the issue from different perspectives, in an attempt to find the most effective solution for the preservation of the environment. Although significant progress has been made, there is still much room left for further improvement both in the quality of the scientific debate and in the choice of practical policy tools.

This paper intends to put in a proper perspective the debate over environment protection, making a short review of the history of ideas concerning this subject. It argues that the property rights paradigm represents the most useful approach to environment issues.

2. How to deal with environmental problems 1: present environmental policy

Public discretionary solutions to contain environmental problems include taxation and tradeable permits

A. Taxation

Taxes are one of the oldest forms of pollution control. The idea of the Optimal Pigovian Tax is simple: internalize costs of pollution. This can be done

* Bogdan Glăvan is Associate Professor of Economics at the Romanian American University in Bucharest.

by imposing a tax of t on each unit produced. As pleasant as this approach might look like, it is nearly impossible to calculate the optimal rate of taxation because external costs are subjective and their measurement is therefore impossible. There is also the public choice argument against such a policy. Special interest groups, like climatologists, economists and environmental groups would gain from increased government intervention in the environment and will dictate government policy in the future. Further, as a pragmatic issue, taxes cannot be applied internationally. But in fact, some countries are polluted to a large extent by foreign countries (for example, 85% of Norway's pollution comes from England). Thus, the attempt to reduce environmental problems by taxation is challenged by serious factors.

B. Tradeable permits

Another solution to reduce pollution consist in the issuance of Tradable Permits (TP). It combines the features of a public measure (the target for pollution reduction is first established by the state; the state also establishes a specific regulatory framework for exchanging TPs) with those of a private solution (TPs are exchanged on the market and a free price emerges, indicating the costs to be borne by the polluter).

The concept of the pollution permit has become an increasingly popular topic of discussion for environmentalists in recent years, although the idea has been in existence since at least 1960s.

The government issues permits in exactly the number needed to produce the desired emission level. They give or sell its holder the right to pollute for a certain amount and they are freely transferable; they can be bought and sold on the market, even internationally, thus they act as property rights.

Establishing a market in tradeable pollution permits leads to a reduction of environmental problems because it becomes costly to continue to pollute. Firms that cannot achieve the targeted level have the option to purchase a permit from those companies that managed to reduce their level of pollution beyond the amount required by the government. Businesses can either buy permits or invest in technology to reduce pollution emissions - whichever approach saves them money. As such, companies are stimulated to find ways to decrease pollution.

On such a market, the demand for permits could increase for speculative or precautionary reasons. For example environmental organizations and environment friendly groups could use their own resources to by permits in order to hoard them. Thus, the number of emission permits available for industrial buyers will be limited, which will determine a drastic reduction of polluting activities (and perhaps their relocation).

For the system to be effective there needs to be common acceptance of the legal framework for the trading of permits and regulation of the amount of pollution produced. The Kyoto Summit on Climate Change (held in December

1997) witnessed a decisive move towards a greater use of internationally traded pollution permits – based on the idea that each country is required to achieve a specific percentage reduction in pollutants such as C02.

Potential problems with traded pollution permits:

- How are permitted levels of pollution decided? If based on current production levels they may be no advantage for firms that have *already* taken steps to control their pollution emissions
- Traded permits may see pollution being concentrated in certain geographical areas. At the Kyoto Summit, developing countries were not required to make reductions in pollution – but could be given credits for "certified reductions" in pollution that could be then traded with other countries. This might allow countries such as the United States to buy up pollution permits from LDC's (including many form high polluting countries in Eastern Europe) – and avoid the need to reduce pollution themselves
- There are likely to be high administrative costs associated with monitoring pollution emissions – particularly if the number of firms involved is very large.

Tradeable permits represent only second-best solutions to the problem of pollution or species exhaustion. "This system could, in some cases, be somewhat more efficient than those currently employed, although it leaves a great weight on bureaucratic intervention to fix, for example, prices and the total amount of pollution or fishing which can be carried out… Second-best solutions are parallel to those 'market socialism' reforms that were so deep a failure in the former communist countries of Eastern Europe" (de Soto, 1997, p. 186).

3. How to deal with environmental problems 2: free market environmentalism

Arguments for creating new property rights in the environment are generally based on arguments that market failure caused by externalities requires corrective government intervention, or that the market failure itself is solely due to inadequately specified property rights and it can be fixed by completely specifying private property rights in the environmental goods.

Complete specification of property rights would resolve environmental problems by internalising costs and relying on the incentives of private owners to conserve resources for the future.

The key to gaining agreement on a substantial and effective international climate change agreement is to better align the currently disparate incentive structures of the players. The incentive structure can be built as a result of a political process, or as the effect of the market process. The political process tends in its very nature to externalize costs through the coercive mechanisms of collective decision. Instead, the market process has the merit of internalizing the employment costs of resources and eliminating the free riding phenomenon.

Authors such as Terry Anderson and Donald Leal (2001) have documented numerous examples of environmental goods that can be and are supplied successfully in private markets, and empirical researchers examining state-centered models of environmental management have highlighted numerous cases of government failure. For land-based environmental assets such as forests and minerals, for example, evidence suggests that private-property solutions are highly successful in generating the necessary incentives that encourage resource conservation and help to overcome the problems of "free riding" associated with open-access conditions (De Alessi 2003). Thus, the record of forest management in Sweden under a predominantly private regime has been noticeably more impressive than the record of forest management under government ownership in the United States, Canada, and Great Britain. Similarly, the private ownership of wildlife in countries such as Botswana has had markedly more success in protecting stocks than government-sponsored trade bans on ivory products that have been put in place over much of Africa (Sugg and Kreuter 1994).

"A true market system would include both components-a price system and recognition of property rights. Tradeable permits alone are an incomplete solution. There is, however, a true market solution that depends on the price system without violating property rights. The first step is to establish a system of clearly defined and enforceable property rights. Once clearly defined, market forces will take over and determine the optimal level of pollution. If a firm creates pollution without first entering into an agreement, or if the parties cannot come to am agreement fixing the cost and degree of pollution, then the court system could be used to assess damages. Such a system provides an incentive for companies to reduce the amount of discharge or bear the full cost of their actions." (Block and McGee, 1994))

Therefore, the free market solution for environmental problems is privatisation. Since pollution problems occur because of a lack of defined property rights, broad-scaled privatisation of the public sector would clearly solve this dilemma. If most public goods were privatised, the property right structure was clear and pollution problems could be solved on an interpersonal base.

Comparison between different strategies to contain environmental problems

	Taxation	Tradeable Permits	Property Rights
Costs	Maximum	Variable	Dependent on individuals' preferences
Level of emissions	Depends on how rate is set	Capped, but it may fall due to flexibility in response	Dependent on individuals' preferences
Certainty	Mixed as tax unlikely	Depends on consistency	

	to fall but can be raised more easily than other forms of regulation can be changed	of administration, built/in review arrangements and whether changes are compensated	
Other issues	Can be seen as revenue raising device. Can be conflict between objectives, ie, less pollution means less revenue Impossible to calculate optimal taxation Cannot be applied internationally	Difficult to extend trading inter-regionally	Resolves ethical issues associated with environmental problems

References

Block, Walter and McGee, Robert. 1994. "Pollution Trading Permits as a Form of Market Socialism and the Search For a Real Market Solution to Environmental Pollution." *Fordham Environmental Law Journal* VI(1): 51-77.

Cait, Murphy. 2002. Hog Wild for Pollution Trading. *Fortune*, September 2.

Guerin, Kevin. 2003. "Property Rights and Environmental Policy: A New Zealand Perspective." *New Zealand Treasury Working Paper* 03/02.

OECD. 2002. "Implementing Domestic Tradeable Permits: Recent Developments and Future Challenges." *OECD Proceedings*.

De Soto, Jesus Huerta, 1997, "Entrepreneurship and the Theory of Free Market Environmentalism" in Leube, K., Petroni A. and Sadowsky J. eds., *An Austrian in France. Festschrift in honour of Jacques Garello*, Torino, La Rosa Editrice.

EVOLUTION OF THE EUROPEAN NEIGHBOURHOOD POLICY –INSTRUMENTS, LIMITS AND CONDITIONALITIES

Oana Mihaela Mocanu*

Abstract

There is no doubt that the enlargement of the European Union in 2004, with the eight Central and Eastern European countries plus Cyprus and Malta, completed in 2007 by the accession of Romania and Bulgaria has brought to the attention not only the need to reform the EU's institutional framework and to revise some policies, but also the way to approach the external relations, mainly with the new immediate neighbourhood. Confronted with new challenges at its Eastern borders, the European Union has proposed to its neighbours a European Neighbourhood Policy (ENP) that intends to avoid creating new dividing lines in Europe and also to ensure the development of fruitful cooperation relations with the partner states. Concentrating on adapting former mechanisms of cooperation and benefiting from the enlargement process experience, the ENP also brings new policy tools and instruments (see for instance the European Neighbourhood and Partnership Instrument) to the negotiation table. It remains under debate the ability and willingness of the EU Member States to join forces in order to define better and more coherently and concretely the support they intend to offer to the "ring of friends", as well as the extent to which the ENP partner states will identify other ways to embark on the necessary reform process, in the absence of the ultimate incentive: the perspective of membership to the European Union.

1. Introduction

The European Union's enlargement of 1st May 2004 (with Estonia, Czech Republic, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia, Cyprus and

* Oana Mihaela Mocanu is a researcher and project coordinator within the European Institute of Romania and also editor-in-chief of the Romanian Journal of European Affairs. She is a PhD candidate within the Academy of Economic Studies in Bucharest, International Business and Economics. Research areas of interest: European neighbourhood policy, enlargement, security and defense, globalization and regional integration. (oana.mocanu@ier.ro).

Malta), followed by Romania and Bulgaria on 1st January 2007, undoubtedly represents the most important event in the evolution of the *European project* in the last decade.

The changes entailed by this enlargement wave with so different countries than the older member states were not merely internal – political, economic, but mostly institutional – but also external, the new configuration of the borders of the European Union (EU) gaining more attention in the general policy of the Union.

The old institutions, mechanisms and policies in the EU external relations becoming rather insufficient for the new context after 2004, it was necessary to reconfigure these policies and to also bring a breath of fresh air to the EU policies towards the new neighbouring countries. The European Neighbourhood Policy (ENP) was set up precisely as a result of this necessity and as a consequence of moving the external borders of the Union further to the East.

Short comments will be given in this paper on the reasons for a new European Neighbourhood Policy, context, objectives, focusing on some conditionality elements and instruments, limits of the policy and the need to further consolidate the ENP.

Reasons for a European Neighbourhood Policy

Perceived as a moment of glory in the history of the European Union or only as the opening of a new and complicated chapter of sensitive issues, the EU enlargement towards the Central and Eastern European countries has represented the most important moment in EU's recent history. The firm commitment of those countries to democracy, rule of law, free market economy has perfectly fit the general objectives of the Union to extend the political, economic, security and stability climate to this part of Europe.

The enlargement has increased the interest of the European Union in developing strong cooperation relations with the new neighbouring countries. Initially, the new neighbours of the Union have positively received the proximity of their borders to the "western world". Despite early official declarations and positions, the enthusiasm from EU's part has not registered a very high level. The enlargement towards the Central and Eastern countries not only has internalized some of the shortcomings of the new member states, but has also brought the Union near unstable and conflict areas, with a low economic development level. Regions that in the past were the object of the more or less neutral official EU declarations/positions have become the immediate neighbourhood of the Union and the issue of securing the borders and ensuring a climate of peace, stability and security has been brought to the attention of EU policy-makers.

The different flaws in the adoption of an effective common position of the EU vis-à-vis different external policy actions (see for example the war in Iraq) has matched the ambiguity towards the new neighbourhood context. Confronted with potential terrorist pressures, proliferation of mass destruction weapons, failed states, regional conflicts, the European Union must deal with less predictable and less visible, but no less dangerous threats[1].

On the other side of the borders, the expectations are high. The countries in the EU's immediate neighbourhood have seen enlargement as an opportunity to get closer to prosperous areas and with high potential for growth and states like Republic of Moldova and Ukraine have reaffirmed their European vocation and orientation, hoping to become full members of the Union.

In the European Security Strategy (2003), the European Union envisages three strategic objectives: to respond to threats, to build a climate of stability in its neighbourhood, to contribute to an international order based on multilateralism. The enlargement should not and will not create new dividing lines in Europe. The goal is to create a "*ring of well-governed states*" to the East of the Union and to the Mediterranean area[2].

The forms of cooperation prior[3] to the European Neighbourhood Policy have proven not to be perfect and the structural shortcomings together with the new regional background were at the origin of building a new policy.

The asymmetry in the Union's relations with the neighbouring countries, combined with the particular context given by the EU's enlargement to the East and the new potential threats at its new borders have led to the necessity to redefine the framework of EU's external relations with its neighbours.

Main stages in the evolution of the European Neighbourhood Policy

Former president of the European Commission, Romano Prodi, has expressed, in a speech delivered to the 6th Conference of the European Community Studies Association (December 2002), the importance of a sustainable security and stability climate and the creation of a "*ring of friends*" around the Union, after its enlargement to the Central and Eastern Europe. The willingness to give more than a partnership, but less than accession was reiterated

[1] European Council, *A Secure Europe in a Better World – European Security Strategy*, Brussels, 12 December 2003, http:// www.consilium.europa.eu/uedocs/cmsupload/78367.pdf

[2] *Ibid*, p. 8

[3] The relations with the Mediterranean area were covered by the *Barcelona Process*, within the Euro-Mediterranean Partnership (since Nov. 1995), with the goal to create a free trade area by the year 2010 (through bilateral Euro-Mediterranean Association Agreements). The EU's relations with the Western Balkans were governed by the *Stabilization and Association Process* (starting 2001) aimed at developing a stability climate and economic development and, most of all, reconciliation in the region. The former Soviet countries were governed in their relations with EU by *Partnership and Cooperation Agreements* (starting 1994) that aimed at promoting trade relations and cooperation between the parties and support these countries in their transition process to a market economy.

in the offer that was about to be given to the new neighbours: "*everything with the Union, but the institutions*"[1].

The European Council in Copenhagen (December 2002) confirmed the necessity to strengthen EU's regional and cross-border relations with the neighbouring countries, in order to fully develop the region's potential and to *avoid the risk of creating new dividing lines in Europe*[2].

In this context, the Commission issued a Communication on 11th May 2003, on "*Wider Europe – Neighbourhood: A new Framework for Relations with our Eastern and Southern Neighbours"* which proposed the development of an area of prosperity, a ring of friends at the external borders of EU, characterized by close peaceful and cooperation relations.

The objectives[3] proposed by the new neighbourhood policy were concentrated upon poverty reduction and creation of a prosperity area, sharing common values, close political and cultural relations, solid cross-border cooperation and common responsibilities in conflict-prevention and on concrete benefits and preferential relations in a differentiated framework, according to each country's progress in political and economic reform.

In exchange for the progress in sharing the Union's values and in the effective implementation of the political, economic and institutional reforms, the neighbouring countries under the ENP were to benefit from a deeper economic integration, ensuring these countries a stake in the Internal Market and deeper integration and liberalization by promoting the free movement of persons, goods, capital and services[4].

To achieve these objectives, the Union envisaged a variety of instruments such as: an increased access to the Internal Market, preferential trade relations, opening of the market, a legal framework for migration and for free movement of persons, strengthening the cooperation in preventing and combating the threats, a higher involvement in conflict prevention and crisis management, integration of the new neighbours in the transport, energy, telecommunications networks, promotion of investments etc.

---

[1] Prodi, Romano, "*A Wider Europe – A Proximity Policy as the Key to Stability*", Speech at the 6th ECSA-World Conference, Brussels, 5-6 December 2002, SPEECH/02/619, http://ec.europa.eu/external_relations/news/prodi/sp02_619.htm

[2] European Council, Copenhagen, 12-13 December 2002, *Presidency Conclusions*, http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/73842.pdf

[3] European Commission, Communication from the Commission to the Council and the European Parliament - *Wider Europe-Neighbourhood: A new Framework for Relations with our Eastern and Southern Neighbours*, COM(2003) 104 final, Brussels, 11.03.2003, p. 9 http://ec.europa.eu/world/enp/pdf/com03_104_en.pdf

[4] European Commission, Communication from the Commission to the Council and the European Parliament - *Wider Europe-Neighbourhood: A new Framework for Relations with our Eastern and Southern Neighbours*, COM(2003) 104 final, Brussels, 11.03.2003, p. 4,10 http://ec.europa.eu/world/enp/pdf/com03_104_en.pdf

Two basic principles for the ENP were acknowledged by the European Commission: differentiation and progressivism. The countries in the EU's immediate neighbourhood do not start from a similar position in their relations with the Union, some of them being governed by free trade agreements, others by a strategic partnership (Russia), some by partnership and cooperation agreements and even if the Union has proposed a more coherent approach, offering the same opportunities to the neighbouring countries, the *differentiation* will remain a basic principle of ENP. On the other hand, the ENP partner states will benefit from (new) opportunities/incentives in accordance with the progress registered on their way to political and economic reform and to fulfill their commitments to consolidate their own administrative, institutional and legislative capacity.

The new neighbourhood policy will be implemented through the Action Plans, the main political documents governing the relations with the neighbours on medium term. These will be built on the already existing agreements and will set up strategic and political targets, common goals and a calendar for the regular evaluation of the progress on the way to economic, social and political reform.

On 1st July 2003, the Commission issued a Communication on a *New Neighbourhood Instrument*[1], establishing the main steps and actions to be performed in 2004-2006 and then after 2007. It was foreseen the introduction of *Neighbourhood Programs*, that would cover transport, energy infrastructure, environment, cultural cooperation etc[2].

The strategy document adopted in Brussels on 12th May 2004, *European Neighbourhood Policy – STRATEGY PAPER*[3], marked the official launch of the new policy. The strategic goal of the ENP, as stipulated in the strategy, was to share with the neighbouring countries the benefits of EU enlargement to the Central and Eastern Europe, for their consolidated stability, security and prosperity.

The European Neighbourhood Policy covers countries participating to the Euro-Mediterranean Partnership (Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia and Palestinian Authority – *Barcelona Process*); Moldova, Ukraine, Belarus; Armenia, Azerbaijan and Georgia (the latter three

---

[1] European Commission, Communication from the Commission - *Paving the Way for a New Neighbourhood Instrument*, COM(2003) 393 final, Brussels, 1 July 2003 http://ec.europa.eu/world/enp/pdf/com03_393.pdf

[2] European Commission, Communication from the Commission - *Paving the Way for a New Neighbourhood Instrument*, COM(2003) 393 final, Brussels, 1 July 2003, p. 8 http://ec.europa.eu/world/enp/pdf/com03_393.pdf

[3] European Commission, Communication from the Commission, *European Neighbourhood Policy – STRATEGY PAPER*, COM (2004) 373 final, Brussels, 12 May 2004 http://ec.europa.eu/world/enp/pdf/strategy/strategy_paper_en.pdf

being included under the ENP only at this stage)[1]. *Russia* has refused maintaining its relations with EU under ENP umbrella, preferring to further strengthen the Strategic Partnership with the EU (agreed "*on a more equal basis*"- at the summit in St. Petersburg in 2003), through the creation of four common spaces: an economic space (focused on energy and environment), a space of freedom, security and justice, a common space of cooperation in the external security and a common space in research, education and culture.

The ENP is implemented through a series of *instruments* such as country reports (for every neighbouring country, presenting the political, economic situation, main institutional issues, analysis of the bilateral relations etc), Action Plans, European Neighbourhood Instrument, other community programs (such as Taiex, twinning etc).

*The Action Plans***,** representing the central element of the ENP, identify several priorities[2]: commitment to common values, efficient political dialogue, economic and social development, promotion of trade relations, cooperation in justice and home affairs, integration into the infrastructure networks (energy, transport, environment, research and innovation), social policy. The Action Plans will be differentiated for each country, according to the specific needs of the partner ENP states and to their capacity to reform. These plans are drawn up by the Commission together with the ENP partner country, for 3-5 years and they are built on the previous agreements. Once their goals are achieved, they will be replaced by *European Neighbourhood Agreements*.

The European Neighbourhood Instrument will add to the already existing financial instruments (Tacis, Meda), gradually replacing them and will operate within the Action Plans framework.

Progress-to-date in consolidating the European Neighbourhood Policy

In December 2006, the European Commission has published a report *On Strengthening the European Neighbourhood Policy*, with several recommendations to further consolidate the mechanisms of ENP[3], illustrating the

[1] The **E**uropean **N**eighbourhood **P**olicy does **not** include either EFTA/EEA countries (Island, Liechtenstein, Norway, Switzerland), or candidate and potential candidate countries (Croatia, Macedonia, Turkey; Albania, Bosnia-Hertzegovina, Serbia, Montenegro) or Russia. The other two countries, once partners in the Euro-Med, Cyprus and Malta, have become, in the meantime, full members of the European Union.

[2] European Commission, Communication from the Commission*, European Neighbourhood Policy – STRATEGY PAPER*, COM (2004) 373 final, Brussels, 12 May 2004 http://ec.europa.eu/world/enp/pdf/strategy/strategy_paper_en.pdf

[3] European Commission, Communication from the Commission to the Council and the European Parliament, *On Strengthening the European Neighbourhood Policy*, COM(2006) 726 final, Brussels, 4 December 2006 http://ec.europa.eu/world/enp/pdf/com06_726_en.pdf

strong and weak points of the policy, specifying some concrete measures to consolidate it and proposing new financial instruments. Among the *strong elements* of the policy, there are mentioned: a unique framework that covers a wide range of issues pertaining to the neighbourhood policy, the partnership concept, the tangible measures proposed by some Action Plans agreed at political level by both parties, a better allocation and use of the available funds (through the European Neighbourhood and Partnership Instrument).

In this document, the European Commission has identified several *areas of ENP*[1] that would require *further strengthening*:

a. Consolidation of the economic and commercial component – a deeper economic integration of the ENP partner countries, through:
    - „*Deeper and comprehensive Free Trade Agreements*” that would go beyond the traditional free trade of goods and services and would incorporate standards and technical norms, competition issues, innovation, cooperation in the field of research. On the long run, these new agreements would lead to a *Neighbourhood Economic Community*[2], but it would be strictly dependent upon the permanent dialogue and sustainable progress;
    - Additional support for reforms and for investment climate improvement
b. Facilitating the free movement of persons and an efficient migration management, through:
    - Visa facilitation, especially for short (study or business) visits;
    - Adoption of a package deal for a better management of migration, cooperation for combating illegal migration and for an efficient border management.
c. Consolidation of dialogue, „*people-to-people*” contacts, by:
    - Education, cultural exchanges, common research programs;
    - A higher involvement of the civil society in ENP;
    - Know-how exchange among local and regional authorities
d. Building a thematic/sector dimension within ENP, with a particular focus on including the ENP partner countries in the European infrastructure and energy networks
e. Consolidation of political cooperation, through:

[1] European Commission, Communication from the Commission to the Council and the European Parliament, *On Strengthening the European Neighbourhood Policy*, COM(2006) 726 final, Brussels, 4 December 2006 http://ec.europa.eu/world/enp/pdf/com06_726_en.pdf

[2] Non-Paper Expanding on the proposals contained in the Communication on „Strengthening the ENP”- COM (2006) 726 final of 4 December 2006, „*ENP – A Path towards further Economic Integration*”
http://ec.europa.eu/world/enp/pdf/non-paper_economic-integration_en.pdf

- A more active role of the European Union in the efforts to solve the regional conflicts (Moldova, Southern Caucasus, Palestinian territories), by a more active participation to the peace-keeping operations in the areas;
- Participation of the neighbouring states to European Security and Defense Policy operations;
- A consolidated inter-parliamentary dialogue

f. Better regional cooperation, by:
   - An intensified dialogue with Black Sea Economic Cooperation Organization and formulation of a regional strategy in the Black Sea Area;
   - Full implementation of the five-year Euro-Mediterranean action programme adopted in Barcelona in 2005 (in conformity with the ENP agenda)

g. Consolidation of the financial cooperation:
   - Starting with 2007, the cooperation with the neighbouring countries will be financed through the European Neighbourhood and Partnership Instrument**.** A lot more flexible than the previous instruments, oriented towards policies, the ENPI has been allocated 12 billion euros for the period 2007-2013, representing a real increase with 32% compared to the previous one (2000-2006)[1]. The funds are still insufficient, given the diversity of the areas covered by the financial support through the ENPI[2]. This instrument will follow the principles of multi-annual programming, partnership and co-financing[3]. The cross-border component of the ENPI will be co-financed by the European Fund for Regional Development.
   - The Commission has also introduced two *new financing mechanisms*:
     - *Governance Facility*, with 300 million euros for the seven-year period, for supporting the ENP partner states which have made significant progress in implementing the reforms in the Action Plans;
     - *Neighbourhood Investment Fund*, with 700 million euros for the seven-year period to support the lending programs of the

---

[1] European Commission, Communication from the Commission to the Council and the European Parliament, *On Strengthening the European Neighbourhood Policy*, COM(2006) 726 final, Brussels, 4 December 2006, p. 12 http://ec.europa.eu/world/enp/pdf/com06_726_en.pdf

[2] Missirolli, Antonio, „ The ENP Three Years on: Where From – And Where Next?", *European Policy Centre, Policy Brief*, March 2007, Brussels

[3] Regulation (EC) NO 1638/2006 of the European Parliament and of the Council of 24 October 2006 laying down *General Provisions establishing a European Neighbourhood and Partnership Instrument,* Official Journal of the European Union, L 310 din 9.11.2006 http://ec.europa.eu/world/enp/pdf/oj_l310_en.pdf

international financial institutions (such as EIB, EBRD) given to the ENP partner states.

The funds allocated to each country will depend on the specific needs identified in the Action Plans, on the absorption capacity of the funds and on the level of implementation of the agreed reforms.

The Report of the General Affairs and External Relations Council on "*Strengthening the European Neighbourhood Policy"*[1], of 18/19 June 2007, has made record of the progress registered since the European Council in December 2006, namely the steps forward in deeper economic integration, implementing a significant number of action plans, negotiations in the energy field, in facilitating the visa regime, readmission agreements with Ukraine and Moldova.

The most recent evaluation of the ENP strengthening initiative was given in the Commission's Communication: „*A Strong European Neighbourhood Policy*"[2] from 5th December 2007 which proposed a series of objectives for 2008 and the next period: a better economic integration and an increased access to the markets - also for the agricultural goods, facilitation of visa regime, firm commitment to involve in solving the frozen conflicts, increased support from EU for the sector reforms (energy, environment, transport, education, social policy) in the partner states.

As Benita Ferrero-Waldner, the European Commissioner for external relations and European Neighbourhood Policy, stated, the European Union is in the ***implementation phase of the ENP***[3]. At the end of 2007, the European Union has finalized 12 Action Plans from the 16 partner countries.

The Action Plans with Ukraine, Moldova and Israel will expire in 2008. They may be extended for another year or negotiations might begin for concluding new agreements (for example, on 5th March 2007 negotiations began with Ukraine for a new neighbourhood agreement). At present, Algeria, Syria, Libya and Belarus do not have an Action Plan concluded with the European Union. Contractual relations with these countries will depend upon the particular progress made[4].

---

[1] General Affairs and External Relations Council (GAERC), "*Strengthening the European Neighbourhood Policy"- Presidency Progress Report*, 10874/07 http://ec.europa.eu/world/enp/pdf/enp_progress-report_presidency-june2007_en.pdf

[2] European Commission, Communication from the Commission*: A Strong European Neighbourhood Policy*, COM(2007) 774 final, Brussels, 5 December 2007 http://ec.europa.eu/world/enp/pdf/com07_774_en.pdf

[3] Ferrero-Waldner, Benita,"The European Neighbourhood Policy and the Regions", Speech Structured Dialogue - Committee of the Regions, Brussels, December 18, 2007, SPEECH/07/829 http://www.europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/829&format=HTML&aged=0&language=EN&guiLanguage=en

[4] Syria has to ratify the Association Agreement already negotiated. Libya must firstly participate effectively to the Euro-Mediterranean Partnership. There is still needed progress on the way to democracy in Belarus in order to have contractual relations with EU.

In 2007, the first funds allocated through the Governance Facility were destined to Morocco (28 million euros – mainly for reforms in public administration) and Ukraine (22 million euros – for reform in the energy sector)[1]. Once the financing through Tacis programme being finalized, the Strategic Partnership with Russia will be financially supported by the European Neighbourhood and Partnership Instrument (for cross-border cooperation and for the implementation of the four common spaces' priorities), thus ensuring the link between Russia and the European Neighbourhood Policy.

An important component of the ENP is the *cross-border cooperation* that follows objectives such as: promotion of the economic and social development of border regions, solving some common environmental problems, efficient border control, increased participation of civil society in cross-border projects. The budget allocated for this kind of cross-border programs amounts to 1.1 billion euros up to 2013[2].

In 2008, in spring, a new Communication from the European Commission is expected to evaluate the performance and progress of the partner states in the ENP.

Black Sea Synergy

The necessity to consistently and distinctively approach the Black Sea region issue has been emphasized only after the accession of Romania and Bulgaria to EU, given the changes in the Eastern border of the Union.

On 11th April 2007, the European Commission issued a Communication "*Black Sea Synergy*"[3] which intends to be a new EU regional cooperation initiative. Comprising states with rather different economic development levels and history of cooperation relations with the European Union, the Black Sea region is seen more as an area of sensitive issues like organized crime, terrorism, trafficking, fragile states, instability and conflict potential, rather than as an extensive abundance of opportunities.

---

[1] "A Strong European Neighbourhood Policy – further efforts are needed", *CEPS Neighbourhood Watch*, Issue 33, December 2007, p. 9

[2] Ferrero-Waldner, Benita,"The European Neighbourhood Policy and the Regions", Speech Structured Dialogue - Committee of the Regions, Brussels, December 18, 2007, SPEECH/07/829 http://www.europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/829&format=HTML &aged=0&language=EN&guiLanguage=en

[3] European Commission, Communication from the Commission to the Council and the European Parliament *Black Sea Synergy – A New Regional Cooperation Initiative*, COM(2007) 160 final, Brussels, 11 April 2007
http://ec.europa.eu/world/enp/pdf/com07_160_en.pdf

Giving only a brief description of the objectives proposed by the strategy, several areas of cooperation[1] can be mentioned: democracy, respect of human rights and good governance projects, good management of movement of persons, combating illegal migration and organized crime, increase of EU role in solving the frozen conflicts in the area by facilitating the dialogue between the conflict parties, more efficient dialogue in energy issues: ensuring energy security, improving energy infrastructure, enhanced cooperation in transport, environmental issues, regional development.

The Commission suggests to fully benefit from the institutional framework of the cooperation initiatives already in place, the most important being the Black Sea Economic Cooperation Organization and the Black Sea Forum for Dialogue and Partnership[2], creating a regional platform for cooperation in the area.

Co-financing principle would also apply to this new initiative; the funds allocated to the cross-border cooperation, through the ENPI, the European Fund for Regional Development, the EIB, EBRD funds, the Black Sea Trade and Development Bank being the main financial instruments available.

The European Parliament approved on 17th January 2008 a *Report*[3] elaborated by a Romanian Member of the European Parliament, Roberta Anastase, report that requests the identification of concrete proposals to support the regional cooperation and the creation of an *authentic partnership* in the Black Sea Area. The Parliament approves the doubling the funds available through the ENPI, for cross-border programs and notes the main priority areas for cooperation: greater involvement of EU in the unsolved conflicts in the area, creation of new infrastructures and viable transport corridors for energy, solving the environmental problems in the Black Sea Area (in particular in the Danube Delta), acknowledging the importance and the necessity to involve Russia and Turkey in the cooperation initiatives in the region[4].

---

[1] European Commission, Communication from the Commission to the Council and the European Parliament *Black Sea Synergy – A New Regional Cooperation Initiative*, COM(2007) 160 final, Brussels, 11 April 2007, p. 3 – p. 8 http://ec.europa.eu/world/enp/pdf/com07_160_en.pdf

[2] A Romanian Initiative, the *Black Sea Forum for Dialogue and Partnership* has reaffirmed, during its first summit in Bucharest, on 5th June 2006, the intention and commitment of all countries involved to cooperate, using all the instruments at their disposal offered by the regional organisms in place, for the welfare and stability in the Black Sea Area.

[3] European Parliament, "*MEPs speak out in favour of more regional cooperation in the Black Sea region and the South Caucasus*", 17 January 2008 http://www.europarl.europa.eu/news/expert/infopress_page/030-18599-014-01-03-903-20080115IPR18588-14-01-2008-2008-false/default_en.htm

[4] European Parliament, "*MEPs speak out in favour of more regional cooperation in the Black Sea region and the South Caucasus*", 17 January 2008 http://www.europarl.europa.eu/news/expert/infopress_page/030-18599-014-01-03-903-20080115IPR18588-14-01-2008-2008-false/default_en.htm

4. Some conditionality elements and limits of the European Neighbourhood Policy

In the case of EU enlargement to the Central and Eastern European countries, the conditionality functioned both as an incentive element and of constraint. Sometimes used as an element of justification for painful economic and social reforms, it was occasionally alleged as a limitation of these countries' own modernization options.

In comparison, in the case of the neighbouring countries, we can hardly speak about a real conditionality. In the absence of the most important incentive: the perspective of membership to the European Union, the partner states can hardly commit to fulfill a series of exigencies and reform plans. Given the fact that the Action Plans are drawn up by the Commission together with the ENP partner countries, some analysts speak about a "*soft conditionality*[1])". In the different stages of the ENP evolution, it was reiterated the fact that ENP is NOT a preceding phase for membership. In this way, the conditionality could be explained by the possibility of the partner states to have increased access to the Internal Market, but this incentive is far from having the same impact as the accession perspective.

Can we really discuss upon the conditionality issue within the ENP, not to mention furthermore the success or failure of this 'conditionality' in ENP partner states? How much commitment can these countries have on the road to democracy, respect of human rights, rule of law, how can they share these *common values*, especially when some of the countries in question do *not* have a tradition in observing these rules or promoting these values[2]? Being regions with a different level of economic development, with a different history of (cooperation) relations with EU, and with diverse visions upon their future relations/position towards the Union, some of them constantly affirming their European vocation and orientation, the harmonization of interests and priorities is rather difficult to accomplish[3].

Zaiotti questions the real commitment of the European Union to create a true "ring of friends", explaining that the necessity to build better "protective

---

[1] Noutcheva, Gergana and Michael Emerson, „Economic Regimes for Export – Extending the EU's Norms of Economic Governance into the Neighbourhood*", CEPS Working Document* No. 233/December 2005, Brussels

[2] Smith, Karen E., „The Outsiders: the European Neighbourhood Policy", in *International Affairs* 81, 4 (2005), pp. 757-773

[3] Sasse, Gwendolyn, „The European Neighbourhood Policy: „conditionality-lite"?", in *Development & Transition*, No. 4, published by the United Nations Development Programme and the London School of Economics and Political Science, June 2006, p.13

fences" is not going to bring *friendship* or *trust* from the part of the neighbouring countries, on the contrary, *hostility* and even *suspicion*[1].

Looking thoroughly to the strategy documents, action plans, progress reports and implementation phase of the ENP, we can distinguish several limits of the ENP:

- The heterogeneous character of the neighbours. Ukraine, Moldova, Belarus, Georgia, Armenia, Azerbaijan have a short history of independence and state-consolidation, being far from an appropriate economic modern society, but with European vocation and aspirations. The countries in Southern-Mediterranean area benefit from a different institutional and cultural climate, having more experience in a free market environment and being exposed to international competition, still some of them being authoritative regimes[2].
- The policy is still not very articulated, gathering a variety of instruments and bilateral programs under the same umbrella. Neither an enlargement policy, nor a proper foreign policy[3], the ENP is still looking for the optimal way to serve the interests of EU and of the neighbouring countries at the same time;
- Inefficient or limited conditionality, in the absence of the major incentive of membership perspective;
- The Action Plans are not legally binding documents, but only political agreements, and they do focus on the priorities established *jointly* between EU and the partner countries ("*soft conditionality*"[4]).
- Promoting the differentiation principle (differentiated Action Plans with differentiated priorities) can lead to absence of common standards and may dilute the legitimacy and credibility of the EU's initiative
- The ENP does not answer to the dilemma up to where the EU can enlarge. There is the problem of the Union's capacity to absorb new member states, the opportunity to further enlarge becoming a top subject on the European agenda. An infinite and indefinite enlargement of the European Union can generate an "identity crisis" which cannot be dealt with only through technical criteria.

---

[1] Zaiotti, Ruben, „Of Friends and Fences: Europe's Neighbourhood Policy and the Gated Community Syndrome", *Journal of European Integration*, Vol 29 No. 2, pp. 143- 162

[2] Noutcheva, Gergana and Michael Emerson, „Economic Regimes for Export – Extending the EU's Norms of Economic Governance into the Neighbourhood*", CEPS Working Document* No. 233/December 2005, Brussels, p. 12

[3] Missirolli, Antonio, „ The ENP Three Years on: Where From – And Where Next?", *European Policy Centre, Policy Brief*, March 2007, Brussels

[4] Noutcheva, Gergana and Michael Emerson, „Economic Regimes for Export – Extending the EU's Norms of Economic Governance into the Neighbourhood*", CEPS Working Document* No. 233/December 2005, Brussels

The main deficiency of the policy can be shortly explained by the fact that the ENP partner countries have a varied and full reform agenda to fulfill, with very limited resources and still low implementation capacity.

Conclusions

There is no doubt that the enlargement of the European Union in 2004, with the eight Central and Eastern European countries plus Cyprus and Malta, completed in 2007 by the accession of Romania and Bulgaria has brought to the attention not only the need to reform the EU institutional framework and to revise some policies, but also the way to approach the external relations, mainly with the new immediate neighbourhood.

Confronted more with sensitive issues rather than with new opportunities at its Eastern border, the European Union was compelled to involve itself, beyond declarative level, in a project of anticipating and solving potential problems. The sometimes excessive protection reactions, in order to ensure a stability climate at its external frontiers, have not been enthusiastically received by the neighbouring states.

EU has strictly delimited its new neighbourhood policy, since 2003 and 2004, stating repeatedly that *the ENP is NOT a preceding phase for membership*. In the absence of the accession perspective, countries like Ukraine and Moldova, who declared more than once their European vocation and orientation, could not be contented with the status of EU's neighbours.

The objectives proposed by the ENP to create an area of prosperity and common values, privileged trade relations, deeper economic integration, political and cultural cooperation will follow the principles of differentiation, progressivism and (soft) conditionality.

The European Neighbourhood Policy is not an entirely new policy. It resumes objectives and instruments from the previous cooperation relations, namely from the Euro-Mediterranean Partnership with the Southern-Mediterranean countries, from the Partnership and Cooperation Agreements with the Eastern European countries, at the same time using some of the instruments that proved to be efficient in the enlargement process. The ENP intends to use the *"soft coordination"* method in its external relations - based on differentiation, partnership, political commitment of the partner states to internally reform. Based on the enlargement experience, the method is an adjustment of policies (based on shared values, partnership, differentiation, participation, decentralization, conditionality, a financial assistance package complementary to the existing instruments)[1].

[1] Tulmets, Elsa, „Is a Soft Method of Coordination Best Adapted to the Context of the EUs Neighbourhood?" în Cremona, Marise and Meloni, Gabriella (eds) „*The European Neighbourhood*

The main instruments proposed by the ENP reside in the Country Reports, the Action Plans and the European Neighbourhood and Partnership Instrument. The creation of this instrument is one of the positive elements of the policy, being flexible and policy-oriented, and adapting to the priorities stipulated in each Action Plan.

By its constant concern to strengthen the ENP, the European Union proposes a consolidation of its commitments towards the neighbours and also a reaffirmation of the proposed objective not to create new diving lines in Europe.

We may ask if the conditionality can really exist and function within ENP and to what extent the partner countries can pursue difficult internal reforms in the absence of the ultimate incentive: the perspective of full membership.

At the same time, being regions with different traditions, levels of development, different relations with the EU, different expectations from the future relations with the Union, it is difficult to harmonize the interests of the countries in Southern Caucasus and Eastern Europe with the Southern – Mediterranean ones. Although the Union has proposed a unique approach, the result cannot be other but a differentiated approach, for every particular region or country.

The main challenge remains to identify foreign policy measures complementary to the ones used by enlargement that would prove efficient in promoting transformation, modernization and reform in the partner states.

There is a need for more coherence in building the ENP. Some analysts state that, at present, "*it is more a policy for neighbours rather than a neighbourhood policy*"[1]. A better structuring of the incentives and priorities to be followed, combined with a higher cooperation *among* neighbours will improve the degree of acceptance in the countries.

If the older member states might show some resistance to the pro-active attitude towards the ENP partners, the new member states have a more open attitude and are willing to make alliances in building common positions for consolidating the policy. It is a known fact Poland's position in supporting Ukraine to follow the European path, developing and consolidating an Eastern dimension of the ENP being one of the proposed goals.

Romania has expressed on a number of occasions its support for the ENP and towards the European aspirations of the Eastern European countries, supporting the implementation of the Action Plans with Moldova and Ukraine. At the same time, Romania has concentrated upon and will continue to focus on the consolidation of the cooperation in the Black Sea Area, playing an active role in

---

Policy: A Framework for Modernisation?", European University Institute Working Paper LAW no. 2007/21, Florence, p. 116

[1] Smith, Karen E., „The Outsiders: the European Neighbourhood Policy", in *International Affairs* 81, 4 (2005), pp. 757-773, p. 771

better defining a policy, and even a strategy of the EU in this region. The approval by the European Parliament of the Report of the MEP Roberta Anastase on the Black Sea Synergy Paper, requesting the identification of tangible measures to support the regional cooperation and building a genuine partnership in the Black Sea area is a very important step ahead in supporting Romania's efforts in the field.

Also the Southern Caucasus might become a test for the capacity of EU and Russia to cooperate and to give substance to the Strategic Partnership. Otherwise, the region will be permanently split between two spheres of influence, putting under question any real and sustainable development perspective[1].

It remains to be seen to which extent the EU Member States will be able to join forces in order to carry on and better and more coherently and concretely define the support they intend to offer to their *ring of friends*, as well as the extent to which the ENP partner states will identify other ways to embark on a reform process, in the absence of the perspective of membership to the European Union.

References

European Commission. 2003. Communication from the Commission to the Council and the European Parliament - *Wider Europe-Neighbourhood: A new Framework for Relations with our Eastern and Southern Neighbours*, COM(2003) 104 final, Brussels, http://ec.europa.eu/world/enp/pdf/com03_104_en.pdf

European Commission. 2003. Communication from the Commission - *Paving the Way for a New Neighbourhood Instrument*, COM(2003) 393 final, Brussels, http://ec.europa.eu/world/enp/pdf/com03_393.pdf

European Commission, 2004. Communication from the Commission, *European Neighbourhood Policy – STRATEGY PAPER*, COM (2004) 373 final, Brussels, http://ec.europa.eu/world/enp/pdf/strategy/strategy_paper_en.pdf

European Commission. 2006. Communication from the Commission to the Council and the European Parliament, *On Strengthening the European Neighbourhood Policy*, COM(2006) 726 final, Brussels, 4 December. http://ec.europa.eu/world/enp/pdf/com06_726_en.pdf

European Commission. 2007. Communication from the Commission: *A Strong European Neighbourhood Policy*, COM(2007) 774 final, Brussels, 5 December. http://ec.europa.eu/world/enp/pdf/com07_774_en.pdf

[1] Meloni, Gabriella, „ Is the Same Toolkit used during Enlargement still Applicable to the Countries of the New Neighbourhood? A Problem of Mismatching between Objectives and Instruments" în Cremona, Marise and Meloni, Gabriella (eds) „*The European Neighbourhood Policy: A Framework for Modernisation?*", European University Institute Working Paper LAW no. 2007/21, Florence, p. 98

European Commission. 2007. Communication from the Commission to the Council and the European Parliament: *Black Sea Synergy – A New Regional Cooperation Initiative*, COM(2007) 160 final, Brussels, 11 April.
http://ec.europa.eu/world/enp/pdf/com07_160_en.pdf

European Council. 2002. Copenhagen, 12-13 December, Presidency Conclusions,
http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/73842.pdf

European Council. 2003. *A Secure Europe in a Better World – European Security Strategy*, Brussels, 12 December,
http://www.consilium.europa.eu/uedocs/cmsupload/78367.pdf

European Parliament. 2008. "*MEPs speak out in favour of more regional cooperation in the Black Sea region and the South Caucasus*", 17 January
http://www.europarl.europa.eu/news/expert/infopress_page/030-18599-014-01-03-903-20080115IPR18588-14-01-2008-2008-false/default_en.htm

Ferrero-Waldner, Benita. 2007. "The European Neighbourhood Policy and the Regions", Speech Structured Dialogue - Committee of the Regions, Brussels, December 18, SPEECH/07/829
http://www.europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/829&format=HTML&aged=0&language=EN&guiLanguage=en

General Affairs and External Relations Council (GAERC), "*Strengthening the European Neighbourhood Policy"- Presidency Progress Report*, 10874/07
http://ec.europa.eu/world/enp/pdf/enp_progress-report_presidency-june2007_en.pdf

Meloni, Gabriella. 2007. „ Is the Same Toolkit used during Enlargement still Applicable to the Countries of the New Neighbourhood? A Problem of Mismatching between Objectives and Instruments" în Cremona, Marise and Meloni, Gabriella (eds)
„*The European Neighbourhood Policy: A Framework for Modernisation?*", European University Institute Working Paper LAW no. 2007/21, Florence Missirolli, Antonio. 2007. „ The ENP Three Years on: Where From – And Where Next?", *European Policy Centre, Policy Brief*, March 2007, Brussels Non-Paper Expanding on the proposals contained in the Communication on „Strengthening the ENP"- COM (2006) 726 final of 4 December, „*ENP – A Path towards further Economic Integration*"
http://ec.europa.eu/world/enp/pdf/non-paper_economic-integration_en.pdf

Noutcheva, Gergana and Michael Emerson. 2005. „Economic Regimes for Export – Extending the EU's Norms of Economic Governance into the Neighbourhood*", CEPS Working Document* No. 233/December, Brussels

Prodi, Romano. 2002. "A Wider Europe – A Proximity Policy as the Key to Stability", Speech at the 6th ECSA-World Conference, Brussels, 5-6 December, SPEECH/02/619,
http://ec.europa.eu/external_relations/news/prodi/sp02_619.htm

Regulation (EC) NO 1638/2006 of the European Parliament and of the Council of 24 October 2006 laying down *General Provisions establishing a European Neighbourhood and Partnership Instrument,* Official Journal of the European Union, L 310 din 9.11.2006

http://ec.europa.eu/world/enp/pdf/oj_l310_en.pdf

Sasse, Gwendolyn. 2006. „The European Neighbourhood Policy: „conditionality-lite"?", in *Development & Transition*, No. 4, published by the United Nations Development Programme and the London School of Economics and Political Science, June.

Smith, Karen E. 2005. „The Outsiders: the European Neighbourhood Policy", in *International Affairs* 81, 4, pp. 757-773

"A Strong European Neighbourhood Policy – further efforts are needed", *CEPS Neighbourhood Watch*, Issue 33, December 2007

Tulmets, Elsa, „Is a Soft Method of Coordination Best Adapted to the Context of the EUs Neighbourhood?" în Cremona, Marise and Meloni, Gabriella (eds) „*The European Neighbourhood Policy: A Framework for Modernisation?*", European University Institute Working Paper LAW no. 2007/21, Florence Zaiotti, Ruben, „Of Friends and Fences: Europe's Neighbourhood Policy and the Gated Community Syndrome", *Journal of European Integration*, Vol 29 No. 2, pp. 143- 162.

Romanian Economic and Business Review – Vol. 2, No. 4

KNOWLEDGE-BASED ENTREPRENEURSHIP IN HUNGARY

Andrea Szalavetz*

Abstract

According to rich and growing empirical literature, one of the main deficiencies of Hungarian SMEs is their low growth potential. Survey results underline the strong influence of cultural factors including behavioral features rooted in the socialist era among the main explanatory factors of entrepreneurs' reluctance to expand activity and drive the company ahead, along the usual growth path. As opposed to this gloomy general picture, my field investigations have supported the hypothesis that knowledge-based entrepreneurs and companies are different from average Hungarian entrepreneurs and SMEs in many respects.

Introduction

According to rich and growing empirical literature, one of the main deficiencies of Hungarian SMEs is their low growth potential. They are not growth oriented, unable and unwilling to move beyond stage one in their life cycle.[1] They adopt a traditional attitude of non-reinvesting but taking the profit out of their small, family managed ventures. *(Czako et al.* [1995]; *Laky* [1998]; *Laki*[1998]; *Major* [2003])

Survey results underline the strong influence of cultural factors *(Kuczi* [2000]; *Szerb-Ulbert* [2002]) including behavioral features rooted in the socialist era[2] among the main explanatory factors of entrepreneurs' reluctance to expand activity and drive the company ahead, along the usual growth path.

---

* Andrea Szalavetz is researcher at the Institute of World Economics, Hungarian Academy of Science in Budapest.

[1] Following *Adizes* [2004] I refer to stage one of the corporate life cycle as infancy. In this stage the idea has already been translated into a product. The main challenge ahead is growth and market expansion. The organization is still entrepreneurial: the firm is directed by the owner and founder. Transition to professional management is still ahead. Self-financing is the main form of financing.

[2] Socialist entrepreneurs were in a sense similar to the Schumpeterian entrepreneurial ideals. A thick layer of citizens (according to estimates, in the early 1980s approximately two thirds of Hungarian families) earned at least some of their income in the second economy *(Galasi-Szirâczky* [1985]). These entrepreneurs have thus become capable to understand something about the functioning of the market, about autonomous decision-making and about risk-taking. They have

Alongside to their lack of dynamism in terms of sales, employment and productivity growth, Hungarian SMEs also feature various other deficiencies. They operate below minimum efficient size[1]; they are unable and unwilling to invest into and accumulate intangible assets and they are not innovative.

As opposed to this gloomy general picture, my field investigations have supported the hypothesis that knowledge-based entrepreneurs and companies (KBEs; KBCs) are different from average Hungarian entrepreneurs and SMEs in many respects.

Dissimilarity is first of all related to above-the-average knowledge intensity, i.e. to the fact that KBCs' most important asset is knowledge. This becomes manifest in above-the-average educational attainment of founders and in the above-the-average values of various R&D input and output indicators of the firms (R&D ratio; number of researchers employed, patents etc.). This is all the more conspicuous in the Hungarian setting, where domestic companies' innovative performance is meager. Few of them engage in any kind of R&D

---

become capable to learn, adjust and innovate. Their mentality however differed from that of the Schumpeterian capitalist entrepreneurs. Second economy participants had a stable job in the state sector and they utilized the resources and the assets (raw material and production equipment) of their SOEs, which exempted them from the dominant part of the risk capitalist entrepreneurs take. Furthermore, their activity satisfied a huge existing demand the centrally planned sector could not meet. They thus faced little demand constraint, and little competition. The constraints they faced were of a different character: state regulations *aimed mainly at restricting expansion.* By relaxing some restrictions on private enterprises following 1982 the government aimed at increasing consumption and at reducing the gap between demand and supply. Private enterprises were thus considered as complementary and not contradictory to the socialist system *provided their expansion remains below a predetermined threshold.* It was thus acceptable to increase private consumption using the income raised from private entrepreneurship - market supply being the only limitation of this endeavor. On the other hand, corporate growth was restricted by several regulations, since it was considered contradictory to socialist principles. The mentality of increasing entrepreneurs' consumption rather than reinvesting profit has become deeply rooted and survived even after the change of the regime. All this is very much different form Schumpeterian entrepreneurs whose key feature is a relentless strive for growth.

[1] Although in advanced economies firms are frequently larger than their hypothetical efficient size (size being determined among others by the features of the production technology) SMEs of relatively underdeveloped economies often face the opposite problem: market constraints or rather their market acquiring deficiencies as well as capital market imperfections make them operate below the efficient size (See *Artner* [2005] about Hungary, *Surdej* [2000] about Poland). *According to textbook theses the likelihood of survival is minimal if the gap between the existing and the minimum efficient size is persistently large, many of the Hungarian micro and small enterprises contradict this thesis: they are dragging on, on the edge of bankruptcy and/or market exit for long years, unable to grow.* This gives rise to considerable policy concern, because the exit rate, i.e. enterprise death rate is also high (which has to be added to those, dragging on without growth and profit). Enterprise birth and death in industry was 4,262 and 6,647 respectively in 2003. The corresponding data for services was 47,589 and 50,127 respectively. Consider Portugal's respective data for comparison (a country of similar population size): 2,678 versus 2,327 in industry, 10,853 versus 7,545 in services. (Source: *European Business Facts and Figures 1995-2005.* Panorama of the European Union. European Commission, Eurostat, 2006, p. 20)

activities. According to Pitti's [2006] data taken from the Hungarian Tax Authority's database in 2004 there were altogether 434 companies undertaking R&D activity in Hungary, with altogether 4309 researchers (These data are much lower than the ones registered by the Central Statistical Office (669 and 6704 respectively) - though according to Pitti, more reliable. The average picture is however not really different: more than 99 % of Hungarian companies do not perform any R&D activity at all. Although the share of foreign companies (within R&D performers) is about 15 % (with 103 R&D-active actors out of 669) - they are the ones who finance the dominant part of total corporate R&D expenditures.

Difference between KBCs and average SMEs (ASMEs) is conspicuous also in terms of the former group's performance, capabilities and prospects. Most of KBCs are high-growth companies they belong to the emerging group of gazelles. KBCs usually internationalize quite early in their life-cycle,[1] and they are among the pioneer companies with outward foreign direct investment *(Antaloczy-Elteto* [2002]; *Inotai* [2005]).

Another apparent element of KBC-ASME difference can be identified in terms of KBCs' diversified portfolios of both domestic and international collaborations. Unlike ASMEs' networks, restricted mainly to vertical relationships (customers and suppliers) KBCs are characterized by a tight network of industry-university linkages including both research and educational institutions - partly because their founders have in most of the cases a strong academic background. They also possess diversified relations with domestic and international NGOs, research funds, business and scientific associations.

Although KBCs belong to the cream of the economy in every country, international comparisons have revealed that their degree of success differs a lot even among advanced economies *(OECD* [2006]). The highest aggregate returns related to KBCs' emergence and evolution (i.e. their highest impact on economic growth) can be observed in the United States while several European economies are seriously lagging behind. As for some post-transforming economies, many of the in principle high-growth, new-technology-based startups bounce off an invisible ceiling or at least lose energy because both in the early stage of their existence and in later stages of initial growth and rapid expansion they encounter insurmountable financing difficulties. KBCs' sector-specific features which increase investors' perceived risks (volatility in earnings, intangible assets, new types of products) are coupled with region-specific financing constraints (underdeveloped venture capital markets, unsophisticated public policy instruments and underfunded support programs).

[1] Note, that the theory of internationalization considers international entry as an incremental process, that begins relatively late in a firm's life cycle. In contrast, in dynamic and technology-intensive sectors early internationalization is a catalyst for growth.

This paper summarizes some of the first results of field investigations carried out at Hungarian KBCs[1] with special emphasis on (i) explanatory factors of their performance (section 2); (ii) the impact of diversification and internationalization on growth and competitiveness (section 3). Section 4 concludes and proposes some policy implications.

Explanatory factors of performance

One of the main explanatory factors of the surveyed firms' success stories was their founders' personality. KBCs in the biotechnology and space sectors were founded by scientists - which is sector-specific characteristic, while KBCs in the IT-industry were founded by entrepreneurial professionals. The main motivation of firm foundation was the recognition of commercial opportunity. The surveyed space research company for example - a spin-off of University of Miskolc was founded by university professors and researchers working at the Faculty of Materials Science and Engineering. In the 1980s - still within the Intercosmos[2] scheme - the Hungarian research team developed a universal multizone crystallizator (UMC). In 1991 during the first International Conference on Solidification and Gravity, held in Hungary NASA researchers learned about this equipment and worked out an agreement with the researchers according to which NASA would house the UMC and provide funding for Hungarian scientists to work with it in the United States. The equipment was delivered to NASA laboratory in 1994 and tested for three years. There, scientists proved, it could be used for semiconductor growth. As a result of extensive negotiations on further collaboration and the upgrading of the equipment, in 1998 NASA published a Research Announcement, soliciting proposals for flight experiments and for ground-based experimental and theoretical microgravity research in materials science. The researchers recognized that formal participation in NASA tenders requires the establishment of a private firm. The newly established firm has not only won NASA's tender but has also acquired many further large-scale contracts since then, from customers including the European Space Agency, as well as Hungarian manufacturing firms and research institutions that rely on the company's sophisticated equipment for testing the quality of their products or that order custom-made equipment for research purposes.

Another case for the recognized commercial potential is that of an IT company, whose founder got acquainted with IBM PCs already in the 1980s

[1] This paper draws on the results of surveys at ten and direct in-depth interviews at two Hungarian-owned KBCs (surveys and interviews targeted both science and engineering based technology ventures /see Autio [1997]/ including IT, and biotech firms as well as firms in the instruments and space industries.)

[2] The Intercosmos program was a program by the Soviet Union to allow military from allied Warsaw Pact and other Socialist nations to participate in space exploration.

during a fellowship in the United States. He studied informatics at Wisconsin University, and thereafter worked for various IT firms in New York. This was a good start to learn about frontier level technology as well as about IT-related business and enterprise resource planning systems (ERP) in practice. Furthermore, he earned a lot by Hungarian standards which allowed him to accumulate start-up finance for an own KBC. Following his return, he founded his IT company in 1986 - in an organizational form common that time in the socialist era, a so called economic work community (GMK), with the aim of developing an up-to-date enterprise information system. Development took two years and costs were financed both by the founder's savings and by income generated from hardware import, distribution and system integration. Market for ERP systems grew rapidly from the mid-1990s on, so both sales and employment increased substantially - maybe not as rapidly as in the case of the other surveyed IT-firm that was included as a "Rising Star" firm in Deloitte's Technology Fast 50[1] (the company achieved a 30-fold increase in sales between 2003 and 2006 with sales amounting to HUF 603 million /EUR 2.4 million/ in 2006). This latter company developed intelligent client management system and information terminals used by banks, telecommunication companies, public utility companies and public institutions (including healthcare institutions, registry offices, social services institutions).

As for the founders' personal features, it was interesting to note their strong business orientation (entrepreneurial drive) which is still not common in transforming economies. In the socialist era, company managers used to be engineers and good professionals rather than good managers: their R&D orientation was rather that of technological perfectionism than that of commercial opportunity. Similarly, researchers, working academic institutions were also basic research oriented, caring little for devising applications for new scientific concepts and turning these applications into viable products. The surveyed CEOs are highly talented people, and they could go abroad quite early in their careers - most of them still as university students. In this way they could experience the innovation and commercialization practice of advanced economies.

Following the establishment of their own companies, most of them had to change their core activity in which they were so talented: they have quickly turned from a talented professional into a business manager. They dedicated more and more time to tender application writing, network building, management and market acquiring activities instead of pure research. All in all the founders' personality: their creativity and their relentless strive for business and technological achievements, was always an important explanatory factor of success. The interviewed managers were visionary and risk taking, able to identify trends and emerging opportunities. A highly important success factor was in most

[1] Deloitte's Technology Fast 50 is an annual listing of the 50 fastest growing technology companies in the world.

cases that they managed to transfer their exceptional commitment to other members of the management team.

Their research mindedness was however sometimes in conflict with business mindedness. In some cases business considerations overcame the scientific ones, in others it was strive for technological perfectionism that defeated business considerations. Example for the first was the case the way some science-based biotech firms tried to solve the problem stemming from the ad hoc character of income. Biotech firms are usually tempted to solve this problem by engaging into less innovation-intensive activities (than the firm's core competence), trying to find contracts for their testing laboratories, engaging into routine analytical activities, clinical trials etc. This increases the predictability of business operations but reduces the innovation-intensity involving various related hazards (e.g. losing the skills to be at the frontier of the science, engaging into low value added activities in order to sustain the firm and/or employment etc.).

An example for the latter case was when the technological perfectionism of the founder of one of the surveyed IT companies and his insisting in offering only frontier-level solutions resulted in opportunity costs from business point of view. The surveyed company was the first (in Europe!) to switch from command-line (CLI), to graphical user interface (GUI) in 1994. They abandoned the outdated CLI technology, so they neglected the benefits to be drawn from a carefully managed endgame strategy (see e.g. *Ghemawat-Nalebuff* [1998]) which promised substantial income and a large customer base[1] for local competitors for at least half a decade thereafter!

Factors of growth - diversification and internationalization

KBCs usually target niche markets with their new knowledge-intensive products and services. IT firms usually target the domestic market first. In contrast, the surveyed biotech and space firms were internationalized at the outset mainly because of the sector-specific characteristics of the two scientific disciplines (companies in these sectors are "born global"). In the early stage of KBCs' life cycles even niche markets offer splendid growth opportunities. *High growth means return on capital in excess of the costs of capital.* This is possible in the increasing returns setting of the knowledge economy in general and the high-growth IT-industry in particular. Consider the textbook example for increasing returns: Development of the first copy of a new software solution amounts to a

[1] Note that implementing an ERP system is to some extent deterministic i.e. the technology has substantial lock-in effects. It makes the switching to another system (to another software infrastructure) prohibitively expensive since the implementing firms have to carry out organizational changes: adjust their organizational structure and their business process so that they match with the logic of the system.

couple of millions of dollars. The costs of the second and additional copies are no more than one or two dollars a copy, comprising the costs of the CD ROM and of packaging. However, domestic market oriented IT firms' markets will, irrespective of market size become sooner of later saturated. Furthermore, their niche is usually contested by newly emerging technological startups and/or by diversifying large multinational companies that enter their segments.

Diversification, both in terms of new products and in terms of new markets i.e. the acquiring of foreign markets or public sector contracts alongside to private ones, seems a good way to sustain growth. Public procurement contracts could offer huge growth opportunity for IT firms. Winning public contracts however, proved more difficult for the surveyed firms than expected, even if compared to the solutions of the key multinational actors, KBCs' systems are usually highly price competitive and implementation time is also much shorter. Nevertheless, the 'costs per economic value' reasoning that applies in the private sector has to be complemented with a multitude of other factors to make the products persuasive under public sector conditions. As opposed to private sector companies' unambiguous profit maximization drive, public sector decision-makers are guided by two (often conflicting) motivations: cost minimization and risk avoidance. The latter factor makes them opt for MNCs' much more expensive solutions.

The two surveyed IT firms adopted two different strategies to overcome this problem: one of them tries to avoid applying for public sector contracts and tries to expand its activity internationally instead. The other firm invested in customer relationship management and tried to accumulate a substantial stock of social capital. Accumulating so called "relational assets" in this industry facilitates the acquiring of both new private customers and contracts from the public sector. As for private customers, note, that ERP systems process confidential enterprise data. Trust is crucial also because the benefit an ERP system can yield to the company is not securely predictable. The usefulness of the product can be verified only with a substantial delay following its purchase. Consumers have limited information on most of relevant product details, and the whole process involves considerable risks *{Scott-Vessey* [2002]), which all make transactions more trust-based than in the case of pure market-transactions. As far as public contracts are concerned, transactions are to an even larger extent trust-based than in the case of private customers.

Meanwhile this firm also makes substantial efforts to expand through internationalization, since above and beyond a certain revenue threshold internationalization is a prerequisite for business success also in the software industry.

The surveyed space industry firm offers good example for diversification in terms of products. During its startup phase, the founder concentrated on the specific business opportunity NASA's Research Announcement meant for them.

Previously, researchers at the university performed mainly academic, pre-competitive research. In contrast, NASA's research announcement was a business proposal of a value amounting to approximately hundred thousand dollars. It ensured workload during more than a year for the newly established company. Over time, based on the original concept, a whole family of UMC furnaces was developed.

However, demand for multizone furnaces and single crystal growth techniques suddenly experienced a setback with the shift in Bush administration's space related priorities. In January, 2004 "A Renewed Spirit of Discovery" was published by president Bush, in which he formulated America's new "Vision for Space

Exploration". The new strategy envisaged the return to the moon as top priority (http://www.whitehouse.gov/space/renewed_spirit.html). According to the Vision, the main future focus of American space-related research should be astronauts' health. The main target of public investment in space-related research should be the elaboration of ways to protect the crews from the space environment during long-duration voyages. The new program involved a complete restructuring of NASA activities. NASA had to stop certain research programs, including most microgravity and material science research.

This had painful consequences for international representatives of research and industry that specialized in this field, forcing many of the players to change the core activity or at least to diversify it. This was the time when the surveyed company laid increasing emphasis on another research direction: metal foam research and the development of materials science related technologies. Its customer orientation has also changed. Originally, NASA was the main customer. From the second half of the 2000s on, ESA became the most important customer. Furthermore, the company made increased efforts to gain some *commercial* market share alongside to the *institutional* one. They tried to increase the sales share of services, they provide with the help of their high-tech laboratory equipment. This strategy is in line with Christensen's [1997] concept of "disruptive innovation": the number of consumers can be increased if a high-tech company starts to use its technology also at the lower end of the market. As an example, recently they acquired two high-value infrared cameras, bought in the frame of an EU project, and provide infrared services related to biological applications, thermal conductivity measurement in buildings, diagnostics of electric systems and various other applications. Infrared cameras are used to prepare the thermal map of estates in partnership with a real estate developer.

In sum, the company - similarly to all other international actors in the space industry - makes huge efforts to increase the importance of ground-related (as opposed to space-related) activities. They target universities with the offer of designing and creating specific research equipment.[1] They make business partnership proposals for joint technology development, and target Hungarian manufacturing companies.

Conclusions and policy implications

The surveyed cases demonstrate the validity of the otherwise consensus view, that KBCs are highly important in terms of new member states' necessary transition from their present investment-driven to an innovation-driven growth. Policy requirements go however beyond the objective of contributing to the maximization of the number of knowledge-intensive startups with instruments including direct financial and indirect technical assistance (e.g. funding of feasibility studies, commercialization assistance, training etc.). KBCs themselves, especially university spin-offs have to undergo a transition: from a status of living off research grants and subsidies to that of a business oriented company with commercialization capability and a dense network of linkages to companies interested in using their research results.

Much institutional development (e.g. in the field of support agencies,[2] venture capital market etc.) is necessary to support KBCs, once they enter a high-growth phase (with or without internationalization). Since the most valuable part of KBCs' assets is intangible which limits the opportunity of collateral-based lending, KBCs' financing constraints are even more pressing than those of ASMEs. KBCs should in fact be considered as a special case, featuring special qualities, constraints and requirements. As it was powerfully demonstrated by Storey and Tether [1998], where policies have been focused exclusively upon KBCs (as in Germany, the United Kingdom, or later in Ireland[3]) they have proved quite successful in closing the huge performance gap in this respect, between the U.S. and the European Union.

---

[1] One example is the laser-detector developed for the University of Miskolc that surveys the properties of foams.

[2] Researchers work in a non-commercial environment. However, in advanced economies universities usually have technology transfer offices that support commercialization. In contrast to transforming economies, the term "technology transfer" has a different meaning in advanced economies. In transforming economies this term denotes the transfer of technology and know-how by multinational companies to their local subsidiaries and in a broader sense also the spillover effects of multinationals' investments. In contrast, in advanced economies technology transfer denotes commercialization, i.e. the turning of scientific concepts into viable products by selling the technology of the concept's elaborated commercial application to private companies.

[3] See Szalavetz [2007.a, b] about KBC promotion in Ireland.

References

Adizes, I. 2004. Managing Corporate Lifecycles: Founding Principles in the Management of the Arts. Carpinteha, CA, USA: The Adizes Institute

Antaloczy, K. - Elteto, A. 2002. Magyar vallalatok nemzetkbziesedese - inditekok, hatasok es problemak. (Internationalization of Hungarian companies, motivations, effects and problems.) Kbzgazdasagi Szemle vol. 49, No. 2

Artner, A. 2005. Production technology and the competitiveness in the Hungarian manufacturing industry. Acta Oeconomica, vol. 55, No. 3

Autio, E. 1997. New technology-based firms in innovation networks. Research Policy, vol 26, No. 3

Christensen, C. M. 1997. The Innovator's Dilemma. New York, Harper

Czako, A. - Kuczi, T. - Lengyel, Gy. - Vajda, A. [1995]: A kisvallalkozasok nehany jellemzoje a kilencvenes evek elejen. (Some attributes of small enterprises at the beginning of the 1990s.) Kbzgazdasagi Szemle, vol. 42, No. 4

Galasi, P. - Sziraczki, Gy. 1985. Labour Market and Second Economy in Hungary. Frankfurt, Campus Verlag

Ghemawat, P. - Nalebuff, B. 1998. Declining markets. The devolution of declining industries, in: Philips L. (ed.): Applied Industrial Economics. Cambridge, Cambridge University Press, pp. 81-98

Gibb, A.A. - Davies, L.G. 1990. In pursuit of frameworks for the development of growth models of the small business. International Small Business Journal, vol. 9, No. 1

Inotai, A. 2005. Magyarorsazag, mint tokeexportor. (Hungary as a capital exporter) Elemzo, vol. 1, No. 3

Kuczi, T. 2000. Kisvallalkozas es tarsadalmi kornyezet. Replika Kbr, Budapest

Laki, M. 1998. Kisvallalkozas a szocializmus utan. (Small entrepreneurship after socialism) Kbzgazdasagi Szemle Alapitvany, Budapest

Laky, T. 1998. A kisvallalkozasok nbvekedesenek korlatai, (Barriers to growth for small enterprises) Szociologiai Szemle, No.1.

Major, I. 2003. What makes Hungarian SMEs perform poorly? *Acta Oeconomica,* vol. 53, No. 2 p. 109-143

OECD 2006. The SME Financing Gap. Paris, OECD

Pitti, Z. 2006. A hazai vállalkozások 'demográfiai' jellemzói, a vállalati teljesítmények idóbeli változása és a K+F teljesítmények szerepe a gazdaság új nóvekedési pályára állásában (1992-2004). 'Demographic features' of domestic companies, changing corporate performance, and the role of R&D in switching the economy to a new growth path.

Scott, J.E. - Vessey, I. 2002. Managing risks in enterprise systems implementations.

Communications of the ACM, vol. 45, No. 4

Storey, D.J. - Tether, B.S. 1998. Public policy measures to support new technology-based firms in the European Union. Research Policy, vol. 26, No. 9

Surdej, A. 2000. Small- and Medium-Sized Development in Poland after 1990. UNU WIDER Working Papers, No. 216, Helsinki

Szalavetz, A. 2007a. Klaszterek írországban és a klaszteresedést támogató ir gazdaságpolitika. (Clusters and cluster promotion policy in Ireland.) Paper prepared for the Hungarian National Office for Research and Technology, Mimeo Szalavetz, A. 2007b. Klaszter alias tudásközpont? Klaszterfejlesztés az ir tudásgazdaságban a dublini Adaptív Informados Klaszter példáján. (Cluster or knowledge center? Cluster development in the Irish knowledge economy - based on the example of Adaptive Information Cluster in Dublin) Paper prepared for the Hungarian National Office for Research and Technology, Mimeo Szerb, L. - Ulbert, J. 2002. A kis- és közepes vállalkozások növekedési potenciáljának átalakulásáról. (Transformation of SMEs' growth potential) Vezetéstudomány, vol. 33. No. 7-8.

Romanian Economic and Business Review – Vol. 2, No. 4

FINANCING STRATEGIES FOR LEASING COMPANIES

Razvan Mustea and Ovidiu Folcut*

Abstract

The paper describes the financing sources for the leasing companies (self – financing, capital increases, loans, venture capital, etc). Most of the times, these sources can be combined in an efficient way that leads to the minimum cost of financing. This is recommended when the most efficient financing instrument cannot cover the entire investment need. The authors need to present a model of simulation of the financing strategies directed to the procurement of some technical equipment by a leasing company, based on a minimum cost of the capital. This algorithm was integrated in the LEASYM Software, developed in Visual Basic.Net and meant to assist the managers of the leasing companies in selecting the best financial alternatives for their clients' investment projects. The program simulates the choice of the financing sources, with the main purpose of minimizing the costs.

Financing Strategies for Leasing Companies

There are several methodologies that lead to the substantiation of the procurement decision in leasing selecting a certain financing source. The most popular of them is the one based on the Net Present Value (NPV) criterion.

Another alternative could be the methodology of comparative analysis based on the Total Net Present Cost (TNPC) of the financing sources, because the calculation of this indicator considers not only the acquisition cost of the good(s), but some other elements as well:

- The expenses and fees specific for each transaction;
- The fiscal economy derived from the transaction;
- The profits tax;
- The actualization factor.

This indicator considers the fiscal economy (fiscal savings) specific to each transaction, which represents a strong argument for leasing. The structure of

* Răzvan Mustea is Associate Professor of International Business at the Romanian American University in Bucharest.
Ovidiu Folcuț is Associate Professor if International Trade at the Romanian American University in Bucharest.

the expenses excludes the registration fees, the maintenance fees or the liability insurance, as they exist no matter the financing source.

The Cost of the Goods Procured in Leasing (Financial)

Besides the cost of the goods procured by the leasing company, the user (the client of the leasing company) needs to pay the interest rate, an administration fee and the insurance fee (if needed). The administration fee is paid once, at the beginning of the contract. The cost of the leasing operation (CT_l) for the user is:

$$CT_l = P_a + Dob_l + C_{gest} + C_{asig}$$

Where:

P_a = The acquisition price of the goods, (the CIP price);

Dob_l = The total interest rate levied by the leasing company, calculated by adding the monthly interest rates;

C_{gest} = The administration fee, calculated once, at the beginning of the contract, as a percentage of the initial value of the contract;

C_{asig} = The insurance costs; they are calculated as follows: in the first year they represent a percentage of the initial value (the acquisition price and all the fees required), and every year they decrease in proportion to a certain quote.

This cost is higher than the acquisition price with $D_{lt}+C_g+C_{asg}$ monetary units. However, such an analysis is not efficient if the actualization and the fiscal economy are not considered. The procurement decision needs to take into consideration the the Net Present Cost, which is calculated by deducting the fiscal economy from the total cost, both of them made actual at the initial moment of the operation.

The calculation formulas for the Net Present Cost of Leasing are:

$$CT_l = P_a + Dob_{leasing} + C_{gest} + C_{asig} = Av + P_{rinc} + Vr_m + Dob_{leasing} + C_{gest} + C_{asig}$$

$$CT_{ded\ i} = Am_i + Dob_i + C_{gest} + C_{asig\ i}$$

$$Am_i = P_a / D$$

$$Dob_i = \Sigma\ Dob_{hi} = \Sigma\ r_{dl}(\%)/12 * Sd_{lhi}$$

$$C_{gest} = P_a * Pr_{gest}(\%)$$

$$C_{asig\ i} = P_a * Pr_{asig}(\%) \quad \text{pt } i = 0$$

$$C_{asig\ i} = (P_a - \Sigma\ Am_i) * Pr_{asig}(\%) \quad \text{pt } i >= 1$$

$$E_{f\ i} = CT_{ded\ i} * Imp_{pr}(\%)$$

$$==> CTN_{ded\ i} = CT_{ded\ i} - E_{f\ i}$$

$$CTN_{neded\ i} = Av\ (\text{pt } i = 0) + (P_{rinc\ i} - Am_i) + Vr_m\ (\text{pt } m = n+1)$$

$$P_{rinc\ i} = P_a - Av - P_{rinc\ i-1}\ ,\ i >= 1$$

$$CTN_i = CTN_{ded\ i} + CTN_{neded\ i}$$

$$CTN_{act(leasing)} = \Sigma\ CTN_i * f_{act\ i}$$

$$f_{act\ i} = 1/(1+a)^i$$

Where:

Av = The user's contribution to the financing project (the advance payment);

P_{rinc} = The financed value minus the residual value;

Vr_m = The residual value

n = The term of lease (number of years);

i = The year of the contract (values from 1 to n)

CT_{ded} = The total deductible cost

Am = The amortization (writing off) of the goods - it is reflected in the leasing monthly rate;

D = The normal length of operation for the goods;

r_{dl} = The annual interest rate;

Sd_{lh} = The monthly balance due in the month h;

h = The month of the year (values from 1 to 12);

Pr_{gest} = The administration fee;

Pr_{asig} = The insurance fee;

E_f = The fiscal economy for the deductible expenses;

$Imp_{pr}(\%)$ = The profits tax; CTN_{ded} = costul total net deductibil

CTN_{neded} = The net total undeductible cost;

f_{act} = The actualization factor;

a = The actualization coefficient;

When the term of lease exceeds one year, the actualization is based on the principles of the actuarial mathematics, which means that the Total Net Present Cost is the sum of the The Annual Net Present Costs actualized with the factor corresponding to the year „i".

The Cost of the Goods Procured with Cash Payments

The value of the investment derived from the cash payments equals the acquisition price plus the profits tax, as from the moment of acquisition the buyer becomes the owner of the goods and it will have to pay taxes, according to the legislation of each country. The insurance expenses need also to be added to the total investment. The buyer will have fiscal deductions from the acquisition price only for the amortization of the goods corresponding to the month following the one in which the payment is done. The difference (the acquisition price minus the amortization described above) will represent taxable revenues.

The calculation formulas for the Net Present Cost of the Cash Payment are:

$$CT_{ch} = P_a + Imp_{pr} + C_{asig}$$

$$CT_{ded} = Am \text{ (1 month)} + C_{asig}$$

$$E_f = CT_{ded} * Imp_{pr}(\%)$$

$$\Longrightarrow CTN_{ded} = CT_{ded} - E_f$$

$Imp_{pr} = P_a * Imp_{pr} (\%)$
$CTN_{neded} = (P_a - Am) + Imp_{pr}$
$CTN = CTN_{ded} + CTN_{neded}$
$CTN_{act(cash)} = CTN * f_{act}$
$f_{act} = 1/(1+a)$
Where:
P_a – The acquisition price;
Imp_{pr} – The profits tax;
C_{asig} – The insurance fees;
CT_{ded} – The total deductible costs;
Am (1 month) – The amortization;
E_f – The fiscal economy;
CTN_{neded} –The net total undeductible costs;
CTN_{ded} – The net total deductible costs;
CTN – The net total costs;
f_{act} – The actualization factor;

Regarding the VAT (value added tax), if the user is not allowed to deduct this tax, it will appear as an additional expense, which is to be added to the net cost of the transaction.

The Cost of the Goods Procured with a Bank Credit

This is a very popular method of acquisition, but it has several disadvantages, such as: the need for bank guarantees, the requirements for high financial performances of the applicant and sometimes the fluctuating interest rate.

The total cost of the bank credit includes all the expenses related to the acquisition (the advance payment, the cost of the feasibility study, the insurance fees, the cost of the bank guarantee, the interest rates, the adminitration fee) plus the taxes for the expenses paid from taxable revenues. The taxes are to be calculated substracting the deductible expenses (the interest rates, the administration fee, the insurance, the amortization, the cost of the feasibility study) from the total expenses and multiplying the difference with the tax percentage.

The calculation formulas for the Net Present Cost of Bank Credit are:

$CT = P_a + Dob_{credit} + C_{gest} + C_{asig} + C_{fezab} + C_{asig\ Pty} + Imp_{pf} = Av + P_{ramasa} + Dob_{credit} + C_{gest} + C_{asig} + C_{fezab} + C_{asig\ Pty} + Imp_{pf}$

$CT_{ded\ i} = Am_i + Dob_i + C_{gest\ i} + C_{asig\ i} + C_{fezab\ i} + C_{asig\ Pty\ i}$
$Am_i = P_a / D$
$Dob_i = \Sigma\ Dob_{hi} = \Sigma\ r_d(\%)/12 * Sd_{hi}$
$C_{gest\ i} = (P_a - P_{ramasa\ i}) * Pr_{gest} (\%)$
$C_{risc} = P_a * Pr_{risc} (\%)$

$C_{asig\ i} = P_a * Pr_{asig} (\%)$ pt i = 0

$C_{asig\ i} = (P_a - \Sigma\ Am_i) * Pr_{asig} (\%)$ pt i >=1

$E_{f\ i} = CT_{ded\ i} * Imp_{pr}(\%)$

$\Longrightarrow CTN_{ded\ i} = CT_{ded\ i} - E_{f\ i}$

$CTN_{neded\ i} = Av\ (pt\ i = 0) + (P_{ramasa\ i} - Am_i) + Imp_{pf\ i}$

$P_{ramasa\ i} = P_a - Av - P_{ramasa\ i-1}$, i >= 1

$CTN_i = CTN_{ded\ i} + CTN_{neded\ i}$

$CTN_{act(credit)} = \Sigma\ CTN_i * f_{act\ i}$

$f_{act\ i} = 1/ (1+a)^i$

Where:

$C_{gest\ i}$ = The administration fee corresponing to the year „i"; it is calculated yearly to the remaining balance;

C_{fezabi} = The costs of the feasibility study (paid once, at the beginning of the contract);

$C_{asig\ Pty}$ = The costs of the bank guarantees;

D = The normal length of operation for the goods;

Dob_{hi} = The interest rate corresponding to the month „h" of the year „i", applied to the remaining balance;

r_d (%) = The annual interest rate;

Sd_{hi} = The remaining balance due in the month „h" of the year „i";

P_{ramasa} = The remaining balance due;

a = The actualization coefficient;

For the bank credit, the actualization coefficient equals the interest rate levied by the bank.

The Cost of the Goods Procured with a Supplier Credit

In this case, the deductible expenses are: the amortization, the interest rate and the insurance rate. We assume that the Casco insurance rate is calculated for the whole value of the good in the first year, and in the second year for the unamortized value, and the financial risk insurance rate is calculated for the whole value in the both years.

The calculation formulas are, in this case, similar with the bank credit ones, the difference being that the supplier of the good is , at the same time, the creditor (instead of the bank). Generally, the suppliers use credits from banks or other financial institutions to cover the amount that will be colected in the future from the final users, in order to avoid the potential deficit derived from these operations. For the automobiles, we can state that is „fashionable" that the suppliers (importers for a defined market) set up their own leasing companies to finance the potential clients, offering better conditions than other financial institutions.

An intermediary solution between these ones would be the leasing combined with the supplier credit, which means that the leasing company is credited with the goods by the supplier and offers it to the final user. They pay instalments to the supplier as they collect the amounts due from the users. The collection rate is, generally, lower than the payment rate (ussualy, they collect the money monthly and pay the instalments every three months).

The calculation formulas for the Net Present Cost of Supplier Credit are:

$CT = P_a + Dob_{furnizor} + C_{risc} + C_{asig} + C_{asig\ Pty} + Imp_{pf} = Av + P_{ramasa} + Dob_{furnizor} + C_{risc} + C_{asig} + C_{asig\ Pty} + Imp_{pf}$

$CT_{ded\ i} = Am_i + Dob_i + C_{risc} + C_{asig\ i} + C_{asig\ Pty\ i}$

$Am_i = P_a / D$

$Dob_{fi} = \Sigma\ Dob_{fhi} = \Sigma\ r_d(\%)/12 * Sd_{hi}$

$C_{risc} = P_a * Pr_{risc}(\%)$

$C_{asig\ i} = P_a * Pr_{asig}(\%)$ pt $i = 0$

$C_{asig\ i} = (P_a - \Sigma\ Am_i) * Pr_{asig}(\%)$ pt $i >= 1$

$E_{f\ i} = CT_{ded\ i} * Imp_{pr}(\%)$

$==> CTN_{ded\ i} = CT_{ded\ i} - E_{f\ i}$

$CTN_{neded\ i} = Av$ (pt $i = 0$) $+ (P_{ramasa\ i} - Am_i) + Imp_{pf\ i}$

$P_{ramasa\ i} = P_a - Av - P_{ramasa\ i-1}$, $i >= 1$

$Imp_{pf} = (CTN - CTN_{ded}) * Imp_{pf}(\%)$

$CTN_i = CTN_{ded\ i} + CTN_{neded\ i}$

$CTN_{act(credit)} = \Sigma\ CTN_i * f_{act\ i}$

$f_{act\ i} = 1/(1+a)^i$

Where:

$Dob_{furnizor}$ = the interest rate levied by the supplier;

C_{risc} = the risk fee, calculated at the beginning of the contract;

Pr_{risc} = risk quote that will be applied (percent);

Pr_{asig} = the insurance quote (percent) – will be calculated for the entire value of the good in the first year, and in the second year for a diminished value, depending on the insurance company;

It is very difficult to compare the total payments for the cash procurement versus the leasing operations, if we do not consider the same period of time.

In this case we need to analize the expenses related to the use of the goods for the entire period of the location (at least the insurance fee for the next years). Usually, the cash procurement leads to a lower financial effort comparing to leasing, but this means the use of capitals obtained in the past, and not future capitals obtained from the use of the goods. In the leasing operations, for the imported goods, the VAT and the custom duties will be paid at the residual value at the end of the contract (usually, in Romania, this is 20% of the acquisition value). For the cash procurement, these payments are to be done in the moment of the transaction, and the taxes are calculated to the entire value of the goods.

Based on this methodology, we developed a software and experimented it in several leasing companies. This way, we noticed that, applying the net present cost criteria, the bank credit is recommended (if the user has the necessary bank guarantees, the required financial performances and, of course, if the interest rate for the credit is lower than the leasing interest rate).

If we consider the total present payments, we find the bank credit to be more efficient as well. This happens when the leasing company finances the procurement of the goods using a bank credit. All the expenses related to the operation and the profits are recovered from the instalments paid by the final users.

The structure of the expenses related to the bank credit is very similar to the leasing operations. The exceptions for the leasing operations are the addition of the residual value to the total expenses, but there are no expenses for the feasibility study or with the insurance of the bank guarantees.

The interest rate for leasing is usually higher than the bank credit one, and the contract fee used in leasing operations is similar to the administration fee, levied by banks for a credit. The leasing operations would be more attractive if the leasing company financed it from its own capitals. For the imported goods, the leasing is preffered if the fiscal facilities compensate the cost difference.

We conclude that the advantages of the leasing operations are not related only to the payments, but to the complex facilities offered to the clients. If the interest rates for leasing would be lowered, the leasing was more efficient even to the respect of the payments made by the user. If the goods are imported, than leasing is preffered, if the custom duties apply. The former profit tax reductions in Romania decreased the leasing attractivity.

Romanian Economic and Business Review – Vol. 2, No. 4

A NEW ECONOMY?

Mircea Udrea*

Abstract

Along human history there were periods in which advanced technology and changes in business management generated both social and economic upheavals. These events do not only bring forth an increase of productivity in a leading economic sector but they also offer solid instruments for all social-economic sectors, producing such major transformations so that we can speak about an economic revolution or the emergence of "a new economy". Nowadays we are the witnesses of a transition period towards "a new economy" often called "Knowledge Economy".

Along human history there were periods in which advanced technology and changes in business management generated both social and economic upheavals. These events do not only bring forth an increase of productivity in a leading economic sector but they also offer solid instruments for all social-economic sectors, producing such major transformations so that we can speak about an economic revolution or the emergence of *"a new economy"*. Nowadays we are the witnesses of a transition period towards *"a new economy"* often called *"Knowledge Economy", "E-economy" or "Digital Economy".*

„For leading countries in world economy, the balance between knowledge and resources inclined so much that knowledge probably became the most important factor to determine the living standard, more than land, tools or labour. Nowadays the most developed economies are based on knowledge" [1].

We leave in an information era. The cycle of development and implementation of new technologies is permanently reducing. The number of Internet users worldwide is continuously increasing. More than 50% of the Gross Domestic Product of the developed countries' economies is the result of the production and dissemination of "knowledge". We witness a transition from *"the industrial era"* to *"the information era"*.

As compared to matter or energy, *information* presents distinct characteristics. It is never original, it can be copied on and on and it does not

* Mircea Udrea is Director, Program Coordination Division, CERONAV – Romanian Maritime Training Centre

[1] *World Development Report,1999.*

depend on location. Information never "gets old" and it can be combined unlimitedly. A very important characteristic of the information is that it is highly condensable.

The *Internet* proves an evolution of the academic world which is today stimulated especially by the computer industry. In essence, the Internet is a communication system representing an alternative to telephony. Also, with regard to the use of standards it is one of the rare exceptions in computer industry which, along its history, hasn't generated opened and generally accessible standards. But the standards which allow communication by Internet are opened and accessible to anyone and they are not the private property of companies. This standard makes the Internet, both software and hardware, independent from its producer.

In the last two hundred years, the neo-classical theory of production identified only two production factors: *labour* and *capital.* Knowledge, productivity, education and intellectual capital were considered as exogenous factors. The economist Paul Romer from the Stanford University, together with other economists tried to explain the causes of a long-term economic growth (exactly what happened in the USA economy between 1980 - 2000) by developing a new theory on economic growth, as the traditional economic models could not coherently explain it. Starting from the results of the models developed by the supporters of the neo-classical theory of production like Joseph Schumpeter, Robert Solow and others, Romer proposed a modification of the neo-classical model by introducing the *technology* (and implicitely *knowledge* on which it is based) as an inherent factor of the economic system. Knowledge became the third production factor in the most developed economies.

"Knowledge Economy" is that in which the generation and use of knowledge are predominant in creating welfare". During the industrial era, welfare was created by the use of machines which replaced and multiplied the human labour based on energy consumption. In information era, "workers based on knowledge", the so called "symbol analysts" are workers operating more with symbols than operating machines. Among these, there can be included not only IT&C specialists but also architects, bankers, designers, researchers, professors, political analysts and others. In advanced economies such as that of the USA, more than 60% of workers belong to this category of "knowledge workers".

Research, marketing, advertising, sales, client assistance and other non-productive activities became major aspects of business management. This tendency towards a non-productive company profile reflects itself in business strategies based on quality management, information technology, client-oriented strategies, brand support, re-invention of technological processes. In terms of employed labour force, four of five USA workers were employed in non-productive sectors in the year 2000.

The economic order which dominated between 1938 and 1974 was based on the production of goods, oriented towards a standardized production, managed by a rigid hierarchical structure, preoccupied mainly by the reduction of costs and oriented especially towards domestic markets. These factors represented the beginning of prosperity for the majority of the national economies.

Nowadays in the most developed countries *a New Economy* has emerged: *a knowledge economy based on innovation, an economy in which the key of success and creation of new work places is given by the extent to which the ideas, innovation and technology are implemented in all economic sectors.*

Better said, the New Economy is a new model of management rather than a new technology. One of the major structural changes in the New Economy is the degree in which the dynamism, permanent innovation and rapid adaptation have become norms.

Enterprise and initiatives brought along the risk. Almost one third of work places permanently change each year in the USA economy (either they have recently appeared or will be soon eliminated). This is an effect of the new technologies but also of the increasing competition – as a result of the globalization.

„Competitiveness – as Ricardo Petrella highlighted – became the only real objective – sold, disseminated and defended – of the dominant economy in Northern parts of the planet"[1]. While in Economics the competitiveness represents only a facet of economic actors behaviour, in the context of markets supposed to be competitive, it is no longer a means. It became the prior objective not only of companies but also of states and society in its entirety.

The successful experiences of the United States of America regarding the economic growth and creation of new work places, based on the new information and communication technologies, demonstrated the viability of the new economic approaches.

Counting on the advance in mobile communication and digital television, the European Commission set up the bases for the development of the information society and creation of the new economy through a coherent and programmatic approach. Thus, on the European Commission initiative, at the special meeting of the European Council of March 2000 in Lisbon, there was presented and adopted, as programmatic document, the thesis "*eEurope – an information society for all*".

The main objective of this programme is to offer an advantageous environment for private investments in order to create new work places, to stimulate productivity, to bring up-to-date the public services and to offer anyone the opportunity to get involved in global information society.

In order to revive the partnership for development and creation of work places, as a new start of the Lisbon strategy, the European Council, convened in the spring of 2005, defined "the knowledge" and "the innovation" as main motors

---

[1] Ricardo Petrella – "Europe between competitive innovation and new social contract", International Social Science Journal, March, 1995

for a durable development and stated that it is essential to build an information society for all in which IT&C is used on a large scale, in public services, small and medium enterprises and housing.

To address the fundamental technological changes, the European Council considers that a pro-active policy is necessary. Digital convergence requires a concurrent policy and the need to adapt the institutional and regulation framework where necessary so that they be in accordance with the new digital economy.

The Commission proposed a new strategic programme, i2010 – Information European Society 2010, defining the general policy framework. This programme promotes an open digital economy, based on competitiveness and considering IT&C as the decisive factor in development, creation of new work places and life quality improvement.

Our new intellectual instruments – modern IT&C – enlarge and focus the mental power in a way similar to that in which the instruments produced by the Industrial Revolution increased the physical power. IT&C is the strongest instrument discovered so far which permits any of the previous instruments to refine and increase their utility.

The rapidity with which this technology passed from laboratories to real life and its development dynamics are unprecedented in human history. The development and infiltration of this technology in all economic and social fields require a detailed approach not only of the legal aspects but especially of those regading the social and economic organization.

The term *„new economy"* refers especially to actual changes of the economic activities as a result of using digital technologies, which ensure the access to, processing and storage of information in a cheaper and easier manner. The new economy is characterized by the intensification of knowledge inclusion in the new products and services, and the emphasis on learning, innovation, globalization and durable development. The huge amount of information changes the way in which the markets are functioning, enabling the enterprises restructuring and the appearance of new opportunities for obtaining value by fully using the available information.

Nowadays we are the witnesses of a transition period towards *"a new economy"* often called *"Knowledge Economy", "E-economy" or "Digital Economy"*. The new economy develops within groups of peoples (nations) generating a new society model, the so called *"information society"*. The two notions, the new economy or knowledge economy and the information society, are interdependent and they cannot exist separately.

"New economy" has a strong global character. It is a net of networks which crosses the national state boundaries. This fact requires, not necessarily common regulations, but harmonization, consistency rules allowing the economic networks to operate as a single large global system.

The close and regulated markets turned into open electronic markets, interconnected by means of networks similar to the railways and roads in the industrial era. The present data networks play the same role within the international data and information changes as the goods and passengers transport infrastructures. The difference is that roads and railways are palpable realities while the electronic networks remain, by their nature, invisible. Even less tangible is the information transfer by these means.

In the New Economy, the economic success will be more and more determined by the extent to which it will respond the technological challenges, innovation, entrepreneurial initiative, education, specialization, development of new skills and competences, but especially the transition of all organizations – private or governmental – from bureaucratic hierarchies to educational networks. In this sense, there are a few strategies to be followed, which are particularly important for the political decision factors:

1. investments in labour force training;
2. investments in an infrastructure generating innovation;
3. promotion of a client-oriented governing system based on innovation;
4. support in turning the economy into a digital economy;
5. support in civic cooperation.

Romanian Economic and Business Review – Vol. 2, No. 4

AUTOMOBILE INDUSTRY AND JAPAN'S STRATEGY FOR THE GLOBAL ENVIRONMENT

Şerban Georgescu*

Abstract

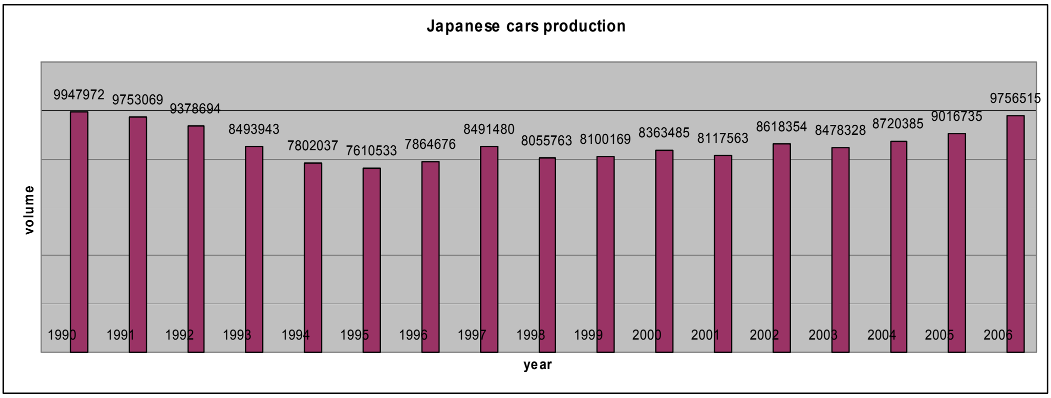
Japan's automobile industry evolution for the last five years was a succes story, based on long-term strategy and strong innovative development. This article makes a review of the automobile industry's main trends and challenges for the Japanese manufacturers.

The recent development of the Japanese economy, after a long period of socio-economic and financial turmoil, marks the exit from the crisis period in a manner that has surprised a lot of specialists. The Japanese economy has experienced a rise which has surpassed through its length all the previous records, the GDP being in constant growth (2.3 % in 2004, 2.7 % in 2005, 2.8 % in 2006, the estimates for 2007 have presented a 2% growth and the 2008 assessments are maintaining the same growth level). Another relevant aspect is the end in 2006 of the deflation period; the consumption price index has recorded a 0.3% growth.

Given this favourable environment, the auto industry in Japan was not left out of the general trend. The last years have marked peaks hard to even conceive: in the year 2006, Toyota overtook Ford, in sales volume in the United States, for the first time while in 2007, the same car manufacturer was to become, for the first time ever, the biggest automobile producer on a global scale, overtaking in sales volume General Motors.

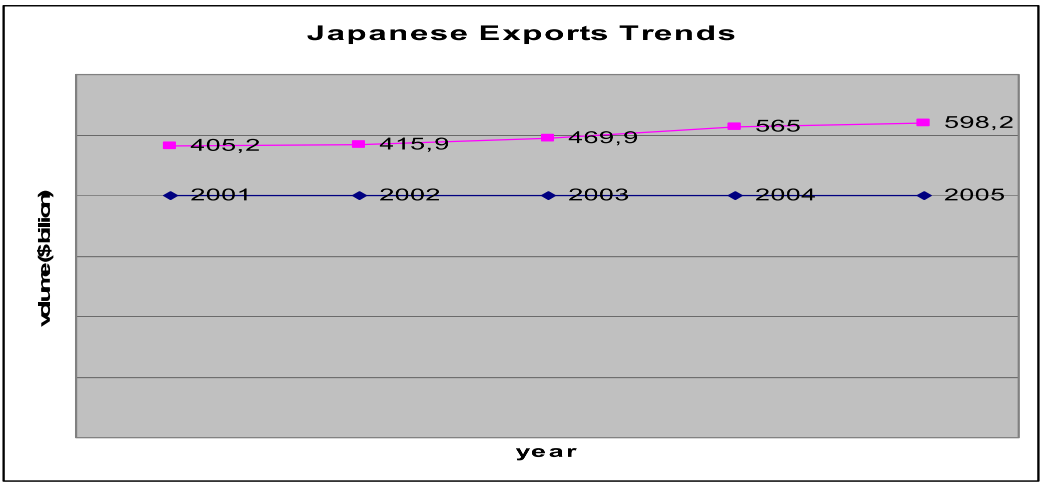
After the oscillating evolution from the 1990s, the car industry in Japan has regained the growth tendency, the level reached in 2006 (9.756.515 automobiles, of which 3.826.819 were Toyotas) was the highest level reached since 1990 (the number of cars produced then was 9.947.972).

* Şerban Georgescu is Associate Professor of Economy of European Union and International Trade at the Romanian American University in Bucharest.



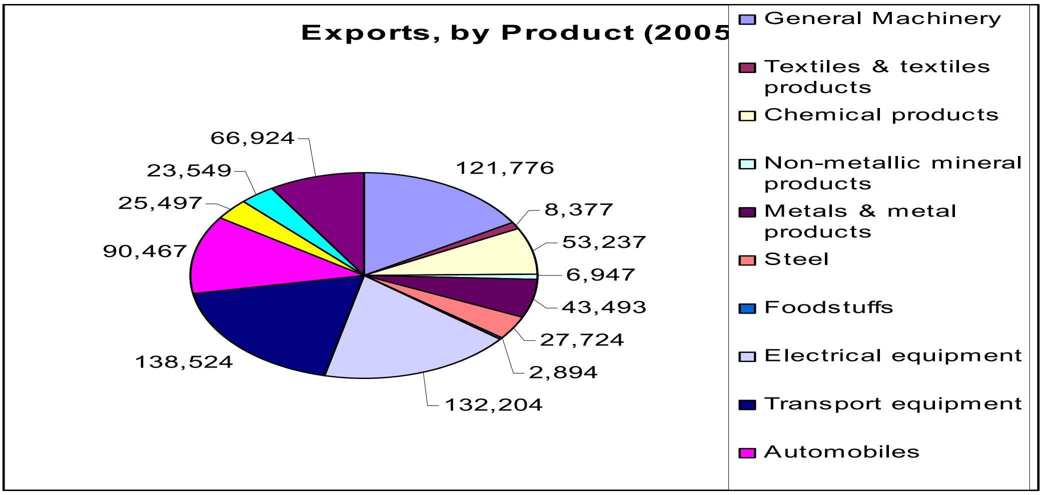
Source: Japan Automobile Manufacturers Association, Inc.

Another indicator reflecting the outstanding performances of the Japanese car industry in the recent years is the export level. The constant growth, for five consecutive years, of car exports has lead to a record figure of 5.295.497 cars exported in 2006, 21.4% higher than in 2005. The total value of exported automobiles has recorded a 15.5% growth than in the precedent year, reaching the figure of 134.4 billion US dollars.



Source: Ministry of Finance, Japan

The automobile export has been one of the primary sectors that have lead to the significant growth in Japanese exports in the recent years, along with the export of transport equipment (other than automobiles).



Source: Ministry of Finance, Japan

The main challenges that the Japanese car manufacturers face are:

- *The ageing population in Japan*, which has lead, for the first time in five years, to a mild decrease in sales on the internal market;
- *The rise of the oil price*;
- *The problems that the United States are facing*, as this is the main export destination of the Japanese automobiles (in 2006, approximately 42% of the total exports were made in the US) ;
- *The strict and harsh legislation concerning the environment*, which, in recent years, lead to allocation of important resources into finding new solutions.

We will focus our attention on the last challenge.

According to recent studies performed by a team of Japanese researchers from the University of Tokyo, National Institute for Environmental Studies and The Japan Agency foe Marine-Earth Science and Technology, it is estimated that the average temperature on a global level will be with four degrees higher than the average temperature in the years 1671-2000. The researchers claim that a growth of the average temperature by more than two degrees will have serious effects. Based on these studies, the Japanese government launched, in the spring of 2007, the long-term strategy called “Cool Earth 50”. The main objectives of this strategy are: to reduce the emissions of greenhouse gases globally, to design a concrete campaign framework for addressing global warming beyond 2013 and to launch a national campaign for achieving the Kyoto Protocol target. One of the main targets of the Strategy is to achieve compatibility between environmental protection and economic growth through innovative technological development (such as efficient solar power generation, nuclear power and next generation automobiles such as fuel cell vehicles).

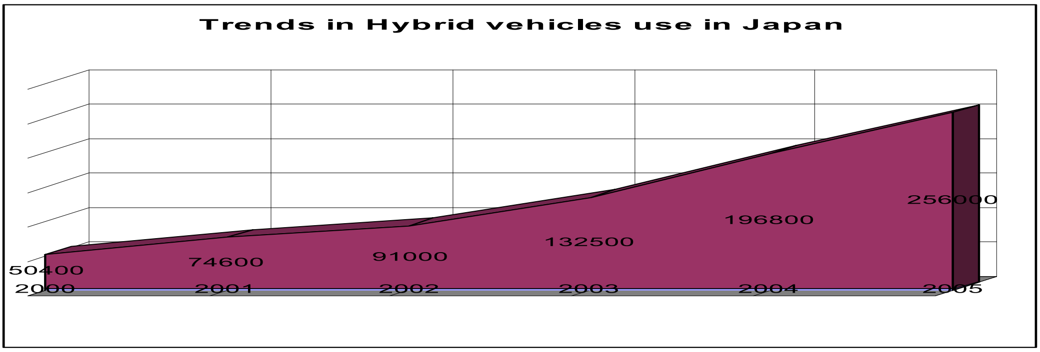
For the Japanese automobile producers these objectives are not new. Concerns for this aspect have made the global battle with the American and European competitors to be fought with new weapons. The Japanese advantages were the long term oriented perspective and the huge investments in technological innovation. Toyota Motor Corp. introduced the world's first mass-produced hybrid car in 1997 (Toyota Prius). The sales of Prius began in North America and Europe in 2000, and in April 2007 the domestic and foreign sales of Toyota's hybrid cars reached one million units. Prius's success may be observed also in the clients' satisfaction level not only in the sales figures. CNNMoney.com realised a study, at the end of 2007, of the most appreciated hybrid cars in the US, concerning the quality – price factor. On the first place, according to the above mentioned study, is situated Toyota Prius. Worthy of mentioning is the fact that, among the total 14 models nominated, seven are Japanese (Toyota being the best represented, alongside Prius there are also Carmy, Land Cruiser and Lexus GS450h and RX400h, also Nissan Altima Hybrid and Honda Civic Hybrid). At the 2007 edition of Tokyo Motor Show, Toyota presented 1/X model, which is desired to be a future successor of Prius model. 1/X represents a new guideline for technical innovation.

But the Hybrid vehicles are not the only option for the future: clean-energy vehicles that run on alternative fuels such as natural gas, electricity and diesel-alternative LPG are rapidly gaining in popularity owing to their significantly reduced CO_2 emissions. Meanwhile, the use of low-emission gasoline-powered vehicles is also actively promoted by the Japanese automobile manufacturers; as a result, the combined total of clean-energy and low-emission vehicle shipments reached 4,21 million units in 2005.[1]

Clean-energy & low emissions vehicle shipments (2005) - in vehicle units[2]

	Passenger Cars	Trucks	Buses	Total
Fuel-cell vehicles	16	0	0	16
Electric vehicles	0	0	0	0
Hybrid vehicles	59756	1469	38	61263
Natural gas vehicles	36	2936	94	3066
Methanol vehicles	0	0	0	0

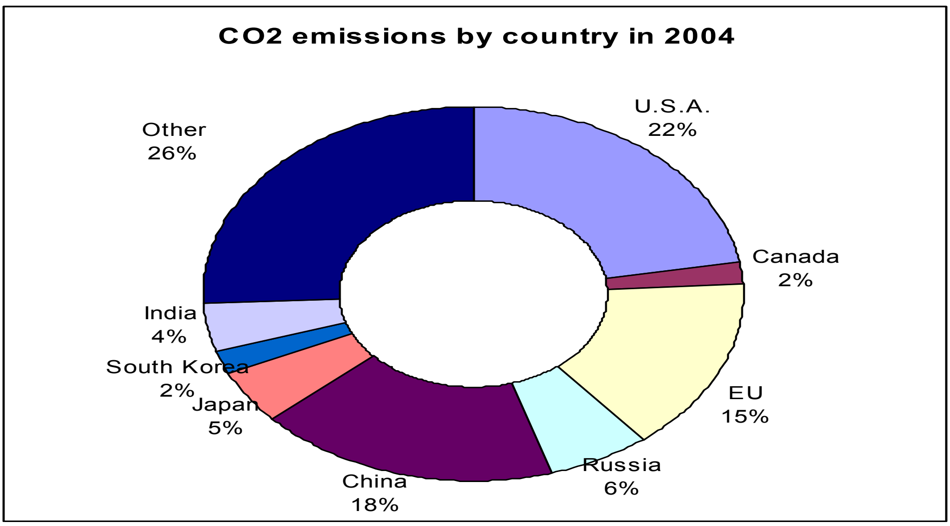
[1] Source: Japan Automobile Manufacturers Association
[2] Source: Japan Automobile Manufacturers Association



Source: Japan Automobile Research Institute

The main targets that the Japanese automobile industry is looking to achieve in the area of environmental protection and resource conservation are:

- The further reduction of harmful vehicle exhaust emissions and increased fuel efficency. CO_2 emissions in Japan's transport sector dropped significantly in 2005, owing largely to improved fuel economy in passenger cars and greater efficency in goods distribution[1] .
- The development of alternative-energy vehicles;
- Increased efficiency in plants and infrastructure to reduce air, water and noise pollution;
- To further improve vehicle recycling and recycling in the production process.



Source: Japan Automobile Manufacturers Association

[1] Source: Japan Automobile Manufacturers Association

References

Institutul de Economie Mondială. 2007. *Conjunctura Economiei Mondiale 2007*, Academia Română, Institutul Național de Cercetări Economice, Bucureşti.

Japan Automobile Manufacturers Association, Inc. - *Motor Vehicle Statistics of Japan*, 2007 (www.jama-english.jp/publications)

Japan Automobile Manufacturers Association, Inc. - *The Motor Industry of Japan*, 2007 (www.jama-english.jp/publications)

Japan Journal - august 2007, vol. 1, no. 1

Japan Journal - november, 2007

OECD Economic Outlook , no.80, 2006, Paris

Ministry of Finance, Japan - www.mof.go.jp