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EUROPEAN INTEGRATION: FIRST EXPERIENCES AND FUTURE CHALLENGES

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FOREWORD

The transition from planned to market economy in Central and East European countries has triggered far-reaching structural change driven by technological development, globalization, new social demands. Though structural change induced by the European integration is already a traditional topic in the economics of transition and a vast literature exists, it seems promising to consider this problem for several reasons. From a methodological point of view there are still many challenges. The lack of a comprehensive theory on transition economies, their structural change and sector models or the proper extraction of policy impacts in econometric analyses are only a few of the unsolved problems. However, the application of sophisticated tools for analyzing structural change is not an end in itself, but contributes to the discussion of current problems and future challenges in the economics of transition.

This volume is the outcome of the 1st International Conference in Emerging Economies (ICEE), *European Integration: First Experiences and Future Challenges* organized by the Faculty of Economics, Partium Christian University, Oradea [Nagyvárad], Romania, in October 22-24, 2009. The major objective of the conference was to discuss and to analyze the state-of-the-art in research methods for economic analysis, as well as the political and social aspects of European integration especially the emerging economies of the Central and East European countries. A specific objective was to offer a platform for exchanging ideas and generating an integrated view of first experiences and future challenges of the integration process. As current topics of the integration policy were addressed, this proceedings volume of conference is relevant not only for a scientific community but also for decision makers in politics, social security and administration.

The conference was attended by 52 participants representing 3 Central European Countries. In the three days program of the meeting 5 presentations were made during the 3 plenary sessions, 15 papers were presented in the 4 contributed paper sessions. Plenary speakers included

Gábor Hunya from *The Vienna Institute for International Economic Studies*, Csaba László member of the Hungarian Academy of Sciences, Daniel Dăianu member of the Romanian Academy of Sciences, Imre Fertő professor at Corvinus Universtiy of Budapest and Maria Vincze professor at Babeș-Bolyai University.

The scientific organization of the conference was particularly stimulating thanks to the important contribution made by the international scientific committee together with the participation of organization committee. The International Program Committee was constituted from distinguish professors of different European universities Štefan Bojnec (University of Primorska, Slovenia), László Fekete, (Corvinus University of Budapest, Hungary), Iuliu Horvath (Central European University, Hungary), Zsolt Sándor (University of Groningen, the Netherlands) as well as Romanian universities Maria Vincze (Babeș-Bolyai University), Sándor Elek (Sapientia University), András Biró, Ioan Nistor, Gábor Flóra, Györgyi Szilágyi (Partium Christian University). The local Organizing Committee was chaired by József Fogarasi and included Hajnalka Kánya, Csaba Pajzos and Zoltán Zakota. In addition we would like to express our gratitude for the help provided by the staff of the Faculty of Economics, Partium Christian University and Hajnalka Izsák for language editing.

This conference proceedings book is composed by 5 chapters which reflect the organization of conference. The first chapter presents the plenary session reports which tackle important issues of particular relevance for the whole conference. The other chapters cover a wide range of themes connected directly or indirectly to the conference main topic.

Finally, we wish to thank all the authors who have contributed to the high quality of the conference and the debate with their research, and who have helped publishing this book.

László Csaba, József Fogarasi, Gábor Hunya

Editors

ROMANIA FROM EU ACCESSION TO CRISIS AND THE NEED OF A NEW GROWTH STRATEGY

Gábor HUNYA*

This paper provides a description of economic developments and FDI in the new EU member states and especially in Romania in the years leading to the financial crisis. As a first subject it explains the economic overheating in Romania as the result of overspending based on the lax risk assessment of investors. A second topic is related to the current economic crisis which caused an extremely strong setback of GDP in Romania. The extent of the crisis in Romania was not a mere production of the global development but has its domestic routes as well. As a third topic we discuss the relationship between FDI and current account deficit. The development strategy of the NMS was to a large extent based on the growth stimulus provided by FDI. The modernization effect of foreign capital was significant but it failed to develop the export base in several countries and triggered huge income outflows. Growth prospects of the NMS are quite diverse and this is the subject of the fourth section of the paper. We shall argue that recovery will depend of external demand in the first place. In the longer run a new growth strategy is necessary based more on domestic savings than on imported capital.

Key words: Romania, new EU member states, FDI, financial crisis, economic growth
JEL Classification: O11, O57, F21

Introduction

The EU enlargement to new member states (NMS) was a major event of recent history. Eight CEECs joined in May 2004 followed by Bulgaria and Romania in January 2007. The first Eastern enlargement was a measurable economic success leading to higher rates of economic growth than the new member countries had had before accession. The notable exception was Hungary where the averages of three years before and after accession (2001-2003 vs. 2004-2006) produced equal rates of growth (Gligorov et al.,

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2007). If the time-horizon is extended by another year or two, the Baltic States also fall out. A successful development for the more recently acceding countries was stopped by the global financial crisis. We cannot really find out how the countries of the second enlargement would have performed without the global financial crisis. However there were warning indicators that the impact of country-specific tensions could have led, if not to a collapse as in the Baltic States, but to an enforced adjustment of the foreign balance. The first subject of this paper is to show, that the economic overheating in Romania which was the result of the lax risk assessment of investors was partly the product of EU accession. The end of such a development path could be predicted even if in a less dramatic way compared to what happened during the global crisis.

A second topic of this paper is related to the current economic crisis which caused an extremely strong setback of GDP in Romania. The NMS vary distinctly in terms of the course that the current crisis has taken. Rates of decline as well as the composition of decline are different. The extent of the current crisis in Romania is not a mere production of the global development but has its domestic routes as well. The development before the crisis was overheated, which would sooner or later give way to an adjustment. This adjustment has been enforced after September 2008 and stability could be achieved with relying on an IMF-led rescue package.

As a third topic we dwell in detail on the relationship between FDI and current account deficit. The development strategy of the NMS was to a large extent based on the growth stimulus provided by FDI. As the return on capital was large in capital-scarce, relatively backward countries, FDI was attracted on a massive scale. The modernization effect of foreign capital was significant but it failed to develop the export base in several countries and triggered huge income outflows. Still, this is the most resilient type of private capital inflow during the crisis.

Finally the wiiw forecast for 2010 will be explained. Future growth prospects of the NMS are also quite diverse and this is the subject of the fourth section of the paper. We shall argue that recovery will depend of external demand in the first place. In the longer run a new growth strategy is necessary based more on domestic savings than on imported capital.

This paper provides a description of developments and relies on the findings of wiiw forecast and country reports (www.wiiw.ac.at) rather than empirical research.

Romania, the extreme case: a brief overview of pre- and post-accession economic development

The three years preceding Romania's accession to the EU in 2007 were more successful than the three years following it. We distinguish three periods:

1. pre-accession recovery from 2002 to 2006 characterised by high rate of economic growth, institution building, privatization and FDI inflow;
2. post-accession overheating from 2007 to September 2008 characterised by excessive rate of economic growth and extreme foreign imbalance;
3. deep depression since September 2008 with contracting GDP and enforced adjustment of the external balance.

The 2002–2006 period was that of large-scale reforms and privatization. At the Copenhagen Summit in December 2002, EU leaders set 2007 as the target date for Romania to join the Union. This demanded a fast-track adjustment of legislation and economic behaviour. In the subsequent years, record high rates of economic growth were achieved not only compared to the previous decade spent mainly in stagnation, but also compared to other European countries. The accession process gave a great stimulus to legislative change and privatization. The conditions for doing business improved which also attracted FDI.

All new EU member states privatized large enterprises including banks primarily to strategic investors. This was necessary to ensure their restructuring and develop their market position. The sale of the Romanian Commercial Bank and of Petrom to foreign investors had symbolic effects beyond their economic necessity. Few years later, when these companies performed in an outstanding way and especially Petrom benefited a lot from high international oil prices, both cases came under unfounded political attack. It was argued that privatization via the stock exchange could have been a better alternative; but in our opinion only after market economy conditions had been established. Before, when the majority of the banking system was not in the hands of strategic investors, it would have been dangerous to give banks to dispersed owners and allow concentration of shares in the hands of non-professionals. But once a strong competitive banking system is established, the remaining banks can go private by public offering.

Beyond privatization-related FDI, thousands of investors in the manufacturing sector appeared in Romania mostly with the aim to benefit from low wages. Still the export sector developed only slowly. The country could not be successful as the "tailor of Europe" in a longer run. Rising wages and the liberalization of EU trade with China put an end to this narrow specialization simultaneously with EU accession. A slow but steady structural change followed, driven by FDI. Electrical machinery and vehicles exports took over the role of light industry goods.

Several imbalances characterized the Romanian economy by the time of EU accession and also later. Domestic demand became much higher than supply, thus an increasing foreign trade deficit emerged. Currency appreciation and wage drift reduced competitiveness. Productivity improvement, though rather fast, did not compensate the wage drift. This imbalance was to some extent due to EU accession. Romania used the historical window of opportunity to join the EU when it did, but from an economic point of view this happened pre-maturely. Increased competitive pressure is good to enforce structural change but it came too suddenly for domestic companies. SMEs were too weak to adapt and their output and exports declined. A foreign–domestic duality emerged in the company structure similar to those in other NMS.

EU accession reduced the risk perceptions, which was good as far as FDI attraction, but it also stimulated short-term investments. Direct investments in new capacities helped a lot to modernize the economy, brought new technology and higher value-added production to the country, but much of the credit expansion was too risky. It produced a bubble in real estate prices and bank loans. In addition, infrastructure and educational bottlenecks appeared as limits to growth and further restructuring.

In 2007 and most of 2008 economic growth was driven by private consumption and also investments which were financed from abroad and led to expanding foreign trade and current account imbalances. The crisis came at an unfavourable moment. Romania was in a phase of rapidly adjusting industry and services, with a lot of technology being imported. This was necessary as domestic production was not in a position to meet the demand for investment goods. Private demand also expanded rapidly as consumers benefited from growing wages, improved creditworthiness and an appreciating local currency. Exports increased at two-digit annual rates, albeit slower than imports. This deficit was financed by abundant foreign currency inflow which appreciated the local currency triggering a further widening of the foreign trade deficit. The current account deficit to GDP ration increased from about 7% in 2005 to 10% in 2006 and 17% in 2007 and 2008. Obviously, the acceleration of deficit creation coincided with the EU accession. While in 2006 as much as 85% of the deficit was financed by FDI, in 2007 less than 50%. The main source of financing became foreign credit channelled in by commercial banks and other creditors.

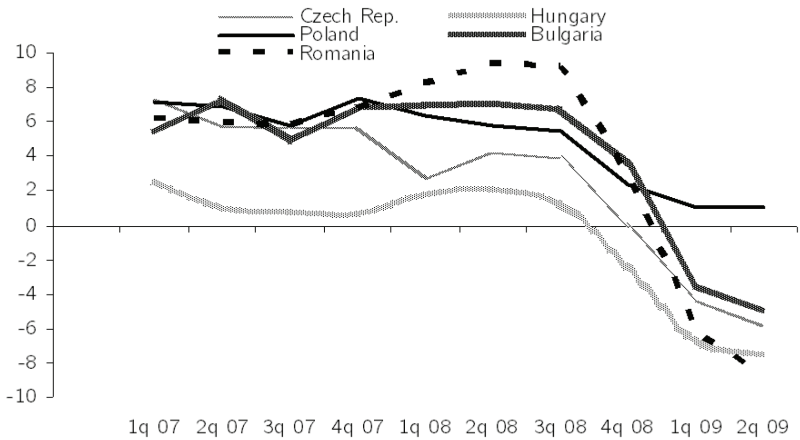
Record-breaking GDP growth-rates continued up until September 2008 when the global crisis pushed Romania into recession. Boom gave way to bust. All of a sudden, the risk awareness of investors increased and capital started to flow out which pushed the local currency into depreciation. Also export markets contracted which made much of the production redundant.

Different depth of crisis in the NMS – the situation of Romania

Average NMS economic growth in the first nine months of the year 2008 was close to 6% – in line with the previous year's rates. Slovakia, Romania and Bulgaria achieved peak growth rates. This was partly due to new capacities coming on stream in export-oriented sectors, while the two latter countries also enjoyed a credit-based consumption boom and a bumper harvest. The exceptions to the rosy picture were Estonia and Latvia; they were already in recession after external financing had dried up the previous year when their debt to GDP ratio exceeded 100%. Another exception was Hungary with its very slow economic growth and large external disequilibria. Hungary differed from the Baltic countries, as it was not the private, but the public credit stance that proved unsustainable. The austerity policy implemented from late 2007 was bringing down the deficit already in mid-2008 but not enough to persuade investors when they started to flee from risky assets.

Following the collapse of the US investment bank Lehmann Brothers in September 2008, investors suddenly took a closer look at risks and capital started to flow out. At the same time Western banks faced trouble at home. The financial squeeze hit production and exports which both began to contract. As a consequence, economic growth slowed down substantially in all ten NMS in the last quarter of 2008. None the less, the average GDP growth rate of 4.7% for the region as a whole in 2008 was not that disappointing. It was remarkably robust, 6-8% in Bulgaria, Romania and Slovakia implying that these countries were catching up quite significantly with the more developed West and other NMS. The growth slowdown from 6% to some 4% in the Czech Republic, Poland and Slovenia was quite modest. But the final quarter already foreshadowed the upcoming recession (Fig. 1).

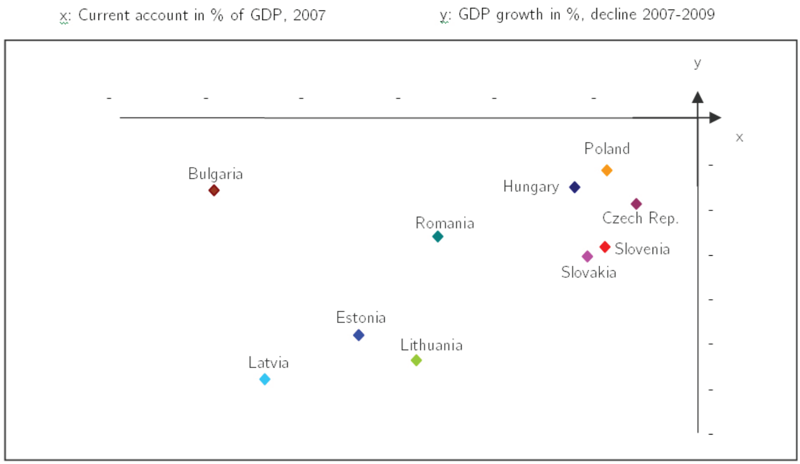
Figure 1 **GDP, 2007-2009 Quarters, real change, compared to the previous year, in %**



Source: wiiw Annual Database incorporating national statistics, Eurostat.

In the beginning of 2009 the key issues became financial stability, both fiscal and external, in each individual country. The investors' perception of risk deteriorated for all NMS, but less so for the more stable countries with low external debt, low current account and low budget deficits: in brief, those countries which only relied to a modest degree on foreign financing. The current account per GDP indicator showing the extent to which countries relied on external financing at the outset of the crisis marked the extent of adjustment necessary during the crisis. The adjustment on the current account triggered the adjustment in output as well. Countries in higher current account deficits (external financial needs) at the outset of the crisis suffered the biggest growth reversal (Fig. 2). The exception is Bulgaria which has kept up a rather modest decline by depleting foreign exchange reserves.

Figure 2 **GDP growth decline and current account/GDP**



Source: wiiw Annual Database incorporating national statistics, Eurostat.

By all indicators the Czech Republic, Poland and Slovakia were better equipped to weather the storm at the outset of the crisis than others. A second group comprised those countries that were highly vulnerable and could soon be nudged into recession; they faced a severe financial meltdown. Bulgaria and Romania were two main candidates for recession, but both were struggling hard to avert a more serious crisis. There were signs already in the beginning of 2009 that some international financial support (IMF, EU, etc.) will prove necessary, at least in Romania, to avoid a hard landing, but Bulgaria survived relying on its own domestic reserves.

The third group comprised those countries that plunged in recession and became dependent on external assistance, the Baltic States and Hungary.

For most countries in the region the second quarter of 2009 brought a deeper recession than the first. Taking these latest GDP growth rates one is inclined to conclude that the recession is deepening. However, this conclusion must be qualified because more detailed data and information about the current state of the economies give substance to some optimism. This is first of all related to the external sector where deficits started to be curtailed. Exports fell less than imports and the current account improved. In addition, industrial production showed less decline year on year in July and August 2009 than before and there was a positive change in the otherwise negative business sentiment.

Table 1 **GDP development in the first half of 2009, the contribution of its components and the reversal compared to the same period of the previous year**

	GDP, Jan-June 2009 %	Private consumption	Gross fixed capital formation	Change in inventories	Government consumption	Contribution of foreign trade	GDP growth reversal Q2 2008 – Q2 2009, in %
Latvia	-18.4	–	–		+	++	-16.8
Lithuania	-17.0	–	–		+	++	-25.4
Estonia	-15.6	–	–		+	++	-14.9
Slovenia	- 8.8	0	–	-	+	+	-14.9
Romania	- 7.6	–	–	-	+	++	-18.0
Hungary	- 7.2	–	-	-	-	++	-9.6
Slovakia	- 5.5	0	-	–	+	0	-13.2
Czech R.	- 5.1	+	-	–	+	+	-10.0
Bulgaria	- 4.2	–	–	-	+	++	-12.0
Poland	+1.1	+	-	-	0	+	- 4.7

Source: wiiw Annual Database incorporating national statistics, Eurostat.

Most countries booked severe declines of GDP in the first half of 2009 mostly due to diminishing private consumption and investments (Table 1 and Fig. 1). Exports declined severely but as imports fell even more, net exports had a positive contribution to GDP.

The worst performance (GDP decline of 16-18%) was in the Baltic States which still struggled to uphold their overvalued exchange rates. This required an internal adjustment with wage decrease and output contraction. With a steep adjustment of the foreign balances they booked a current account surplus. The fiscal balance deteriorated which would not be a big problem given their low level of indebtedness, but financing was a problem due to the reluctance of foreign creditors, most severely in Latvia.

The next, quite heterogeneous group of countries was Slovenia, Romania and Hungary with GDP declines of 7-9%. The small open economy on Slovenia suffered mainly from the lack of investments while private consumption was maintained by fiscal measures. In the other two countries, but especially in Romania, the contraction of private demand was the most significant source of diminishing GDP and also investments suffered a setback despite upheld government expenditures. For Hungary the setback was not that severe as the country had slow growth already the previous year due to its fiscal recovery programme. It maintained the control over public deficits in 2009 also but was over-indebted already at the outset of the crisis. Romania, in contrast, was over-credited and credits piled up into future debts meaning that there was a difference in the phases of the credit to debts cycle between the two countries. In addition, there was a structural difference; in Hungary the government accumulated the debts while in Romania it was first of all the private sector. The risk avoidance of investors after September 2008 hit both countries. Hungary immediately got on the brinks of public debt default, Romania was only hit by a dry-out of external financing with a prospect of a sudden stop. In both cases it was IMF-led support packages which ensured survival and stabilization became possible at a decreased level of output and consumption. Also the own efforts of the two governments showed a remarkable time-gap. For Hungary it was clear from the very beginning that public debt had to be brought under control and the budget deficit capped, as the external financial situation did not allow for more new debt than those financed by the IMF package. A budget deficit for 2009 and 2010 targeted in the range of 4% of GDP was singularly low by European standards. In Romania there was room for the public sector to finance an increasing deficit from a similar package. The need for saving was not internalized and the IMF showed remarkable flexibility. A budget deficit two times higher than the Hungarian was allowed and even that did not increase public debts extremely.

In a third group Slovakia, the Czech Republic and Bulgaria had declines of 4-5%, close to the EU average. Czech Republic and Bulgaria were almost success stories, although sustainability could be questioned in case of Bulgaria. The Czech Republic was special in the way that the decline in GDP was not related to the decline in consumption. This was a result of falling saving propensity; as households were not extremely indebted, consumption was not dependent on credit conditions. Thus the crisis was imported through the foreign trade transmission. A specific impact of low demand was the depletion of inventories, the item most responsible for the GDP decline in the first quarter. Bulgaria was another distinct type. It had a fixed exchange rate regime, thus the adjustment had to be absorbed domestically. A rigid fiscal policy and accumulated public reserves provided the necessary buffer and made IMF help avoidable. Although deficits were accumulated before the July 2009 elections but the deficit-spending programme of the outgoing government was abandoned by the new. Large-scale public investment projects once thought to pump life into to the economy were slashed. No mitigation of the recession could be provided from domestic sources. In both Czech Republic and Bulgaria an important rationale for the accumulation of fiscal reserves in previous years was exactly to be in a position to use part of this reserve for countercyclical measures which when necessary, had not been implemented by either of the two governments.

Poland is the real success story as GDP growth stayed positive in the first half of 2009 and was expected to stay for the year as a whole. Private consumption grew by a relatively strong 3%, while gross fixed capital formation fell a bit. These were remarkable features when compared with other countries of the region. The performance of the foreign trade was similar to other countries, as imports fell more than exports and the deficit diminished. But the dependence on foreign trade is much lower than in other NMS as Poland did not follow the development path of other countries in the region during the previous 5-7 years. The confidence in the Polish economy was further strengthened by the access to a low-cost Flexible Credit Line of USD 20.6 billion of the IMF. This provides an additional reserve that the Polish authorities could use under a major speculative attack.

As to the growth reversal, Romania looked similar to the Baltic States. Some of the underlying features like overheating and current account imbalance and modest public debt before the crisis were the striking similarities. But the extent of these problems was smaller in Romania than in the Baltic States. A further important difference was that Romania had a flexible exchange rate regime while the Baltic countries maintain fixed rates. With depreciation in late 2008 and early 2009 Romania could correct the earlier appreciation-driven loss of competitiveness and make a successful external adjustment with the support of the IMF.

The excessive appreciation of the Romanian currency in the 2007 – mid-2009 period already evoked the danger of a sudden reversal. This came in several steps in autumn 2008 and February 2009. The RON/EUR rate fell back to where it had been three years earlier. The stabilization during summer 2009 seemed lasting and was in line with other floating currencies of the region. The depreciation in mid-October 2009 was evoked by the political crisis and the renewed departure of foreign investors.

FDI both finances and creates current account deficits

High current account deficits appeared in the course of the externally financed economic boom in several countries in 2007-2008 (Hunya, 2009). The current account deficit in per cent of GDP was low only in the Czech Republic, higher but moderate in the range of 5-6% in Hungary, Poland, Slovakia and Slovenia while in Bulgaria and Romania it reached 15-25%. High deficits were to a large but decreasing extent financed by net FDI. Back in 2005, FDI had financed at least half of the current account deficit in eight NMS, and four of them featured an FDI inflow that was higher than the current account deficit. The situation worsened in subsequent years and in 2008 only the Czech Republic had an amount of net FDI in surplus of the current account deficit and only Bulgaria, Romania and Slovakia financed more than half of the current account deficit by FDI. The rest of the region relied on more volatile sources of financing.

FDI does not only finance but also creates current account deficits. The current account includes the total income (profits and interest earnings) of the foreign investors in the country as outflows. (Incomes earned by outward FDI are treated as inflows and are still insignificant for the NMS.) In mature FDI receivers the income of foreign investors makes up more than half of the current account deficit. This was the case in all five Central European

NMS and Estonia in 2008. For these countries the major source of external deficits is not the trade or the services account, but the income accrued by foreign investors.

Foreign investment enterprises have become more profitable over time. The FDI-related income (outflow) relative to the inward FDI stock provides the rate of return on the foreign investment. These rates are particularly high in Hungary (18%) and the Czech Republic (14%). In most other countries they are at about 10% which is still a fairly good rate. High and increasing profit rates prove that the region has been an attractive FDI location. It also suggests that mature FDI receivers get relatively little new FDI compared to the amount of income foreign investors earn there.

Part of the foreign investors' income is *reinvested* and is booked as FDI inflow on the financial account of the host country, another part of it is repatriated, leaving the host country. It is the interest of the host country to keep as much FDI-related income as possible in the country. This has not been the case in recent years. The share of *repatriated income* in the total income of foreigners increased with time. In the mid-2000s about half of the income was repatriated from the five Central European countries plus Bulgaria and Romania. In 2008 the average rate of repatriation was about 70%, the highest in the history of the region. Slovenia, Slovakia, Bulgaria and Hungary were above the average, the Czech Republic significantly below. Income repatriation has generally been low from the Baltic States, perhaps due to local strategies of Scandinavian investors.

High rates of FDI-related income and high repatriation rates have resulted in net *"inward-FDI-related outflows"* in several countries in the past couple of years. Taking the repatriated income in relation to FDI inflow (which includes reinvested income) we get the net direct effect of FDI on the balance of payments. Hungary had a high negative balance and Slovakia a small one in 2008. Income repatriation and FDI inflow were of almost equal amount in the Czech Republic. High positive balances appeared in Bulgaria and Estonia. Also this indicator tends to grow as FDI matures and indicates *growing net losses* a country suffers due to FDI (Table 2).

Table 2 **FDI inflow and income repatriation, 2008, EUR million**

	Bulgaria	Estonia	Czech R.	Hungary	Poland	Romania	Slovenia	Slovakia
FDI inflow	6163	1366	7329	4406	10970	9084	1239	2323
FDI income (outflow)	2190	1389	11830	11560	12090	4689	732	3153
Repatriated FDI income (outflow)	1691	378	6820	8232	7675	3104	716	2579
FDI inflow/repatriated FDI income (outflow), %	364	361	107	54	143	293	173	90

Source: wiiw database on FDI

The above trend of low FDI inflow in relation to investors' income has important economic policy implications. While in the past foreign investors provided an indispensable technical and organizational stimulus to the successful transformation and modernization of CEE economies and also financed a substantial part of the current account deficit, more recently FDI has become a source of permanent income outflow and creates more current account deficit than it finances. An overall negative balance of payments effect of FDI is something that governments have not envisaged and it has also not been discussed much in FDI-related research.

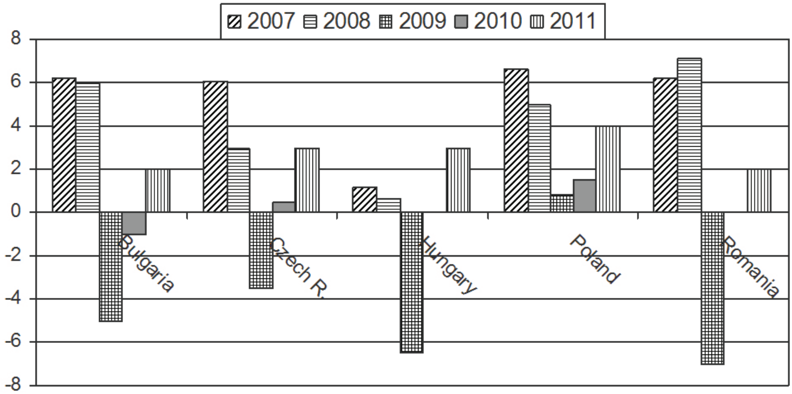
The negative effects of the repatriation of FDI-related income can be balanced by other positions in the balance of payments. In the ideal case, foreign investors *establish export capacities*; thus, when the income balance turns highly negative, it can be compensated by the improving foreign trade balance. In fact, trade deficits of goods with the EU-15 have turned into surpluses and exports of services have also started to grow more rapidly than imports in countries such as the Czech Republic and Hungary. But export growth has by far not been enough to compensate both the high import content of exports and the surge of income repatriation in most countries. The Czech Republic with its FDI inflow outpacing the current account deficit is the exception. Efforts to direct FDI further to export-generating investments are therefore desirable; the same holds for the reinvestment of incomes. This could be encouraged by promoting new investment possibilities in technologically more advanced, higher value-added and R&D-intensive products.

The current crisis changed the existing picture of the foreign sector's performance in relation to the balance of payments. In 2009 the current account deficit shrank very fast in the NMS and the SEE countries due to lack of external financing. A net outflow of foreign private sector credits and portfolio investments was expected, while FDI would be positive although lower than earlier. Official credits and EU transfers would substitute for some of the shortfall in external financing but allow for much smaller current account deficits than before. FDI would again play a bigger role in balancing the current account. Already in the first half of 2009, the declining FDI inflow financed a higher share of the contracted current account deficit than in the previous year. It was expected that 2009 would most probably bring little or no profit for investors, so there would be nothing to be repatriated or reinvested next year. This would keep FDI depressed for at least another year.

The need for a new development strategy in several NMS

Most of the NMS were hit by the recession later than the EU-15 due to more indirect crisis-contagion. This may hold valid also for recovery. Romania was late, compared to the other NMS, by a few months as the fourth quarter of 2008 still showed modest growth. Thus the recovery may come with even more delay. 2010 will be a year close to stagnation throughout the region. 2011 is too far to be predicted. Assuming that the EU-15 will have a recovery of 2-3% in that year, the NMS will follow. Poland has the best chance to recover faster while Bulgaria and Romania may lag behind. This differentiation is based on the expected turn in the growth strategy. Countries which are able to generate growth from domestic savings, and technological progress can recover faster than those which need more external financing and in the case of which investors perceive higher risk.

Figure 3 **wiiw forecast: GDP y-o-y real change, %**



Source: wiiw Annual Database incorporating national statistics, Eurostat, wiiw forecast

In autumn 2009 the reform of the global financial architecture progresses at a slow pace. Supervision of financial innovations hardly emerges, thus there is no safeguard against future bubbles. Risk appetite and with that foreign financial inflows may be limited for some time. Developed world governments are desperate for finance; they will attempt to constrain private-sector credit growth and are likely to ease the economic pain with inflation and exchange-rate depreciation. More dynamic BRICs will also attract a larger part of the available finances than before. As a consequence, private capital inflows to the NMS will be more restricted than before the crisis. This holds true especially to real estate development, portfolio and other investments. The main sources of external financing for the NMS will be EU transfers and FDI in export oriented sectors. The result will be a moderate rate of economic growth and less vulnerability to a sudden stop.

The former high-growth period of the NMS based on capital imports where domestic investments are higher than savings, will most likely not be feasible in the forthcoming years. Slower inflow of external financing will call for more domestic savings to finance new investments. This may leave less scope for consumption. Recovery may not be fuelled by private households but by foreign demand. The NMS will stay highly integrated into the European economy and their growth will to a large extend be determined by the foreign demand pull. In addition, NMS can free-ride on the fiscal stimulus programmes of old EU members e.g. sell more cars there. But the economic development model of most NMS, which had proved so successful up until quite recently has been terminated. The model was based on external financial inflows which are not forthcoming under the present international crisis conditions. NMS economies are on the way to adapting to the new conditions by lowering the level of economic activities, some of them also by currency devaluation. Current account deficits have contracted in line with the availability of external financing. At the same time, fiscal deficits expanded and public debt to GDP increased.

Most NMS governments consider export expansion to be the only possible way out of the crisis. They can have justified hopes of reviving their exports in sync with a recovery in Europe. Their cost competitiveness has not been shaken and, if the recent devaluation proves lasting, it will dramatically improve. The situation of the new euro zone members is more tenuous; they will have to increase productivity in order to keep pace with the loss of their relative cost positions compared to other NMS. Another question for the future is the rise of 'protectionism' – not solely in Europe, but worldwide. Owing to increasing unemployment in the EU-15, multinational companies are under pressure to keep their capacities up and running at home – even if it be to the detriment of their NMS subsidiaries. None the less, it is more likely that EU-wide competition rules will not be restricted; the NMS can thus hope for an even larger share in Europe-wide manufacturing, when demand recovers. The various forms of support for domestic companies and banks also constitute a certain form of protectionism.

Future growth in Romania will have to rely on domestic savings to a large extent. Switching from the consumption to the saving mode will depress demand still further and postpone recovery. The emergence of domestic investment-led growth is quite a slow process. Fortunately, given the current financial prospects, greater support can be expected from EU funds. Also, the cost competitiveness has not suffered in a country with flexible exchange rate regime and FDI in the export sectors can revive. The growth perspective for 2010 is that of stagnation which stays below that of the EU average. The medium term forecast is 3-4% annually. The positive growth differential with the EU 15 will emerge but not exceed 2 percentage points as against 4 percentage points in the period before the crisis.

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ECONOMICS OF THE NEW MEMBER STATES: A POST-CRISIS PERSPECTIVE

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This essay addresses four major issues confronting the new Central and Eastern European members of the European Union in the decade to come. First: what to think of the financial meltdown of 2008-2009. Second: what have they learned from the tremors that having shaken the previous star performers of the EU? Third: we ask if we can expect a return to 'normalcy' as forecast by most models of financial rating agencies and international financial institutions? Fourth: the question is raised what did the new members benefit from their EU membership? Some conclusions on the future of EU reforms and policies close the overview.

Key words: financial crisis, European Union, new members of European Union, Eurozone

JEL Classification: G01, E65, F59

2008-2009 witnessed a largely unexpected derailment in the catching-up process of the new member-states (NMS) of the European Union. Convergence to EU-15 levels has already come to a halt by 2008 with the slowdown of economic activity, and has been positively reverted in 2009. The contraction of GDP in most NMS exceeded that of the Eurozone, 2.1 per cent, with Hungary registering a drop of 6.3 per cent and the previous envy of the rest, the Baltic States registering double digit drops, unprecedented in peace time development (more on that in: WIIW, 2010). Since recovery in 2010 is modest and is also likely to be mediocre in 2011, at least an election cycle- but perhaps more – is wasted in terms of real convergence, conventionally postulated in theories of economic integration. This development also stands in stark contrast with the generally upbeat mood, strongly represented in the literature

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(Kolodko, 2009) seeing a fast and continuous catching up as a baseline scenario, provided rather innocent, commonsensical maxims of economic policy making – such as avoidance of excessive deficits and disregard for externalities – are being observed.

These developments took most observers of the regions by surprise as well as central banks, fiscal authorities and international institutions. The vulnerability of the NMS to external disturbances was though a subject of some theorizing, however the intensity and imminent occurrence of the spillover of global financial crisis has called for some reflection, both among policy-makers and academics. In short, while some envision a return to normalcy and that relatively soon, others (Myant and Drahokoupil, 2010) interpret the financial crisis as the final verdict on transition, one that has finally uncovered the long lasting unilateral dependence and unilateral, asymmetric integration of Central and Eastern Europe in the global hegemonic system of capitalism.

On the Global Financial Crisis

A. With the passage of time we learn more data about the size and scope of the meltdown. First, while the crisis indeed wiped out entire industries, such as most investment banking, it has not wiped out the entire financial sector. Moreover the more we learn about the balance sheets of banks around the globe, the more we might be surprised to see, that many of the big financial institutions are in pretty good shape. Profits are slightly below the levels of the previous year, but all in all business seems to have been as usual. And while the press was preoccupied with cases of major public bailouts, several other institutions were in no need of public money, and by far not only Barclays with its conspicuous overseas takeovers. Major banks in a number of EU states, including those in Spain, Poland and Hungary did not require public action, contrary to their Irish or German counterparts. In short, while some financial institutions collapsed, others flourished. We can by no means talk about the crisis of the entire financial sector of the globe, not even of that in all advanced economies. Interestingly, major collapses occurred not in the relatively unregulated areas like hedge funds, but in the fields where the visible hand and yes, the so frequently required regulator was more than marginally present, such as in mortgage lending. The subprime crisis was therefore clearly one of state failure, rather than market failure (Dimsky, 2010). The role of over the counter deals, structured products and financial innovation with its related lack of transparency was clearly overrated in the popular reaction.

Likewise more detailed analyses of the causes and the mechanisms of the crisis (Reinhart and Rogoff, 2009) were able to demonstrate the fundamental differences to those of the Great Depression, not least owing to differences in the workings of global capital markets and owing to the presence of major automatic stabilizers, primarily public transfers and coordinated action by the public authorities in the global scale, avoiding thus the beggar thy neighbour policies of the interwar period. The much criticized disciplines of the WTO as well as the mechanisms of the EU single market, most importantly competition policies and the joint fiscal framework, helped avoid a relapse into old fashioned protectionism. Likewise the survival of the institutional and policy framework allowed starting to work on what is euphemistically called as an *exit strategy,* implying the discontinuation of pumping indiscriminate amounts of money into the economy, and at same time to revert the mostly improvised proliferation of interventions into the workings of the market.

In short, a return from exceptional, 'war-time' management practices of the panic phase of 2008-2009 a certain 'return to normalcy' is already in the making. Governments declared their schedules to return to the numerical limits of the Stability and Growth Pact, and ECB calls to revive solid operations, typical of the 'peace times' are being heeded. The wrestling over Greece in early 2010 is a clear indication, that in most of Europe the inclination to take wartime as normalcy and peacetime as exceptional is no longer given.

B. What should we think about the real economy in terms of usual activity indicators that characterize macroeconomic performance of EU nations? First and foremost, it is important to recall, that global output in 2009 contracted by a mere 1.2 per cent, Eurozone output by 2.1 per cent, EU output by 4.3 per cent, while several economies managed to grow, like China, India but also Poland. This is exactly the opposite pattern to the ones observed during the Great Depression, when core economies contracted much more than those in the periphery.[1] According to the consensus view of analysts, from OECD to IMF and EU Commission, the global and the European economies are to grow in 2010 and 2011, even if recovery is fragile and thus its robustness may well be less than mechanistic modelling would have it. Thus, at the bottom line, we registered *a single year of contraction,* which is though unpleasant, but not without parallels.

In terms of inflation the good news is that it has not been extricated. While many analysts feared of a *deflation,* the overall contraction of price levels has not materialized in the sense of ECB, implying four- rather than just two- quarters of consecutive decreases in the overall price levels. On the contrary, in some cases- as Hungary and the Baltic States- inflation already flared up, and in other cases, a sin Britain and Ireland, Spain and Greece, the question whether governmental spending translates into inflation is a matter of 'when', rather than of 'if'.

In terms of unemployment the situation is equally sobering, but by no means extreme or catastrophic. The unemployment rate of the EU has climbed close to the double digit levels by early 2010, which is certainly bad news.[2] But this overall number is hardly above the customary rate of the 1990s. True, this had been, already then a major social and economic challenge for the Union. Still, 9.9 per cent for the Eurozone and 9.5 for the entire EU at end 2009 is not a severe overshooting of the 9.8 per cent of the 1996-2000 average, or 8.6 per cent for the 2001-2005 average[3], even if in certain countries and regions, especially in Spain, reaching 20 per cent by spring, 2010 and Latvia, exceeding the 25 per cent level, which is devastating. By contrast, and defying the bad track record of the 1995-2005 period, unemployment has not soared in the traditionally weak Slovak and Polish labour markets. Their respective 12.9 and 11.9 per cent[4], but remain way below the 18 to 18.5 per cent that featured the preceding period. This observation should not be read in terms of complacency, as governments must surely

[1] While the US economy contracted by about 50 per cent in the seven years between 1929-36, the Hungarian contracted by only 10 per cent in 1930-31 and grew from 1932,
[2] Sources of data, unless otherwise indicated, ECB: **Statistics Pocket Book,** February, 2010.Frankfurt/M.
[3] ECB: *Statistics Pocket Book,* March, 2010. Frankfurt/M, p. 44.
[4] Central Statistical Office of Poland webpage, accessed on 15 March, 2010.

act, but the macroeconomic impact must be put in proper numerical perspective. Even in the Czech Republic, the 2009 figure of 9.2 pc is surprising by traditional standards, rather than extremely high in EU standards.

C. What has been summarized above translates in economic theory as a clear case of a *cyclical slump as contrasted to a structural crisis,* a difference the world has known to appreciate in the 1973 and 1979 global downturn. If the recession is cyclical, it usually does not call for structural measures, let alone rethinking the economic theories and the fundamentals of the market system, as several commentators, and not in the press, have called for. What we observe is rather a *return to normalcy,* a point to be elaborated below.

First and foremost, what we observe is a corrective phase, when previous overvaluation of assets, especially on the stock markets, was cut back to size, i.e. brought in line with the realistic ability of those assets to generate revenues in the medium run. Certainly, following two decades of what Alan Greenspan termed already in 1996 as 'irrational exuberance' it takes a longer period of trial and error until the new terms of exchange emerge, thus there is nothing surprising in the relatively slow and tumbling recovery of financial markets.

Second, as previously privately hold toxic assets have been transferred to public hands, authorities will have a tough time in figuring out what to do with those. In other words, the crisis of private banking has been transformed into a severe disequilibrium in public finances, with no clear cut strategy to overcome the new challenge. What is clear however is that private markets are unwilling to finance any levels of debt, and a relapse into inflationary finance in the open manners of the 1970s is no longer an option. Under this angle it is a welcome development that EU institutions in general and the ECB in particular continues to act in defence of solid finances and do not make allowances coming from the political sphere to 'bridge' fiscal disequilibria at any cost and by any means, irrespective of costs and consequences.[5]

[5] Top Notenbanker droht merkel mit Verfassungsklage. *Handelsblatt,* 24 March, 2010/ online edition/, downloaded the same day.

Third, as it can be elaborated at greater length, the improvised set of state interventions created a situation where unintended side effects dominate the intended ones, therefore the exit strategy can by no means be found in the direction of further state intervention and the revival of Keynesian recepies, that were elaborated under different conditions, especially different conditions pertaining to the transmission mechanisms of money markets (Leijonhufvoud, 2009 and Csaba, 2009). From this it follows that the way-out will be in the discontinuation of conditions of an economic martial law and a return to established peace time practices, with significant improvement in terms of regulation.

New Member States in the Meltdown

A. New member states could gather a series of experiences during the 2008 -2010 period. First, as can be shown prior to the outbreak of the crisis, simplistic policy options aiming at shortcut solutions – and aiming at saving the pains of slow ad complex institution building – enhanced the external vulnerability of the star performers, primarily the Baltic States and Bulgaria, to an unprecedented degree (Csaba, 2008). This vulnerability translated into immediate external shocks when quick adoption of the single currency proved impossible, and when the currency mismatch, between earnings in local currency and debts accumulated in foreign currency, primarily of households and the corporate sector, exploded as a side effect of the global financial panic that ensued from the collapse of Lehman Brothers in September 2008.

But the fragility of economic development has become manifest in all other states. Czech GDP declined by 4.2 pc and unemployment rose to 9.2 per cent. The previous growth champion of Central Europe, Slovakia also experienced a steep decline in her GDP, reaching a drop of over 5 per cent against the impressive growth of 6.2 per cent in 2008 and 10.2 per cent in 2007[6]. While Poland managed to grow by nearly 2 per cent in 2009 (after the upward revisions of the last quarter), Hungary experienced a drop of 6.3 per cent, and the currency crisis could only be averted by resorting to a jumbo IMF-EU-World Bank loan, a unique ar-

[6] Data from the website of the National Bank of Slovakia, accessed on 15 March, 2010.

rangement of its kind orchestrated in October, 2008. The experience of the Visegrad countries excepted Poland reflect that doing nothing over several years is not an innocent lapse that would run without costs in the short and medium runs.

The deepest decline hit the previous star performers, the Baltic States, where the decline of GDP was double digit, and unemployment rates soared accordingly. The crux of the problem here was lack of institutions and lack of will, on the side of the authorities, to cool down the economy when unsustainable current account deficits surfaced already in the middle of the decade. While the currency board regime does exclude devaluation and severely limits the possibilities of setting interest rates at will, however it does not mean a lack of any policy instrument. For instance banking supervision is at the hand of authorities and borrowing, especially in foreign currency, can be limited by imposing a compulsory deposit requirement or taxing the profits accruing from this form of lending. Likewise tax policy has been around and so are many other policies, provided higher tax revenues are spent on a variety of items with public goods character, such as improving the physical and institutional infrastructure, protecting the environment or building up stabilization funds along the Norwegian or Russian lines. But authorities have refrained from acting, as the naive belief in growth as a panacea for any social ills, along the 'bigger the better' lines, was universal. The steep fall of output and living standards that followed Soviet disintegration also propelled expectations.

B. What has been described above is a set of policy mistakes, that revolve around the notion of populism. This implies a propensity of decision-makers to follow the immediate preferences of their electorate, irrespective of their longer term ramifications. Procrastinating with long overdue reforms in the central Europeans (save Slovakia), or staying idle when faced for longish years of overheating is certainly not attributable to broader systemic factors, to institutional structure or long term historical path dependence. On the contrary: these are prime examples of *policy omissions/mistakes,* which recall in elder observers the Latin American experience with recurring currency crises, i.e. inability to learn the lessons of the past. While these may, and indeed do, have deeper social, historic and other roots, the mistakes themselves should not be

identified with the former. For this reason it seems premature to consider the crisis as 'the final verdict on transition', as the insightful collection by Myant and Drahokoupil (2010) does. For the structural and institutional weaknesses they list, including the insufficient upgrading of export patterns and the one-sided integration of the transition economies to the global financial markets, together do not explain the specifics of the crisis. Neither its timing, nor its mechanism, let alone the differences in scope by the country.
Should we accept the view that asset bubbles are by and large inevitable by-products of the workings of free markets, as we have observed over the past two centuries or so, it were difficult to see the Spanish or Irish burst of the real estate bubble as systemic rather than cyclical crises. Likewise it would be hard to draw such broad, theory-shaping conclusions as the above cited authors do, joining the choir of many voices deploring the allegedly incurable ills of market capitalism. Be what those ills might be, it is certainly a *non sequitur* to infer them from a cyclical downturn whose length is neither unprecedented nor its depth is unparalleled in post-war economic history.

C. What NMS experienced in the 2008-2010 years was, in terms of European policies, the *limits to solidarity.* If one compares the unprecedented- and of course more than justified- efforts of the EU to forestall the collapse of the Greek domino/not least in fear of its spillover to Spain, Italy and Ireland/ in the spring of 2010, to the hesitant and regularly belated reaction to the deep crises in the Baltic States, Hungary, Romania and their neighbours, Ukraine and Serbia, all turning to the IMF for rescue, the picture becomes sobering. Moreover, while public authorities, including the Commission, did finally act to assist the countries listed, private agents, especially headquarters of financial institutions were no slow in using their affiliations in NMS as milking cows for covering the losses suffered by themselves from adventuresome investments, primarily in overseas markets.

It is important to put the events in perspective. For one, it is beyond doubt that actually- registered- capital flows have not followed calls from President Sarkozy and other leaders for patriotic economic policies and relocate their activities in the home countries. On the other hand, the credit crunch in the region was exacerbated by the freeze on lending decisions, not justified by local market conditions. This was certainly not an outcome of 'concerted action' orchestrated by some dark forces. But the consequence of having outsourced the centres of decision making to abroad, following the microeconomic considerations and neglecting macro repercussions has also become manifest for the policy-makers in and outside the NMS.

After the Crisis- Back to Normalcy?

A. Seeing the end of the crisis phenomena, the recovery of output and financial market indicators, it is indeed tempting to offer the convenient assumption: after rainy days sunny ones must be coming. However, reality might be more complex. Recovery in the global economy might turn more fragile and less evenly distributed as most models customarily would have it. If there is any lesson commonly distilled from the experience of previous crises (Eichengreen, 2001 and Stiglitz, 2009) is that after a crisis 'normalcy' does not mean a return of the *status quo ante.* On the contrary, the only item we know for sure that new players, new rules of the game, new modalities of conducting business and new forms of regulation are bound to emerge. One of the obviously foreseeable outcomes is that surviving actors will be even bigger to fail, than the traditional ones. Efforts of the US administration, to tackle those by way of the Volcker rules, go in the right direction; however the problem will be hard to tackle. It is not only the size, it might be other, and often hard to delineate broader considerations, such as regional relevance, or professional significance that may prompt governments to intervene, in a chain, quite in line with the bleak forecast of Ludwig von Mises before World War I (v. Mises, 1929 or 1996).

B. Coming to the NMS we may revive the insight, summarizing the first decade of systemic change: institutions matter but so do policies (Havylyshyn and van Roden, 2003). Comparing the experiences of Hungary to those of Poland in the 2002-2010 period speaks for itself already at the elementary level. Instituting measures of solid public finance, avoiding adventuresome external funding for consumptive purposes, sustaining price stability and conducting policies generally converging to EMU criteria allows saving the country from vulnerability and externally imposed discipline.

On the other hand, Bulgarian, Romanian and the Baltic experience seem to suggest that shortcut solutions, often advocated by policy-makers and businessmen as well as the media, do not work in the longer run. Sound macro policies though do create growth, which is good. But without creating the institutional memory in the form of setting up institutions capable of sustaining the results of social learning previously experienced problems may revive, and avoidable mistakes might be repeated. The relevance of regulation, especially in the financial sector, counts by today among the platitudes, thus is in no need of elaboration. Implementing rules of prudent banking is certainly a must, especially if the already observable return of malpractices is to be avoided and social explosion- or alternatively even more costly future bailouts- to be avoided.

C. One of the truly strategic debates in and on the NMS is whether or not they should/can return to the previous path of export-led growth, or a more 'balanced' path, i.e. more reliance on the domestic markets is the way to sustainable growth. On the base of what we know from economic theory and history, we do not know of a single case in the postwar period, where growth based on domestic markets could have been sustainable, especially in small open economies. While outward orientation- a concept much broader than export-led growth- does carry a cost, the experience of the past three decades is overwhelming in terms of the efficiency of outward orientation. True, more recent literature (e.g. Pitlik, 2008 and Baitagi et al, 2009) calls attention to the relevance of institutional and policy complementarities. In short, it is not a sectoral approach, but a broad set of coordinated policy and institution building measures that deliver results in the long run.

D. Finally mention should be made of the erosion of the European growth potential, which is particularly observable in the NMS (Halmai, 2009). By dodging most of the structural reforms by most member states, the EU has manoeuvred itself into a dead alley. Structural changes that should have revived the labour markets remained fragmentary. The crisis also called attention to the procrastination in terms of capital market reforms and their regulation at the EU level. What was called the Lisbon Agenda, i.e. to try to balance flexibility and competitiveness (Palánkai, 2006) was to a large degree watered down and implementation remained partial.

The erosion of European growth potential has also been exacerbated by the insufficient attention to long term challenges, such as ageing and the research and development potential. It is not just the amount of spending which is inadequate, but its composition and relation to business practices, where 'embodied technological progress' is being generated remained lukewarm. The explosion of public debt in a number of core EU economies is itself a factor of slowdown owing to the inevitable crowding out effects.

The foreseeable slowdown in the core EU implies that the external environment of the NMS will not be particularly strongly conducive to growth. Mistaken hopes on the EU as a major factor fostering growth, which used to figure high in the pro-EU political discourse in the NMS is likely to produce disenchantment only. The farther is the perspective of joining the Eurozone, the graver is the risk of aggravating myopia in the policy conduct of the NMS, further delaying painful but necessary changes if the growth potential is to be revived. The drift between formal qualifications, which exploded, and actual marketable skills, social and professional alike, is likely to develop into a major factor of social discontent, reflected in the lastingly low levels of labour market participation in all NMS. In turn, their ability to cope with expanding health and pension costs will remain structurally constrained- an issue demonstrated also for a historically vibrant and much less aging US economy (Rogoff and Bertelsman, 2010).

While the global discourse, influenced to a large degree by environmental considerations, often calls for a zero growth scenario in order to avoid the climate catastrophe, from the point of view of NMS zero growth is a non starter. The level of their per capita GDP is between 40.5 per cent of the EU average (Bulgaria) and 88.2 per cent (Cyprus)[7] that is for the majority the catching up process will take generations, even under the best of circumstances. Furthermore, as we argued above, catching up is by no means an automatic process triggered by EU membership. Rather the question marks behind any scenario of relatively fast and steady real convergence continue to multiply, not least due to the structural and institutional weaknesses uncovered by the impacts of the global financial meltdown.

[7] ECB: op.cit, p.40.

What to Think of EU Membership?

A. Accession to the EU tended to be over politicized from the very outset. As a consequence, there were both inflated expectations in terms of immediate welfare improvements, and conversely, sceptical voices aired before any of the joint European policies could take effect. The latter is the case in terms of cohesion, in terms of the single currency as well as in terms of environmental protection.

In a way the process of Europeanization has progressed considerably, insofar as the paradoxes typical of old member states could be seen replicated. The median voter does not seem to be very well informed about the complexities of the Union. Therefore if his concern is joblessness, he/she can blame the EU, although the Community has next to no competences in terms of labour markets. If democratic controls, or the judiciary for that matter, do not work perfectly in a member state, the tendency to blame for the EU is there even if it is not justified on material grounds. For this reason the Hungarian public tends to be fairly eurosceptic according to recent surveys.[8]

However, if we take the proper historical perspective, EU accession is surely a major success story in any area we care to mention. First and foremost, NMS ceased to be on the borderline of competing empires, threatened by constant insecurity and being treated as sources of insoluble interethnic conflicts. While nobody would doubt the presence of ethnic strains, this is by no means constrained to NMS, as the recent attacks on French police by Baque terrorists indicate. In short, being a member of the European architecture constructed in the spirit and practice of postwar reconciliation has ruled out many options, which were indeed on the cards, should the EU not have played its anchor role for the NMS. Therefore it seems simplistic to 'try to put numbers on EU membership' and try to assess costs and benefits exclusively or even mainly in terms of transfer balances, or in terms of additional trade or FDI flows. Important as these might be, they surely remain subordinate to the fundamental historic rearrangement discussed above.

[8] Eurobarometer survey, published on 18 September, 2009, available on the website of the Commission.

But if we take the narrower, financial perspective, the beneficial impact of the EU is still beyond doubt, despite the well known methodological problems of assessing the macroeconomic impacts of EU cohesion funds properly (Sirehej, 2008). First and foremost, the 'convergence game' has been at play ever since 2002, i.e. when the political decision on eastward enlargement was taken. This implied more stable exchange rates and lower external costs of funding, for public and private investments alike. Second, from the point of view of capital investors, direct and portfolio managers, the NMS ceased to be a part of some murky emerging market economies and were requalified as secure European investment spots protected by a supranational imposed Community legislation. Third, the revision of the post-2007 financial guidelines decreased the co-financing requirements to EU sponsored projects to as low as 15 per cent, which of course allowed for more projects to be implemented than under the traditional arrangements, when 50 per cent co-financing was the rule. It is a different cup of tea if we were to ask, whether the priorities set by the NMS, or more precisely the outcome of what many observers consider as an outcome of ad-hoc political bargains on the spot, indeed produce those growth accelerating and multiplier effects, or more broadly speaking any externalities that figure high in the official justification of cohesion spending.[9]

Finally in terms of institution building we might be upbeat. Whatever may the weaknesses of EU practices be, introducing a degree of Community-wide transparency, accountability and even-handedness, including regular external checks on the way money had been spent, are welcome addition in countries which are in the middle of setting up new and in theory, internationally competitive institutions of their own. Under this heading the administrative and material expenses on setting up specialized agencies and introducing the practice of competitive bidding in a number of areas might well be seen as a benefit rather than a sacrifice in the NMS concerned.

[9] As a fan of classical music I can only welcome the long overdue renovation of Liszt Music Academy in Budapest, wherever the funding is coming from. Likewise constructing funeral houses where the number of deaths exceeds that of births, or building fountains in the center of small towns are all welcome, without however being anywhere close to the theories justifying why these expenditures should be Community funded, rather than locally financed.

B. One of the more important insights in assessing the overall impact of the Union on the NMS is that the EU, with its policies and institutions, surely constitutes *a framework for, rather than a guarantee of, economic success.* Joining the Eurozone, for one, does entail a number of straightforward advantages widely appreciated in all strands of the literature. Meanwhile experiences of countries like Portugal and Greece clearly indicate that being within the fences is though clearly a plus over being left out in the cold, but is a long way from being the panacea for all economic ills, be that sustaining low productivity or profligate public finances.

The broader the perspective of assessment, the more important it is to underscore this point, which might sound as a truism for the economist. For if we recall the political atmosphere that lead to the rejection of the Constitutional Treaty in France and the Netherlands, or the one that surrounded the ratification of the Lisbon Treaty in Ireland, Poland, Britain and the Czech Republic, the relevance of the argument increases. Those opposing any deepening tend to underscore- often very real- shortcomings of the existing arrangements. They often express very profound doubts that improvised policy options could be indeed beneficial. And it is common experience for old and new members, that public opinion tends to blame the EU for a number of issues the Community has no competences over, such as taxation or public education.

The discourse in the NMS has switched from bad to worse in the past few years. Initially the tendency to overrate the benefits from Union membership reached ironic points. By now the shuttle moved to the other extreme, and the Union tends to be blamed for most of the local illnesses, from corruption to lack of fiscal discipline, from the insufficient support for small businesses to the lack of willingness of commercial banks to lend.

Let us be clear: an organization in charge of redistributing a mere 1 per cent of GNI is by definition in no position to work miracles. On the other hand, if such framework arrangements as the Stability and Growth Pact, or the European Social Charter are made use of, these may allow for a more professional and more pragmatic streamlining of local arrangements, than a free experimentation along any initiative in a perfect democracy would.

C. Finally one should rethink the position of the NMS on issues of the fundamental reform of the EU. Both the decision-making/organizational structure and the major common policies (Kengyel, 2010) are known to have evolved as an outcome of ad-hoc policy bargains rather than following any theoretical maxim, let alone constructivist design. The numbers in the Stability and Growth Pact, the relative share of farm related spending or the entitlements in cohesion spending count among the best known and most widely analyzed items in the literature on Europe.

Thus there are two basic ways one my approach these complex issues, intensively discussed at the official level in the preparation for the Financial guidelines for the post-2014 period. In one, traditional way we may adopt a static approach. If we take things as given, it is in the interest of the NMS to stick to present arrangements, since these contain references to and potentials for solidarity, in terms of sustaining substantial spending on rural areas and on physical infrastructure development, two fields where the Communist heritage of negligence is certainly strongly felt. By contrast, if prioritizing R+D and competitiveness related spending, the edge of the UK and the Scandinavians, which is quite significant anyway, is only to be further increased. Under this angle the status quo is the best of all conceivable worlds.

The alternative approach calls attention to the fact that net contributors have already found ways of attaining a de facto equalization of net contributions and benefits in most areas (Richter, 2008). Furthermore by sustaining expenditure priorities which clearly do not reflect the changed perceptions of European electorates, favouring such items as environmental protection, energy security and inward migration, will be next to impossible to legislate and sell domestically. From the economic perspective, narrow as it may be, it is hard to justify the public finance sense of the expenditure items I listed in the preceding section, from funeral houses to city fountains. The more serious we get about the agenda of competitiveness- or Europe 2020- the less grandfatherish our position on sustaining spending items unrelated to either demonstrable common gain or competitiveness we may be. Furthermore it is already foreseeable that global trade talks and domestic pressures will translate into a major trimming of agriculture related expenditure (Elekes and Halmai, 2009).

Under this angle a fundamental rethinking of the way priorities are set is in order. For one, if the EU is not, in the future, about to support big and often wasteful investment projects, the 'maximization of drawable funds' should no longer be seen as the interest of any NMS. The more we appreciate that expenditure priorities often follow a logic alien to them, such as the priority to the development of sparsely populated and arctic areas, or the focus on animal welfare, the less we shall see it as a sensible and axiomatic requirement that those funds should be drawn, just because of their availability.

Such a reassessment of priority setting would be in line with more recent insights of broader development economics (Szakolczai, 2006) stressing the relevance of institutional and generally broader social considerations at the expense of mere quantitative expansion. Under this angle the quality of growth, just as much as the quality of life, is the real success indicator. In order to improve that, there is a Community spending focusing on externalities and common value added, creating a framework for sustainable development, a category much broader than growth, is becoming the focus. And this is in line with the long term interests of the population of the NMS as well.

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RETURN TO COMMON SENSE IS NEEDED*

Daniel DĂIANU**

This paper focuses on the root causes of the financial and economic crisis and its implications. Its main theses are that this crisis is closely linked with a financial system that has gone astray. The flaws of the financial system originate, primarily, in an inadequate economic paradigm (market fundamentalism) and policies of deregulation of financial markets in the western world. Economic freedom is not synonymous with non-regulated markets. The impact of this crisis is enormous and will clobber western economies for years. This situation should be judged against the backdrop of economic power redistribution in the world. This crisis poses also an ethical issue which is constantly shunned by vested interests. A return to common sense, a deep overhaul of the regulation and supervision of financial markets are badly needed.

Key words: financial crisis, market regulation, economic freedom, public goods
JEL Classification: O16, G01

1. Economic freedom is not synonymous with non-regulation

I write these words at a time of a deepening financial crisis which is ricocheting worldwide and causing tremendous anguish and tremors, a spreading economic downturn. It is also not a long while after the European Parliament passed a report which I worked out together with a Dutch colleague, Ieke van de Burg, in which we argue in favour of an overhaul of the regulatory and supervision frameworks of financial markets in the EU (van den Burg and Dăianu, 2008). I should underline that the paradigmatic underpinnings of our report were not dawned upon us by a growing financial mess engulfing western economies; for a longer period of time both of us, though belonging to two different political

*This lecture is based on excerpts and theses from my book "Which way goes capitalism", Budapest/New York, CEU, 2009

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groups in the European Parliament, had harboured similar views on what has been wrong with the dynamics of world finance.

Economic freedom and entrepreneurship, which lie at the root of innovation and economic advance, rely on and feed on free markets; this is indisputable and explains why communist economies collapsed, eventually, during the last century. In this regard Ludwig von Mises, Friedrich von Hayek, Joseph Schumpeter and others[1] were quite right. But it is misleading to argue that free markets are synonymous with non-regulated markets, with the practical extinction of public sectors and public policies. Modern economies and societies do need regulations and public policies so that public goods are in adequate supply and negative externalities are prevented or constrained; this implies the functioning of public sectors against the backdrop of a free allocation of resources (at market prices) and vibrant economic competition. That one needs to streamline public sectors and make them run efficiently so that public resources are not wasted goes without saying. And there is also need of a moral compass, without which everything else gets bogged down, sooner or later.

I was chief economist of Romania's central bank when I was asked by some IMF officials whether I would support the opening of its capital account; that dialogue happened in 1996, about one year before the eruption of the Asian financial crisis. I responded that such a move would be highly risky in the Romanian environment, a dangerous course of action, which I would not recommend to my country's political leaders. Fortunately, Romanian policy-makers took the right course of action during those years. As many accept nowadays the Asian crisis was caused, not least, by a premature opening of the capital account in the economies of that region. I have always felt that the rush to privatise public utilities is not warranted. As Stiglitz (2006); Serra and Stiglitz (2008) and others highlighted institutional contexts are essential for companies which are turned private to perform well. In addition, there are public utilities which should rather stay in public hands. One has to add here that institutional change is time consuming and time cannot be compressed at will.

[1] Especially economists who belong to the Austrian School.

The oversimplification of 'good practices' in governance and, not least, the hypocrisy which has, in not a few instances, accompanied their propounding, by major industrialized countries, around the world is more than obvious nowadays[2]. The deep financial crisis, the failed Doha trade round (with the controversy between free and fair trade), the lack of results where-ever development policies have been simplistically encapsulated in the ideological mantra of neo-liberalism are quite telling. Having said that, I do not overlook the corruption, lack of clarity of property rights, waste and stealth of public resources in many poor countries, a terrible misallocation of resources, all of which impede economic growth (Easterly, 2001). But such structural weaknesses do not make up a convincing argument in favour of accepting, without qualifications, policy remedies which are too general and, sometimes, in divorce of concrete local conditions. Market-oriented reforms have unfettered entrepreneurship and have stimulated economic growth in China after 1978, and in India during the last decade, but those reforms have been implemented in a pragmatic way, with a close attention paid to social issues and rural development problems, while financial markets have not been liberalised recklessly. In these two very complex cases big policy trade-offs and dilemmas remain, though economic progress has been extraordinary. Rodrik (2007, 1998), Krugman[3] (1999) and other clairvoyant economists have constantly asked for open-mindedness in examining the major problems afflicting poor countries; they have rejected oversimplifications and asked for policy variety depending on local circumstances. Although their intellectual credentials are exceptional their voices were not sufficiently listened to.

I lived for a substantial part of my life under communism and I value economic and political freedom in ways which those who were fortunate to live in liberal democracies (to use Fareed Zakaria's concept) may not understand fully. But I am not blind to the bads which can plague market

[2] The World Bank has been concerned with 'good practices' (good governance) for a long time and disseminates information on this topic around the world regularly. I wonder why hasn't this institution paid attention also to malpractice in the financial industry in wealthy economies, that is not of recent vintage.

[3] Paul Krugman got his Nobel Prize for having shown the effects of economies scale on trade patterns and on the location of economic activity. He was prescient in foreboding the pitfalls of the new financial system.

economies, especially those that are not adequately regulated and do not offer a decent amount of public goods to their citizens. I consider myself an economist of a liberal persuasion, though I am not a libertarian. For me, liberal values (in the European sense) under-gird, essentially, liberal democracies; in a democracy liberal creeds, arguably, underlie various political inclinations – be they more social-democratic, or of the 'people´s party' brand, along the European political spectrum. I espouse a type of liberalism which owes o lot to Karl Popper and his concept of an 'open society' (Popper, 1945). For me individual liberties coexist with concepts of social solidarity, social equity (Rawls, 1971), public goods and moral values (trust, honesty, trustworthiness, sense of accountability, etc). The German notion of 'social market economy' (soziale Marktwirtschaft)[4] illustrates pretty well my way of thinking in this regard. I mention moral values because, frequently, I hear people (in the European Parliament, too) who claim that morality is meaningless in business. I would argue that it is so for those who choose to disregard moral values and for whom the notion of society is quite meaningless. I also think that ruthless competition in the global economy does strain European societies and their social model. But measures which focus on boosting competitiveness, while ignoring social cohesion and the social contract between state and citizens, can be equally damaging to society as it is a policy status quo. In the European Union the experience of Scandinavian countries with undertaking reforms that enhance competitiveness without disregarding the social fabric of society is quite relevant in this regard.

2. A shift of paradigm

The financial crisis which has struck the core of the world financial industry is, in my opinion, a decisive refutation of the paradigm that glorifies total deregulation in economies, be they wealthy or poor[5]. The repeal in

[4] A main theorist of the social market economy was Wilhelm Roepke and a leading practioner in Germany was chancellor Ludwig Erhard.

[5] In a letter published by the leading French daily Le Monde, 22 May 2008 one can read: "Some are tempted to see the ongoing financial crisis as a recurrent accident, albeit more severe, along an economic cycle and following worldwide very cheap credit for years in a row. But a careful reading would go at its structural roots. Globalisation of markets and financial engineering, with precarious and, frequently, missing regulations, highly skewed incentive schemes, and numerous conflicts of interest, have created the milieu for the

1999 of the Glass-Steagall Act that limited ownership of financial companies operating in other market segments, like the decision in 2004 to exempt the brokerage operations of Wall Street investment banks from limits on the amount of debt they could take on, have proved to be historic blunders[6]. The root cause of this crisis is an inadequately and under-regulated financial system. The waves of deregulation in the financial industry brought to the market a plethora of fancy products whose risks were poorly understood. Mortgages are not toxic per se; badly constructed securities based on them are toxic. The packaging and repackaging of financial products are toxic, making their valuations increasingly unclear and reducing their tradability. Reward schemes that shape the decisions of managers and agents in markets and that make their behaviour irresponsible - that is toxic. Misleading quantitative methods are toxic. The trigger for this financial crisis may have been in the housing industry, but housing is not the structural cause of the crisis.

What this crisis should make plain to everyone is that not all financial innovation is benign. It is baffling to hear the argument that fresh regulation is bad because it would stifle financial innovation. Fresh regulation is necessary because there has been a lack of proper regulation and supervision. The enormous mistakes that have been made by allowing finance to develop its own, highly risky 'raison d'être' must be undone. But are we capable of learning that lesson? Why is it that we fail to learn from previous crises? Alexander Lamfalussy issued warnings almost a decade ago; the financier Warren Buffett and the former Federal Reserve chairman Paul Volcker are among those important figures who fired off warnings years ago. Nouriel Roubini did the same, including at Davos Forum meetings. How is it that their predictions of a crisis have not been listened to? As traffic needs rules and lights in order to protect people's lives, so market economies need regulations to limit collateral damage and enhance the production of public goods. A lax monetary policy can lead to higher

current crisis". The letter was signed by Helmut Schmidt, Otto Graf Lambsdorff, Lionel Jospin, Jacques Delors, Michel Rocard, Romano Prodi, Jacques Santer, Göran Persson, Pär Nuder, Massimo d'Alema, Hans Eichel, Poul Nyrup Rasmussen, Daniel Dăianu, Paavo Lipponen, Ruairi Quinn,Laurent Fabius, Anneli Jaatteenmaki.

[6] Alan Greenspan, the long-serving president of the Fed is quoted by the International Herald Tribune to have acknowledged that something has been wrong with the free market theory he has upheld (Knowltoon, B and M. Greenbaum, 2008). Greenspan is well known for having been a staunch opponent of regulating derivatives, the 'new banking sector'.

inflation and, ultimately, to a recession, but cannot, by itself, cause the meltdown of a financial system. This is the crux of the matter: the features of the financial system that have brought the threat of collapse are structural features of the 'new' financial system, including a breakdown of due diligence.
Vested interests can have a long arm and try to influence regulations and supervision. But vested interests must be strongly resisted, using all means available. Regulators and supervisors should know that financial markets are volatile and prone to instability, and that the efficient-markets hypothesis – that prices reflect all known information – is a fantasy.

3. If 'they are too big to die', then split them up!

The fall of Lehman Brothers, a leading Wall Street investment bank, is seen by most analysts as the event that brought the confidence crisis to a climax in world financial markets. While the financial crisis irrupted almost a year before the Lehman Brothers's fall it seems to have been a tipping point – into a spreading economic recession worldwide. Here I wish to focus on an issue that has under-lied much of the debate on government bailouts in mature economies. The bottom line in this debate is whether/why the entities which are supported, or rescued, via public money, pose any significant systemic risk. When AIG was bailed out through a staggering amount of American taxpayer's money the argument was quite clear: the scope and depth of its operations, its intricate linkages with a very large number of financial clients around the world, made such a rescue operation a must; non-intervention was judged to, potentially, had been quite fatal to the financial system as a whole. In a way, the action to rescue AIG replicated, on a much larger scale, what the FED did in 1998 when it helped, indirectly, the LTCM by summoning five investment banks to participate into a joint aid demarche.

I wrote several articles in the European Voice on the causes of the current financial crisis, but there is one aspect which needs more emphasis when the argument 'too big to fail' comes to the fore. If the size of financial groups becomes an overwhelming problem and an overriding policy issue, in the sense that enormous risks to the financial system emerge when their network of linkages cripple it, then 'size' has to be dealt with. A long time ago anti-trust legislation was enacted by governments, in the US and in Europe, in order to combat monopolistic behaviour that undermined competition and extracted undue rents. Remember the splitting of Standard Oil in the early 20tieth century; later on AT&T suffered a similar fate. There were also waves of divestiture, in certain industries, when it became clear that conglomerates and oversized groups do not bring about better performance necessarily; just remember Textron.

In finance, waves of deregulation in recent decades (I would point out the repeal of the Glass Steagall act in 1998, in particular) increased the scope for the formation of very large groups, with operations covering the whole gamut of financial services. Citigroup comes easily as an example in this respect. The globalization of markets and the new information and communication technologies (which enhanced global trading in real time) gave a very powerful stimulus to the emergence of genuinely global players. By the way, AIG was one of them. Some of these groups have cornered the markets –which can be easily evidenced by the manifold rise in the share of the financial industry's profits in the world GDP in last couple of decades. But a fundamental challenge is that the reckless behaviour of not a few financial giants and their fantastic interconnectedness have become synonymous with and have epitomized systemic risks. Such systemic risk-producing trans-frontier groups are an obvious nuisance for and a flaw of the financial system to the extent governments are forced to step in when there is need to avoid a financial meltdown.

It appears to me that a major component of the current efforts to overhaul the regulatory and supervision systems of financial industry in industrial economies needs to address the size issue of financial groups. For if they are too big to be left to die, one has to find an effective response to two ensuing problems: the moral hazard (not to encourage bad practices by eliminating failure); and reduce, as much as possible, the burden on public money in case government action does involve it. Simply by increasing transparency, capping leverage, improving capital adequacy ratios and avoiding pro-cyclical behaviour, new remuneration schemes, trying to regulate conflicts of interest, improving quantitative methods in order to capture complexity and anticipate 'Minsky moments', etc., is arguably, not sufficient when the size of some players keeps the system hostage. I would say that splitting large financial groups does make sense under such circumstances! Anti-trust legislation needs to be re-examined/completed in this regard. I would also consider a resuscitation of a sort of Glass-Steagall Act. It goes without saying that such measures would need to be considered from a global perspective.

The irony is that the current crisis has induced a spate of takeovers (some of them prodded by governments – like Bank of America's takeover of Merrill Lynch), which goes counter to the policy venue advocated herein, though deleveraging and a dramatically reduced securitization will very likely reduce the share of financial services industry in overall economic activity. In addition, in Europe, the burden-sharing of rescue packages for trans-frontier groups is more than murky (what Charles Goodhart pointed out quite a while ago) while the supervision and regulation of banking sectors is fragmented along national lines. This state of affairs may relent many banks' drive to continue to expand internationally; they may even retreat and turn more parochial. But, overall, this crisis is likely to lead to a consolidation in finance, the perpetuation of the 'too big to fail' syndrome (be it on a local/international scale), that might recreate the systemic risks we are trying to diminish via regulatory and supervision reforms. This situation is a further reason to resort to anti-trust law, or very strict regulation of finance (should banking be deemed a special industry, of a 'public utility' nature).
Some might ask: can the US and Europe afford to split up 'too large to die' financial groups at a time when Asian financial entities appear to gain a competitive edge in the wake of the current crisis? This motivation has to be seen in relation with the regulatory arbitrage argument. Both these issues need to be taken into account. But it would be wrong to jeopardize the functioning of whole economies for a corporate benefit which is uncertain, in the end. In addition, why would Asians themselves ignore the lessons of the current financial crisis, which has worldwide implications? Why shouldn't G 20 and the Financial Stability Board help major countries see eye to eye in this regard?

4. The financial crisis and tectonic shifts in the global economy

The huge bail outs underway (in the financial sectors) are going to introduce, or reinforce, elements of state capitalism in numerous industrialized countries, including the US. The impact on national budgets would by burdensome for years to come. In order to mitigate the pains and reduce dependency on external borrowings saving ratios would have to go up in all economies where bank recapitalization will be very serious. A legitimate question arises: can wealthy societies become, almost all of a sudden, much less spendthrift and forward looking. This very much hinges on social cohesion (solidarity) and the capacity of politicians to lead in times of distress. If one adds here the implications of aging and strained welfare states, climate change, as well as the competitiveness challenges posed by emerging global powers, the contours of very complicated public policy agenda in the decades to come are not hard to delineate.

The effects of the current financial crisis have hit the western world at a time when tectonic shifts in the global economy had been taking place for more then a decade. The rise of China, India, Brazil, the resuscitation of a capitalist Russia (that benefits on huge natural resources) are ushering in an increasingly multi-polar world, with growing reverberations economically and geopolitically. The struggle for the control of exhaustible resources (oil and gas in particular) epitomises this phenomenon. The financial crisis has given more salience to the inherent weaknesses of policies that are not pragmatic and succumb to fundamentalist tenets.

The fall of communism, which was equated by some with the 'End of History' (Fukuyama, 1990), has favoured immensely the advance of neoliberal ideas. In the western world this advance has fuelled the ascendancy of the so called Anglo-Saxon type of capitalism – with its "Third Way" (Giddens, 1998) reflex on the left side of the political spectrum. Needless to say that the overwhelming superiority of the US on all fronts (economic, military, technological), offered a sort of a sui generis Pax Americana and created prerequisites for an international regime. The latter was supposed to order the world by providing international public goods and resolving/preventing possibly major conflicts. Neo-liberalism (market fundamentalism) has revealed its serious flaws over time and is, currently, willy-nilly, put on the shelf for the sake of salvaging the functioning of market economies. Because, what is happening now is not a dismissal of market forces as an essential mechanism for resource allocation and stimulating entrepreneurship, but an invalidation of a gross misinterpretation of what it takes for a modern economy to perform economically and socially over the long run.
Fragments of state capitalism are being put in place and we will see what

will remain out of them over time. Probably, substantial chunks of the new state sectors in the making will turn private at one point in time. Monetary policies are geared now toward achieving financial stability and have acquired a sort of flexibility that is reminiscent of the injunctions of John Maynard Keynes, the great British advocate of the value of government intervention, regarding ways of avoiding bad equilibrium (the Great Depression was a terribly bad 'equilibrium'). The very concern of governments and central banks with radically overhauling the regulation and supervision of financial markets, so that 'Minsky moments' – moments at which, according to the now deceased economist Minsky (2008), financiers lay waste to the economy – are averted is a strong validation of Keynes' intellectual legacy and of his sense of realism in understanding the functioning of markets in general.
The crux of the matter is that the reshaped mixed economies have to function in such a way that extravagant policies be avoided for the benefit of democracy and the welfare of most citizens. Cycles cannot be eliminated, and crises will pop up again. But a financial meltdown, with its very dire effects on the real economy, can be prevented by adopting proper policies and regulations; and very severe crises can also be averted.

The EU and US will come out of this crisis with reshaped economies (with larger public sectors) and will, very likely, continue to be, fundamentally, liberal democracies. But the financial crisis has already weakened them whereas the ascendancy of the new global powers is hard to stop, although an economic slowdown will be felt worldwide. I see the future as being driven by a competition between liberal democracy and authoritarian forms of capitalisms – the latter being represented by China and the Russian federation, principally.
For the European Union the aims of the Lisbon Agenda are not diminished by this financial crisis. But they have to be pursued while momentous changes are occurring in the Zeitgeist and the frame of policy-making.
Liberal democracies will have to come to grips with their weakened relative status in the world economy and shed much of their hubris in dealing with the rest of the world, for their own sake[7]. This would apply to the reform of the International Financial Institutions and a new architecture for tackling global governance issues, which would have to involve the

[7] To see how 'others' view the US and the EU in the 21st century read Mahbubani (2008).

emerging global powers. As some say, a new Bretton Woods is needed. This period, the years to come, mark the prominent return of Keynes and the idea of government intervention. We need common sense and pragmatism in economic policy-making, not fundamentalism. As some aptly observe 'History proves the importance of policies for preserving the social fabric' (Shiller, 2008, 2).

5. Limits of openness

In the midst of the deepest financial crisis after the Great Depression, the instability of the world's financial system is all too evident. But that is not a momentary instability: there have been several crises in industrialised countries in the past couple of decades, numerous financial and currency crises in emerging markets, trade liberalisation has left many poor countries in the dust, the myth of the 'new economy' has dissipated, corporate scandals have shown that cronyism and bad governance are more complex and widespread than thought, wealth is more unequally distributed than it was and social fragmentation and exclusion have risen in rich and poor countries alike.
And yet this disorder has co-existed with a 'consensus' on the principles and practice of economics, translated into policies that have unbridled markets, privatised the economy and downsized the public sector to the maximum. This 'rational economics' is perhaps of a piece with what Max Weber referred to the 'rationalisation of life', our tendency to ascribe primacy to knowledge and theory and the search for the ultimate piece of wisdom.

This crisis should deal another coup to the belief that economics is a hard science. It has certainly revealed serious weaknesses of market fundamentalism. There have, of course, been significant market-driven transformations – but they too appear a little different under close inspection. Liberalisation and privatisation transformed post-communist societies – but their unique geography, cultural and political consciousness combined with considerable support from the US and Western Europe made these countries exceptional. Market-oriented reforms have spurred China and India forward – but their reforms have been pragmatic, with close attention paid to social issues and rural development problems, while financial and trade markets have not been liberalised recklessly.

Globalisation (and liberalisation) does not, though, need to be an ideological mantra; it could be an open-ended concept that purports to define the 'opening up' of societies, under the impetus of technological change and the manifold quest for economic progress. Such an interpretation would encourage pragmatic and flexible policies, and would rid globalisation of its perceived Western-centred origin.
Such a nuanced interpretation of globalisation would have major repercussions for national public policies and international politics. Thus, national public policies could become fairly pragmatic, varied and geared towards the traditional goals of economic growth, price stability and social justice. Some might say that too much variety in institutional and policy design would damage a level playing-field and prevent markets from functioning effectively. There is truth in this argument, but it underplays the importance of working out policies that keep in mind the extreme diversity of conditions in the world economy and the fact that market forces do not automatically bring convergence.

We may already be seeing the start of a significant change in financial policy-making. One of Keynes' intellectual legacies – namely that highly volatile capital flows are inimical to trade and prosperity – has demonstrated its relevance in this crisis. For decades now a mantra has been heard worldwide: that not much can be done in national policy-making because global markets would punish a government. This crisis encourages fundamental questions (such as: is the complexion of global markets God-given?) and questions that raise the prospect of policy changes (are not global markets, aside from their technological drivers, also the product of human beings' decisions to set rules for finance, trade and investment?). The claim that nothing can be done about financial flows, when they bring about misery, is unconvincing. There are plenty of specific regulations that can be imposed and restraints that can be exercised.
Similarly, free trade is likely to be re-examined as states' concerns grow about its impact on security. One concern – shared by leading and developing economies alike – is the cost of adjustment to competitive pressures. Another set of concerns relate to 'hard security'. How much 'trading with the rival' is likely before restrictions are imposed? Will the US, or major EU member states, accept big chunks of their most sensitive manufacturing and IT sectors being acquired by China's and Russia's companies and sovereign-wealth funds? Food security and climate

change will concentrate minds on preventing over-reliance on overseas suppliers. We may think globally, but risks may force us to limit ourselves to ‘safer’ patterns of trade and production.

In other words, we may well see a partial domestication of market forces in national governments’ quest to cope with systemic risks and social strain. This would involve a greater state presence in the economy (state capitalism) and broader regulations; elements of ‘war economy’-style conduct in public policy will also be quite visible, even in liberal democracies. Perceived needs will trump ideological propensities.

Such concerns could stimulate the formation of alliances among groups of countries that share common interests. The EU is one such a bloc. A transatlantic trade area could also emerge. We could see a replica of it in Asia. Rivalry and experience – no monetary union emerged after the Asian crisis of 1997 despite speculation – suggest this might not happen; however, if the yuan turns into a reserve currency, the rationale for creating an Asian monetary area would grow.

Several sub-global clusters might, then, emerge to mitigate the potentially devastating effects of a completely open world system. They would operate in a multi-polar world of major global state powers – and the presence of poles that are alternatives to US power could itself create barriers to unrestrained free world trade, investment and finance.

How might the EU evolve in such a context? The logic of single markets might remain dominant, but policy-making would be quite nuanced at national level. In the absence of a common foreign and security policy and faced with greater security risks, national governments would be more active in the economy. The EU would therefore continue to have a fairly complicated policy-making structure.

So, who would formulate and enforce a suitable international regime for the 21st century? The US will not have the capacity do so any longer. In its current shape, the EU could not take over such a role. And an overhaul of the international architecture of financial institutions hinges on what the main international actors wish to do and on how they relate to each other. If the US, the EU, and the emerging global powers can strike a deal on reform, other significant players would eventually come along. Their challenge would be to make openness work for the world as a whole. That implies shedding a blind belief in the self-healing and self-regulatory virtues of markets. That may be happening.

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INTEGRATION OF CEE AGRI-FOOD SECTOR INTO THE EU: WHAT DOES TRADE THEORY AND EMPIRICAL EVIDENCE TELL US?

Imre FERTŐ*

The article provides an overview on the main results of empirical research on the integration of the CEE agri-food sector into the EU. Contrary to early expectations, countries in the region have not became major agri-food exporters. We can observe great diversity in trade specialisations, the patterns of intra-industry trade and price and quality competitiveness among countries and major product groups. These outcomes are based mainly on the differences in relative factor endowments and different initial conditions of the countries. The recent theoretical and empirical developments in international trade may help us to better understand the agri-food trade integration of new member states.

Keywords: theories of international trade, EU integration, international agricultural trade
JEL Classification: Q12

1. Introduction

Anderson (1992) argued at the early stage of transition from the central planning to a market economy that the transition Eastern European countries and the Soviet Republics might become major agricultural exporters. From this perspective Tangermann (1994) provides western looks to the East. They shed light on two important development and trade factors. First, the restructuring of the economy in the transition countries implies improving product quality by upgrading the production technologies. Secondly, production specialisation changes the quantity of exports in response to liberalisation. As trade barriers are removed, the composition of exports changes to reflect comparative advantages.

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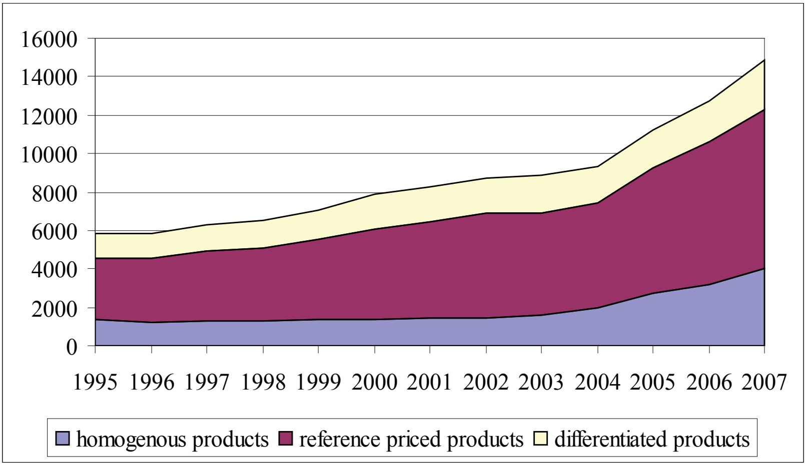
Depending on the relative factor endowments, this leads to specialisation in certain industries. Even if a country specialises in low-skilled labour or resource-intensive industries, it could still experience restructuring. This can be done by gradually improving the production technology and thus the quality of the products in that industry. Now, almost two decades later the research question is what has really happened with agro-food export growth from transition countries to the European Union (EU-15) and what kind of factors have been shaping a potential agro-food export growth? Rozelle and Swinnen (2004) provide evidence for productivity improvement in agricultural sectors in a wide set of transition countries. However until now the potential sources of agro-food trade growth in transition countries are less documented.

Figure 1 **Agro-food exports of the CEEC-12 to the EU-15 by main product groups (in 1995 Euro prices, in millions)**



Note: The nominal Euro values are deflated by annual average harmonized indices of consumer prices (HICP 1995=100) for Euro area.
Source: Own calculations based on Eurostat Comext trade dataset, and Eurostat and European Central Bank for HICP.

Figure 1 shows the agro-food exports of the CEEC-12 to the EU-15 in real 1995 Euro prices by Rauch's (1999) product groups. Between 1995 and

2007, the CEEC-12 agro-food exports to the EU-15 markets increased from 5.8 billion Euros to more than 18.7 billion Euros in current prices or deflated in 1995 Euro prices, from 5.8 billion Euros to 14.9 billion Euros. At the 1995 Euro prices and during the same analyzed period, the CEEC-12 differentiated products exports increased from 1.3 billion Euros to more than 2.5 billion Euros or by 95.7% between the first and the last analyzed years. The CEEC-12 reference priced products exports increased from 3.2 billion Euros to 8.3 billion Euros or by 163.7%. The most rapid was the CEEC homogeneous products exports from 1.4 billion Euros to 4.0 billion Euros or by 194.1%. There have been particularly rapid CEEC-12 agro-food exports to the EU-15 markets since the EU enlargement in 2004.

The aim of the paper is to provide an overview on the main results of the empirical research on the integration of CEE agri-food sector into the EU. The structure of the article is the following. In the second section we present the relevant theoretical background following by related empirical evidences according to the various pieces of international trade theory. The final section provide the conclusins.

2. Trade Dynamics

2.1. Theory

The standard Heckscher-Ohlin model implies that the pattern of trade specialisation only changes if trading partners experience a change in their relative factor endowments. This suggests that the existence of persistent trade patterns is perfectly consistent with the model, if relative factor endowments of countries do not change significantly with respect to their main trading partners.

The New Trade Theory emphasises the importance of increasing returns scale in explaining trade flows, which complicates the predictions of trade theory, because they depend on specific assumptions about the nature of return to scale. On strand of this literature assume that economies of scale are internal to the firm (e.g. Krugman, 1987; Helpman and Krugman, 1985). In this case the main implications of the factor proportions theorem basically do not change.

If national external economies of scale exist, dynamics of trade patterns depend on the effects of the external economies of scale on the slope of the production possibility frontier- Kemp (1969) and Markusen (1981) have proven. If external economies of scale are negligible with respect to the factor intensity differences between two sectors, then a relative supply curve is positively sloped, and yields similar implications as in the standard Heckscher-Ohlin model.

If national external economies of scale are relevant, the predictions of the model will change substantially. Wong (1995) has shown that in the presence of national external economies of scale, world trade pattern is determined by initial comparative advantage.

However, Either (1979, 1981) argues that increasing returns depend on the size of the world market. He demonstrates that in the case of international external economies of scale, increasing returns of scale do not influence the pattern of international trade.

Grossman and Helpman (1990, 1991), under the assumption that knowledge spillovers are international in scope, have shown that the history of the production structure of a country does not affect its trade pattern in the long run, which only depends on the relative factors endowments.

However, another family of models find that dynamic scale economies which arise from learning by doing are country specific and suggest a lock-in effect for the pattern of specialisation. Krugman (1987) and Lucas (1988) demonstrate that in the presence of dynamic scale economies the long run trade pattern is determined by the initial comparative advantage. The main implications of these models are that international trade patterns tend to be more specialised.

Proudman and Redding (2000) built a model focusing on international trade and endogenous technical change which illustrates that a precisely specified model yields ambiguous conclusions concerning whether international trade patterns display persistence or mobility over time. They conclude that it is ultimately an empirical question.

2.2. Empirics

The empirical research on international trade specialisation often uses a wide array of trade indicators. The revealed comparative export advantage (RCA) index by Balassa (1965) is particularly popular. However, this index is subject to criticisms in empirical trade analysis. First, the agricultural trade is usually distorted by various trade barriers and ageicultural policy measures. Thus, Vollrath (1991) offered an alternative specification of revealed comparative advantage, the relative trade advantage (RTA), which accounts for exports and imports simultaneously. It is calculated as the difference between RXA and its counterpart, the relative import penetration advantage (RMA). A further problem is the distortion introduced in the analysis, which may arise from the evolution of minority flows, the relative weight of the products, and from the macroeconomic situation so that cyclical factors confound the measurement of trade specialisation with the RCA index. Lafay (1992) proposed solving some of these shortcomings through the construction of weighted indicators of contribution to the trade balance, which even if contain interesting information, are ambiguous precisely in the measurement of trade specialisation.

Bojnec - Fertő (2007b) investigate the revealed comparative export advantage, the relative import specialisation advantage, the relative trade advantage, the intra-industry trade and its quality types in agro-food trade of Croatia, Hungary and Slovenia with the European Union (EU) market. The analysis of the levels and compositions of agro-food trade and the relative trade advantages and their patterns are conducted by the degree of product processing over time to provide broader socio-economic implications for agro-food sectors and multifunctional rural development. The empirical results confirmed the bulk of agro-food and forestry products with revealed comparative export advantages on the EU markets for Hungary and to a lesser extent for Croatia, but except for some niche products less for Slovenia. Hungary and Croatia have faced difficulties in sustaining revealed comparative export and relative trade advantages in higher processed consumer-ready foods and processed intermediaries. Improvements in intra-industry trade for agro-food products are identified for Hungary and to a lesser extent for Croatia, but less for Slovenia.

Bojnec - Fertő (2008a) analyse the agro-food trade developments and the relative comparative trade advantages between the CEE-8 countries and the EU-15. Trade in bulk primary raw agricultural and wood commodities is found to perform the best and consumer-ready foods the least. The empirical results imply a clear sign of an inefficient agro-food trade adjustment for the Central and Eastern European countries analyzed, but there are large variations across countries, by product groups and over time.

Fertő (2008b) describes the evolving pattern of Central European countries' agri-food trade using recently developed empirical procedures based on the classic Balassa index. The extent of trade specialisation exhibits a mixed trend. The results suggest that the trade pattern converged in the Czech Republic, Hungary, Lithuania, Poland and Slovenia, while it polarised in Estonia, Latvia and Slovakia over the given period. For particular product groups, the indices display greater variation. They are stable for product groups with comparative disadvantage, but product groups with weak to strong comparative advantage show significant variation. In addition, in the Baltic countries many specialisation improvements occurred in those product groups for which the world demand expanded at the fastest rates during the period analysed.

Bojnec - Fertő (2008c) investigate the level and composition of agro-food trade structures, differences in dynamics of the revealed comparative advantages and the trade specialization patterns of the twelve New Member States (NMS-12) on the enlarged European Union (EU-27) markets. The empirical analysis for the 1999-2006 period using country and product trade structures revealed trade increases and, to a lesser degree, strengthening of the revealed comparative advantages in agro-food products, but also indicated catching-up difficulties in the revealed comparative advantages in higher value-added processed products and mainly agro-food trade de-specialization in the longer-run for the NMS-12 on the old EU-15 markets.

Bojnec - Fertő (2009a) evaluate the agro-food comparative trade advantages/disadvantages and their implications for food policy for eight Central European and Balkan countries. Levels, compositions and patterns in agro-food trade developments and long-run stabilities are analyzed across countries, over time and by main agro-food product groups by the degree of processing. Relative trade advantages are more stable than revealed comparative export advantages. Higher and more stable comparative trade advantages on the European Union markets are found for bulk primary raw agricultural commodities and less for consumer-ready foods, implying competitiveness shortcomings in food processing and in international food marketing.

Bojnec - Fertő (2009c) analyse agri-food trade competitiveness and specialisation patterns of the former Central European Free Trade Agreement (CEFTA-7) countries compared with the European Union (EU-15) from 1995-2007. Agri-food trade specialisation stability and duration are investigated by main agri-food product groups according to the degree of product processing and dynamics in the demand growth exhibited by the EU-15 market. Except for Poland and Hungary, the former CEFTA-7 countries face a trade deficit in agri-food products within the EU-15 markets. The former CEFTA-7 agri-food exports to EU-15 markets are specialised towards higher-value, processed, consumer-ready food as a result of the agri-food sector restructuring and integration into more competitive EU markets. The former CEFTA-7 agri-food export specialisation towards the EU-15 markets' most demanded products is also revealed. The results confirm that EU integration increases volume of trade, stability, and the duration of former CEFTA-7 agri-food trade products on EU-15 markets.

Bartova - Drabik (2009) analyse the agri-food trade specialisation pattern in Slovakia prior to and after its accession to the European Union in the 2000 – 2005 period. The most competitive Slovak agri-food commodities in trade with the examined trade groupings were consumer-oriented products. The degree of agri-food trade specialisation dropped over the period for all the most important markets. At the same time, Slovakia did not maintain the positions of the most competitive commodities; however, it improved the positions of a number of previously uncompetitive ones. After 2004, the dynamics of previously rigid trade specialisation with the EU-15 and the New Member States of the 2004 EU enlargement accelerated. This is likely to lead to convergence of Slovak trade specialisation dynamics across trade partners/groupings.

Bojnec - Fertő (2010) evaluate agro-food trade specialization patterns of South-Eastern European (SEE-6) countries with the EU-15 in the period 1995-2007. The agro-food trade specialization stability and duration are investigated by main agro-food product groups according to the degree of product processing and the dynamics in the demand growth by the EU-15 markets. Except for Serbia and Montenegro and to a lesser extent for the FYR of Macedonia, the SEE experienced an increasing trade deficit in agro-food products with the EU-15 markets. The SEE-6 agro-food exports to the EU-15 markets are highly concentrated on the bulk raw commodities with a lack of export specialization for higher-valued processed consumer-ready food. The most recent SEE agro-food export de-concentration is an outcome of the new, emerging competitive niche products as a result of the SEE agro-food sector restructuring. Except for Bosnia, Herzegovina and Croatia, the SEE agro-food export specialization is heading towards the most dynamic demand growth products on the EU-15 markets. The regression and survival analyses confirm that the EU integration increases stability and duration of agro-food trade specialization on the EU-15 markets.

In sum, the pattern of agri-food trade specialisation in the CEE countries exhibits a mixed picture. We can observe both convergency and divergency in agri-food trade patterns in various countries with an increasing trend over time. For particular product groups, the indices display greater variation. They are stable for product groups with comparative disadvantage, but product groups with weak to strong comparative advantage show significant variation. Estimations show that the CEE countries could not efficiently adjust to the increased demand in the EU-15. The results also highlight competitiveness shortcomings in food processing and in international food marketing in all countries.

3. Intra-industry trade

3.1. Theory

The traditional IIT model, often referred to as the Chamberlin-Heckscher-Ohlin (C-H-O) model, assumes that goods are horizontally differentiated. In these models (Krugman 1979; Lancaster 1980; Helpman 1981), IIT opens up in monopolistically competitive markets, with increasing returns to scale on the supply side and diverse consumer preferences on the demand side. Helpman – Krugman (1985) add factor endowment differences to a model that explains the co-existence of intra- and inter-industry trade. They consider two countries (A and B), two factors (labour and capital) and two goods: a homogeneous commodity which is relatively labour intensive and a differentiated product which is relatively capital intensive. If country A is relatively labour-abundant and country B is relatively capital abundant, Helpman – Krugman (1985) show how country A tends to export a homogeneous product and both countries import the differentiated good. This model predicts that IIT will decrease as the factor endovement of countries diverge.

The theoretical models for vertical IIT developed by Falvey (1981), Falvey – Kierzkowski (1987) and Flam – Helpman (1987), overcome the traditional indetermination of the direction of IIT, and allow us to establish the pattern of varieties that are produced by each country. Falvey (1981) assumes a perfect competitive market with two countries, two goods (a homogeneous product and a differentiated one) and two factors (labour and capital). He introduces technological differences between countries, but only in the homogeneous product sector. In the differentiated sector it is assumed that more capital is used in producing higher quality product varieties than lower quality product varieties. So, the higher income, relatively capital-abundant country specialises in exporting relatively high quality varieties, while the lower income, relatively labour-abundant country specialises in exporting low quality varieties. Falvey's model does not have an explicit demand side, but Falvey – Kierzkowski (1987) elaborate the demand side. On the demand side, goods are distinguished by perceived quality. Although all consumers have the same preferences, each individual demands only one variety of the differentiated products, determined by their income. Given that aggregate income is not equally distributed, consumers with lower incomes will demand low-quality varieties, and high-income consumers will demand high quality varieties, regardless of their country of origin. Thus, it is possible to establish a marginal level of income whereby consumers with higher earnings will purchase varieties produced in a relatively capital-abundant country, while consumers with low earnings will purchase varieties produced in a relatively labour-abundant country. In this framework, intra-industry trade exists because each variety of a differentiated good is produced in only one country, but is consumed in all countries. In a two-country world, the country which is relatively labour-abundant will tend to export the lower quality/labour intensive varieties of a differentiated good demanded abroad by low-income consumers and to import the higher quality/capital intensive varieties demanded by high-income consumers in that country. Thus, the greater the differences in the relative factor endowments (which are corresponding to per-capita income differences in the context of model) between two countries, the greater the IIT will be. The model has no clear conclusions with regard to the effect of differences between income distributions of partner countries. But, we can argue that demand in countries with highly concentrated income would be biased towards high quality varieties, reducing the extent of vertical IIT. Therefore, a more evenly distributed income leads to a higher share of IIT.

In short, theoretical literature argues that HIIT determinants and VIIT determinants differ. This may explain why econometric analyses having a total IIT (horizontal and vertical) as their dependent variable may be misspecified. Therefore, the determinants of HIIT and VIIT will now be investigated separately.

3.2. Empirics

Fertő (2005) analyses the relationship between factor endowment and vertical intra-industry trade (IIT) in agri-food products between Hungary and the EU. Results show vertical type trade is predominant in total IIT of agri-food products. In order to achieve more general results, we consider different types of productive factors: land, human and physical capital. Using the Flam and Helpman-type vertically differentiated trade models, he found a positive relationship between factor endowment and vertical IIT. More importantly, using a measure of IIT that reflects the level of trade produces better regression results than those based on the degree or share of IIT.

Fertő (2007) investigates the horizontal and vertical intra-industry trade in agri-food products between Hungary and the EU. His results show that horizontal IIT in agri-food products is low, but vertical type trade is more prevalent, though still less important than inter-industry trade. The results lend support to the contention that there are different determinants for horizontal and vertical IIT. More importantly, using a measure of IIT that reflects the level of trade produces better regression results than those based on the degree or share of IIT. The model relating to Hungary's vertical IIT in agri-food products yields the most promising results in terms of a priori expectations

Bojnec et al. (2005) evaluate the pattern of agricultural and food trade in Slovenia. The large share of agricultural and food trade is inter-industry trade. The significance of intra-industry trade (IIT) is increasing with the degree of processing. In particular, IIT is based on products differentiated in quality where low quality vertical IIT prevails. This kind of trade specialization and trade patterns, together with trade geography, imply some similarities in these trade developments with developing countries and countries with less competitive food processing rather than with more advanced European Union countries with a competitive food processing sector.

Bojnec - Fertő (2008b) investigate agri-food trade competitiveness and specialisation patterns of the former Central European Free Trade Agreement (CEFTA-7) countries compared with the European Union (EU-15) from 1995-2007. Agri-food trade specialisation stability and duration are investigated by the main agri-food product groups according to the degree of product processing and dynamics in the demand growth exhibited by the EU-15 market. Except for Poland and Hungary, the former CEFTA-7 countries face a trade deficit in agri-food products with the EU-15 markets. The former CEFTA-7 agri-food exports to EU-15 markets are specialised towards higher-value, processed, consumer-ready food as a result of agri-food sector restructuring and integration into more competitive EU markets. The former CEFTA-7 agri-food export specialisation towards the most demanded products of the EU-15 markets is also revealed. The results confirm that EU integration increases size of trade, stability, and the duration of former CEFTA-7 agri-food trade products on EU-15 markets.

In general, the main lessons from the limited number of empirical studies are that the role of IIT in agri-food trade between CEE countries and EU-15 is low with an increasing trend. Furthermore, the IIT is predominantly vertical in nature. However the share of low and high vertical IIT is highly diverse among countries and major product groups. The econometric estimations confirm the importance of the distinction between horizontal and vertical IIT which is strongly emphasised by the empirical literature on manufacturing trade.

4. Dynamic intra-industry trade and adjustment costs

4.1. Theory

The analysis of the SAH does not apply IIT models; the usual framework for adjustment issues is the specific-factors model (Brülhart and Elliott, 2002). This model assumes a small open economy which produces and consumes an exportable and an importable good, facing perfect competition in all markets and given world prices. Labour can move between two sectors (but not between countries), all factors are fixed (the 'specific' factors), and there are diminishing returns to factor inputs. Suppose an export boom, which is equivalent to a fall in the relative demand for importables, is triggered by some measure of trade liberalisation. If adjustment were perfectly smooth, the economy would instantly attain a new equilibrium where the unique economy-wide wage in terms of the exportable has fallen, and some workers have switched from the contracting import sector to the growing export sector. In reality, this transition is likely to be costly. The specific-factor model suggests two sources of adjustment costs: factor price rigidity and factor specificity, with the empirical manifestation being unemployment and factor price disparities, respectively (Neary, 1985). In practice, we are likely to find both phenomena simultaneously.

The relative extent of adjustment depends partly on the pattern of factor intensities within and between industries. It also depends on the general equilibrium effects of different types of trade expansion, which involve changes in domestic consumption or absorption and production. Lovely and Nelson (2000) provide a model where the exact opposite pattern of trade and labour market adjustment follows trade liberalisation. They show that all of the labour reallocation is inter-industry, with change in total trade accounted for entirely by IIT expansion. By contrast, Lovely and Nelson (2002) present a different model using specific–factor and a general equilibrium framework, where most of the change in trade is accounted for by changes in net trade following liberalisation, and the bulk of the labour reallocation may be intra-industry in nature.

To summarise, we are faced with theoretical ambiguity on the relative amounts of inter- and intra-industry trade labour adjustment associated with intra- and inter industry trade. There does not exist a formal theoretical model that can generate marginal intra- and inter- industry trade, and thus serve as a base for the specification of empirical models. Furthermore, the choice of control variables in such exercises therefore lacks a coherent theoretical base.

4.2. Empirics

Fertő (2008) analyses the structure of Hungary's food trade expansion over the 1992-2002 transition period, examining its implications for labour-market adjustment. An econometric analysis of trade and employment data suggests that changes in domestic consumption and productivity have significant influence on employment changes. But his results do not provide support for the smooth-adjustment hypothesis of intra-industry trade

Fertő (2009) investigates how partial trade liberalisation due to the Association Agreement affects employment changes in the Hungarian food industries between 1995 and 2003. The results provide some support for the smooth-adjustment hypothesis of intra-industry trade. Estimations confirm that industry-specific variables may have a significant effect on adjustment costs.

In sum, empirical evidence is very restrictive, being limited only to Hungary. Thus, it needs further research to better understanding the relationship between dynamic intra-industry trade and labour market adjustments. This question will be crucial for evaluating the impact of the EU accession on the new member states.

5. Price and quality competition

The recent developments in international trade theory reveal the importance of quality in explanation of trade flows incorporating this aspect into theoretical models (*Fan 2006; Faruq 2006; Hallack 2006*). The distinction between quality and price competition can be useful for evaluation of trade between partners. The empirical literature in this field is closely related to the studies on the IIT, because both strands of literature use commonly rooted empirical measures (*Bojnec - Fertő 2008e*).

Bojnec - Fertő (2007a) analyze trade balances and unit values in Hungarian and Slovenian bilateral agricultural, food, and forestry trade with Austria, Germany, and Italy, respectively, to distinguish types of one-way and two-way trade flows, categories of price competition, and categories of quality competition. Two-way trade flows prevail among trade types. In two-way bilateral trade, categories of price competition prevail over categories of nonprice competition, but vary across trading partners. In Hungarian trade, successful price and quality competition prevail, suggesting comparative advantages for Hungarian produce arising from available agricultural factor endowments and technological improvements in processing compared with bilateral EU trading partners. In Slovenian two-way trade, unsuccessful price and quality competition prevail, suggesting comparative trade disadvantages arising from agricultural and structural disadvantages compared with bilateral EU trading partners. Looking dynamically, we find no significant catch-up in successful competition, as for Hungary, both successful price and successful nonprice competition increased only for Austria, but deteriorated for Germany and Italy. For Slovenia, successful price and nonprice competition remain at a similar level as for Austria, but are in decline compared with Germany and Italy. The probability of remaining one-way trade is greater than the probability of staying within the same competition category in two-way trade. There are differences across countries and over individual years, but the mobility indices indicate decline in trade flow mobility, and thus, more stable trade patterns over time.

Bojnec - Fertő (2009b) investigate determinants of agro-food trade competition between the five Central European Countries (Czech Republic, Hungary, Poland, Slovakia, and Slovenia) and the European Union, finding that the effect of trade balance on trade competition to be more significant than the effect of export–import unit values. Natural, and to a lesser extent human factor endowments increase price and quality competition and reduce unsuccessful price and quality competition. R&D expenditures improve quality competition and reduce price competition. Foreign direct investment reduces unsuccessful price competition and increases unsuccessful quality competition. The size of the economy improves price competition and reduces quality competition. Consumer demands associated with a higher level of income per capita increase unsuccessful price and quality competition.

6. Duration of trade

6.1. Background

One question is often unaddressed in international trade literature: when do countries trade and how long do their trade relationships last? This issue is motivated by the findings of recent research, which state that many countries do not trade in any given year and for any given product (Haveman and Hummels, 2004; Feenstra and Rose, 2000; Schott, 2004). Being in or out of the international market may be a particularly important issue when the market at stake is one of an expanding economic integration. The enlargement of the EU in 2004 is such a case, with possible changes in export specialization patterns. Besedeš and Prusa (2006b) extend Rauch and Watson's (2003) matching model to generate three hypotheses. First: the initial purchase size for relationships involving homogeneous goods should be larger than those involving differentiated products. The second hypothesis states that for each product type, the duration of trade increases with initial purchase size. Finally, holding initial purchase size constant, duration of relationships involving differentiated goods should be longer than those involving homogeneous goods.

6.2. Empirics

Bojnec - Fertő (2009) examines the impact of EU enlargement on agro-food export performance across 12 new EU member states and 5 newly independent states in the EU markets covering the 1999-2007 period. The performance is examined by the duration of export and hazard models. We find longer duration for the agro-food exports from the new

EU member states. The results confirm gains from the eastward EU enlargement and governance on export increases and longer duration for exporting higher value-added specialized consumer-ready food and more competitive niche agro-food products.

7. Export variety

7.1. Theory

In general, an increase in trade could be a result of three factors: an intensive margin where the same set of goods is exported in larger volumes; an extensive margin, where larger quantities of a larger set of goods and higher quality goods are exported (Hummels and Klenow, 2002). Our special focus is on the role of export variety on agro-food export growth, which is in line with extensive margin factors and higher quality goods.
During the last three decades following Krugman's (1979) pioneering work on potential gains from trade through the import of new varieties and the impact of an increased variety on aggregate welfare, the importance of new trade theory for national welfare has been tested by several studies. Feenstra (1992), Klenow and Rodriguez-Clare (1997), Bils and Klenow (2001), and Yi (2003) made further contributions to the role of varieties and differentiated trade.

The importance of international trade in differentiated products has been highlighted by the theory and evidence on intra-industry trade (IIT), which explains occurrence of trade within the same industry. Gains from IIT reflect economies of scale with lower costs and wider consumer choices. The product differentiation is likely to lead to the monopolistic competition in producing the differentiated good that is exported in a greater volume than it is imported, and to consumer demand for variety, where international trade increases welfare by increasing consumers' utility. The benchmark model for product variety was developed by Krugman (1979, 1980, 1981), who modelled countries as producing an endogenous number of varieties. With fixed output costs of producing each variety, the number of varieties produced in a country is proportional to the size of the economy. In this simplest Krugman world, all countries export the same quantity per variety and export at the same unit prices. Neither unit prices nor quantity per variety vary with the gross domestic product

(GDP) per worker or the number of workers. The Krugman model has the property that, conditional on producing a variety, a country exports this variety to all other markets. In the model there are two channels for the gains from trade arising from variety growth. The first is through reductions in trade costs. If trade costs fall, countries will gain through the import of new varieties. The second is through the growth of the foreign country. The larger the size of the foreign country, the more varieties it will produce, and this will be a source of gain for the home countries. The product variety has an important policy implication as well. Romer (1994) demonstrates in a simple calibration that trade liberalization increases the number of traded varieties as a source of welfare gains.

7.2. Empirics

Bojnec - Fertő (2009) analyse determinants of agro-food export from transition countries to the European Union (EU). The baseline model explains agro-food export by its previous year, income in importing countries, real effective exchange rate, and measure of export product variety. The positive effect of the privatisation, transformation and restructuring process on agro-food export and its variety growth is confirmed, whereas price and trade liberalisations reduce agro-food export. The EU enlargement has induced agro-food export increases in homogeneous and referenced priced products, but less in differentiated products. The impact of increased agro-food product variety on agro-food export growth is positive.

8. Conclusions

The article provides an overview on the main results of empirical research on the integration of the CEE agri-food sector into the EU. Contrary to early expectations, countries in the region have not became major agri-food exporters. We can observe a great diversity in trade specialisations, the patterns of intra-industry trade and price and quality competitiveness among countries and major product groups. These outcomes are based mainly on the differences in relative factor endowments and different initial conditions of the countries.

The slowly increasing empirical research suggest that this research area is still underdeveloped in both agricultural economics literature and the EU integration studies. Consequently, the limited empirical evidence provides only various pieces in the large puzzle of agri-food trade inegration of the CEE countries. One of the reasons of this outcome is based on growing diversity of international trade theory to explain emerging new phenomena. Interestingly, the exisiting literature neglected some traditional topics of the trade integration including trade diversity and trade creation. Furthermore, the agricultural economics studies apply only in a restricted way the recent developments of international trade. It must be noted that increasing availability of firm level data opens a new avenue for both theoretical (see new-new trade theory) and empirical international trade research in order to contribute to a better explanation of the firm level export strategies. In sum, the recent theoretical and empirical developments in international trade may also help us to better understand the agri-food trade integration of new member states.

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ROMANIAN RURAL AREAS AT PRESENT[*]

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The study consists of five major parts. Firstly, there are presented the specific characteristics of Romanian rural areas, secondly the situation of the rural employment, followed by the specification of rural development dilemmas and some territoriality aspects. The concluding part summarizes reflections on several new challenges of rural development Romania has to face.

Key words: characteristics of Romanian rural areas, objectives of the new rural development, key problems
JEL Classification: Q18, Q19, R58

Introduction

The general aim of this paper is to give an overview of the specificity of rural areas in Romania through the angles of the economic structure, employment situation and several development dilemmas, and thus contributing to a better understanding of what the term 'rural' in Romania means.

The rural area in Romania is defined as the administrative territory including all communes of the country. The 'commune' (rural LAU2 settlements) means the basic administrative unit in Romania (Law 2/1968). A commune consists of several villages, in average about 5 villages/communes. According to the Census of Population survey – organized in 2002 – there have been 2685 communes (13042 villages) and 267 towns in Romania. In 2008, the number of communes reached 2860 (12956 villages), the number of towns and municipalities changed to 320.

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Specificity of Romanian rural areas

Characteristics of the Romanian rural is going to be presented in the following section, starting with a comparison with EU-average data using a specific set of indicators, followed by a focus on the economic activity structure – composed by the structure of agricultural exploitations, of animal breeding and that of farms – with a final part measuring the labour productivity by sectors.

The specificity of Romanian rural areas against the EU average is presented in Table 1. A set of indicators has been used: some of them calculated on the basis of OECD definition of rural areas[1], others on the national definition of the notion[2]. Based on OECD system of criteria, from a territorial point of view Romania nearly as a whole (99%) can be considered as being rural. Regarding the Romanian population, 47% of the people live in predominately rural and 43.6% in significantly rural areas. Compared to the share of 45% of Gross Value Added generated in rural areas on EU level, in Romania a much higher value, that of 80.9% of GVA is being generated in rural areas (using the OECD definition for rural here). The share of rural employment reaches the value of 90.3% in Romania, compared to 53.3% EU-average. *(Table 1)*

Table 1: Characteristics of the Romanian rural areas against EU-average (2005)

	EU-27 (EU-15)	**Romania**
The share of rural territory*	92.7 % (84.4 %)	99%
The share of rural population* - in predominantly rural areas - in significantly rural areas	 20.5 % (9.7 %) 37.8 % (37.4 %)	 47.0 % 43.6 %
Gross value added generated in rural areas*	45%	80.9 %

[1] The OECD defines rural settlement, where the population density does not reach 150people/km^2, if it exceeds the above value, it is considered urban. The rural territories are areas with more than 15% of population living in rural settlements.

[2] According to Territorial Administrative Law no. 2/1968 and 351/2001, a settlement can be defined as town and/or municipality if it fulfils a set of criteria (several economic, socio-cultural, and other aspects are being analyzed) defined by law. However, in Romania, all settlements which are not defined as towns and /or municipalities by law are considered communes.

The share of rural employment*	53.3 %	90.3 %
Age structure Farmers <35/>55 years old	Ageing 0.16 (0.12)	Ageing 0.14
Gender	"Masculinisation" Out-migration of younger women	"Masculinisation" Out-migration of younger women
Employment rate	60.1 % Lower than urban	53.0 %** Higher than urban
Unemployment rate - total - of the youth (15-24 years old)	10%, Higher than urban 17.6 %	5.2 %,** Lower than urban 13.9 %**

*OECD definition of rural areas; ** Romanian definition of rural areas

Source: Vincze, 2007

The value that shows the ageing ratio is nearly equal in all the three cases considered: slightly higher on the level of EU-27 (0.16), and slightly lower in EU-15 (0.12) than that of 0.14 observed in Romania. On the whole European territory and in Romania as well, a masculinisation of rural areas is noticeable, due to the out-migration process of younger women from these areas. Calculations on EU-level show a lower-than-urban employment rate (60.1%), and a higher-than-urban one (53.0%) in Romania on the one hand. On the other hand, we can observe a 10% higher-than-urban on EU-level and a 5.2% lower-than-urban unemployment rate in Romania. An age group based decomposition shows, that the rural unemployment rate among the youth (15-24 years old age) is much higher both on the level of the EU (17.6%), and in Romania (13.9%).

Table 2: The evolution of the agricultural holdings' number and area in Romania between 2002-2007, by size of the holding and type of ownership

Agricultural holdings' size	**Values from 2007 reported to values from 2002**					
	Total holdings		**Individual farms**		**Commercial companies**	
	Number	**UAA (ha)**	**Number**	**UAA (ha)**	**Number**	**UAA (ha)**
<1 ha	0.78	0.86	0.78	0.86	0.26	0.33
1-5 ha	0.95	1.00	0.95	1.00	0.57	0.58
5-10 ha	1.37	1.40	1.38	1.41	0.63	0.62
10-20 ha	1.87	1.96	1.92	2.00	0.93	0.94
20-50 ha	1.70	1.71	1.78	1.79	0.95	1.00

50-100 ha	1.24	1.29	1.30	1.35	1.06	1.12
>100 ha	0.94	0.79	1.11	1.14	1.03	0.90
Total	0.90	0.99	0.90	1.16	0.87	0.90

Source: General Agricultural Census 2002, Survey on Agriculture 2007

Analyzing the data referring to the evolution of the number and area of the agricultural holdings *(Table 2),* a land concentration process is noticeable in Romania between 2002-2007 due to the decrease both in number and in utilized agricultural area of small sized (<1 ha, 1-5 ha) agricultural holdings, and the increase of medium and large-sized ones (5-100 ha). The number of farms smaller than 5 hectares decreased by 431617 in the 2002-2007 period.

Table 3: The structure of cattle-breeding farms in Romania, in 2002 and 2007

Size of holding	2002				2007			
	Cattle heads	%	Utilised agricultural area (ha)	Cattle heads per UAA	Cattle heads	%	Utilised agricultural area (ha)	Cattle heads per 100 ha UAA
<1 ha	572232	19.93	758815.08	0.7541	365104	13.36	649530.35	56.21
1-5 ha	1626081	56.64	4180568.33	0.3890	1401971	51.29	4179874.35	33.54
5-10 ha	358481	12.49	1440944.55	0.2488	502891	18.40	2017538.56	24.93
10-20 ha	90552	3.15	471097.55	0.1922	198208	7.25	924227.9	21.45
20-50 ha	40240	1.40	281172.09	0.1431	94783	3.47	481253.26	19.70
50-100 ha	18053	0.63	258042.66	0.0700	44819	1.64	333053.59	13.46
>100 ha	109728	3.82	6540069.84	0.0168	125781	4.60	5167568.48	2.43
Total	2870782	100.00	13930710.10	0.2061	2733557	100.00	13753046.49	19.88

Source: General Agricultural Census 2002, Survey on Agriculture 2007

Structure of animal breeding is being analyzed in *Table 3*. The concentration process - observed in the case of the agricultural area – is also noticeable considering cattle-breeding in Romania between 2002 and 2007. While the number of cattle and the utilized agricultural area occupied by them shows a decrease in small sized (<1 ha, 1-5 ha) holdings in 2007 compared to 2002, in medium and large sized holdings an accentuated increase is noticeable *(see Table 3).* This phenomenon is associated with a higher under-employment in about 2 million small (<5 ha) farms.

Table 4: The changes in the number of agricultural holdings carrying out non-agricultural activities in Romania between 2002 and 2007, by type of ownership

Type of non-agricultural activities	**2005/2002**			**2007/2005**			**2007/2002**		
	Indiv. farms	Com. comp.	Total	Indiv. farms	Com. comp.	Total	Indiv. farms	Com. comp.	Total
Food processing	6.11	0.55	6.04	0.67	0.71	0.67	4.08	0.39	4.04
Wood processing + other proc.	0.73	0.27	0.72	1.10	0.65	1.10	0.81	0.18	0.79
Agro-tourism	1.75	0.37	1.66	0.74	1.24	0.74	1.29	0.45	1.24
Services	2.98	1.27	2.95	0.09	0.15	0.09	0.26	0.19	0.26
Production of non-conv. energy	2.33	0.50	2.16	0.93	0.88	0.93	2.18	0.44	2.02
Handicraft	0.63	0.27	0.63	0.87	1.27	0.87	0.55	0.35	0.55
Aquaculture	2.47	0.23	1.88	1.55	0.94	1.53	3.83	0.21	2.88
Other activities	1.87	0.23	1.74	0.63	0.55	0.63	1.17	0.13	1.09
TOTAL	4.49	1.23	4.41	0.53	0.33	0.53	2.39	0.40	2.35

Note: Com.-commercial

Source: General Agricultural Census 2002, Surveys on Agriculture 2005 and 2007

Changes over time (between 2002 and 2007) of the number of agricultural holdings carrying out non-agricultural activities show an increase (4.41) in the 2002-2005 period, and a reduction (0.53) between 2005 and 2007 *(Table 4)*. Almost all non-agricultural branches show an increase between 2002 and 2005 – of which food processing activity (6.04) being the most accentuated, supported mainly by SAPARD programme. A decrease of wood processing could be explained partly by increases in the severity of regulations regarding wood cutting and decreases of handicraft (0.63) by reduction of demand. The general decrease of non-agricultural activities between 2005 and 2007 is defined partially by the demand for respecting of EU conform conditions.

Table 5: Number of days worked annually

	Romania	**North-West**
Total farms	100%	100%
under 50 days	31.03%	35.72%

Source: General Agricultural Census, 2002

A high level of underemployment on the level of subsistence-farms both from countrywide perspective and on a regional level - taking the North-

West region – can be observed *(Table 5)*, which justifies demands for complementary income sources from non-agricultural activities.

Table 6: Evolution of labour productivity[3] in the sectors of the national economy

Sector / Years	1995	2000	2005
Agriculture	65	31	26
Industry	131	138	107
Construction	149	140	116
Services	102	150	155
National economy	**100**	**100**	**100**

Source: Own calculations on the basis of the Romanian Statistical Yearbook, 1993-2005

The lowest levels of relative labour productivity can be observed in the agricultural sector, which can be associated with the problem of a decreasing tendency between 1995 and 2005 *(Table 6)*. Agriculture as a sector, in spite of an increase in the absolute value of labour productivity, shows an accentuated reduction in relative value, compared to the change in other sectors of economy.

Differences in employment situation between urban-rural areas, in the 2002-2008 period

Analyzing employment aspects through urban-rural differentiation in Romania, the following trends are noticeable in rural areas between 2002 and 2008: a decrease of economically active and employed persons; higher-than-urban but decreasing activity and employment rate; a lower-than-urban but increasing ILO unemployment rate *(Table 7)*.

Table 7: Romanian population, by economic activity and urban/rural area, in 2002 and 2008

Area / Period	Economically active persons			In-active persons	Activity rate*	Employment rate*	ILO unempl. rate
	Total	Employed	ILO unemployed				
	thou. pers.	thou.pers.	thou.pers.	thou. pers.	%	%	%
URBAN							

[3] Labour productivity is calculated as the ratio of GVA and employment

2002 Q III	5259	4681	578	6320	53.9	48	11
2008 Q III	5503	5143	360	6305	53.9	50.4	6.5
RURAL							
2002 Q III	5127	4927	200	5089	62.1	59.7	3.9
2008 Q III	4675	4484	191	5021	58.2	55.8	4.1

** equal or more than 15 years*

Source: Labour force in Romania. Employment and Unemployment in the 3rd quarter 2008

According to the data in *Table 8* there are real differences between urban and rural, especially in the case of the age groups: 15-24 years, 55-64 years, and 65 years and above: activity rate is higher in rural areas, but a decreasing activity rate is characteristic for the young people, partially explained by migration.

Table 8: Activity rate of the population aged 15 years and over, by age group and urban/rural area

	Total population aged 15 years and over	Total 15-64 years	of which: 15-24 years	25-34 years	35-44 years	45-54 years	55-64 years	65 years and over
URBAN	%							
2002 Q. III.	53.9	61.2	32.8	83.3	84.5	70.2	18.5	2.9
2008 Q. III.	53.9	62.2	25.9	81.2	84.9	73.3	34.4	1.9
RURAL	%							
2002 Q. III.	62.1	70.7	52.5	80.4	84.8	77.8	60.1	32
2008 Q. III.	58.2	67	41.4	72.9	84.4	78.4	62.9	27.7

Source: Labour force in Romania. Employment and Unemployment in the 3rd quarter 2008

On the other hand, Table 9 shows the evolution of the ILO unemployment rate by age groups in an urban-rural differentiation, highlighting the lower-than-urban but increasing unemployment rate noticeable in rural areas, especially in the case of those aged 15-24. We can conclude that the high economic growth in the analyzed period did not have direct positive impact on rural employment situation.

Table 9: ILO unemployment rate, by age groups and area, (%)

	Total	of which: 15-24 years	25-34 years	35-44 years	45-54 years	55-64 years and over
URBAN	%					

2002 Q. III.	11	29.1	10.5	8	7.2	3.4
2008 Q. III.	6.5	24.8	5.3	5	4.9	3.1
RURAL	%					
2002 Q. III.	3.9	11.6	4.5	3.4	2.3	0.1
2008 Q. III.	4.1	14.8	4.3	3.1	2.3	0.9

Source: Labour force in Romania. Employment and Unemployment in the 3rd quarter 2008

We can observe a significant difference between the distribution of low and high level of earnings by urban-rural areas and according to the economic activities (table 10):

Table 10: Distribution of employees on decimal of average gross earnings by sectors of economic activities and by urban/rural region (%)

	801-876 lei	877-976 lei	1251-1551 lei	1552 lei and over
URBAN	9.4	10.6	11.2	11.8
Agriculture	9.6	9.5	12.2	11.9
Industry and construction	10	10.9	10.8	9.6
Services	9	10.3	11.5	13.3
RURAL	10.1	9.1	6.5	4.7
Agriculture	12.1	6.8	2.4	3.4
Industry and construction	9.6	11.1	5.9	4
Services	10.2	7.3	7.8	5.7

Source: Labour force in Romania, Employment and Unemployment in the third quarter 2008

The share of those who are working in rural areas, mainly in agriculture, are higher in the low earnings group than in the high one, and is contrary in the case of urban areas, for all economic sectors. So the difference in employment situation and in level of earnings is really high between urban and rural areas, and between economic activities.

Characteristics of rural employment situation in Romania

The situation of rural employment is going to be presented from three angles: evolution and structure of employment by activities before 2002 in Romania; specific features of Romanian rural employment in the present (year 2008) and concluding with the idea whether agriculture can function as an occupational buffer nowadays.

In the decade of the ‘90s the massive flows to subsistence farming hid unemployment in Romania. Agriculture became an occupational buffer in the period of transition as the share of agricultural employment increased from 28% (1989) to 42.3% (2001). Other, associated characteristics of the ‘90s are that: none or only a very slow rise in the paid-employment during 1990-2001 is noticeable; marginal labour productivity in agriculture was not significantly different from zero; labour force transition took place from the higher to the lower productivity branches. The agricultural restructuring process also took place in this decade, which leads to an inefficient, land fragmented agricultural sector, but with a high rural employment rate and with low income level. However, agriculture became a buffer for unemployment in the transition period. The aging process of the rural population, the lower educational level of rural employment and the low diversity of economic activities became characteristic features of rural areas.

There are two major problems considering current rural employment in Romania. The first is given by the high dimension of rural employment which consists of 9.7 million rural residents; a 4.6 million active population in rural areas, out of which 4.4 million are employed persons. The second problem is the high share of employment in agriculture, a sector which has the lowest labour productivity. On national level 28% of the people are employed in agriculture, which means the highest rate among EU member states. Beside this, 60% of those living in rural areas are self-employed and unpaid family workers in agriculture.
As a concluding part of the rural employment situation, the question “Agriculture as an occupational buffer?” arises. Several changes in the role of agriculture as an “unemployment buffer” have been noticeable since 2002, which can be summarized as follows: the number of small farms and that of animal keeping farms has decreased, the large farms are well motorized, and the number of farms with non-agricultural activities has also decreased. After Romania’s accession to the EU, a real decrease of agricultural employment can be observed.
In rural employment studies the age structure, the training level and the distribution by sectors of economic activities are usually taken into consideration (however, the gender aspect will be neglected at present).

The situation concerning the most "vulnerable" age groups is the following (table 11):

Table 11: The rural labour force in Romania, by age groups, 3rd quarter 2008

Age group	Activity rate (%)	Employment rate (%)	ILO unemployment rate (%)
15 years and over	58.2	55.8	4.1
working age (15-64 years)	67	64	4.6
Young (15-24 years)	41.4	35.3	14.8
Aged (55-64 years)	62.9	62	1.5
65 years and over	27.7	27.7	-

Source: INS, 2008

In Romanian rural areas, where employment includes self-employed and contributing family workers who work in agriculture a minimum of 15 hours a week, the 14,8% unemployment rate in case of the youth is alarmingly high. The figures in table 12 highlight the extremely low level of participation of the young people in vocational training organised by recruitment agencies, thus the employment of these individuals is not possible in the short run.

Table 12: Persons, 15-24 years old in rural areas, who attended a certain level of training within the last 4 weeks in the national education system, and by training purpose, 2008

Training purpose	Persons who attended a level of training	%	15-24 years	%
RURAL	607031	15.68	586981	16.54
Basic school education/ University education	578020	14.93	559579	15.76
Vocational training courses organised by recruitment agencies	23273	0.60	21822	0.61

Source: Labour force in Romania, Employment and Unemployment in the third quarter 2008.

The distribution of unemployed persons by educational level and by working experience (table 13) emphasizes the positive impact of a high educational level on the chance of employment. In rural areas the most difficult situation appears to be that of those with medium educational level, looking for jobs appropriate to their skills.

Table 13: ILO unemployed by work experience, by unemployment duration, and by educational level, 2008

	ILO unemployed Total	%	of which: Unemployed who have never worked	%	24 months and over	%
RURAL	191139	100	104971 54.90%	100	27291 26%	100
Educational level						
High	7941	4.15	..		..	
Medium	95168	49.79	49783 52.30%	47.43	15158 (30.5%)	55.54
Low	88030	46.06	49498 56.20%	47.15	9822 (19.8%)	35.99

Source: Labour force in Romania, Employment and Unemployment in the third quarter 2008

The problem is not only on the level of unemployed but also on that of those who are self-employed, with low income level, who do not have a secondary activity, i.e. supplementary income sources.
In Romanian villages only about 7.5% of self-employed persons have a secondary activity (table 14).

Table 14: Persons having a secondary activity, by educational level and by age groups in rural area

	Persons having a secondary activity	Shares
Total	343854 (7.5%)	100.00%
Educational level		
High	24689	7.18
Medium	261622	76.09
Low	57542	16.73

Age groups		
15-24 years	19720	5.74
25-34 years	91615	26.64
35-44 years	125362	36.46
45-54 years	80037	23.28
55-64 years	24385	7.10
65 years and over	..	..

Source: Labour force in Romania, Employment and Unemployment in the third quarter 2008

These persons mainly have a medium educational level and they are between 25 and 54 years old.

For the question "do you wish to work a greater number of hours?" the majority (92,4%) answer was "NO", and among those who gave a positive answer only a very small part were looking for another job (table 15).

Table 15: Employed persons by age groups, by rural area and by willingness to work

	Employment	
	Total	%
RURAL	4484464	100
Do not wish to work a greater number of hours	4142986	92.4
Wish to work a greater number of hours, of which:	341478	7.61
- are not looking for another job	295164	6.58
- are looking for another job	46314	1.03

Source: Labour force in Romania, Employment and Unemployment in the third quarter 2008

Regarding employment, we can conclude that several measures should be taken in order to improve the situation of rural areas and lead to the creation of new jobs (in the remote, backward areas as well): conservation of natural resources, development of tourism, the increased use of re-generable sources of energy, the valorisation of traditional local values, etc. However, making use of all these possibilities needs changes in the mentality of rural persons, avoiding risk aversion attitude, a much better collaboration between rural actors and creation of partnerships.

Dilemmas of Rural Development

Romanian rural development policy faces a number of dilemmas (Kerekes and Vincze, 2009). The first and most important one is prioritizing between competitiveness and cohesion. This dilemma leads us to several issues linked closely to rural development, such as the contradictions between the free market and the sustainability of rural areas, reinforcement of the social versus the competitive sector, efficiency versus equity and cost-efficiency versus quality. The principle „No convergence without competitiveness" expressed by the Fifth Progress Report on Economic and Social Cohesion (EC, 2008), is an attempt to answer this dilemma, but does not provide unequivocal answers for all situations, and it is not easy to apply to rural development in Romania. The second question raised by both policymakers and academics, is "Should rural development be part of the agricultural policy or of the cohesion (regional) policy?" The opinion expressed by EC member Mariann Fischer Boel is straightforward: „Agriculture and rural development should stay together under the same policy roof" (Fischer Boel, 2008). The third question is „Should rural development policy concentrate primarily on agrarian or on non-agrarian rural development?" The answer is more complicated in the case of Romania, where agriculture needs to go through a phase of modernisation. "We are facing a great compatibility dilemma between the new Common Agricultural Policy, with its objectives, adapted to the current situation of agriculture in the European Union and the situation in Romanian agriculture" (Otiman, 2008). Romanian agricultural objectives are the following: "deep restructuring of farms, through agricultural land consolidation and adequate equipment, massive support to increase the technical and economic yields, placing the Romanian agricultural products on the EU and world markets, the establishment of producers' groups, of cooperatives for input supply, processing and marketing of products, the establishment of agricultural chambers, etc." (Otiman, 2008)
Some more, equally important and intriguing questions related to rural development policy can be raised, such as:

- Should rural development policy sustain at all costs rural settlements or accept the depopulation of backward areas?
- Should rural development policy concentrate primarily on the development of growth poles or on the closing up of backward rural areas?
- Should rural development policy concentrate on rural job creation locally, or adopt a wider approach to rural employment?

- Should rural development policy focus on pluriactivity of farmers and farming households, on setting up other gainful activities by diversification of farm activities, or on the creation of non-agricultural jobs?
- Should short-term growth objectives prevail in the rural development policy or long-term development objectives?
- Should rural development policy encourage social assistance or labour market adaptation?
- Which elements of rural development involve local decision-making and implementation, and which are not achievable through local resources?

We believe that at present nobody has unequivocal answers backed up by arguments, to these current questions of rural development on the level of Romania and different Member States. Documents of the European Union (COM (2005) 24 final, EC No 1698/2005, COM (2006) 857, Council Decision 2007/144/EC, Cohesion Reports, etc.) give us some orientation concerning the formulated questions.

The 'Lisbon Strategy for Growth and Jobs' encourages investments in regions with high growth capacity, as well as investments in the driving forces of growth and employment, such as: human capital, physical capital (ICT infrastructure), R&D, education, adaptation of labour force. These measures are not in the advantage of Romanian rural areas in the short term, but could be so in the long term.

The employment guidelines focus, besides their main objective (full employment), on the following: increase of quality and productivity, social and territorial cohesion, facilitation of youth employment, increased participation of women in employment, family-friendly working conditions and access of immigrants to the labour market. Full employment in the present situation of Romanian rural areas, with about 3.9 million small subsistence and semi-subsistence farms is unrealizable, when the jobs in towns are in decline.

Economic renewal of rural areas is the focus of a number of integrated measures (within ERDF, EAFRD, ESF and FIF), in order to ensure a minimum level of access to services of general economic purpose, to promote an integrated approach to tourism, to reach a critical mass for service-creation, to invest in milestones of development and to organize economic clusters based on local values. The realization of these measures at the moment is certainly affected by the economic-financial crisis.

In CAP documents there are high expectations formulated towards agriculture, which at the same time are difficult to meet:
- to produce safe food in sufficient quantities, in a more sustainable way;
- to contribute to energy supply;
- to ensure protection of natural resources and maintenance of landscape;
- to contribute to the growth of economy and employment, through the diversification of economic activities;
- to ensure relaxation, rehabilitation, leisure and cultural opportunities for visitors;
- to ensure access to modern services for those living in rural areas.

The general conclusion of DG AGRI is that rural areas have specific characteristics which require an autonomous, specifically rural development policy, where agriculture has a central role, being the main user of agricultural land, having close links to other activities carried out in the rural areas and carrying rural history and culture. (Guyomard, 2008)

Agriculture has a very important role in Romanian rural areas, as Romania has good natural conditions for agriculture: 64% of the agricultural land is arable, 33% are pastures and hayfields, 2% vineyards and 1% orchards (Eurostat). At national level the role of agriculture has been relatively high, but decreasing: the share of agriculture in the GDP decreased from 13.3% in 2001 to about 7% in 2007, the share of agricultural employment in the same period decreased from 44.4% to 32.8% and the share of food consumption in the total household expenses decreased from 54.5% in 2000 to 46.4% in 2005. Still, all these data are much higher than EU averages. According to official statistical figures, a large segment of the active population is employed in agriculture. In reality, the circulatory migration of the young people abroad, as well as migration to the towns generates a lack of skilled workers, which is one of the main bottlenecks for rural investments. The rudimentary technical endowment of small farms and the poor management and marketing experience of bigger farms generates low productivity with a negative impact on the level of income and on the competitiveness of Romanian agricultural products on the domestic and foreign markets. (Vincze, 2007)

On micro (household) level the main characteristics in the 2000-2006 period have been the following: high level of self-consumption of the agricultural production (the market is not well organised and therefore does not stimulate commercial output); increasing gap between agricultural and industrial products' price indexes (which reduces motivation to produce for the market); the lack of appropriate infrastructural services in remote rural areas (which discourages farmers from participating in commercial production); pluriactivity as a strategy for survival (wage incomes of the households are generally higher than income derived from agricultural production); the land fragmentation in small plots prevents the establishment of economies of scale; a mentality of risk aversion (farmers prefer to apply a strategy of risk minimization, thus the low technology investment and low return) (Sofer and Bordânc, 2006, Giurca, 2006). In 2007 and mainly in 2008 the level of agricultural products' prices increased significantly (with more than 30% in average), which can lead to changes in market-opposing attitudes of semi-subsistence farmers, too.
The general answers found in EU documents do not clear up the dilemmas of Romania, and of different member states about the necessary measures to be taken and the allocation of Funds between these measures.

For the 2007-2013 period in Romanian rural development programme (PNDR, 2009) the financial allocation by axis is the following (Table 16)

Table 16: Financial allocation by axis in the Romanian rural development strategy

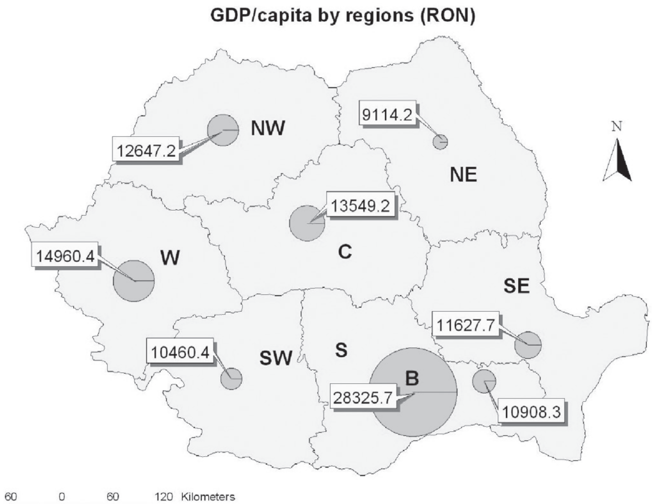
Axis	Public spending		Private spending		Total cost	
	EURO mn	%	EURO mn	%	EURO mn	%
Axis 1	3967.3	44.2	1907.9	83.9	5875.2	51.9
Axis 2	2293.3	25.6	71.1	3.1	2364.4	20.9
Axis 3	2473.9	27.6	340.5	14.9	2814.3	24.9
Axis 4	235.1	2.6	25.4	1.1	260.4	2.3
Total Axis		100		100		
Technical assistance	376.1		0		376.1	
Complementary direct payment	625.1		0		625.1	
Total	9970.8		2344.8		12315.6	

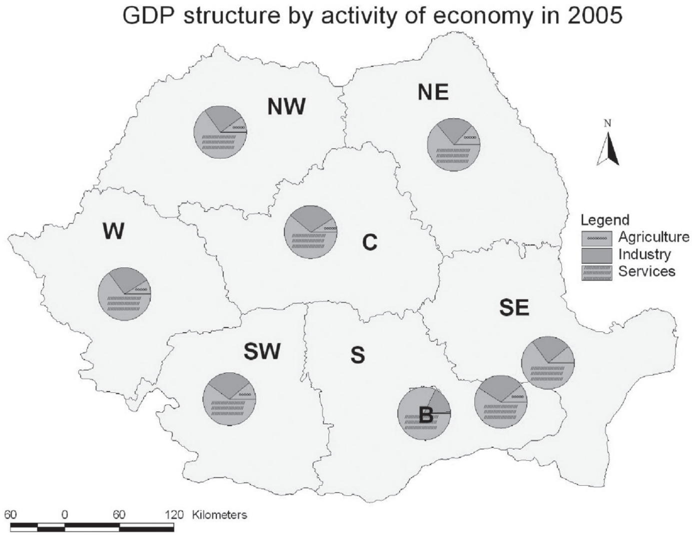
Source: PNDR, 2009

Considering the shares of the four axes regarding public spending in Romania, we can observe that Axis 1: Improving the Competitiveness of the Agricultural and Forestry Sector (requiring sectoral measures) with a percentage of 44.2 is predominant. Axis 2: Land Management (requiring mixed measures) and Axis 3: Diversification of Rural Economy and the Quality of Life in Rural Areas (requiring territorial measures) have almost the same shares (25.6, respectively 27.6%). Axis 4: LEADER - building local capacity; promoting private-public partnership; promoting cooperation and innovation; improving local governance has far the lowest (2,6%) share from the total amount of public spending allocated to rural development in Romania, because first creation of the LAGs and elaboration of local strategies is necessary which will only begin in 2010.

Territoriality in approach to rural development

The existence of a territorial approach regarding rural development can be supported by the idea that there exist several regional differences in the GDP/cap and in the economic structure associated with a set of local differences on issues which may have an impact on rural employment.





Issues, that may have an impact on rural employment, and which should be analyzed - in order to get a territorial view of rural development - are listed below: share of urban-rural population- indicator of urbanisation and counter urbanization; municipalities and towns – level of urbanisation; number of population, respectively changes in the number of the population – depicting demographic trends; natural increase/decrease rate, net migration rate, the share of the 0-14 year-old population, the share of the 15-59 year-old population, dependency ratio, aging index – as indicators of demographic trends; population density on LAU2 levels; the share of the arable land- the defining natural capital; and distance to growth poles – as a potential measurer of commuting possibilities.

Resources and needs are different in each area, thus development has to be adjusted to local realities, but local development has to be coherent with the regional, national and EU development strategy as well. Some problems can not be solved at local level (such as the increase of competitiveness, upgrade of technology, gathering information about the market, adaptation to climate change, modernization of the rural areas, etc.), therefore national and trans-national cooperation is necessary; the EU and national RD networks can contribute to this.

New challenges of rural development

There are five basic challenges rural development has to face and cope with in the short, medium and long run: globalisation, trade liberalisation, demographic change, secure energy supply and climate change. From Romania's point of view, the central question is whether we are prepared to face all these challenges on national level. It is evident, that EU membership and access to European Funds give a chance for the development of Romanian rural areas. Agriculture also has an important role in the Romanian rural economy, but the future of agricultural farms depends in a great degree on the general situation of the rural economy. So – when speaking about Romania's degree of being prepared – we can state that the country is not, or only partially prepared for the new challenges connected to rural development.

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THE EUROPEAN UNION AS A CONTINENTAL STATE

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The central thesis of the study is the following: the European Union is a Continental State, which was established through the voluntary integration of sovereign nation states, and which has just now reached the threshold of geopolitical maturity. The paper does not want to launch a debate on the question whether or not the European Union is a state. I view this as a matter of fact. The interesting thing which happened in Europe is unique in human history: the European State has emerged while the traditional nation states have not disappeared. The truth is, however, that they consented to the emerging of this wholly new Continental State which – in terms of Western- and Central European history - differs from the nation state as much as the latter differs from the pre-modern or pre-national state.

Key words: European Union, large states, ecumene, geopolitical maturity
JEL Classification: O52, B25

An American geopolitician – more precisely a political geographer, (that is what he professed himself to be) – working in the thirties and forties of the last century, Derwent Wittlesey (1939), in his book *The Earth and the State*, dealt with the question of the relationship between the area of the so-called very large states and the *ecumene* on their territories, as well as with the issues of the consequent geopolitical maturity and geopolitical immaturity of the very large states.

What a very large state of a continental size means, obviously does not need an explanation. The meaning of the *ecumene* is a bit more complicated. It is present in almost every state in the form of a nuclear core, which is also the most populous part. 'The *ecumene* – Wittlesey writes - is the portion of the state that supports the densest and most extended population and has the closest mesh of transportation lines.' (Wittlesey, 1939, p. 2)

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The expression is derived from Greek. For Strabo, who lived in the first century AD and might be considered the first Western geopolitician, the *ecumene* meant inhabited land, which - in essence - comprised the Greco-Roman civilisation and its border territories. Wittlesey adopted this from one of the experts on economic geography, Mark Jefferson (1928), who defines it as the land within ten miles of a railroad.

On the other hand, Wittlesey defines the *ecumene* – rightly so – by including every transport route and – furthermore – all communicational networks. At the end of the thirties, the expert – taking into account of area, population, railroad mileage, road mileage, waterway mileage, airline mileage, telegraph mileage, telephone mileage – had listed seven very large states: Russia (i.e., the former Soviet Union), China, Canada, Brazil, the United States, Australia and India. The territorial order could be established only by adding Mongolia to China, but not adding Alaska to the United States. However, this is not really significant for this order of size.
The *ecumene* of the individual large states is much more significant. On the basis of examining the correlation between the area and the *ecumene*, Wittlesey came to the conclusion that 'none of the very large countries has attained geopolitical maturity, except the United States'. (Wittlesey, 1939, p. 18)
It is evident in the case of Canada and Australia: their *ecumene* – primarily because of their demographic weight (the population of Australia had not reached seven million and that of Canada barely passed ten million – are too small. Nearly the whole of Brazil's landward boundary 'is so beset by swamp, rain forest, or mountain ranges that transcontinental railroad lines, in the North American, Australian, or Russian sense, are not projected even by the optimistic'. (Wittlesey, 1939, p. 15)

The communication system of India was relatively well-developed. Its rail mileage ranked with that of Russia and Canada, and was surpassed only in the United States. 'The thus ensured mobility enabled a hundred thousand British to conquer and administer 340,000,000 Indians'. Anyway, the effective Western – i.e. British – organization 'has for the first time made it possible for India to realize to the full the values inherent in its large area and an ecumene not much smaller, although less well endowed, than those of the United States and Russia'. (Wittlesey, 1939,

p. 16-17) Hence, India – at that time – could not become geopolitically mature only because its population was too underdeveloped and the country was not independent.

The geopolitical maturity of China could be considered even less at the end of the thirties because of the total lack of a continental-sized communicational system and the immense political disintegration. 'Modern China – writes Wittlesey (1939, p. 18) – has lacked the power or has missed the opportunity to bind itself into a firm unit with steel. It seems likely that real unity will be delayed until an adequate transportation system has been constructed.'

At that time, among the seven very large states only the *ecumene* of Russia was more or less similar to that of the United States; yet in the eyes of the American geographic expert Russia could not be construed as mature from the geopolitical aspect. Wittlesey's arguments are not really convincing, yet it is an undeniable fact that 'in Russia the mesh of the transportation net was much coarser than in North America' (Wittlesey, 1939, p. 15). However, this very aspect has not much significance as regards Wittlesey's system of criteria itself that we are interested in.

Let us sum up the criteria according to which the American writer classified the so-called very large states in 1939 as geopolitically mature or immature: 1. area, 2. *ecumene*, i.e. the correlation of the population and communicational system, or – displayed on the map – their juxtaposition, and 3. political independence and unity.
Based on these criteria, which indicate that 'the correspondence of *ecumene* and communication lines is so inseparably interwoven with political unity', Wittlesey could not understand 'why Europe, with the densest rail web in the world, has taken no real steps toward unity' (Wittlesey, 1939, p. 18).
In his opinion the answer is probably entailed in chronology: 'Western and Central Europe had become crystallized into national states before the railroad era dawned. (...) If the past is any sort of guide to the future, the state will always remain closely identified with whatever means of transportation and communication are current. (...) the national state which took shape in the days of dirt tracks for horses and oxen, pulled boats on the rivers, and sailing vessels along the coasts, would appear to be an anachronism.' (Wittlesey, 1939, p. 22)

Before we attempt to reformulate these criteria defined seventy years ago in order to make them valid for the present global situation, which would provide points of reference to determine which of the present-day large countries might be considered as being mature in the geopolitical sense and to establish where Europe – i.e. the European Union – is situated on this spectrum – let us take a short detour on the geopolitical- and the historical relevance of the 'very large states'.

An interesting book written by Professor Azar Gat (2010) of Telaviv University will be published in the coming months. In this book – as in a preliminary study published in Gat (2007) – the author discusses the return of the authoritarian great powers, as well as the relativity of the victory of liberal democracy in WWII – and a half century later – in the cold war. The Israeli expert emphasizes the fact that the defeat of Germany and Japan in WWII was not due to the undemocratic nature of their regimes, but primarily to the insufficient size of their countries and the lack of adequate tolerance vis-à-vis their strategic losses.

On the other hand, the Western democracies – thanks to the colossal power of the United States – were able to handle such catastrophic disasters like the loss of the Russian alliance in WWI, and that of France's fall and the annihilation of the American fleet at Pearl Harbour in the Pacific Ocean during WWII (Gat, 2009). Along the lines of this logic we can claim that owing to its huge size and significant *ecumene* (which was noted by Wittlesey, too), Russia was able to survive not only the huge human- military and territorial losses suffered at the beginning of WWII, but – and this might be even more significant – the collapse of the communist regime, too and the demise of the Soviet internal and external empire as well, which – from a geopolitical point of view – against the appearances, was not less damaging to Russia. Only now did Russia reach the stage of geopolitical maturity, given that it has shed its dysfunctional political regime, the geopolitically burdensome Baltic States, the Trans-Caucasian and Central Asian republics, as well as its East-Central European satellites.

Let us now briefly list the criteria, which are relevant to us today to determine – in the spirit of Wittlesey –, which great countries are geopolitically mature, i.e. are worthy to play a geopolitical role in the 21st century.

1. The ‘very large’ size naturally remains a necessary criterion. However, this circuitous and not subtle enough Whittlesey-expression (‘very large state’) is not a particularly apt phrase. On the other hand, the simple ‘large state’ is a relative term: France compared to Luxembourg, or Belgium is a large state, and similarly, Germany is ‘large’ compared to Austria, the Czech Republic, or Slovenia. Still, they are not accidentally omitted (nor is Great Britain with its huge colonial empire at the time) from Wittlesey’s list of very large states.
In my view, the **Continental State** would be the appropriate term. Of course, being of a continental size, in itself is not a sufficient criterion for geopolitical maturity in order to play a global role. Despite the continental size of Canada, or that of the Australian Continent, their *ecumene* is so minute and is distributed on the periphery – hence, they must be satisfied with their territorial magnitude only.

2. The *ecumene* – expressing the correlation between population and the communication system, or network – remains the most important criterion. However, from now on - besides the rail-and road network, water and air transportation – we should include not just the telegraphic and telecommunication network – as they were seventy years ago – but the internet, too. The complex networks, based on the internet – functioning beyond and beneath and only partially through the state – overruled traditional geopolitics that perceived the world as an enclosed chaotic system of states that clash with each other like billiard balls (Slaughter ,2009).

3. One more important criterion – curiously not mentioned by Wittlesey – is economic power. Here, I am not thinking of per capita GDP, but of absolute numbers, primarily of the global economic influence indicated by export-import data.

4. Finally, we should not forget the criteria of political independence and political unity either.
On the basis of the analysis above, we can state that there are four continental states in the world today, which could be considered as geopolitically mature, i.e. they are not only destined to play a global role, but *de facto* play that role. These are the following: America, China, Russia and the European Union. India and Brazil are also destined to play a global

role, but despite their continental size and significant *ecumene*, they can be viewed only as regional powers at present.

The list of four is not irreversibly final either: it is not only possible to be included on it, but can be excluded as well. If, for example, Russia were not able to improve its chronic demographic problems and the world – as predicted by some – will progress beyond the oil-and gas age in twenty to twenty-five years, Russia will irreversibly plunge into the ranks of regional powers.
Otherwise, the latter is an interesting club as well, holding many surprises: Turkey for instance has just entered the ranks of the geopolitically mature regional powers and it is probable that in a few years Japan will follow its example. (On a brief note - Japan despite its economic weight, primarily because it is not a continental-sized state – will never become a global geopolitical factor.)
I have mentioned almost everybody, but have yet said practically nothing about the main topic of this conference, the European Union beyond mentioning how Wittlesey was surprised seventy years ago that owing to some strange historical regression, the united Europe has not yet materialized, and – moreover – it had splintered further after WWI and thus, it could not be included among the greatest. On the other hand, you might be surprised now at my audacity to include it in the ranks of the particular four.

My thesis related to the EU is the following: the European Union is a Continental State, which was established through the voluntary integration of sovereign nation states, and which has just now reached the threshold of geopolitical maturity. Of course, the emphasis – not only in grammatical terms – is in the present progressive and not in the past tense. This makes my thesis look a bit hazardous.

I shall not launch a debate on the question of whether or not the European Union is a state. I view this as a matter of fact. I know that not everybody shares this view, but the only issue worth debating pertains to the character of the EU State and not whether it is a State at all.[1]
Still, I do not claim that the European Union was conceived as a ge-

[1] The legal and institutional aspects of the European State as being constituted by nation states and not being itself a nation state – which I am not dealing with in this presentation – were exhaustively treated by Jean-Luc Ferry (2000) in his important book, *La Quéstion de l'État Européen*.

opolitically mature state in the heads of Giscard d'Estaing, Jean-Luc Dehaene és Giorgio Amato – to mention only the three most important members of those who compiled the European Constitution. As we know, the Constitution failed in 2005, i.e., ceased to exist. But in the spirit and content of the Lisbon Treaty to be implemented by the end of this year, every essential element of it has been preserved. This is also a kind of *Aufhebung*.

Please allow me one more short Hegelian flourish, quoting this time Charles Tilly, who is probably the most noteworthy expert on the evolution of the nation states, who wrote in the last paragraph of the final paper in a standard-setting collection of studies edited by him in 1975: 'Let us recall the definition of the State in a given territory as an entity exercising the monopoly of control over the forces of coercion, and as an independent, autonomous centralized apparatus operating separately from other organisations in the same territory. If there is any truth in the trends we have described, then they are threatening practically every aspect of the specific character of the state: the monopoly of coercion, the exclusiveness of the control over the territory, autonomy and centralisation. Even the separation from other organisations begun to lose the edge, i.e., in such structures as the European Common Market. (...). It is probable that – as it has often happened - we shall only understand this important historical process, i.e. the evolution of the nation state – when it begins to lose its universal character. Perhaps – even unwittingly – we are writing the obituary of the state.' (Tilly, 2000. p. 638)

I do not claim that an analogous, but considerably larger continental-sized state has taken the place of the increasingly eroding European nation states. The interesting thing which happened here is unique in human history: the European State has emerged while the traditional nation states have not disappeared. Truth is, however, that they consented to the emerging of this wholly new Continental State which – in terms of Western- and Central European history - differs from the nation state as much as the latter differs from the pre-modern or pre-national state.

Since I have indicated at the start of my lecture, the degree to which Wettlesey was surprised "why Europe, with the densest rail web in the world, has taken no real steps toward unity", I cannot refrain myself from referring to Czech President Vaclav Klaus – who announced a few days ago that even he cannot stop the European train any longer, and thus pointing to the universal disaster - that he, too, will sign the Lisbon Treaty. Klaus – who compares himself to Jan Huss – is a rather comic figure, but we must recognise that he perceived something, i.e., that this particular signature, which will put an end to the long agony of the constitutionalising process that commenced with the December 2001 Laeken Declaration will also sanction legally the already existent continental-sized European state.

When I say – in contrast to those who perceive the situation as being tragic, or those that belittle the issue – that soon (as of January 2010), with its own president and foreign service and a multitude of measures introduced alongside the extension of the qualified voting system and the considerable enhancing of the competency of the European Parliament, the European Union will irreversibly join the ranks of the great states that direct the course of global politics, I would not like to make the mistake that – along with several others – I made between 2001 and 2004 when, in an extensive study (Molnár, 2003) and in several articles I wrote that whatever the outcome of the ratification of the European Constitution would be, a core-Europe, in the form of a federal state – resembling the Carolingian Europe – a kind of European United States, would emerge.
As I have already said, my present thesis is based on facts and it is not a mere prediction. However, it contains some unavoidable scepticism vis-à-vis the – inevitably – deficient nature of reality.

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INSTITUTIONALIZED TRANSBORDER COOPERATION IN CENTRAL AND EASTERN EUROPE

István Loránd SZAKÁLI*

On the local and regional level, cross-border cooperation has mirrored the effects of the larger process of European integration, which took place on the national and state level. Few would claim that integration was more successful had it been directed and desired only from above in a top-down approach and from the centre outwards. The last fifty-some years of our most recent history are clear evidence of this fact. Subsidiarity is one of the key tenets of the European Union (EU): decisions and actions are taken at the level of competency closest to those they will affect. In this spirit of subsidiarity, stakeholders such as regions, counties and other types of administrative areas or municipalities serve as the sub-national territorial units which are empowered with the freedom and competency to participate independently in international cooperation. Therefore, a system of cross-border cooperation is reserved for lower-level administrative units. These stakeholders then define their own interests and establish their own goals in this most obvious form and framework of international cooperation.

Key words: transborder cooperation, euroregions, subsidiarity
JEL: R58

Introduction

In Western and Northern Europe, where external or internal factors did not hinder the development of democratic civil societies, frameworks for cross-border cooperation appeared in institutional structures as early as the 1950s and 1960s. In Central and Eastern Europe, these frameworks only developed in the early 1990s. In Europe's western and northern countries, cross-border cooperation resulted from the recognition of the need to find common solutions for shared or interrelated problems. Given the history of peaceful coexistence in their case, national borders were primarily *not* about isolating and separating enemies (countries and

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peoples) from one another. To the contrary, as similar problems arose on either side of a border, it was recognized that these issues could be solved efficiently through cooperation and collective action.

Further, individuals in free, democratic and cooperative societies with shared values have many opportunities; this is especially true in the case of neighbouring geographic areas where institutions are separated only by an official borders which can be passed without any restriction due to extension of Schengen regime. Local communities, institutions, enterprises or civil society organizations are indeed connected by common interests and goals across a larger region. Certainly cross-border cooperation can be exercised within the institutional framework of a Euroregion however other forms of cooperation exist, too. In the Iberian and Italian peninsulas, for example, cross-border working groups aimed at achieving the same kind of cross-border cooperation are the structures of deliberate choice.

In Western Europe the creation of euroregions – at least in certain cases – was greatly influenced by ethnically motivated processes and was seen as the practical form of cooperation for solving common problems. Despite the fact that the majority of western and northern European borders are deeply rooted in history, there are several cases where territory of a nation was displaced outside the current political borders of the state (e.g., South Tyrol, Belgium, Germany, Finland, Sweden, etc). Regionalism has offered a solution to this situation and is the most recognized manifestation of cultural or territorial autonomy in the European context. As a result, euroregions may be regarded as a subsystem of European regional processes. These regions are characterized by an internal cohesion and share a system of common aims on the regional level. Their official boundaries, however, often cross at least one state border.

In Central and Eastern Europe (CEE), the communist system suppressed the development of regionalism and any Euroregional processes as part of a ‘divide and conquer’ policy. Despite the standardized communist political system imposed by the Soviet Union in all Eastern Bloc nations and the idea that countries of the region were supposed to belong to one camp, some nations of CEE found themselves in a hostile relationship with one another. This prevented the success of grassroots territorial initiatives. It was obvious that the omnipotent state wanted to control each and every segment of society. In CEE, the borders are relatively new: created in the 20th century of which many transformed through previously integrated, cohesive and cooperative geographic areas. Additionally, administrative obstacles are frequent and in several instances people of the same ethnic origin constitute the majority on both sides of a border, yet they had no way to establish frameworks of cooperation (e.g. cultural, economic, interpersonal) between their communities.

Nowadays, Central Europe is part of the European Union. For the past twenty years, the EU has accelerated the process to diminish divisive nature of borders by creating and extending the Schengen zone, the basis of development integrated markets on the European Union (the free movement of capital, labour and goods). The first euroregion (the Carpathian Euroregion) was established in Central Europe in the early 1990s with technical and financial support provided primarily through Western European and U.S. organizations. These initiatives were aimed at the dissolution of the rigid framework of nation states and anchored cross-border cooperation in the spirit of peace and democracy. Already in these initial cases one could see the process of a conscious 'spread of democracy.' Later, however, one had to admit that euroregions created as a result of purely external influence could never really be successful. For these regions to prove truly successful, euroregions had to be based on the principle of subsidiarity and had to be organized along shared interests and goals. Despite these observations it is clear that the first initiatives provided a useful model and demonstrated a previously unknown framework of cross-border cooperation

In Eastern Europe and mainly in the successor states of the former Soviet Union (FSU), one can observe a delay in adopting new institutions. The majority of newly created (especially FSU) countries had no traditions of independent statehood. Their democratic transformation was also doubtful. In many cases it was unclear whether progress would last. It is also evident that the EU does not consider admitting these countries to the Union as a priority. The divisive nature of borders is intensifying: the extensive bureaucracy, a lack of infrastructure and mutual distrust still exists and hinder trans-frontier cooperation. In the case of these countries, raising awareness of the possibilities of cooperation (in the framework of euroregions or any other type of cross-border initiative) provides a genuine opportunity to gradually dissolve or permeate rigid boundaries. Ultimately, this would contribute to transforming the mindset of the people living in those regions.

The current system of European borders was based on the creation and consolidation of nation-states; this process started following the French Revolution and was essentially completed by the second half of the nineteenth century. In earlier times, the border areas separating empires or countries did not mark rigorously defined cartographic or geographic regions as dictated by history, but rather provided a loose framework reflecting the development of the state up until that point. These areas often enjoyed a special status in the state (e.g. *Grenzmark*, *kraina*, *frontier*). The national borders that emerged in the eighteenth and nineteenth centuries were quite different compared to earlier boundaries and fulfilled a fundamentally different role. In fact, national boundaries provided the geographic framework for the development of nation-state ideologies. In many cases, these frontiers became instruments of protectionist economic policy. Borders played primarily a defensive role: with the rise of modern states, separating and dividing neighbors turned out to be the most important function of the border. Nation-states attributed an important role to identity therefore elevating the role of state borders by separating the people, institutions and economy of the country from neighboring competitors (or, in some cases, from enemy countries or nations). Borders created obstacles between neighboring areas in terms of interaction; for example, when dividing lines were established between states, the result was greater difficulty in the movement of persons or trade. The introduction of passports as understood today was also linked to the emergence of nation-state borders. Passports served as administrative tools to make the borders permeable and more controllable.

Today, thanks especially to the integration process of the European Union; boundaries in Europe have lost much of their significance as obstacles to contacts between persons and the free movement of goods. In the future, the role of borders will continue to change with the expansion of the Schengen regime to additional countries. (It must be noted, however, that even in the context of the EU, internal borders have disappeared altogether only within the Schengen area. The external borders of the EU have maintained their role and function of separating and protecting EU members from the risks of unauthorized and uncontrolled flow of international migration.)

The origins of the Euroregion experience

The first instance of euroregional synergy was created in Western Europe in the late 1950s and early 1960s. By that time, distrust typical between Western European countries earlier had begun to diminish. Following the World War II, efforts promoting cooperation intensified. The first breakthrough in 1958 was achieved by the 'Euregio' headquarters agreement signed in Gronau, Holland, and instituted by the Dutch and German governments in the border areas of the rivers Rhine, Ems and Ijssel. Another important milestone was in Basel: the 'Region Basiliensis' in 1963 covering the Upper Rhine region of France, Germany and Switzerland.

These were the first initiatives. Since then, a number of other institutionalized cross-border cooperation initiatives have been launched in Western and Northern Europe. Nearly 110 various forms of euroregional cooperation are in place throughout Europe today including CEE as well as the Balkan region.

Conditions and reasons for formation of Euroregions

The main recognition leading to the creation of euroregions is the fact that certain tasks cannot be provided efficiently within the constraints of state borders. The separating character of borders often contradicts the natural organizational logic of the spatial arrangement of functions such as infrastructure, health and human services. This problem mainly impacts areas in border regions where certain functions must be established on both sides of the border (even within short distances from each other) in order to meet the needs of those within the geographical margins of both countries. Public functions and services such as ambulance stations, healthcare institutions, fire departments, civil protection and disaster relief operations or the capacity for sewage treatment, are better organized and maintained if the territorial range of their operations is extended to the border areas of the neighbouring country as well.

Another vital argument in favour of creating Euroregions is the recognition that people on both sides of the border actually share more ties (e.g. familial, cultural, and ethnic) than divisions. Promoting the concept that people living on two sides of a border have much in common helps reduce existing suspicions and tensions particularly if those issues are due to the general absence of relations. Mistrust between people living on the two sides of the border and not having much contact with one another also translates negatively into politics and neighbourly relations of the countries as a whole. On the other hand, border areas engage in balanced and intensive cross-border interaction (i.e. overcoming the inherently separating function of the modern boundary between states) which leads to a markedly positive effect and can improve political relations between the respective countries.

In the global economy, regions compete primarily with other regions. Competition is not necessarily between countries as a whole. This is yet another factor warranting the invigoration of institutionalized cross-border cooperation and intensifying integration. In order to make any region competitive, it is necessary to ensure the availability of transportation connections and that no part of the region is kept in economic isolation. This can only be achieved if opportunities for economic cooperation – in every geographic direction – are the same in the border (peripheral) regions of a country as in areas closer to the political and/ or economical centre of the country. The significance of cross-border regional marketing has continuously increased as a critical component of competitiveness. If adjacent areas and border regions are artificially isolated from one another, the result is mutually disadvantageous for all sides. It is in the shared interest of border regions to increase cooperation with each other, to enhance their competitiveness and diminish the potentially detrimental effects of their peripheral location.

Mainly in the central areas of Europe but to a lesser extent in the eastern parts of the continent as well state boundaries have a strong administrative character dividing formerly functional areas and creating artificial border regions. These borders hinder and often forcibly prevent economic, political, cultural, institutional and human relationships which otherwise may have strong historical roots and have developed naturally. The border regions of CEE have another specific unfavourable feature. Central governments have never considered the development of these regions a priority precisely. As a consequence, these areas are characterized by economic backwardness, a lack of public investment, the emigration of young people and high unemployment rates.

The emergence of cross-border and institutionalized cooperation in Western Europe clearly benefited from the developments of the European integration process in the 1950s that later gave rise to the predecessor of the EU. In addition, the development of partnerships was an answer to a natural demand for cooperation: it should not be forgotten that Western European borders usually coincided with historically and geographically established functional boundaries. As a result, these frontiers were burdened with less stress and as a result of integration processes have disappeared altogether by now.

Establishing the appropriate legal framework has been a key prerequisite for cooperation among administrative units belonging to different nation-states. In general, the principles of subsidiarity and decentralization have dominated administrative law in Western Europe since the 1950s. Initiating cooperation then depended simply on the recognition of needs and intentions. This process was accelerated in 1980 when under the auspices of the Council of Europe; 'the European framework agreement about regional authorities and administrative organization on border cooperation'[1] was adopted in Madrid (Council of Europe, 1980).

[1] European Outline Convention on Transfrontier Co-operation between Territorial Communities or Authorities (Madrid, 21.V.1980). European Treaty Series (ETS), No. 106. [ON-LINE]. [Strasbourg]: Council of Europe, Treaty Office, [15.10.2003]. Available on http://conventions.coe.int/treaty/en/Treaties/Word/106.doc.

Euroregional cooperation in EU context

As it expanded in recent decades Europe has also witnessed the transformation of cross-border cooperation from defensive lines into zones of reconciliation between peoples and communities. Regional cooperation is also an integral part of a country's preparation for integration into the European structures. The European Commission's (2004) Third Report on Cohesion notes that cross-border cooperation is a key priority for the EU with a view to fostering integration and to limiting economic and social fragmentation. During the process of enlarging the EU, a double transformation occurred: one, cross-border functions dissociated in space and, two, the newly formed EU territory became one large cross-border region. As a result, Europe is perceived as a 'regional form of ineluctable globalization process, in which the exchanges are establishing the economic interferences the guarantee for peaceful relationships'.

In Europe, euroregions are one of the most common instruments for the development of border regions and for fostering cross-border cooperation. Euroregions should be 'magnets' for the social, economic and cultural development of the areas and populations concerned in full synergy with the activities of territorial authorities (Council of Europe, 2004). Existing euroregions are the initiatives of specific border regions or other local entities of several countries and have no defined statute in the context of the EU.

Euroregions can take any of the following legal structures: a community group without a legal entity, a nongovernmental organization or a public entity. Euroregions do not create a new type of government at the cross-border level. Their work, competencies and power are defined by those local and regional authorities, which constitute them. If one defines euroregions, a definition could be the following: a cross-border structure established between entities of local or regional government, across a border in order to promote common interests. Further, the Association of European Border Regions (2004) sets the following criteria for the identification of Euroregions[2]:

[2] http://www.coe.int/T/E/Legal_Affairs/Local_and_regional_Democracy/Transfrontier_co-operation/Euroregions/2Definition.asp

- an association of local and regional authorities on either side of the national border;
- a transfrontier association with a permanent secretariat and a technical and administrative team with its own resources;
- is of private law nature, based on a non-profit association or foundations on either sides of the border in accordance with national laws;
- is of public law nature, based on inter-state agreements, with the participation of territorial authorities.

At the initiative of the Council of Europe (1980), a group of European countries concluded an international treaty called the Madrid Convention which was a first step towards cross-border cooperation structures based on public law. Both the EU and the Council of Europe consider the development of cross-border cooperation one of their top priorities. For the EU, cross-border cooperation is an important instrument towards ensuring the balanced development and integration of the European continent. One of the objectives of cross-border cooperation in the EU is to prevent the isolation of border areas. The legal framework for the EU's actions within the scope of cross-border cooperation is composed of the following three EU policies: the Cohesion Policy, the European Neighbourhood Policy and the pre-accession policy for candidate countries.

Central European Experiences with Euroregions: implications for Eastern Europe

The boundaries of Central European countries are among the newest in Europe. For the most part, borders evolved after World War I and II. Recently, however, the process was completed by the dissolution of Czechoslovakia as well as the disintegration of Yugoslavia and the Soviet Union in the years between 1990 and 1992. Typically, strong historic and ethnic tensions were palpable along these new lines of division. Institutionalized cross-border relations emerged only after a period of transition. The atmosphere of distrust was relatively difficult to change while rigid and closed borders promoted strong feelings of separation. The administrative units along the new borders clearly had no experience in cooperation across interstate boundaries.

The first euroregions were created through and with foreign (U.S. and Western European) initiatives, aid and support (e.g. Carpathian Euroregion, DKMT Euroregion etc.). These initiatives were aimed primarily at fostering knowledge and experience transfer across borders, but ultimately most of them did not prove viable in the long term. Later, cross-border cooperation programs were stimulated by opportunities offered in the form of assistance through EU pre-accession funds. The number of euroregional cooperation projects increased: participating administrative organizations recognized that these programs could be used as the institutional framework to facilitate the acquisition of further external funding.

As an example of such early Central European regions, here are the key lessons of euroregional lessons from the Visegrad Countries:

- Input initially came from outside. The synergies created by this cooperation were not based on shared interests and local needs, but rather focused on ideas and learning to collaborate.
- The first euroregions covered an area too large to operate efficiently (e.g. the Carpathian Euroregion covering the border areas of Hungary, Poland, Romania and Slovakia.)
- Initially, it was a problem in several places (Romania and Slovakia, for instance) that local laws did not allow lower-level administrative organizations to participate in international cooperation initiatives.
- In the end only those euroregions remained vibrant and operational which had a real, vested, interest in cooperation. These cover geographically limited areas.
- The most common areas for cooperation are the following: developing joint strategies; culture, small-scale infrastructure development programs; environmental protection and nature conservation; institutional relationships; common regional marketing approaches as well as the strengthening of regional identities.
- It is important to allocate financial resources for operation and for common development planning and implementation or create special non-governmental and independent cross-border grant making organizations such as the Carpathian Foundation.
- In many cases, efforts of cooperation do not move past the level of protocol and are never imbued with substantive content.

- In several cases, cross-border ethnic relations played a role as a factor of cohesion in the development of cooperation.
- Euroregions involving both EU members and non-member states play an important role in spreading the values and practices of democratic cooperation.

Border regions of Eastern Europe

Eastern European national boundaries are mentioned as 'new frontiers' less often than other boundaries of the Central European region. According to the typology spelled out by Bufon (1998), the borders established between the countries of the former Soviet Union represent a combination of both "old and new lines.

They existed as borders during the Soviet era, but their role at that time was much different from the role they played after member states had won their independence. Another feature of this region was the fact that the concept of regionalization was unable to take hold as an idea and as an instrument of alternative territorial organization. According to Bufon (1998), the regions along local borders here have limited or little opportunities to establish cross-border initiatives on their own accord; therefore, the role of external assistance and support is just as important here as it was in Central Europe.

The general characteristics of Eastern European boundaries are the followung:

- Rigid boundaries with a very pronounced separating role.
- Borders prevent pre-existing natural, functional cooperation.
- Political and cognitive levels of distrust hinder the development of relations.
- Lack of information about one another and a lack of experience in cooperation.
- Centralized government with a low degree of decentralization and subsidiarity. International cooperation among administrative (territorial) units is not regulated in local law.
- Funds available for developing cooperation among border regions is either very limited or absent altogether.

The geography of border landscapes with its social, cultural and political aspects has been gaining increasing importance in the process of the 'humanization' of the traditional geographic approach to the issue of political and other social and cultural borders. In addition to the cross-border 'macro' transactions between border communities, 'micro' transactions on the level of border populations and border areas in providing for everyday vital necessities and for the transition from conflicting to harmonious forms of border character are now coming to the fore. In Central and Eastern Europe the regionalization as a process in general, the creation of euroregions in particular has been related to Western and North Europe. In this region are some specific problems which have to be taken in account regarding to creation of Euroregions. These are related to ethnical circumstances, to relative high bureaucracy, to centralization ambitions of central governments and to lack of longstanding democratic cooperation experience.

As to the new legal instrument of the European Grouping of Territorial Cooperation (EGTC), respondents thought it would simplify the management of cross-border cooperation projects among countries with differing legal systems and laws. They also believed that the possibility for an EGTC to enter into agreements with private sector entities would improve cooperation among the public and private sector and academia.

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EVERYDAY ECONOMIC LIFE IN CENTRAL ROMANIA OBEYING BUREAUCRATIC RULES OR SURVIVING THROUGH SOCIAL NETWORKS?*

Árpád SZABÓ**

This paper presents some partial results of a wide regional research regarding the economic integration of nations and economies in the areas surrounded by the Carpathian Alps (Réti, 2004). The research was elaborated by 8 teams in 5 countries. The author of this paper conducted his research in the Central Statistical Region of Romania, mainly in the areas populated by ethnic Hungarians.

The paper presents, how an area placed in the center of a country can be regarded as a peripherical area, and how the periphery can act like a center. We described what differences can be found between the official data and the everyday life. Our conclusions explain why those differences occur.

Key words: regional economics, Central Romania, economic development, social networks

JEL Classification: R10, R50

Introduction

This research was part of a wider range regional study on the economic transformation of the territories populated be ethnic Hungarian people outside the borders of Hungary. The first phase of the research was conducted in 2003 by 8 groups of scholars from 5 countries with the aim of giving a general overview on the analysed regions (Réti, 2004).

* The paper was prepared using some of the conclusions of a regional research funded by the European Foundation for Minorities Research (EÖKiK) from Budapest. (The complete research report is not yet published, but it can be found at the EÖKiK with the title: Dilettáns dialógus Székelyföldről az Unióban – Dilettante's Dialogue about Székelyland in the EU)

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Resuming the project[1] my purpose was to analyse and present the place and role of Szekelyland in Romania, and the impact of EU integration on this region. In the same time I uncovered some of the future possibilities of development for the region in the first decades of the 21st century.

This paper is based on information and data gathered especially in Szekelyland, situated in the Central Statistical Region of Romania. I studied the statistical reports on the territory, analyses and studies published in workbooks and newspapers, the results of other researches and strategic development programs. In the same time I did interviews with representatives of local self-governments, professional associations, political parties, local consultants, lecturers and scholars.

It is good to know that statistical data do not always tell the reality (Sánduly and Szabó, 2004, 6). In the same time in 2007, when the research went on, I only had the national statistical yearbook of 2006, which contained data series ending in 2004 or 2005, which were extremely downdated in 2008.

The most up-to-date in the research report were the macroeconomical data. Those data were obtained from the National Statistical Institute of Romania and the Romanian National Bank's reports. Some data presented the status of the Romanian economy in July 2008.

The research had a very strong qualitative background, because of the interviews made with the representatives of local and county-level self-governments and institutions involved in the EU integration process and in the process of controlling the usage of pre-accession- and later the structural funds. I also did interviews with local business consultants, academics, scholars, and, naturally, with business people who had successful projects and obtained EU funding for operating them. Many of the people with whom I made my interviews, asked me, if they should tell me the official point of view of their institutions, or their personal points of view.[2]

[1] The results of the first research were published together with Edit Sánduly (Sánduly and Szabó, 2004)
[2] Somebody even asked me if I want to get from him the official county development strategy, or the unofficial one, which was for internal use and not even fully completed.

The research report contains many subjective thoughts. They are not the ideas and thoughts of the researchers, but because some of the interviewed asked us not to mention their names, no names and quotes appear in the report. While preparing the report, I also used analyses from scholars' works and newspapers, the Internet and official statistical data. Some of the subjects of my interviews were contacted through my own social network, so the sample is far from being representative.

Szekelyland, the most central periphery

The final conclusion of the previous research was, that Szekelyland is the most central periphery (Sánduly and Szabó, 2004). In the follow-up of the research I considered the most important thing to discuss once again this theme and to see if it is still a valid expression.

Figure 1 **Romania and the Central Statistical Region with the belonging counties**

Szekelyland is located in the North-Eastern part of the region; nowadays Covasna, Hargita and the Eastern side of Mures county are considered to belong to it.
Source: National Statistical Institute, http://www.insse.ro/

Szekelyland is located in the geographical centre of Romania. It has many highlands, forests and pastures. The soil is not proper for performant agricultural cultivation. The area is mostly rural, the only big city being Targu Mures (population: 160 000), the former capital of the region. The only airport is located at the region's Western border, near the same Targu Mures, but no main railroad is located near that city. The region has no highway and is hit by poverty and unemployment. Almost 2/3 of Szekelyland's population is ethnic Hungarian, having to cooperate with Romanian central government.

One of my interview subjects clearly pointed out, that in his opinion 'traditional' means 'very obsolete' and most of the tourists go to Transylvania to see natural and social reservations.

The central and peripherical status is still present, and EU integration even enhanced this situation. In the opinion of the subject of one interview, one can even state that Szekelyland is a peripherical centre. The central status comes not only from the geographical position of the region, but also from its internal structure. (The people in the region do not want to become part of any central area, but they use some relational networks that take centre-like control over their lives.)
In this case the concept of periphery means, that local people bring capital and knowledge from the outside, take them in a very specific manner, but they don't want to depend of any centre.
This strange status has its roots in the autonomy – not the political autonomy, but the everyday life's autonomy[3]. Szekely people feel that political autonomy would be less good and helpful then the actual status. Political autonomy would mean that narrow-minded and mediocre Hungarian politicians from Transylvania would take their places in power positions and would try to control and conduct de everyday life of people living in the region. How can a periphery operate as an autonomous centre?
In the opinion of my interview subjects living and acting in remote areas of the region, contrary to the everyday common loci, the szekelys have

[3] There are a lot of arguments about the concept and frameworks of autonomy. My discussion partner had a vider view on autonomy, considering that if someone double-cross the central government and does what he wants, it means autonomy. A narrower meaning of autonomy is that the central government permits one by law to do what he wants, and they don't interfere in one's life because they intend not to.

learned the ‘EU lesson’. For example, since they are getting subsidies based on the owned territories, they stopped selling their lands because the market price of the lands is almost equal with the amount of the subsidies.

The payment of the subsidies has some pre-conditions, which can be somehow jumped over. For example szekelys use mechanical reapers to make hay for their animals. The controller goes to the site only when the grass is 10 cm high and people tell him that they scythed manually. There are villages in Szekelyland with over 100 hectares of meadows. It is practically impossible to scythe them manually. The strangest thing about this is that the controller gets no money or brandy to act like this. He acts this way because of his own conscience. What we see here is not corruption. Corruption exists just where bureaucracy exists. This is ‘rascally honour’. People don’t double-cross each other, but do mutual services for each other.

The basis of the social structures in this region is still the land-ownership. The land is still owned by the eldest man of the family (some 70-80 years old men). All the other members of the family are still ‘menials’. It could be unbelievable, but this structure is very effective, because this keeps families together. If this ownership structure would change (for example because of the foreign citizen’s land acquirements), everything in Szekelyland will turn upside down. What will be the answer of the region to the pressure of modernism? This could be a good theme for a wider and deeper research.

The affective attachment to the land, the houses and the communities’ customs is proved by the example of an ‘urban’ man who went to the village to buy land: ’A few weeks later I returned to the village and I found out that all the houses were sold. The deals were made on the basis of the old bargaining prices, they did not take account of my higher offers. No unsold house remained. This was the first lesson that I learned in Énlaka from the szekely honour. The custom says that a merchandise should be given to the first enquirer, even if the next one makes a higher offer. There is a strong defence against market economy and strangers.’ (Kolumbán, 2007)

Lately even the insiders are unable to buy land. In Énlaka one parcel speculator was even beaten up. Before days when land transactions were

still done, no official records were done. No land transaction is recorded in the land register, just bills of sale are signed. In remote areas the recording of movements in the land register is more expensive than the price of the land.
Even if a grandfather, who was landowner, dies, the grandchildren living in the cities take no official steps. The bequest trials, topographers and other official costs are high above the price of land.

In this society information travels extremely fast. A viewer from outside hears just whispers, he doesn't see anything, and suddenly something begins, it gets into the structure and starts functioning. For the outsiders this world is a hermetically closed entity. If someone's descendants move farther, they will be excluded from these communities. One member of a co-possessorate who moved farther from his ancestors birthplace, was not even invited to the general assembly where decisions had to be taken on the usage of some forests. When he found this out, he donated all the incomes from the forest to the church, so the others could not 'steal' his part.

As an other example of the centuries old szekely autonomous mentality and the refusal of any intervention from the outside, one subject of my interviews told me the story of a little town. In the XIX century the town was partially destroyed by fire. The Hungarian state offered to rebuild the quarters that were destroyed with funding from the stat treasury, with only one condition: the reconstruction should be done using their urbanisation plans. But, as one of my interview subjects told me that then the members of the Varga family put their feet in the door and said: Never! Everything would be rebuilt the same way as it had been before. That was why the main square of the town was so unique today. But nowardays we couldn't always find that proudness and usage of their own resources which once had been the bases of development. Today in Szekelyland we didn't see the strong common will and acting power, but just the 'we know everything better and nobody should interfere in our business'. They just talked and talked and didn't do anything useful. Others would come from the outside world and they would organize those things where they saw financial profit opportunities. There would be no spiritual standing together, no civil will, no civil society, no foundations would be able to operate.
Even in smaller villages where neighbours knew and watched each other,

few people broomed the public street in the front of their houses in the evenings before celebration-days and feasts.
If sociologists came, they didn't answer the questionnaires frankly. And even the sociologists didn't ask the proper questions. And most people didn't have any more respect for the church.
If you went to the market on Sunday, you saw just bad taste, ugly dressing and bad music. And garbage everywhere...
But I must admit, that the situation here is better than in other parts of the country. You could see on TV for instance what happened after floods. In the other areas of Romania you saw on the screen people staying between the garbage and the debris crying. In Odorhei, when reporters had arrived, everything had been cleaned up, you could just see sadness on people's faces.

In szekely villages there still exists community life. They still organize big social events, great wedding ceremonies, burial ceremonies, dig, dugs. These need big investment, but people do them. In some places the community makes even the choice of the school for the children. Why is this operational? My discussion partner told me that the main reason is the szekely accept to live on little incomes. They don't go to make more money, but instead go 'fishing' with friends.

The acceptance of the low incomes and the austere pretensions can let to operate industries, which could not survive from the point of view of mainstream economics. For example they operate tourism very badly, but it still functions. This is the same for the Romanian seaside. There are a lot of people in this country accepting to pay for low quality services. Another thing that contradicts the principles of urbanism is, that people living in villages have weekend houses in the neighbouring villages, which are nicer and closer to touristical targets.

The problem solving methods of the szekely people are also very unusual. The economy is based on family-relatives-friends' networks. Go to a village, tell them what is your problem and in 3 minutes you will get a solution. For example if one goes to the official garage of a well known car manufacturer, a special piece component will be delivered to you in 3 weeks. If you go to 'uncle John's' garage at the corner, you will get the same component in 48 hours. There is no need for DHL, or Internet or modern infrastructure. Your component will be put as a package on a coach driving from Budapest Népliget bus station to Szekelyland. The bus driver probably will not even ask for money to do this service. He may need a similar service sometime, and the network will help him...

Before Romania acceded to the EU, its nationals were allowed to continuously stay on Hungary's territory for a maximum of 30 days. After that period they had to travel at least to the border and put stamps on their passports. For szekelys working unofficially in Hungary this would mean a loss of at least one working day (or much more if they travelled to their homes), and a lot of money. So a whole business was built on the passport stamping. People had only to walk to the Budapest Népliget station, pay HUF 5000 to the 'organizer' and give him the passport. A whole bunch of passports were stamped in the same evening and in the next day everybody got his or her passport without losing the working day, travelling and paying the travel expenses.

The author's personal experience about szekely problem solving is also freaky. The water in the swimming pool of a brand new wellness centre in a szekely town had to be changed. The centre was built in an area where the sewage drain could not take in such an amount of water. So the water from the swimming pool was leaked out through a rubber tube. The whole action lasted one day. I was stunned to see that the wellness centre had full house. The guests were using the sauna, the solarium, the Jacuzzi and the fitness room and nobody was nervous for paying a very high entrance price and not being able to swim.

Of course the reality is more nuanced. The things mentioned above are not general in Szekelyland and there are a lot of people who try to abuse the system. They get the profit from the system and move on. Many of the interviewed persons complained about the absence of the services, or the very narrow offer from them. A properly working service system would probably create a lot of jobs. There are a lot of service offers, but most of them are on 'the black' market. Szekelys don't officially register their bed and breakfasts, massage saloons and hairdressers' because they don't like to pay taxes. If your are an 'insider', you can have any service, even in the smallest village. If you are a stranger, you can't see and get anything.

Consequently, 'autonomy exists in the everyday life, but our politicians are blind and narrow minded' – summarized my interview subjects. There are a lot of problems with central and local politicians. Szekelyland belongs to the Central Development Region of Romania and many say that funding don't get to Szekelyland because of poor lobby power of ethnic Hungarians in this statistical region. This is why the Democratic Alliance of Hungarians in Romania tries to transform the operating statistical regions in Romania adopting a solution where the Szekelyland is a self standing statistical development region. But when the times of discussions and decision making are coming, politician don't appear at the debates and there is no quorum for voting on problems.
One of these problems is the Oradea – Brasov highway. They highway-building works start and stop every year and in 21 years from the system change only 39 km of highways were built in the whole country! At the Targu Mures airport the above mentioned highway would turn south and bypass Szekelyland.

The relief roads around the region's cities are also reason for arguments between nature protecting NGOs, mayors and central financers (Antalfi, 2007). The members of the local and county self-governments have no idea about the principles of market economy. They refused the offer of an international corporation to move into the industrial area near the Targu Mures airport, because they asked for a surface which was too large in the self government's officials opinion. (Antalfi, 2005).

The persons in charge with the operating of the same airport were unable to understand neither the principle of the equilibrium of demand and offer, nor the concept of competitiveness. They were not able to get to an agreement with the Wizzair on landing prices and airport taxes and the airline moved its Eastern European base and its flights linking Targu Mures to Barcelona, Luton, Rome and Dusseldorf to the Cluj airport, leaving Targu Mures with a lonely flight to Budapest three times a week.

As seen above, the logistic infrastructure of the region is very poor and there is no chance for improving in the near future. It is a common locus, that corruption in Romania is the highest in EU. Szekelyland belongs to Romania so one can't expect things to work otherwise in this region.

In one of the region's cities a soccer field was built without clearance on the boundary separating the residential district from the industrial area. The game place is let to very noisy 'sportsmen' who disturb the residents of neighbouring houses. The residents go in wane with their complaints to the mayor of the city and the lord lieutenant of the county. The soccer-loving mayor of the city gave a pension building clearance after the building was finished. (The dressing cabin of the sportsmen and the belonging espresso are considered 'pension', the soccer field is the relaxing courtyard.)

A lawyer told to one of the residents who complained: 'The fact that you are right does not matter, Sir! You can go to trial, but the winner will be the one who has more money.' (For this short 'advice' the lawyer charged the client the amount of half of a monthly minimal wage in Romania.)

There is a city in Szekelyland where a new traffic light was put at the crossing of two main roads. It worked only for a single day, because the mayor went there on the first day and the lights turned red when he was in a hurry. Next day the traffic light was turned off for ever. Politics, corruption and economics interfere in Szekelyland. The results of public tenders are often contested and trial go on for such long periods that unused money and funding must be sent back to the country capital.

The role of the church is very important among szekelys. Sometimes the church uses its power and influence to obtain illegal advantages from it. In Miercurea Ciuc a new roman catholic church was built. Before, on the building site the garages of the residents of neighbouring block of flats were standing. They were demolished without any damage compensation.

The capital city of Covasna county is Sfantu Gheorghe (Saint George). It is located only 25-30 km away from Brasov, one of the most developed industrial centres of Romania. People from St. George have their jobs and are commuting to Brasov, while people from Brasov buy the cheaper flats in St. George and use the city as a sleeping city.

Many szekelys travel abroad to work and earn money. But having poor education, they can get only jobs on the black market in the building industry as workers. One employer from Hungary reported me that a worker from Hungary works 5 times faster than one from Szekelyland, but makes a lot of mistakes and asks 2 times bigger wages than one from Szekelyland. The szekelys have their families far away, so they can be put to work on Saturdays and Sundays without paying extra for overtime. Although the above mentioned employer was born in Szekelyland, he told me that he never would move home to make business, because he knows these people better than anyone else and does not trust them. He moved away, lost contact with the network, and is an outsider now.

Conclusions

Motto:
'There will be people who come after I'm gone, my descendants ...
they will not get off the mountains to be the slaves of alien cultures.
They will continue my work and my life will be eternal through them,
because I remained here, at my home ...'[4]
Károly Kós

The conclusions of the research report were, that Szekelyland was in 2007-2008 in the centre of a country which has shown good macroeconomical results, but was a very controversial country on the border of East and West, modernity and underdevelopment, innovation and tradition.

In the region the only 'big' city is the Targu Mures, where the ethnic raport of Hungarians and Romanians has been changing, al the rest being a rural area. People here live in a very patriarchal and authoritarian society based on land property and determinated by social networks and reciprocity. They are proud of being ethnic Hungarian, telling that they are the 'real' Hungarians, because they accept to suffer sometimes from the handicaps and humiliation of the nation living in majority in the country, and they still keep their language and culture. Those living in Hungary were only accidentally born Hungarian.

For those who want to develop, to 'westernise' and enjoy the benefits of a consumer society – education, change of mentality and jobs should

[4] Translated by the author of this article.

be assured. A better education should improve the quality of the working force and it could attract foreign capital, which could be used for development.

In one's opinion Western world wrongly believes that the future will bring a confrontation between Christianity and Islam. China lets its nationals to travel for work and study abroad, all over the world. They are very laborious and studious and settle down everywhere forming little communities and maintaining their culture. Indians do almost the same, with minor, culture based differences. The Western culture is getting lazy, running for consumption and good living standards. The wrong application of the so-called 'Bologna process' in higher education will devaluate European middle class. So in 20-25 years all over the world the management of multinational corporations, small retail businesses and tourism could be controlled by the Chinese, and scientifical research and banking by the Indians.

A local entrepreneur in Szekelyland agreed on that the system of values must change, but not the way things are going now. 'The efficiency and profit driven economy determined by the multinationals cannot uniformly cover the whole Earth. There will be efficient and big profit producing islands in the world, but territories, and eventually whole nations, with low efficiency and low profit producing capacity will float to the margins of global economy or will be left out of its system. This bears threats, but also opportunities for the traditional economy...' (Kolumbán, 2007)

Why should traditional economy be kept alive? 'Because this was the only human activity which was able to maintain biodiversity. The traditional animal breeding ensured that low producing soils could be used for cultivating plants, and assuring food for the population for centuries... It also means safety and an attractive natural environment for the visitors from outside.' (Kolumbán, 2007)
As one subject told me in an interview: 'All these events shaped up in me the conviction, that it is a matter of life and death for my narrower homeland, Szekelyland, to find a modern way of living together with nature. Everybody must start this with oneselves life, using one's own opportunities and resources. We have no time to wait until global policies or uncontrollable economical crises or natural disasters force us to do so.'

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THE EFFECT OF EXCHANGE RATE VOLATILITY UPON FOREIGN TRADE OF ROMANIAN AGRICULTURAL PRODUCTS*

József FOGARASI**

This paper takes a new empirical look at the long-standing question of the effect of exchange rate volatility on international trade flows of transition economies in Eastern Europe by studying the case of Romanian agricultural export to its export destination countries between 1999 and 2008. Based on a gravity model that controls for other factors likely to determine bilateral trade, the results show that nominal exchange rate volatility has had a significant negative effect on agricultural trade over this period. This negative effect of exchange rate volatility on agricultural exports can be reduced consistently by joining the country to the euro zone.

Key words: international trade, gravity model, exchange rate volatility, Romania
JEL Classification: F14, F31, Q17.

1.Introduction

There is a continuously growing literature dealing with the effects of the exchange rate uncertainty on international trade since the break down of Bretton Woods system of fixed exchange rates when both real and nominal exchange rates have fluctuated widely. Most of the studies are focused on estimating exchange rate volatility effects on international trade of developed countries, especially in U.S. as well as between developed and developing countries. This topic was neglected in Central and Eastern European Countries where major economic transformations have taken place in the process of implementing market economy mechanism.

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The literature on agricultural transformation in Central and Eastern European Countries has focused on various aspects of transition, including land reform, farm restructuring, price and trade liberalization and etc. (see a comprehensive survey of Rozelle and Swinnen, 2004). However, until now macroeconomic aspects of agricultural transition, especially the study of exchange rate volatility on international trade were neglected.

In the present research we focus on the relationship between exchange rate volatility on Romanian agricultural trade, using a gravity model based on panel data. This issue is important in transition countries, because international trade with agricultural products and macroeconomic environment have been taken major changes in the last one and half decade. The short- and long-run impacts of monetary policy have been very important for the transition economies` agricultural sector due to the lack of farm policy credibility, where farm incomes are increasingly influenced by the foreign trade of agricultural products. Consequently the central question of the present research is how the exchange rate affects the agricultural trade in a transition Eastern European country.

The article is organized as follows. Section 2 surveys the theoretic and empirical contributions to the literature. In Section 3 the employed gravity model and some methodological aspects of examining volatility effects on international trade are presented. Data and the measurement of exchange rate volatility are presented in Section 4 and Section 5 respectively. Section 6 reports the findings of gravity equation estimations. The last section summarizes the results and draws some policy implications.

2.Literature review

The examination of the effect of exchange rate volatility on international trade has become effective after the abandonment of fix exchange rate regimes which has resulted a growing theoretical and empirical literature. A conventional method applied for these studies are the gravitational models.

The widespread popular perception that greater exchange rate volatility reduces trade has helped motivate monetary unification in Europe (European Union Commission, 1990) and is strongly related to currency market intervention by central banks (Bayoumi and Eichengreen, 1998). However, the theoretical and empirical contributions to the literature fail to conclusively support this notion. A number of models have been advanced which find support for the negative hypothesis that volatility acts to the detriment of international trade. While other models supported the positive hypothesis that exchange rate volatility may lead to grater levels of trade (McKenzie, 1999). Then, inevitably, many empirical studies have failed to establish any significant link between measured exchange rate variability and the volume of trade.

One possible reason for such mixed results is the different time horizon of the analysis. One common argument is that exporters can easily ensure against short-run exchange rate fluctuations through financial markets, while it is much more difficult and expensive to hedge against long-term risk. Peree and Steinherr (1989), Obstfeld (1995), and Cho et al. (2002), presented evidences that longer-run changes in exchange rate seem to have more significant impacts on trade than do short-run exchange rate fluctuations that can be hedged at low cost. On the other hand Vianne and de Vries (1992) show that even if hedging instruments are available, short-run exchange rate volatility still affects trade because it increases the risk of premium in the forward market. Furthermore, Krugman (1989), Wei (1999), and Mundell (2000) argue that hedging is both imperfect and costly as a basis to avoid exchange rate risk, particularly in developing countries and for smaller firms more likely to face liquidity constrains. Pick (1990) analyzes the effects of exchange rate risk on U.S agricultural trade flows and he find that exchange rate risk is not a significant factor affecting bilateral agricultural trade from the United States to seven out of eight developed markets, but indicates that exchange rate risk adversely affects U.S. agricultural exports to some developing countries. DeGrauwe (1988) illustrates how the relationship between exchange rate volatility, whether long run or short run, and trade flows is analytically indeterminate when one allows for sufficient flexibility in assumptions.

Other possible reason for such controversial results is the aggregation problem. The effects of exchange rate volatility on export may vary across sectors (McKenzie, 1999). This may occur because the level of competition, the price setting mechanism, the currency contracting, the use of hedging instruments, the economic scale of production units, openness to international trade, and the degree of homogeneity and storability of goods vary among sectors. The differences among sectors in exporters' access to financial instruments, currency contracting, production scale, storability, etc., may be partly pronounced in developing countries. This contrast is only accentuated by the fact that agriculture is typically a notably competitive sector with flexible pricing on relatively short-term contracts. Furthermore, agricultural products are relatively homogenous, and typically less storable than the exports in other sectors (Such, 1974). Therefore Bordo (1980) and Maskus (1986) argue that agricultural trade may be far more responsive to exchange rate changes than is trade of manufactured products.

Wang and Barett (2007) estimated the impact of the conditional mean and conditional variance of real exchange rates on Taiwan's exports by estimating innovative rational expectations based multivariate GARCH-M model using sector- and destination-specific monthly data. They found that agricultural trade flows are quite significantly negatively affected by high frequency exchange rate volatility that does not seem to impact other sectors significantly. Agriculture appears far more responsive to both expected exchange rates and to expected volatility in the exchange rate and less responsive to importer incomes, than do other sectors in Taiwan's economy. The same results were obtained by Cho et al. (2002) employing gravity models for ten developed country. They found that real exchange rate uncertainty has had negative effect on agricultural trade over the period between 1974 and 1995. Moreover, the negative impact of uncertainty on agricultural trade has been more significant compared to other sectors.

The available literature coping with the effect of exchange rate volatility on international trade, focusing on an individual trade commodity found also negative relationship. Sun et al. (2002) estimated the effect of exchange rate volatility on wheat trade worldwide employing a modified-type gravity model. They found that both measures of short-term and long-term exchange rate volatility showed negative effects on world trade, while the long-effect was even larger. Yuan and Awokuse (2003) analyzed the exchange rate volatility and U.S. poultry export using gravity models with different volatility measures, and they found that exchange rate volatility has negative effect on trade in all the three static models and are statistically significant in two of them. A weak impact of exchange rate volatility on U.S. cotton export found Bajpai and Mohanty (2007) which could be attributed to the high exposure of the cotton and textile sector to the domestic and international policies.

2.2. Gravity Equation

A gravity model has been employed in this study, which has been extensively applied in international trade analysis. Classical gravity theory[1] states that the attraction force a_{ij} between two entities *i* and *j* is proportional to their respective masses m_i and m_j, usually proxied by GDP and/ or population, and inversely proportional to the squared distance d_{ij}^{-2} between these entities. Therefore, this law can be formalized as:

$$a_{ij} = \gamma m_i m_j \, d_{ij}^{-2} \tag{1}$$

where γ - *is a constant proportionality factor.*

The using gravity approach to model international trade flows date back to Tinbergen (1962), Poyhonen (1963) and Linnemann (1966). Linnemann extended the classical gravity equation adding more variables and went further towards a theoretical justification in terms of Warlasian general equilibrium system. The theoretical aspects of gravity model for trade summarized in three main factors: the total potential supply (or exports) of a country to the world market, the total potential demand (or imports) of a country to the world market, and those factors that create a resistance to trade and thus affect the degree of trade intensity. These include ordinary tariff barriers and transport costs. The first and second factors are expected to be equal to one another if one disaggregates the international flow of capital, services or land transfers.

[1] Carey (1871) observed the presence of gravitational force in social phenomena, stating that the force was direct ratio to mass and inverse to distance.

The basic form of the gravity model for examination of international trade following Matyas (1997; 1998) is:

$$EXP_{ij} = \alpha_0 GDP_i^{\alpha_1} GDP_j^{\alpha_2} POP_i^{\alpha_3} POP_j^{\alpha_4} DIST_{ij}^{-\alpha_5} XV_{it}^{-\alpha_6}\ TARIF_{it}^{-\alpha_7} D_n^{-\alpha_8} \quad (2)$$

where, EXP_{ij} represents the trade flow between country i and j in the year t, α_0 is a constant, and α_1, α_1, α_2, α_3, α_4, α_5, α_6, α_7 are coefficients, weighted geometric averages. GDP_i and GDP_j stand for domestic gross product per capita in country i and j, respectively. POP_i and POP_j represent population in country i and j, respectively, while DIS_{ij} expresses trade resistance due to geographic distance between countries i and j and D_n dummy variables to take into account qualitative resistance factors between country i and j. The equation can be augmented to include other factors that may create trade resistance, such as exchange rate volatility (XV_{ijt}) and bilateral trade tariffs ($TARIF_{ij}$).

3.Empirical Specification of Gravity Equation

Because we tested the effects of exchange rate volatility on Romanian (i) export to the selected most important export destination countries (j), and not combined bilateral trade between exporter and importer, we do not included in the econometric model of gravity equation the gravity mass independent variables (GDP_i, POP_i) as they are constant in any combination of export destination countries. We log-linearize equation (2) to arrive at the estimating equation (3):

$$\ln EXP_{ij} = \alpha_0 + \alpha_1 \ln GDP_j + \alpha_2 \ln POP_j + \alpha_3 \ln DIST_{ij} + \alpha_4 \ln XV_{ij} + \alpha_5 TARIF_{ij} + \alpha_6 D_{1,BORij} + \alpha_7 D_{2,EU} + \alpha_7 D_{3,CEFTA} + \varepsilon_{ij} \quad (3)$$

where ε_{ij} is an error term assumed statistically independent from the rest of the regressors, with conditional mean of 0. Because estimating a panel data on Romanian agricultural export, equation (3) above acquires a time dimension as presented in equation (4) below:

$$\ln EXP_{ijt} = \alpha_0 + \alpha_1 \ln GDP_{jt} + \alpha_2 \ln POP_{jt} + \alpha_3 \ln DIST_{ij} + \alpha_4 \ln XV_{ijt} + \alpha_5 TARIF_{ijt} + \alpha_6 D_{1,BORij} + \alpha_7 D_{2,EU} + \alpha_8 D_{3,CEFTA} + \tau_t + \eta_{ijt} \quad (4)$$

where τ_t's are full set of year dummies, and η_{ijt} is the error term. Additional factors may enhance or resist export are also typically included in equation (4). The most common are dummies for common border, common language, and regional trade agreements (RTA). In equation were included a dummy for common border, $D_{1,BORij}$ with value 1 when country j shares common border with country I and 0 afterwards, and dummies $D_{2,EU}$, $D_{3,CEFTA}$ for regional trade agreements. Romania signed a preferential trade agreement with the European Union in 1993 which become effective in 1995. $D_{2,EU}$ with value 1 when the country j is member of EU and *CEFTA* with value 1 when country j is member of Central European Free Trade Agreement (CEFTA) states; and afterwards 0.

Table 1 Country List

Agri-food export destination countries from Romania		
Australia	Germany	Panama
Austria	Greece	Poland
Azerbaijan	Hungary	Portugal
Belarus	India	Russia
Belgium	Israel	Saudi Arabia
Bosnia and Herzegovina	Italy	Slovakia
Bulgaria	Japan	Slovenia
Canada	Jordan	South Africa
China	Latvia	Spain
Croatia	Lebanon	Sri Lanka
Cyprus	Libyan Arab Jamahiriya	Sweden
Czech Republic	Luxemburg	Switzerland
Denmark	Macedonia	Syrian Arab Republic
Egypt	Malta	Turkey
Estonia	Moldova	Ukraine
Finland	Morocco	United Arab Emirates
France	Netherlands	United Kingdom
Georgia	Norway	United States

Source: Author's selection based on data from UN-COMTRADE, 2009.

4.Data

Economic theory would suggest that the income level of the domestic country should contribute to the determination of a country's export, and since the marginal propensity to import with respect to income is positive, as well as the expected sign of a nation's trading partner's income should also be positive. The domestic and export destination countries' income is considered GDP collected from World Economic Outlook Database as well as the number of inhabitants (POP) in these countries, while export destination countries' distance from exporter (i) country is obtained from Pennsylvania State University World Tables. The value of GDP per capita were collected in national currencies and converted to euro at the yearly average exchange rate. The export data of Romanian agricultural products are also expressed in euro and come from EUROSTAT database; are included fifty-four export destination countries were Romania exported agricultural products in every year of the period analyzed from 1999 to 2008 (see table 1).

Table 2 **Summary Statistics**

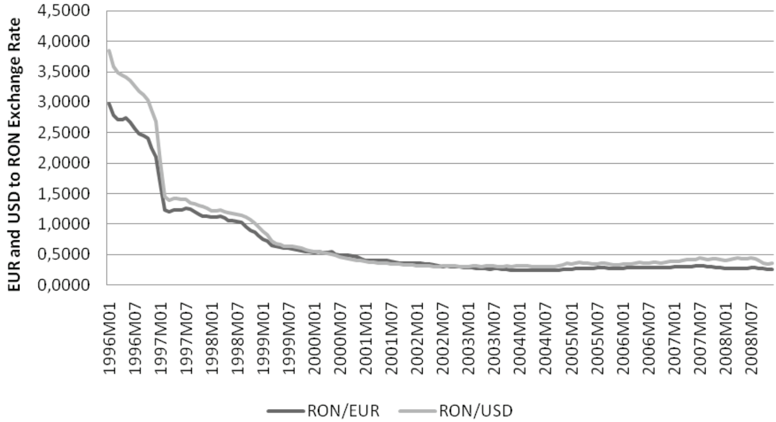
Variable	Mean	St. Dev.	Min	Max
EXP_{ijt}	13,601,936	34,363,609	649	343,616,596
GDP_{it}	3,314	1,620	1,503	6,377
GDP_{jt}	14,833	14,520	301	76,811
POP_{it}	21,857,880	338,015	21,546,873	22,457,994
POP_{jt}	71,017,279	223,860,214	388,000	1,318,309,724
$DIST_{ij}$	2,699	2,963	299	15,242
XV_{ijt}	0.0331	0.0207	0.0128	0.1740
$TARIF_{ij}$	8.659	9.354	0	105

Source: Author's calculations based on data from UN-COMTRADE, 2009.

Table 2 presents summary statistics of the variables used in the estimation of exchange rate volatility on Romanian agricultural exports for the period of 1999 to 2009. Note, that GDP per capita in Romania (i) is only 22% of the average of its export destination countries (j) and the variable POP_{it} is 31% of average variable POP_{jt}. The rows labeled XV_{ijt} represents the summary statistics for the exchange rate volatility estimated based on Standard Deviation (St. Dev.) of monthly nominal exchange rates, which I define in the next section. The monthly average nominal exchange rate series and returns[2] of EUR and USD to RON variability on the analyzed period are presented on Figure 1 and Figure 2 respectively.

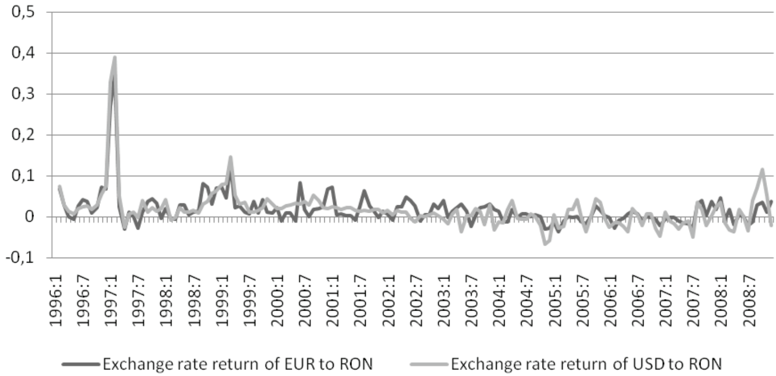
[2] The rate of return of exchange rate is calculated: $(e_m - e_{m-1}) / e_{m-1}$, where e_m represents monthly average nominal exchange rate.

Figure 1 Nominal Exchange Rate Series of EUR and USD to RON



Source: Author's representation based on data from National Bank of Romania (BNR), 2009.

Figure 2 Exchange Rate Return of EUR and USD to RON



Source: Author's representation based on data from National Bank of Romania (BNR), 2009.

5. Measuring Exchange Rate Volatility

A variety of measures of exchange rate volatility have been used in the literature. Usually, the measures used are some variant on the standard deviation of the difference in annual or quarterly or monthly exchange rates, for example, the standard deviation of the percentage change in the exchange rate or the standard deviation of the first differences in the logarithmic exchange rate. In this article, in order to capture ex ante exchange rate uncertainty, the later measure is used. We constructed the measure of exchange rate volatility based on monthly average nominal exchange rates of the period of 1996 to 2008 for every studied year from previous three years to year t. The measurement of exchange rate volatility is based on *nominal* bilateral exchange rates several studies highlighted that nominal and real exchange rate series generate nearly identical empirical results (McKenzie and Brooks, 1997; McKenzie, 1999; Quian and Varanges, 1994).

A moving standard deviation of the first differences in the monthly nominal exchange rate over the prior forty-eight month (m) of the year t and prior three years (t`)[3] is applied for estimating exchange rate volatility for year t:

$$XV_{ijt} = \sqrt{\frac{\sum_{m=1}^{48}\left(x_{ij,m} - \bar{x}_{ij,t`}\right)^2}{48}} \quad (5)$$

where $x_{ij,m} = \ln e_{ij,m} - \ln e_{ij,m-1}$, $\ln e_{ij,m}$ is the log of the monthly nominal exchange rate (e) between countries i and j at the time (month) m, and $\bar{x}_{ij,m} = \sum_{m=1}^{48} x_{ij,m} / 48$ is the mean of $x_{ij,m}$ over the forty-eight month of year t and previous three years. The volatility of Romanian new leu (RON) to the export destination countries national currencies calculated with the above equation is decreasing between 1999 and 2008 (see appendix 1).

6. Results

One advantage of using panel data is that unobservable cross-sectional effects can be accounted. However, there are some econometric issues that need to be addressed when estimating gravity equation (4). First, nonspherical error terms resulting from heteroskedasticity and autocorrelation across panel sets are anticipated in the dataset. In case of trade

[3] t` represents the period based on monthly data of the year s' t-3, t-2, t-1 and t.

between two smaller countries or between a smaller country and a larger country is likely to be more volatile compared to trade between two large countries and heteroskedasticity may occur in this case (Frankel, 1997). Autocorrelation within panels may be present, partly reflecting sunk cost effects (Roberts and Tybout, 1997). To address these problems the heteroskedastic corrected standard errors (Prais-Winsten) approach are applied, that controls for heteroskedasticity, and panel specific AR(1) is applied to control autocorrelation (Beck and Katz, 1995; 1996).

In table 3, the results from the gravity model of equation (4) using the moving standard deviation as a volatility measure, are presented. After excluding outliers from the sample of fifty-four countries the estimations are based on forty-eight export destination countries.[4] The coefficient on XV_{ijt} is negative and significant at 5% level. This implies that the exchange rate volatility has negative effect on Romanian agri-food exports: increasing volatility by 10% results 5% decreases of agri-food exports. The negative effect of exchange rate volatility on agricultural trade is consistent with the findings of Cho et al (2002) and Kandilov (2008).

Table 3 **Exchange Rate Volatility and Exports**

Variable	$\ln EXP_{ijt}$.
$\ln GDP_{jt}$	0.322***
$\ln POP_{jt}$	0.717***
$\ln DIST_{ij}$	-1.482***
$\ln XV_{ijt}$	-0.531**
TARIF	0.000
$D_{1,BOR}$	-0.527
$D_{2,EU}$	-0.280
$D_{3,CEFTA}$	-0.193
const	10.746***
R^2	0.9714
N	480
rho	-0.298

Note: The single (*), double (**), or triple (***) asterisk denote significance at the 10%, 5%, and 1% levels, respectively.

[4] Excluded outliers export destination countries are Australia, China, India, Luxemburg, Norway and Panama. In case of these countries the share of Romanian agri-food exports is very low.

The mass variables of gravity model lnGDP_{jt} and lnPOP_{jt} have the expected positive sign and are significant at the 1% level in both cases of exchange rate volatility estimations. This implies that higher value of GDP per capita of 10% in export destination country (j) increases export by 3%, as well as 10% increases of population (j) result 7% of import increasing from Romania of agri-food products.

The classical trade resistance variable of gravity equation ln$DIST_{ij}$ has the expected negative sign and is significant at 1% level: 10% of distance increasing results 15% decreases of export to these export destination countries. However the quantitative (TARIF) and qualitative ($D_{2,EU}$ and $D_{3,CEFTA}$) trade resistance variables are not significant.

7. Summary

In this article we have studied whether exchange rate volatility has negatively affected Romanian agricultural export. We constructed a balanced panel of Romanian agri-food export to 54 export destination countries for the period 1999-2008. This gave a fairly large panel dataset to which We could apply the gravity model specification, which has numerous advantages over cross-sectional studies that have typically been used to highlight the impact of exchange rate volatility on bilateral trade flows. Exchange rate volatility is captured by a moving standard deviation of the first differences in the exchange rate over the forty-eight month nominal average exchange rate of year t and prior three years. The volatility of new Romanian leu to national currencies is decreasing during the analyzed period.

The estimations of gravity equation indicate that the signs of significant parameters are according to our expectations. The signs of parameters for the variables of population and income (GDP) of export destination countries are positive, while distance is negative. As well as exchange rate volatility has negative effects on Romanian agri-food export.

The policy implications of adverse effect of exchange rate volatility on Romanian agri-food trade are connected to the process of joining to euro zone and to the attitude of trading firms with agri-food products. As the exchange rate volatility has negative effect on trade with

Romanian agri-food products, the agricultural holdings and firms operating in food industry are interested in the speeding up process of joining Romania to the euro zone, introducing euro as earlier as possible. At the same time trading firms with Romanian agri-food products should cover their risks which arise from currency volatility using the opportunities offered by the forward and future markets, which have also been developing intensively in Romania in the last period.

Overall, the results presented make a contribution to our understanding of the connection between exchange rate movements and international trade in case of transition economies. The results are consistent with the findings of Cho et al. (2002), Wang and Barett (2007), and Kandilov (2008) and extend their findings of negative effect of exchange rate volatility on export to transition economies.

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DIGITAL DIVIDE AND RURAL DEVELOPMENT

Zoltán ZAKOTA*

My conference lecture aims to present the notion of the Digital Divide, a frequently used term in topical discussions on information and knowledge societies or in the development narratives of the early 21st century. According to some authors, bridging this digital gap between information-poor and information-rich countries is one of the top priorities of today's politicians. I also intend to present some of the possible ways to fulfil these tasks.

Key words: Digital Divide, Information and Knowledge Societies, Development.
JEL Classification Codes: O33, R58

The nowadays frequently used term *Digital Divide* (DD) covers several related meanings. The simplest perhaps is to be found in Mehra *et al.* (2004): 'digital divide has been broadly articulated as the troubling gap between those who use computers and the internet and those who do not.' The most commonly used refer to some technological inequalities that persist between different regions or countries and are related to certain discrepancies in the fields of economy and knowledge. As Wikipedia (2009) points it out, DD means the gap between people with effective access to digital and information technology and those with very limited or no access at all. It reflects the existing imbalances in physical access to technology and unequal access to Information and Communication Technologies (ICT). It also reflects the imbalances in resources and skills needed to effectively participate as a digital citizen, as well as the unequal acquisition of ICT-related skills.

A related term, the *Global Digital Divide* (GDD), refers to an essentially geographical division meaning significant disparities in opportunity to access the Internet and the information and educational/business opportunities tied to this access between developed and developing

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countries (Lu, 2001). The concept appears in 1970, when Sir Hans Singer coined the term *international technological dualism* meaning essentially unequal developments in the area of science, technology, between rich and poor countries. Nowadays, the term has a global connotation as well: rapidly growing disparities in the utilization, expenditure, and availability of technology on a worldwide scale, involving economic, educational, and social aspects that influence the levels of information communication technology development in each country (Pick and Azari, 2008).

According to the Internet World Stats (IWS, 2009) there are significant differences in Internet usage around the world, which means a significant GDD. These gaps are reflected in the figures of the Internet penetration rate (see Table 1), one of the most important indicators of the Information Society (IS). This indicator shows how widely the access to the Internet has spread in the countries on the general level, not specified by user group. It is expressed in percentages and it is calculated as the number of access lines divided to population, multiplied by 100. The penetration rates presented are based on a world population of 6.767.805.208 and 1.668.870.408 estimated Internet users for June 30, 2009.

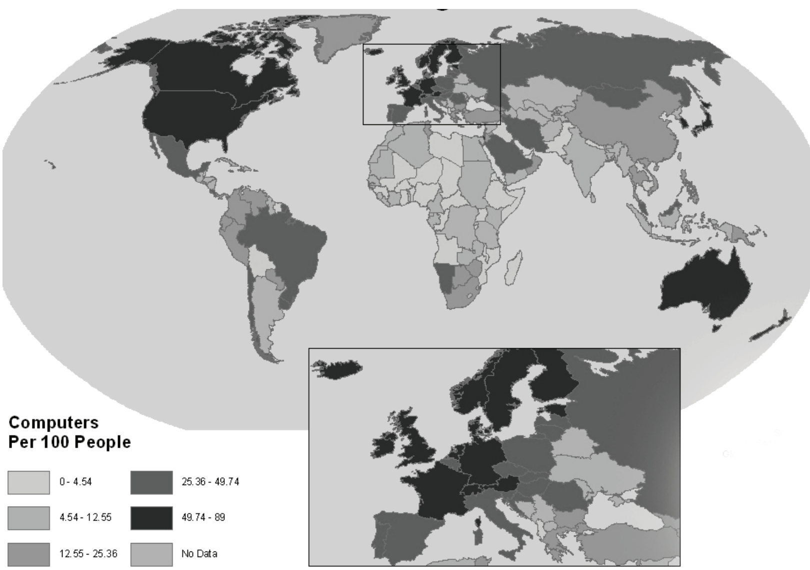
Table 1 **Internet penetration rates and number of Internet users by geographic regions**

	World Internet Penetration Rates by Geographic Regions (%)	Internet Users in the World by Geographic Regions (Millions of Users)
North America	73,9	251,7
Oceania / Australia	60,1	20,8
Europe	50,1	402,4
Latin America / Caribbean	30,0	175,8
Middle East	23,7	48,0
Asia	18,5	704,2
Africa	6,7	65,9
World Average	24,7	–

Source: Internet World Stats

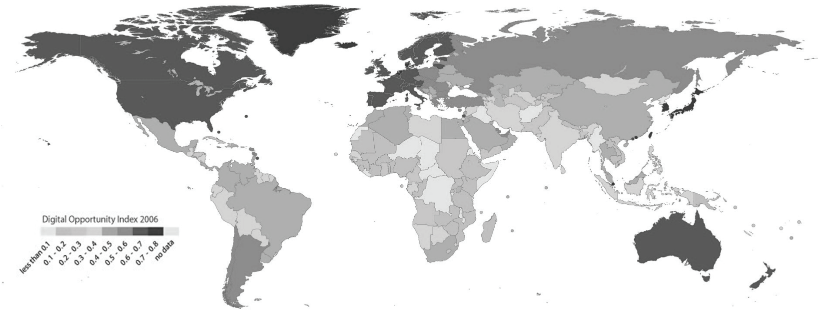
To illustrate the existing geographic disparities we can use the number of existing computers per 100 people, as shown in Fig.1. Another frequently used indicator for the GDD is the digital opportunity index (DOI) based on 11 ICT indicators, grouped in 3 clusters: opportunity, infrastructure and utilization (see Fig. 2 for the year 2006).

Figure 1 **Number of computers per 100 people**



Source: UN Global Development Goals Indicators.

Figure 2 **Variations of the digital opportunity index for the year 2006**



Source: ITU, 2009a

Another quite spectacular indicator is the usage of languages on the Internet, presented in table nr. 2. It cannot be considered really relevant as far as the GDD is concerned, due to the *lingua franca* status of English and because of the usage of some languages like Spanish, Portuguese, Arabic or German in many states.

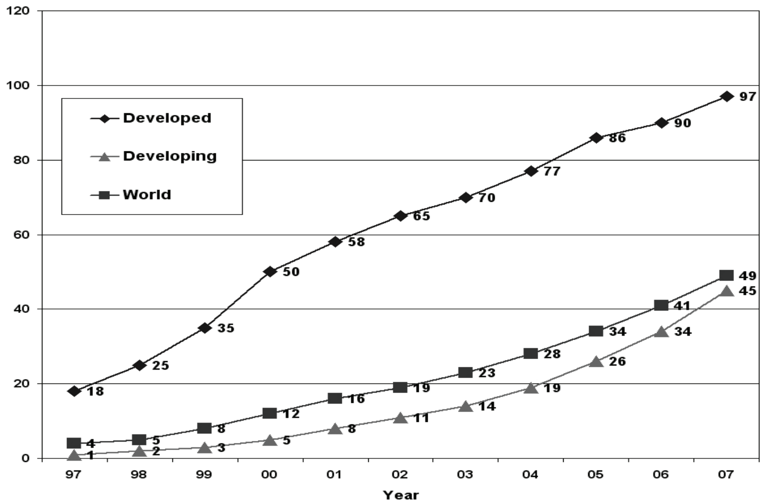
Table 2 **Top 10 languages on the Internet**

	millions of users		millions of users
English	464	Portuguese	73
Chinese	321	German	65
Spanish	131	Arabic	41
Japanese	94	Russian	38
French	74	Korean	37
All others	258		

Source: IWS, 2009.

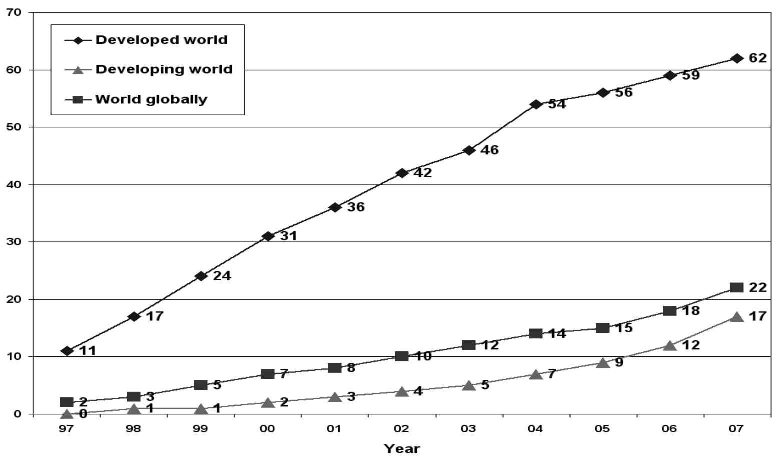
Some more relevant indicators are those published by the ITU regarding the differences between developed and developing countries, as being illustrated by the growth in the number of mobile phone subscribers and that of Internet users per 100 inhabitants between 1997-2007 (see figures 3 and 4). As it is pointed out in ITU (2009b) the GDD narrows faster in the mobile sector while it persists in the Internet usage, especially broadband communications.

Figure 3 Mobile phone subscribers per 100 inhabitants 1997-2007



Source: ITU, 2009b

Figure 4 Internet users per 100 inhabitants 1997-2007



Source: ITU, 2009b.

It is unanimously accepted that the key factor in reducing the GDD is the raise of Information Society. The Main Goal of introducing information techniques (IT) is well drawn up in the Okinawa Charter on Global Information Society adopted at the G8 Summit (Kyushu-Okinawa, July, 21-23, 2000):

> 'The essence of the IT-driven economic and social transformation is its power to help individuals and societies to use knowledge and ideas. Our vision of an information society is one that better enables people to fulfil their potential and realise their aspirations. To this end we must ensure that IT serves the mutually supportive goals of creating sustainable economic growth, enhancing the public welfare, and fostering social cohesion, and work to fully realise its potential to strengthen democracy, increase transparency and accountability in governance, promote human rights, enhance cultural diversity, and to foster international peace and stability... everyone, everywhere should be enabled to participate in and no one should be excluded from the benefits of the global information society.' (Okinawa, 2000)

Overcoming GDD is a quite difficult task and achieving digital inclusion requires considering and addressing many types of access, as they appear on Wikipedia (2009) gathered from various sources. They are, as follows:

- *Physical Access*: individuals need to obtain access to computers, landlines, and networks in order to access the Internet;
- *Financial Access*: ongoing financial support required to cover the cost of ICT applications, technician and educator training, software, maintenance and infrastructures;
- *Cognitive Access*: a certain level of information literacy needed to use computer technology, including the capability to handle information overload and the ability to find and use reliable information;
- *Design Access*: ICT need to be accessible to individuals with different learning and physical abilities including disabilities;
- *Content Access*: developing Internet content directly applicable at the grassroots level using local languages, not only academic or business style;
- *Production Access*: users need the confidence and capacity to be able to produce their own content for their own local consumption;

- *Institutional Access*: the degree in which the numbers of users are greatly affected by whether access is offered only through individual homes or whether it is offered through schools, community centers, religious institutions, cybercafés, or post offices, especially in poor countries where computer access at work or home is highly limited;
- *Political Access*: Internet is considered a form of e-democracy and attempting to control what citizens can or cannot view is in contradiction to this; democratic political regimes enable a faster growth of the Internet than authoritarian or totalitarian regimes.

The Digital Divide (DD) is a very complex phenomenon, organized along many dimensions, each of them being structured by many more or less specific variables, as enumerated in what follows:

- economic dimension – DD between stats:
    - overall economic development;
    - infrastructure;
    - technological foundations;
- socio-demographic dimension – DD between social groups:
    - gender,
    - wealth, income,
    - level of education,
    - ethnic group,
    - religion,
    - age,
- educational dimension:
    - educational system,
    - life-long learning,
- geographical dimension:
    - regional discrepancies
    - rural vs. urban.

The relation between eradicating DD and promoting sustainable development is not yet clear. There are many situations, when the use of ICT brought large social and economic benefits. Yet, there are other cases in which these have not induced any change in life of the people from developing countries, or they have had even harmful effects. Anyway, once the necessity of narrowing the DD being acknowledged, there are some strategic steps, on which most of the specialists agree, such as:

- privatizing the telecommunication sector,
- fostering free business and competition between ICT providers,
- minimizing the external dependency,
- promoting successful private investments to finance ICT projects meant to increase teledensity,
- extending wireless communications,
- founding community-based telecentres.

The indicators used to evaluate the state of the art of IS in different states or regions are mostly those used to quantify the developmental stages of ICT. It is about a large number of indicators which can be categorized in the next main groups:

- political indicators;
- structural indicators of the IS;
- telecommunication services;
- spreading of computers and raising of Internet penetration in households and companies;
- usage of e-commerce by individuals and companies;
- development of individual e-skills.

The DD is a very problem in Europe as well. There are significant differences between the European states, and even between the regions of a given state, regarding ICT-indicators whether they are EU member states or they are not, as presented in tables 3-6. As one can notice, based on these figures, the existence of a DD between the countries of Europe is unquestionable – there exists a northwest (Scandinavia, Iceland, United Kingdom) to southeast (Balkans: Romania, Bulgaria, Greece) gradient in case of most indicators. This is also stressed by the variation of the DOI, as presented in figure 5.

Table 3 **Internet access**

Indicator (2008)	**EU27**	**EU15**	**Max**		**Min**	
Households having broadband access to the Internet (as % of all households)	49	52	83	IS	13	RO
Households having modem (dial-up access over normal telephone line) or ISDN access to the Internet (as % of all households)	11	12	25	DE	2	LV

Broadband penetration rate – Number of broadband access lines per 100 inhabitants	21.7	24.3	37.4	DK	9.5	BG
Level of Internet access - households – % of households who have Internet access at home	60	64	86	NL	25	BG

Source: Eurostat, 2009.

Table 4 **Internet usage**

Indicator (2008)	**EU27**	**EU15**	**Max**		**Min**	
Computer-skills of individuals – % of individuals aged 16 to 74 (2007)	13	13	18	SK SE	8	IT
Internet-skills of individuals – % of individuals aged 16 to 74 (2007)	29	31	45	SE	13	BG
Individuals regularly using the Internet, by access type – % of individuals aged 16–74						
broadband access	82	83	96	HU	62	PT
no broadband access	67	67	88	BE NL	37	PT
Individuals regularly using the Internet, by place of use – % of individuals aged 16 to 74						
at home	53	57	87	IS	22	RO
at place of work	26	29	54	IS	9	RO
at place of education	8	8	26	IS	4	BG GR MT
at other places	7	9	25	IS	1	RO
Individuals regularly using the Internet, by gender – % of individuals aged 16 to 74						
all	56	60	88	IS	26	RO
males	60	63	89	IS	28	RO
females	53	56	87	IS	25	RO

Source: Eurostat, 2009.

Table 5 **e-Government**

Indicator (2008)	**EU27**	**EU15**	**Max**	**Min**		
Individuals using the Internet for obtaining information from public authorities web sites	25.5	28.5	57.7	IS	6.4	BG
Individuals using the Internet for downloading official forms	15.9	17.7	34	IS	3.6	RO

Individuals using the Internet for sending filled forms	11.7	13.3	32.1	NL	3.2	BG RO
E-government on-line availability – Percentage of online availability of 20 basic public services	59	68	100	AT	15	BG
E-government usage by individuals by gender – % of individuals aged 16 to 74 using the Internet for interaction with public authorities						
all	28	32	63	IS	8	BG
males	30	34	67	NO	7	BG
females	26	29	62	IS	8	GR

Source: Eurostat, 2009.

Table 6 **e-Commerce**

Indicator (2008)	EU27	EU15	Max	Min		
Individuals having ordered/bought goods or services for private use over the Internet in the last three months						
all	24	29	49	UK	2	BG
males	26	31	52	UK	2	BG
females	22	27	46	UK	1	BG

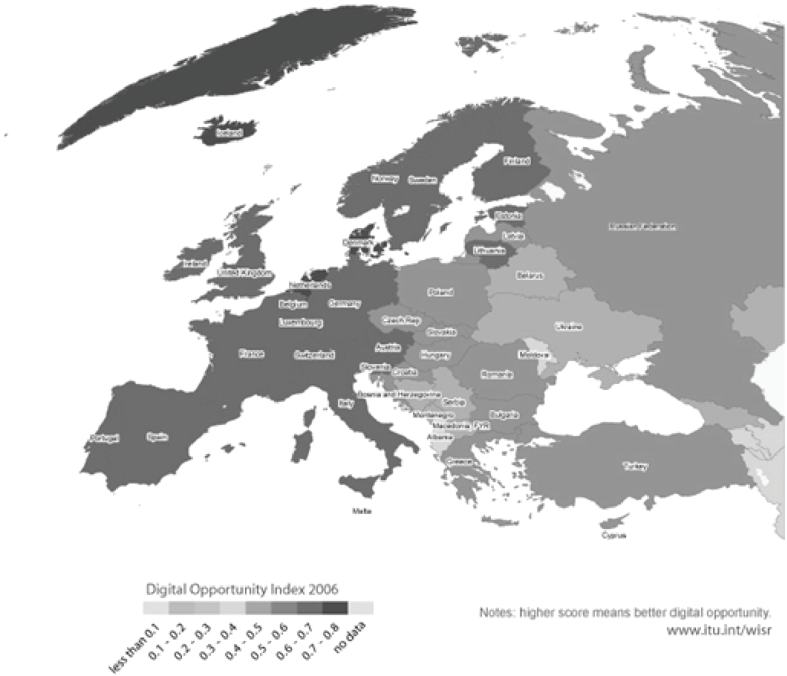
Source: Eurostat, 2009.

Table 6 **Telecommunication services**

Indicator (2006)	EU27	EU15	Max	Min		
Number of mobile phone subscriptions (1000)	520094	418536	85700	DE	347	MT
Mobile phone subscriptions (per 100 inhabitants)	106	107	155	LU	73	TR

Source: Eurostat, 2009.

Figure 5 **Map of digital opportunity index in Europe**



Source: ITU, 2009a

While trying to develop adequate policies to eradicate DD, some specialists have pointed out some questions regarding the opportunity of these attempts, some of them methodological, while the others as a matter of principle:

- is the DD a real threat or is it just a myth?
- what is the dynamics of DD – is it narrowing or widening?
- will eliminating DD be a catalyst of growth?
- can the process of eliminating DD be kept under control?
- what are the most appropriate techniques of eliminating DD?
- how can the width of DD be measured?
- how can the efficiency of DD-elimination politics be measured?

Some doubts have also arisen regarding the principles used in defining, measuring and benchmarking complex research variables used in funding various policies, e.g.:

- most of the indicators and measuring techniques used in evaluation of DD are not fully significant;
- more opinions and far more points of view need to be taken into consideration;
- more precaution is needed when defining and interpreting DD-indicators;
- a better substantiated evaluation of technological differences and interpretation of the DD's implications is needed.

Meanwhile, politics have followed their own way in defining targets and adopting policies to achieve them. One of the most well known of these is the so called Lisbon Strategy of the EU, materialized in a series of documents. The latest one: *i2010 – A European Information Society for growth and employment* (i2010, 2009), deals with IS and the media, working towards growth and jobs and points out its main goals towards:

- establishing a Single European Information Space by offering affordable and secure high-bandwidth communications, rich and diverse content and digital services;
- boosting innovation and investment in ICT research, by encouraging world-class performance in research and innovation in ICT and close the gap with Europe's leading competitors;
- boosting social, economic and territorial cohesion by establishing an inclusive European information society, promoting growth and jobs in a manner that is consistent with sustainable development and that prioritises better public services and quality of life, establishing an inclusive information society, offering high-quality public services and improving quality of life;
- developing proposals and updating the regulatory frameworks for electronic communications, and information society and media services, using the Community's financial instruments to stimulate investment in strategic research and overcoming bottlenecks obstructing widespread ICT innovation, supporting policies to address inclusion and quality of life.

The *i2010* document also fixes some targets on reducing the broadband gap by adopting a broadband gap policy, establishing a European broadband portal, developing synergies with other policies, and elaborating principles of monitoring and data organizing. Another important document is the Council Regulation (EC) No 473/2009 on Rural Development on the use of 1.020 Million Euro in the Recovery Plan to bring broadband in rural areas.

By elaborating National Reform Programmes, Member States have committed themselves to adopting information society priorities in line with the Integrated Guidelines for growth and jobs by mid October 2005, aiming to:

- ensure rapid and thorough transposition of the new regulatory frameworks affecting digital convergence with an emphasis on open and competitive markets;
- increase the share of ICT research in national expenditure to develop modern, interoperable ICT-enabled public services;
- use investment to encourage innovation in the ICT sector;
- adopt ambitious targets for developing the information society at national level.

One of the key concepts of applying ICT in rural regions is that of community informatics, or community networking, also called electronic community networking, meaning: community-based technologies or community technology. This refers to an emerging set of principles and practices concerned with the use of information and communication technology (ICT) as understood in the information systems discipline, in conjunction with community development and other social academic and practice areas, for the personal, social, cultural or economic development of and within communities, a cross or interdisciplinary approach utilizing ICTs for different forms of community action in the real or virtual spheres. In practice, sustaining local/rural communities by ICT means:

- promoting diffusion of knowledge and usage of ICT;
- providing and expanding access to ICT and ICT-based services;
- developing rural and remote infrastructure, providing access to infrastructure, technology support and advice for the development of businesses;
- extending the reach of public services such as education, health and social services;
- providing information of general interest to the local community, including government information;
- providing information of special interest to specific groups such as farmers, local businesses and non-governmental organizations;

- providing rural regions with improved local administration;
- generating (local) employment and foster socio-economic development;
- integrating relatively isolated communities into the national and international information network and thus accelerating exchange of private goods and services;
- training local people and transfer expertise in a number of areas, such as agriculture, to and from the community;
- giving local producers access to market information, thus reducing the need for middlemen and increasing rural incomes;
- creating regional cohesion.

There is a 4P of the main issues constantly arising that can be translated into sustainability for the development circles: policy, partners, participation and planning and there are four parameters to measure the success of specific ICT-solutions in a given region: financial sustainability, performance monitoring, user satisfaction monitoring and benchmarking based on best models.

Many people think that telecentres could have a special importance in reducing the DD between urban and rural/remote areas because they could play an important role in promoting the Lisbon Strategy, especially by:

- providing access to ICT in rural regions with underdeveloped and remote infrastructure;
- integrating relatively isolated communities into the national and international information network;
- promoting and operating modern ICTs and learning skills;
- training local people by using eLearning techniques;
- transferring expertise in a number of areas, such as agriculture or rural tourism to and from the community;
- improving the degree of local employment by offering teleworking opportunities;
- having public utility, offering its services to all members of the community, without any discrimination of any kind;
- being multifunctional, offering services of quality, permanently adapted to the needs of the community;
- being a forum and a catalyst of the community, acting in a responsible way.

When talking about the ways of eliminating DD, there are some basic pillars of action on which practically everybody agrees, such as the existence of an appropriate ICT infrastructure and an acceptable Internet-connection, people having a general ability to use ICT and providing useful content for them. Building these pillars supposes the achievement of appropriate results in all three related fields of society, economy and technology, as follows:

- technological progress:
    - cheaper hardware/systems;
    - more and more powerful devices;
    - cheaper services by new telecom technologies;
    - rapid spreading of wireless technologies;
    - quality free-/shareware accessible for everyone;
    - user-friendlier computing and communication systems.
- economic issues:
    - changes in organizational and management principles
    - spreading of e-working;
    - raising of digital economy: e-commerce, e-banking, e-business;
- social issues:
    - spreading of electronic communication methods: e-mail, chat, blog;
    - changes in the educational systems/processes: e-learning, on-line learning;
    - raising of digital literacy;
    - transformations of the social structure: virtual personalities and groups;
    - community informatics.

As I have been trying to present, DD is a real problem of our time, the eradication of which needs huge investments, especially in technology and education. Although it seems useless and irrational to make it completely disappear, narrowing the DD could have beneficial effects on global development and stability.

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ROMANIAN AGRICULTURE IN THE PROCESS OF EU ACCESSION

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We investigate in this paper the ways in which the Romanian agriculture is adjusting to challenges of EU accession. In spite of the short period of time that has passed since the EU accession some first conclusions could be drawn.
The export-import balance of agricultural products and foods has worsened after the EU accession, but to a lesser extent than the whole Romanian economy foreign balance of trade. The proportion of agriculture in GDP, employment and also in consumption declined in the first two years after the EU accession. But there is no change in the trends of these indicators: these negative processes in Romanian agriculture and food production had begun before the accession. The trend of changing the production structure has also continued: the proportion of crop production has been increasing compared to animal husbandry. But the figures of farm structure are strange and unexpected: the proportion of smaller farms increased meanwhile that of the bigger ones declined in both number and land using.

Key words: Romania, agricultural economics, EU accession, agri-food trade
JEL Classification: Q10, Q17

Introduction

One of the most frequently discussed questions concerning the New Member States of EU was the future of their agriculture after the accession. More specifically how they can cope with the competition among farmers of EU15 and how their farmers can benefit from the Common Agricultural Policy (CAP)? These questions are especially important in a country such as Romania where the share of farmers in agricultural employment and that of agricultural production in GDP is the highest in the EU.

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On the other hand the proportion of small farms producing mainly for their own consumption, the number of farms and the utilized agricultural area is very high according to the indicators. In spite of the short period of time that has passed since the accession of Romania to the European Union we focus on presenting the first experiences of the Romanian agricultural economy after the EU accession.

Our investigation is focusing on some basic issues such as development of agriculture's macroeconomic environment and its role within the Romanian economy, the changes in the production output and farm structure, the development of agricultural subsidies and foreign trade. As we take into consideration the shortness of the period after accession our conclusions have to be interpreted cautiously. The first experiences can be drawn by comparing the most important indicators before and after the accession.

1. Macroeconomic background

In the years before accession the development of Romanian economy was characterized by a dynamic economic growth, an increasing inflow of net direct foreign investments and a strong EUR convergence (Table 1). According to the Convergence Program of Romania a 5-6 percent economic growth is expected per year by the introduction date of EUR as payment facility. Its two main components are the same before and after accession, namely boosting the domestic consumption and the increase of foreign investments.

Table 1 **Macroeconomic characteristics of Romania (2002-2008)**

	Unit of measure	2002	2003	2004	2005	2006	2007	2008
Real-GDP* change	%	5.1	5.2	8.4	4.1	7.9	6.2	7.1
GDP/ capita***	EUR/ capita	6,000	6,500	7,400	7,900	9,100	10,500	11,500
Rate of inflation*	%	22.5	15.3	11.9	9.0	6.6	4.8	7.9

Rate of unemployment*	%	8.4	7.4	6.3	5.9	5.2	4.0	4.4
National budget deficit**	%	-2.6	-2.2	-1.2	-1.5	-2.2	-2.5	-5.3
Net foreign investments	Billion EUR	1.21	1.95	5.18	5.21	9.06	7.25	9.02
Average exchange rate	RON****/ EUR	3.13	3.76	4.05	3.62	3.53	3.34	3.68

Source: Eurostat [2009], INS [2009] and BNR [2009].

* The change of prices compared to the same period of the previous year.

** National budget deficit calculated as the share of GDP.

*** In terms of purchasing power

**** As of 1 July 2005, Romania's legal tender, previously coded as ROL, has been redenominated so that ROL 10,000 are exchanged for 1 new leu (RON).

The economic growth was generated by the increase of domestic consumption[1] which resulted in the rise of food consumption, too. The rate of food consumption continuously decreased as a consequence of its lower increase level compared to the increase of the population's income. Despite of this decrease, the rate of foods within the total consumption is a great deal higher in Romania than in the EU as an average (Table 2).

Even the extra high level of investments is not enough for covering the needs of increasing food consumption in the midterm period. There are several reasons for it, beginning with the low level of the raw material industry's production output, to the fact that their competitiveness is spoiled because of overvalued RON as imported foods become cheaper and cheaper. The increase of net foreign investments was on average 75 % per year in comparison to the pre-accession period. That sum does not contain the very high level of old foreign investments and that of Romanian entrepreneurs. There were a lot of important investments in food industry, whilst there were no large investments in the field of agricultural production. In the short term period the structure of agricultural production, which we are dealing with later, is not enabled for a

[1] In the period 2002-2006 an increase of approximate average 20% took place in the households' consumption expenditures.

quick matching with the needs of food industry. Without taking into consideration the strengthening of RON the macroeconomic convergence is very good for both agricultural and food production.

2. The importance of agriculture

On the one hand an average 11 % share of agricultural production in GDP counts as a very high one compared to that of 5 % in OECD countries. On the other hand its declining trend is similar to what happened in developed countries.

As a consequence of the *exceptionally high rate of agricultural employment* (above 30 %) in Romania compared to that of EU, the number of farms producing only for their own needs is very high. According to Mathijs' and Noev's (2004) estimation the land cultivated by subsistence farms was 37% based on household statistics of 1998-2000. In Bulgaria and Hungary the same figure was 20% and 3% respectively.

Table 2 **Main features of Romanian agriculture (2002-2008)** %

	2002	2003	2004	2005	2006	2007	2008
Proportion of agriculture in GDP	11.4	11.6	12.8	8.9	7.8	5.7	6.5
Proportion of agricultural employees in total employed inhabitant	37.7	37.7	32.6	32.3	30.6	29.5	n.a.
Proportion of agricultural incomes in total income	26.8	27.6	25.9	24.7	19.6	17.0	16,4
Proportion of food consumption in total consumption	49.9	48.6	46.4	41.3	39.2	38.4	37.6

Source: INS (2009).

The high rate of subsistence farms is a consequence of restructuring Romanian economy in the process of transition to market economy. At that time it was the agriculture that made it possible for unemployed to find a work opportunity (Vincze, 2002). Furthermore, agricultural policy has not stimulated competitiveness of agricultural production. The Land Law launched in 1991 set the upper limit of land to be given back to its original owner to 10 hectares (Aligica and Dabu, 2003). After the amendment of Land Law this upper limit changed to 50 hectares and besides this private persons can buy arable land up to a maximum of 200 hectares[2]. However, profitability of the agricultural production wasn't stipulated by law and controlled agricultural prices of 1990-1997 (Gavrilescu and Giurca, 2000) because of the high rate of inflation.

As a consequence of economic growth started in 2000 food production met a payable demand. The situation of agricultural production and rural inhabitants was improved by pre-accession funds available within the EU support system. After accession the possibility of getting direct payments and rural subsidies helped a lot to the development of Romanian agriculture.
The transition period was characterized by a great change in *agricultural gross production value* as a result of ups and downs in crop production yields influenced by extreme weather conditions and agricultural policy. In 2000 for example the value of agricultural gross production declined by 15 %, whilst next year a 23 % growth was registered. In 2002 it continued with a 3.5% decrease followed by a 7.5% and 18 % increase in 2003 and 2004, respectively. In 2005 there was a decline of 13 % again.

In Romania *land market* has started to operate effectively since 1998, when Land Circulation Law was voted by Parliament[3]. The growth of land purchase started in that year. In 1998 0.08% (12,000 ha) of total agricultural land was on sale, whilst in 2005 0.44% (64,000 ha).

Table 3 **Average price of agricultural land in Romania (1998-2005)**

Year	Sold agricultural land (ha)	Average price of sale (thousand RON/ha)	Average price of sale (EUR/ha)
1998	12,119	430	430
1999	31,878	730	448
2000	21,746	790	396
2001	12,928	1,180	453

[2] Law no CLXIX of 1997 and no I of2000.
[3] Law no CCCLVIII.

2002	78,501	910	291
2003	83,613	970	258
2004	11,137	1,930	476
2005	63,999	3,200	883

Source: Agricultural Policy Research Department of AKI based on Popescu and Constantin (2007).

As Table 3 shows the average market price of agricultural land started to grow from the liberalization of land market: in 2005 the average annual price in EUR was 883 EUR/ha, which is nearly doubled (430 EUR/ha) compared to 1998. Despite of the increase, prices in Romania are too low compared to the average price of EU15 (Popescu and Constantin, 2007). Romanian land price is not high compared to that of EU 10.

Before accession it was not possible for foreigners to buy agricultural land in Romania. After accession a moratorium was declared on opening the land market for foreigners (EU citizens) before 2014. However since*1998, foreigners could buy agricultural land through a corporate farm***.** This is one of the first reasons that caused land selling increase, but year by year there is a fluctuation. *The majority of foreigners buying agricultural land arrive from Italy, Austria and the Netherlands.* The share of land owned by foreigners is the highest in Timișoara County.

3. Structure of agricultural production

In Romania **the proportion of agricultural employment was nearly 33 % with 3 million employees:** 13 % of them were employed by corporate farms and the rest of 87 % were individual producers. 58 % of employees were full-time and 42 % were part-time workers. In 2005 *the average size of farms was 3.3 ha,* which is 6.5 % higher than the value used in 2002 census, as stated by Gavrilescu and Voicilas (2007). The average size of individual farms was 2.2 ha and that of corporate farms was 263.1 ha. Thus 65 % (9.1 million hectares) of Romanian agricultural land was cultivated by farms with an average size of 2 hectares.

Table 4 **Distribution by farm types and average size of agricultural holdings in Romania (2005)**

	Number of farms (%)	Cultivated agricultural land (%)	Agricultural land per farm (ha)
Individual farms	99.57	65.45	2.1
Corporate farms	0.43	34.55	263.1
- Agricultural societies	0.04	5.34	455.3
- Commercial companies	0.12	12.81	369.2
- Companies of local authorities	0.11	15.28	441.0
- Other (cooperatives)	0.16	1.13	22.5
Total	4,256,152	13,906,701	3.3

Source: Agricultural Policy Research Department of Research Institute of Agricultural Economics (AKI) based on INS (2007) data.

The growth of Romanian economy which was characteristic before the economic crisis could not be observed in agriculture. Half of the agricultural land is cultivated by farms below 2 European Size Unit (ESU). Table 5 shows that the share of such small farms in arable land increased from 45 % in 2005 to 47 % in 2007. The only growth in number of holdings took place in the mentioned size measure, whilst the number of other size measures declined.

Table 5 **Distribution of farm structure by size in Romania**

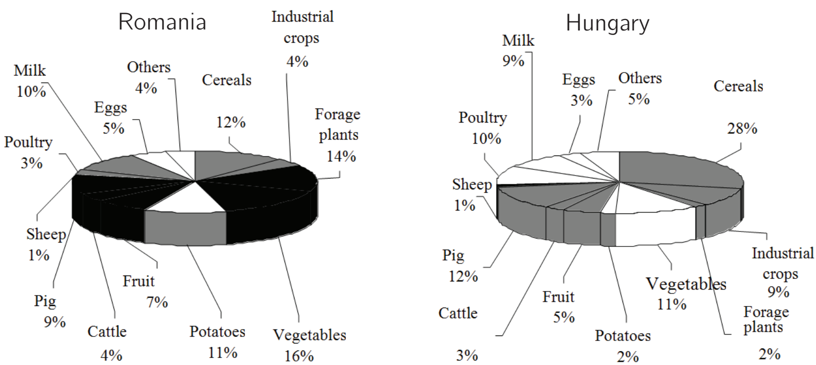
(European Size Unit, ESU)	Distribution of agricultural holdings by size (%)			
	2005		2007	
	Number of farms	Area	Number of farms	Area
< 2 ESU	91.0	45.2	94.0	49.0
≥ 2 and < 4 ESU	6.8	11.4	4.3	8.8
≥ 4 and < 8 ESU	1.5	4.7	1.1	4.5
≥ 8 and< 16 ESU	0.4	3.9	0.3	4.0
≥ 16 and < 40 ESU	0.2	7.5	0.2	7.1
≥ 40 ESU	0.1	27.6	0.1	26.6
Total	100.0	100.0	100.0	100.0

Source: INS (2009).

We do not think that the increase of agricultural output volume is the aim of efficiency growth and the main purpose of agricultural policy. On the other hand increasing the share of the smallest farm category shows that some kind of a special problem occurs which cannot be tackled in a short term period. The increasing rate of small scale farming was surely good for solving the problems of employment in rural areas, whilst it could not be the right way from the point of view of agricultural efficiency.

Taking into consideration the agricultural structure based on production value, cultivation of *forage plants, cereals and vegetables are the main agricultural sectors* in Romania, while cereals and industrial crops in Hungary. Both countries are characterized by the low share of animal husbandry within the production structure (Figure 1).

Figure 1 **Structure of agricultural production based on production value in Romania and in Hungary (2006)**



Source: NIS, KSH (2007).

A growing ratio of crop production and a declining one of animal husbandry can be seen within agricultural production in Romania. The exact shares are 55 % of crop production and 45 % of animal breeding in 1998, 63 % and 37 % respectively in 2001 (Boros, 2004). In 2006 there is only a small change with a 65 % share of crop production and 35 % of animal breeding.

In 2005 the total agricultural area was *14.74 million hectares* in Romania, consisting of 64% arable land, 23% pastures, 10% meadows, 1.5% vineyards and 1.5% orchards. 55 % of the agricultural output was produced on private farms smaller than 5 hectares (Vincze, 2006; Aligica and Dabu, 2003). Cereals were produced on 8.5 million hectares of arable land that is 71 % of the total utilized agricultural area. The most important crop was maize with 31 % followed by wheat (29 %) and sunflower (11%).

4. Agricultural subsidies

After the collapse of the communist regime, support delivered to the Romanian agriculture declined dramatically whilst it was characterized by a higher level of support earlier. The PSE[4] of 50 % in the period between 1986 and 1989 declined to 8 % by the period between 1990 and 1992, whilst it achieved 14 % in the next period (1993-1996). The level of support increased step by step till the years before accession. That period was characterized by support of agricultural producers and somehow by taxation of consumers. Around 2000 a high inflation was characteristic for the Romanian economy which hindered the economy. The low rate of agricultural prices and the greater increase in price rate of agricultural input than in that of the agricultural output kept back farmers from gaining a satisfactory income. As a reason they could not make necessary investments to modernization badly needed for the increase of efficiency (Vincze, 2002).

The rate of direct payments expressed in RON within the budget of the Romanian Ministry of Agriculture, Forestry and Rural Development (MAFRD) *decreased in the years before accession.* In 2005 45 % of agriculture's budget was paid as direct payments, whilst in 2006 only 22 %. On the other hand animal husbandry is in a slightly better situation: its support level is increasing as a consequence of about 2 % growth of direct payments for that purpose per year (Table 6).

[4] The average value of PSE for the OECD countries was 41 % in the same period.

Land based supports increased from ROL 1 million per hectare in 2001 to ROL 2.5 millions per hectare in 2002. Despite the high inflation which on the other hand is declining, from 2002 their share expressed in RON has not changed. Those farmers were entitled to get land based support that had more than 1 hectare[5], used appropriate technology, fertilizer and certificated seeds. An essential share of crop production branches was entitled to get that type of support, namely wheat, barley, rape, sugar beet, sunflower, maize, oat, grain sorghum, chicory, soya bean, potato, vegetables, herbs, spices, line, hemp, vineyards, orchards etc.

Table 6 **Distribution of support from national budget (2004-2007)**

Title	2004		2005		2006		2007	
	mil. EUR	%	mil. EUR	%	mil. EUR	%	mil. EUR	%
Total support	501.7	100	528.5	100	535.2	100	1,860.0	100
	mil. RON	%	mil. RON	%	mil. RON	%	mil. EUR	%
Total support	2,033.4	100	1,914.9	100	1,886.1	100	1,860.0	100
- crop production	1,399.0	68.8	1,111.3	58.0	651.6	34.6	648.0	34.8
- animal husbandry	459.0	22.6	552.9	28.9	563.2	29.9	242.0	13.0
- investments	97.4	4.8	118.1	6.2	587.1	31.1		
- agricultural loan	12.6	0.6	30.7	1.6	12.5	0.7		
- compensation for natural damages	64.2	3.1	100.9	5.2	57.7	3.1		
- market intervention*	1.2	0.1	1.0	0.1	14.0	0.6	249.0	13.4
- rural development	-		-		-		721.0	38.8

* Before 2006 it was granted for export

Source: Romanian Ministry of Agriculture, Forestry and Rural Development, MAFRD (2008)

In the year before accession *cattle breeders* were entitled to an average support of 114-199 EUR/cattle (402 - 701 RON/cattle). The sum was

[5] Except of sugar beet and vegetable producers for whom a lower limit (0,5 ha) of eligibility was established for gaining support.

influenced by the circumstances of breeding such as using natural or artificial insemination for cows, whether the animal was under official control and registration or it was bred on a farm with ecological certification of production. The average support per cattle increased from 83 EUR/cattle (300 RON/cattle) in 2005 to 156 EUR/cattle (550 RON/cattle) in 2006. 5.68 EUR/animal (20 RON/animal) was granted to *sheep and goats* breeders but in case of a farm with ecological certification of production that sum was higher: 8.51 EUR/animal (30 RON/animal) on condition that they kept more than 50 sheep or 10 goats. One could get a further 14.19 EUR/animal (50 RON/animal) support for breeding registered male goats or sheep. In 2006 a *breeder of pigs* was entitled to a support of 34 EUR/hog (120 RON/hog) or in case of a farm with ecological certification of production that sum was 40 EUR/hog (140 RON/hog). An extra 14 EUR/animal (50 RON/animal) was given for buying piglets with weight under 20 kilos. *Poultry* breeders were entitled for 0.40 EUR/animal (1.41 RON/animal) support on condition that the weight of animal alive was above 1.75 kg. For getting that type of support breeders were obliged to fulfil the very strict animal welfare restrictions.

As far as direct payments are concerned, *after the accession to the EU in 2007*, the case of Romania was very similar to that of EU 10. That means a step by step introducing of direct payments. According to the ‘phase in’ rules in the year of accession Romanian farmers got only 25 % of direct payments support level of EU15 in 2007. In the first five years this support level may be increased by an annual 5 percent, after that by a 10 percent growth per year. In that way a 100 % support level will only be reached in 2016. Romania, lik the EU10, has the option to grant Complementary National Direct Payments (CNDP) from the national budget up to 30 % of SAPS. The rules of CNDP’s payments are the same as those of SAPS payments, reflecting the EU legal framework.

Romania might get a total of 4.75 billion EUR (15.85 billion RON) support from the EU budget between 2007 and 2009. That amount consisted of 1.59 billion EUR (5.32 billion RON) for direct payments, of 0.73 billion EUR (2.44 billion RON) for market intervention and of 2.424 billion EUR (8.09 billion RON) for rural development. A simplified system of agricultural payments (SAPS) was introduced for paying direct payments. The basic area of Cereals Oil Protein and Fibre (COPF) plants entitled to direct payments was 7.01 million hectares that is 75 % of Romanian arable land and 43 % of the agricultural land.

Table 7 **Reference support area and number of animals eligible for direct payments in Romania in 2007**

Title	Entitled for support	SAPS
Basic area of COPF	7,012,666	50 EUR/ha
Suckler cow	150,000	
Beef	452,000	
Cattle for slaughtering	1,148,000	
Calf for slaughtering	85,000	
Sheep	5,880,620	

Source: MAFRD (2007).

In the first year of accession the upper level of SAPS support is 50 EUR/ha, and after a continuous increase it will reach 200 EUR/ha by 2016 (Table 7). Romanian farmers are entitled to a lower (with 30 %) level of SAPS support than Hungarian farmers. The reason of this is the lower level of reference yields in Romania than in Hungary: 2.65 tons/ha and 4.73 tons/ha, respectively.

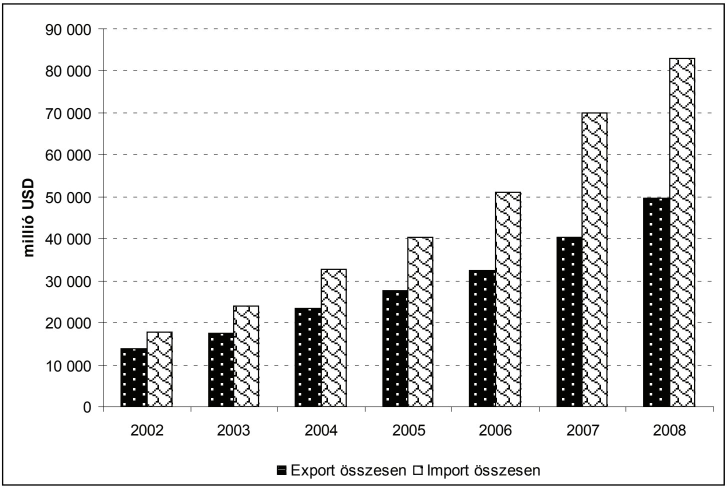
In the case of *rural development support* there are 4 groups of measures to be applied by small farms, corporate farms, young farmers, small and medium-sized enterprises of agriculture and forestry, processing plants, forest holders, farmers in mountain areas and municipalities. The *first group of measures is:* improving the competitiveness of agriculture and forestry. Within them 3.97 billion EUR (45%) should be made available for supporting the improvement of the competitiveness in agricultural and forestry branches, for modernization of subsistence farms, for the first investments of young farmers, for creation of production groups and for trainings. *The second axis* (land management) contains measures for supporting unfavourable areas mainly in mountain territory, for supporting meadows and pastures and for afforestation of agricultural land with 2.29 billion EUR (25%), in the framework of agricultural and environment protection programmes.

For the third group of measures 2.47 billion EUR (30%) is planned. The aim is to improve the quality of life in rural areas through supporting non-agricultural diversification, through investments of micro enterprises in rural areas and through renovation of villages. As far as the *LEADER programme is concerned* 0.24 billion EUR (2.5%) is planned for these objectives. Romania receives 263 million EUR financial support (subsidies) from the Common Fishery Policy budget during the period of 2007-2013.

5. Foreign trade

The annual average increase rate of the Romanian foreign trade was 28% between 2002 and 2008. In this period the export increased by 24% while the import increasing rate was 30%. Between 2002 and 2006 the deficit of export-import balance increased from 3.99 billion USD to 18.77 USD, which is 22% of total foreign trade. (See figure 2.)

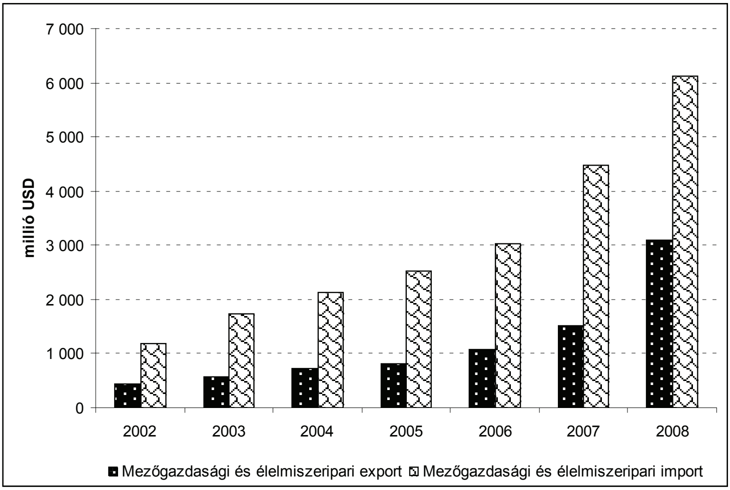
Figure 2 **Total foreign trade of Romania, 2002-2008**



Source: Agricultural Policy Research Department of Research Institute of Agricultural Economics (AKI) based on UNCTAD (2009) data.

In this period (2002-2006) the proportion of agricultural and food products in the total foreign trade was only 5%. The export of these products increased by 25%, meanwhile the import increased 27%. (See figure 3.) In turn the deficit of foreign trade of agricultural and food products increased form 0.74 billion USD to 1.96 USD. However the decay of export-import balance of agricultural and food products was less than in the case of the total foreign trade (29 and 47%).

Figure 3 **Foreign trades of agri–food products in Romania, 2002-2008**



Source: Agricultural Policy Research Department of Research Institute of Agricultural Economics (AKI) based on UNCTAD (2009) data.

In the years before the EU accession the agricultural exports to EU25 increased dynamically, mainly because of favourable conjuncture (increasing agricultural import of EU), and partially because of mending competitiveness of Romanian agricultural export (Fogarasi, 2007). In this period competitiveness of Romanian meat, milk products, eggs, cereals, oil seeds and textile fibre became better in the EU. Meanwhile the competitiveness of fodders, fish, beverages, vegetable oils and fats worsened.

Conclusions

In the years before accession the macroeconomic environment was proper for agriculture in Romania as the domestic consumption increased. On the other hand import was made cheaper by strengthening of the RON. After accession both import and export became free and the competition became stronger on the single market. As a consequence the balance of agricultural export-import worsened though the decline was far smaller than that of total foreign trade.

The proportion of agriculture in GDP and employment and also in consumption declined. But there is no change in trends: these processes had begun before the accession.

The trends in changing of production structure beginning before accession also continued: proportion of crop production was increasing compared to animal husbandry. But the figures of farm structure are strange and unexpected: after the accession to the EU the proportion of the smallest farms (below 2 ESU) increased while the proportion of the biggest ones (above 40 ESU) declined both in number and land use.

It cannot be foreseen whether it is a short or long term feature and how the fragmented structure of land use will be influenced by supports. There is a contradiction in the Romanian agricultural structure: from the point of view of competition the fragmented structure of agriculture is disadvantageous, but from the point of view of rural employment and of keeping inhabitants in rural areas it is favourable.

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THE ELEMENTS OF ENHANCEMENT COMPANY PERFORMANCE WITHIN ORGANIZATION

Hajnalka FEKETE*

Nowadays the most determining processes that affect organizations are globalization and the increase of market competition. Therefore it is more and more difficult for organizations to improve and maintain their competitiveness, as surviving is becoming more and more complicated. The answers given to the challenges differ from company to company. Survival and development can only be achieved by unique answers. Such options reflect in the diverse strategies, structural features, and organizational cultures of companies. These are the most crucial elements that may come to the aid of companies so that they achieve a better contest position nowadays.

Key words: company performance, Balance Score Card, organizational culture
JEL Classification: M21

The strategies, cultures and coordination are all unique and abstract. These are the so-called soft factors which are based on the mental resources of the company. As a result of this, factors become hard to reproduce by competitors, and they also help in the establishment of a competitive advantage in the globalized world. These factors are in the focus of the present day strategic empire of management as well.

The aim of this paper is to examine and analyze how strategy, organizational culture and structural characteristics of companies affect company performance. It is necessary to set up a model for this, in which the dependent variable is the performance and the explanatory variables are strategy, culture and the structural features of the organization (Figure 1). It is also necessary to examine the relationship among the above-mentioned explanatory variables.

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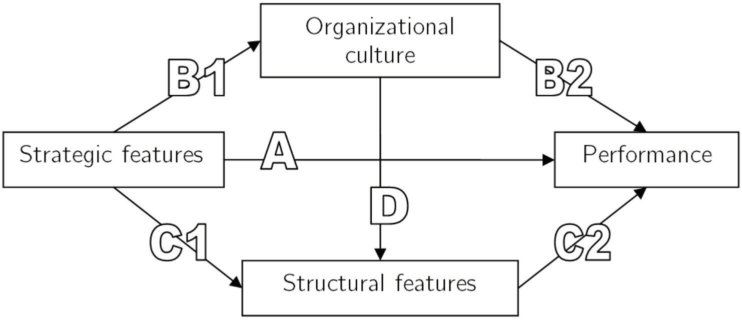
Figure 1 **The central model of research**



Source: Author's representation.

This paper intends to study the elements of an as yet unfinished research, the relationships in point of strategic characteristics, the communication of strategy inside the company in point of organizational characteristics as well as the method of labour division with respect to organizational culture and company performance.

I have analyzed the above-mentioned factors with the help of the following principles:

Strategy

It is important to examine the following factors in connection with organizational strategy:

- The manner in which the organization communicates the accepted strategy to the leaders and employees of the company may be a central issue from the viewpoint of strategy implementation. The strategy exists only in the head of top managers; however employees may also be familiar with the long term strategic goals.
- The breaking down of the strategy into measures and initiatives is also important from the viewpoint of strategy communication.

The content examination of each strategy is also essential. This means the following:

- Dynamics – based on the change of direction in the field of activ-

ity, when the organization makes an effort for expansion, stability or reduction.
- Competitive strategy – which points to the way and area, in which the company wants to compete, as well as to the variety of tools used (cost leadership strategy, differentiation strategy, cost focus strategy, differentiation focus strategy – Porter's competitive strategies).
- The manner of adaptation to the environment – what kind of behaviour does the company try to adopt in order to adapt to the environmental challenges (defender, prospector, analyzer, reactor – Miles and Snow's categorization)
- Orientation – which of the stakeholders' interests come up in the most decisive manner in the focus of the strategy (corporation-, customer-, competitors oriented – Ohmae's 3C-model)

Organizational culture

I have observed the organizational culture on the basis of Cameron and Quinn's culture model since it provides experimentally proven device, which is thus a valid tool for the diagnosis of the organizational culture. It bears useful information for the company practice as well, which enables the observation of organizational culture towards the required parts of the cultural development.

Cameron and Quinn have laid down the cultural types through two dimensions:

1. Dimension: Flexibility $\longleftrightarrow$ Stability

The first dimension differentiates the criteria of flexibility and dynamism from stability, order and control. Certain organizations are effective if they have the ability to change and adapt. At these companies both the products and the organization itself show periodical changes. Others are effective, if they are mechanistic and characterized by stability and predictability. The image and output of these organizations have remained constant for a long time. So, on the one end of the scale there are the multi-faceted, adaptive organizations, while on the other end stand those ones which are featured with steadiness and continuity.

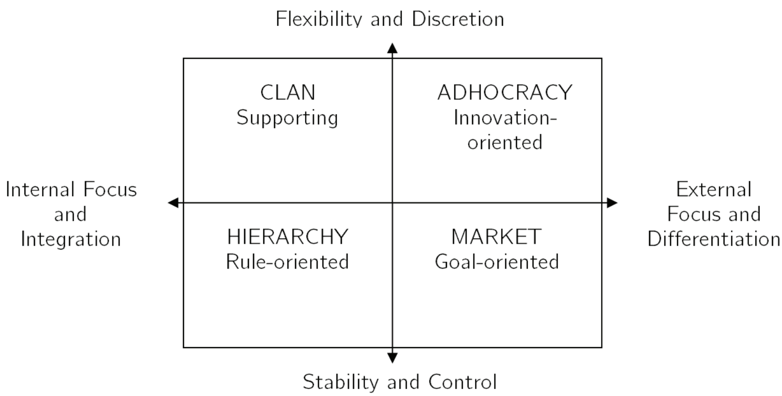
2. Dimension: Internal focus ⟷ External focus

This second dimension makes a distinction between the criteria of internal orientation, integration and concordance and the external orientation and contention. Certain organizations are characterized by consistency but as long as this "think in a global way and act locally" slogan exemplifies the strategy of some multinational companies well, i.e. their units should adapt to the local environment, so they do not work in a centrally ordered way. Thus external orientation characterizes these sorts of companies.

Four culture types may be differentiated on the basis of the two dimensions which express the fundamental values and dominant orientation of organizational working.

The model classifies the cultural types of certain organizations into hierarchy, market, clan and adhocracy. Thus we can speak about rule-oriented, goal-oriented, supporting and innovation-oriented organizations.

Figure 2 **Cameron and Quinn's organizational culture model**



Source: Cameron – Quinn, 2006.

Hierarchy – Rule-oriented (internal focus - close control)

People work on the basis of rules and policies. The effective leader is a good organizer and coordinator. It is important to keep steady and regular (smooth-running) way of operation. The main characteristic features of this are stability, predictability, rationalism, respect of formal positions and division of labour, orderliness and written communication. This is effective in a relatively stable environment. The key of success is the authority of decision making, the standardized rules and orders, the control and the accountability mechanism. Dominant hierarchy culture occurs mainly in large organizations and in the public sphere where standardized orders and a great number of hierarchical levels are more characteristic.

Market – Goal-oriented (external focus – close control)

The word market refers to the fact that such organizations operate similarly to the market itself. They do not give focus to the internal events but to the external environment. As opposed to hierarchy, which is based on rules, labour division and centralized decisions, the market focuses on transactions made with external performers, in order to obtain competitive advantage. The major goals of organizations are profitability, exploitation of market gaps, hitting stretch targets and winning on the market. The fundamental values of organizations are competitiveness and effectiveness which are reached by external positioning and heavy control.
Market culture often takes place in hostile environment where the company is interested in the reinforcement of its position on the market. The manager's duty in market culture is increasing productivity, efficiency and profit. The goals are evident and can be reached by an aggressive strategy. The power of the organization can be obtained through emphasis on success. Success is measured by market share and market penetration. It is important to defeat rivals and to achieve a leading position on the market.

Clan – supporting culture (internal focus – flexible)

The clan type culture is similar to the setup of a family. Workplace is a friendly place in a clan culture. The major characteristic features of this sort of culture are mutual respect and goals, cooperation, consensus, participation, we-consciousness and verbal communication. The organization places emphasis on the development of the human workforce and also the development of the individual. Besides it is important to take care of customers and to be sensitive towards people. The leaders behave as mentors or parents. They consider teamwork, involvement of workmates and also commitment to the organization important. In addition the treatment of customers as partners is the best answer to the environmental challenges. The organization also emphasizes the long-term advantages of individual development. Cohesion and morality also play an important role. Loyalty and tradition hold the organization together. The duties of the leaders are to empower employees, to develop their participation, commitment and loyalty. Success is determined by the internal atmosphere and the care for people.

Adhocracy – innovation-oriented culture (external focus – flexible)

The adhocratic culture is the result of the information era: innovative and pioneering initiative leads to success, i.e. more and more products are developed and put on the market, and the product-lifecycles are shorter and shorter. The innovation-oriented culture is able to react in the best way to the turbulent changes of the environment. The leaders' duty in such culture is to foster creativity, to be venturesome, to help the business to the front line. The innovation oriented organizations change rapidly among new circumstances. The major goal in an unstable environment, overburdened by information is the ability to adapt, maintain flexibility and develop creativity. These sorts of organizations adapt to new possibilities with innovative products and services. There is no centralized and autocratic power within the organization; the emphasis is on individualism, taking risk and on the forecast of the future. The power that holds the organization together is in the commitment to innovation and initiative. The emphasis is on challenges, acquisition of new knowledge, and new products and services. The organization inspires the individual with initiative and freedom. The ability to change is also very important. The long-term goal is the achievement of rapid growth and production of new resources. Success is meant by creating new products. (Cameron–Quinn, 2006)

To a certain extent all four culture types can be recognized in organizations which contain different values, assumptions, priorities. Cameron and

Quinn see the power of organizational culture in that it unifies people with different temper and culture, integrates the different observations, memories, values and definitions – thus leading the organization to success because one culture becomes dominant throughout all organizations.

Structural features

When saying structural features I consider:

- the manner of labour division within organizations; the degree of
    - functional departmentalization,
    - object principled departmentalization (product or costumer based),
    - regional departmentalization.
- division of authority
    - the subordinate units may receive orders from only one or several organizational units,
    - the organization is centralized or decentralized with regard to the daily operational decisions.
- applied coordination devices
    - vertical - horizontal,
    - structural, technocratic, person-oriented.

Division of labour means the separation of a larger process into smaller actions. The establishment of certain organizational units, sections and workplaces is carried out on the basis of labour division. Thus the fundamental part in separating organizational sectors is division of labour which may manifest itself in different principles: functional, object and regional based principles. These are the principles which bind the labour processes to the organizational units.

When talking about:

- Functional division of labour: the division takes place on the basis of professional processes.
- Object-based division of labour: the division turns out on the basis of products, materials and customers.
- Regional-based division of labour: the division of labour processes comes about on the basis of the geographical and sales location of these work processes.

In one-dimensional organizations the division of labour is carried out with the use of one of the previously mentioned principles. In the case of two-and-more-dimensional organizations, the principles are used in line with each other. Two-dimensional organizations are matrix-organizations which apply two of the principles concurrently. When more than two of these principles are applied we can talk about tensor-organizations, however they seldom occur in the real world. (Dobák, 1996)

Performance

The performance of an organization can be understood along the lines of several dimensions. This cannot be summarized within one indicator and evaluated on the basis of one feature. If we made an effort to characterize this with one or some indicators, these indicators would be financial ones. Performance, however, has abstract elements as well which are difficult to define numerically. When evaluating the performance we have to assess not only the value provided to the owners, which can be shown with financial indicators, but the value provided to the other stakeholder as well (customers, employees, social environment). Naturally, during this evaluation, we have to take into consideration the fact that the major goal of the organizations is the maximized suitability to the demands of the owners.

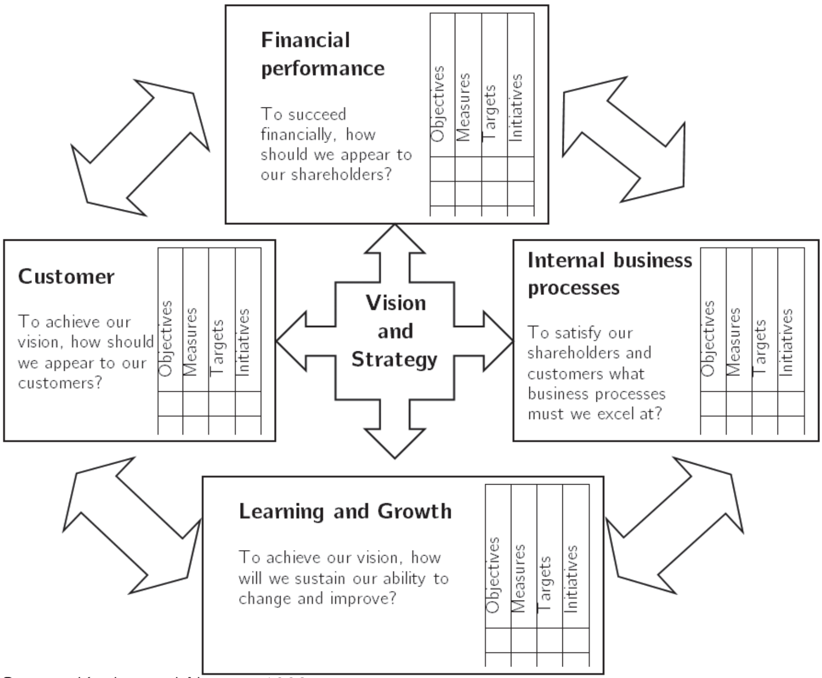
We have to assess the performance - in the interest of sustainability - through the value provided to the stakeholders and we also need to evaluate the renewable-, learning-, and developmental ability of the organization.

Because of these reasons I have chosen Kaplan and Norton's Balanced Scorecard model to value the company performance, which evaluates the performance through financial, customer, internal business processes, learning and growth perspectives, thus covering all the processes of the organization.

The aims and indicators of the Balanced Scorecard are elaborated from the mission and strategies in a top-down procedure, through which strategy is traced back to concrete indicators. This also indicates a strategic performance assessment and management system, that transforms the strategy to goals and the goals to arrangements that helps to reach these goals.

According to Balanced Scorecard we have to determine the indicators used to measure performances concerning financial, customer, internal business processes, learning and growth perspectives. When forming the indicators we also have to take into consideration those factors which affect the outcome of the indicators. After setting the indicators we need to determine the demands against the indicators and later on we have to take actions in order to meet these expectations. Companies that started to apply the Balanced Scorecard are able to determine indicators that are appropriate in number and quality to their specialties. This number moves normally from 4 to 7 per perspective in the interest of transparency. The Balance Scorecard has to cover all organizational activities and processes that are essential from the viewpoint of strategy implementation. Thus the four perspectives determined by Kaplan and Norton can be extended, if these are strategically important to the company or they have some sort of influence on the outcome of the financial performance.

Figure 3 **Structure of Balanced ScoreCard**



Source: Kaplan and Norton, 1998.

Methodology

I have searched for the answers of my research work using questionnaires and altogether 256 questionnaires have been returned to me by Hungarian companies. The questionnaires were sent to top managers of the companies, because I believe it is advisable to ask people in leading positions as they have influential power to set up and increase the values established by the company, and they are able to implement changes in the organization.

The research model examines the impact of the strategy, organizational culture and structural characteristics on the company performance. We must take into consideration that strategy, culture and structure are not independent factors, but they are interdependent. Their impact on the performance can be realized through direct and indirect effects. This is why I have chosen the path-model as the methodology of my work.
All possible relations were revealed with a correlation matrix (significant level: 0.01). I made a further analysis with the linear regression method, which identifies effects that are significant and where the coefficient of determination has sufficient power.

Those who filled in the questionnaires had evaluated their performance, marking strategic and structural features on a 1-7 scale.
The performance was assessed from the perspectives concerning BSC with the addition of the already determined factors designed by Norton and Kaplan, and in comparison with the average of other participants in the industry, on a 1-7 scale, where 1 means the weakest performance and 7- the excellence of the performance.
They evaluated the following statements within the strategic features concerning the communication of the strategy on a 1-7 scale (1-is not peculiar at all, 7- absolutely peculiar):

- strategy exists only at the level of top management
- all employees in leading positions know the strategy
- we communicate the strategy towards the organizational units well
- the staff also know about the strategy

These respondents gave answers with the same method to the questions concerning the division of labour.
I used Cameron and Quinn's culture-diagnosing questionnaire to appraise

the organizational culture which evaluates the present and required culture of the organization using six major question types. There are four alternatives to a question and the respondents divide 100 points among them. The six major question types concentrate on the following fundamental values and assumptions:

1. the dominant characteristics: what is the company like
2. organizational leadership, which pervades the organization
3. management of employees, examines the working conditions and how people are treated
4. organization 'glue' a linking mechanism that holds the organization together
5. strategic emphasis
6. criteria of success: what they consider to be success, what is rewarded and celebrated

The alternative, which obtains the most points, will become the dominant culture of the organization.

Recent results of the research

1. The more characteristics the clan culture features in the organizational culture, the higher the performance is from the perspective of learning and growth. The improvement of the performance from a learning and growth perspective increases the performance from the financial perspective as well.
2. The functional division of labour supports the knowledge of strategy among the leaders, which has a positive effect on performance as far as the learning and growth perspective is concerned, and through this on the financial performance as well.
3. The object-principled departmentalization (product- or customer-based) supports the suitable communication of the strategies of organizations towards the organizational units, which enhances directly and indirectly the performance from the perspective of learning and growth. The improvement of the learning and growth performance increases the financial performance as well. (The indirect effect positively affects the communication towards the leaders as well, if the communication of the strategy towards the organizational units is appropriate.)

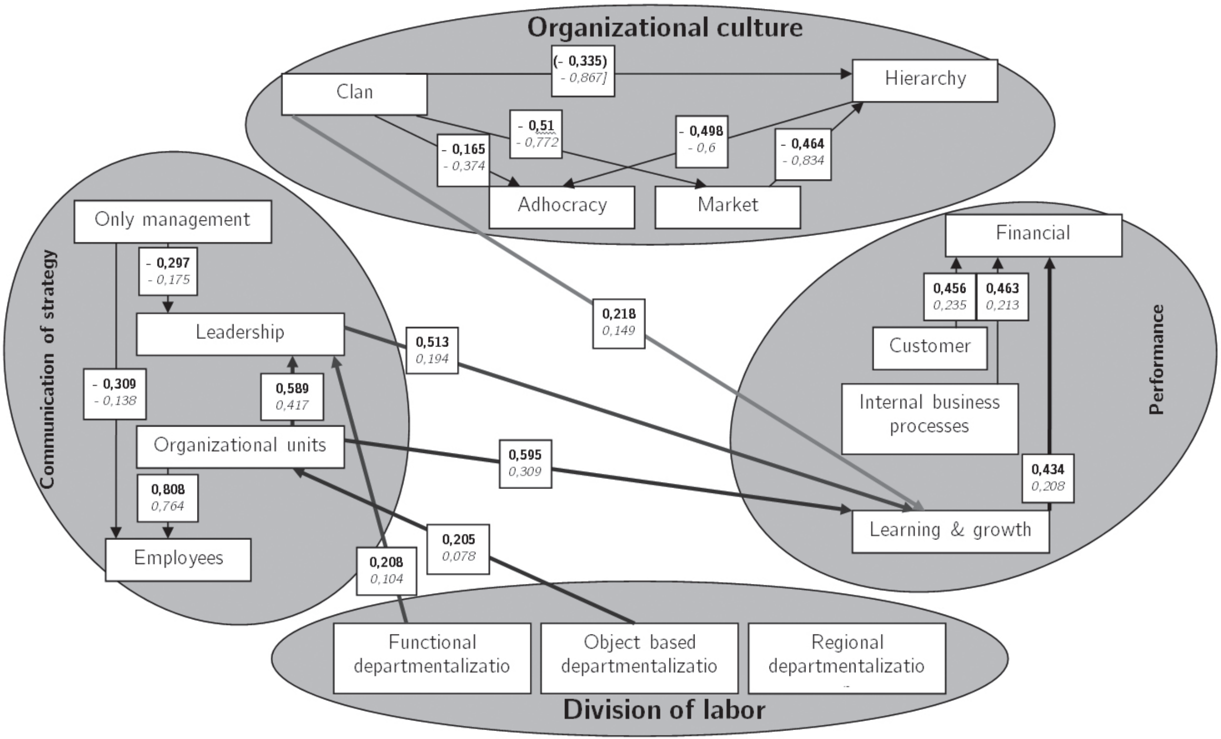


Figure 4 Results of present research

(Coefficient of **correlation**, Coefficient of *regression*)

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THE IMPACT OF THE INTERNET ON THE MARKETING ENVIRONMENT OF ROMANIAN TOURISM ORGANIZATIONS

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The article refers to the impact of the Internet on the marketing environment of Romanian tourism organizations. The managers of Romanian tourism organizations should realize that it is important to analyze those changes, trends in the different segments of the macro environment, in the industry environment, in the competitive environment which have great influence on the organization's activity, survival, success and possibility of development, because it is important to take in view the effects of these environmental changes and trends in the development and implementation of the strategy and marketing strategy. It is also important to understand the impact of the Internet on the internal environment of Romanian tourism organizations, on the value creating and offering processes, the needed resources and competencies in order to remain competitive.

Key words: marketing environment, tourism organizations, marketing strategy, competitiveness, Internet
JEL Classification: M12, M51

Introduction

In the 21 century, when the Internet has an important impact on economic and social life, managers of Romanian tourism organizations should become aware and understand that the environment relevant for the survival and development of their organizations undergone a lot of changes, which sometimes are significant, and which must be taken in consideration when they develop strategies to assure the success of their organizations.

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While global competition is continuously increasing in the tourism industry, Romanian tourism organizations try to improve their competitiveness in order to maintain and/or improve their position on the market. Tourism industry has several specific characteristics which determine those marketing strategies, actions and activities which should be used in order to attract and maintain customers.

The performances of organizations depend a lot on the characteristics of the environment in which they activate. For this reason organizations should analyze and understand what impact does have the Internet on the organization's environment, on different levels of the organization's external environment: on the general (macro) environment, on the industry environment, on the competitive environment. Beside these aspects attention should be paid to the impact of the Internet on the internal environment of Romanian tourism organizations, too.

1. The impact of the internet on the macro environment of Romanian tourism organizations

The macro marketing environment of Romanian tourism organizations refers to those aspects, forces, trends, megatrends, actors of organizations' external environment which affect the success of these organizations, but on which Romanian tourism organizations cannot have any impact, so they should take in account when develop and implement an appropriate marketing strategy, in order to build profitable relationships with their targeted customers for long term (Kotler and Keller, 2006, 77-78, and Kotler and Armstrong, 2006, 68). It is important for Romanian tourism organizations to continuously monitoring and adapting to their changing macro environment.

The major environmental forces from the political environment, the legal environment, the economic environment, the natural environment, the technological environment, the demographic and social environment, the cultural environment, the national boundaries, deregulations/regulations etc. influence the ability of Romanian tourism organization to serve their customers, create different opportunities and threats for tourism organizations, and play an important role in getting organizational performances. The Internet has a great impact on all these macro environment segments, generating different changes in them.

Governments play the one of most important roles in modifying the macro environment, from the point of view of profitability. Even the Internet, the World Wide Web is the result of the initiative of the USA government. We can predict that governmental policies from all over the world will determine how and at what extent will the Internet extend, which industries, and inside these which companies will mostly benefit from this new technology.

Romanian Government has a site www.guv.ro, where it offers different information for citizens and organizations, so adopts the use of Internet in this way, too. The Romanian Ministry of Tourism has also a site www.turism.gov.ro. In September 2003 it was created the National Electronic System of Romania www.e-guvernare.ro, providing e-services and different forms online for citizens and organizations (the World Summit of the Information Society offered an award for Romanian Government's e-government portal, for its achievements). There was developed the National Electronic Auctions System www.elicitatie.ro. In Romania exists a National Electronic Educational System - www.portal.edu.ro.

The number of Internet users is continuously increasing in Romania: in 2002 a percent of 13% of Romanian inhabitants, in 2005 this figure was 22.1% and in 2006 it was 32.4% (ISN, 2009). If we analyze the impact of the Internet from the demographical and social point of view, we can affirm that those persons, citizens who were brought up using every day the Internet for different purposes, they get used to it and its different applications, and as a result will have different needs, expectations in comparison with those persons who have no Internet using culture.
National and international economic factors, as the rate of interest, exchange rate, rate of unemployment, income of population etc. have a great impact on the attractivity of an industry. It is very important to operate - beyond a healthy general business environment - in an appropriate e-business environment. The e-business environment depends on the level of development of information society in a country. Based on the implication of the governments, many countries make efforts in order to develop their information society, which influences the level of standard

of life and facilitates the development of a competitive business environment. As a result the Romanian government decided as a main strategic goal the development of the information society in Romania.

There are a lot of factors which influence the development of information society, the level of e-readiness, the extent of using e-business and ecommerce in a country: physical infrastructure of information and communication technology (ICT) and access to this; appropriateness of ICT for national, local conditions; affordability of ICT for citizens and organizations; ICT competencies of employees and organizations; the use of Internet in daily life of citizens and organizations; harnessing legal, macroeconomic and business environment; security of transactions; government commitment and implication in developing the information society, the Internet culture; the role of government in developing ICT technology and infrastructure.

Romanian Government is implied in the development of the Romanian Information Society (in concordance with the 'e-Europe Plan') through the INFOSOC PROGRAMME. There exists a 'National Strategy for Development of Information Society in Romania', edited in the governmental decision H.G. 1440/2002, in which are set the following priorities:

- development of national IT&C infrastructure and industry;
- dynamic development of Information Society in Romania;
- e-readiness and training of human resources;
- promoting the development and use of special services of Information Society;
- improvements in security of networks, fight against online frauds and electronic criminality.

The e-readiness assessment of a country is important, because it can become an important input in developing a (national) strategy, programs and action plans to reach related goals, to measure the progress in development of information society.

For the moment the Ministry of Communications and Information Technology (MCIT) is responsible for development of Romanian Information Society. There were created other institutions in order to be suitable for the Aquis Communautaire, which together with MCIT contribute to development of information society in Romania:

- Department of Information Technology on Public Administration (Departamentul pentru Informatizarea Administrației Publice);
- National Authority for Communication Regulation (Autoritatea Națională de Reglementare în Comunicații);
- General Inspectorate for Communications and Information Technology (Inspectoratul General pentru Comunicații și Tehnologia Informației);
- Controlling Committee of Electronic Procurement System Functioning (Comisia de Supraveghere a Funcționării Sistemului Electronic de Achiziții Publice);
- Group for Promoting Information Technology (Grup de Promovare a Tehnologiei Informației) etc.

Regarding the legal environment in Romania there exist legal regulations in order to facilitate the use of the Internet in businesses, regarding universal service and the rights of users of electronic communication services and networks, electronic signature, e-commerce, data security and privacy, etc. But in Romania there were a lot of electronic frauds, e-criminality rate is high, so there exists the need to increase the security level in this field, to increase trust in different e-services, e-solutions, e-transactions, e-payments etc.

The Romanian Ministry of Communications and Information Technology and the National Statistical Institute launched in 2003 the e-statistics programme, in order to implement a real-time electronic data collecting mechanism. There was developed a site for this purpose, for the National Electronic Statistical System: www.e-statistica.ro. Organizations should register to this site and obtain an identification code in order to have access to this system and to assure the confidentiality of their reported data.

The National Institute of Statistics from Romania should develop and implement a program for gathering, preparing, analyzing data about Romanian information society and its progress, in appropriate and real-time way, to be able to offer credible, actual information, useful for organizations in investing and doing businesses using the Internet. There exists also a need of gathering data regarding different industries from Romania, among them the tourism industry.

There exists an important gap between the level of development in rural and urban areas, and between Bucharest (capital of Romania) and other regions. Also some social and business categories can not afford the access of information and communication technologies and infrastructure. There exists a Knowledge Economy Project which established the goal of reducing these gaps. Romanian Government wants to eliminate these gaps in e-readiness, formulating actions needed in this direction:

- consolidation of national information infrastructure, the communications and information technology industry;
- acceleration of constructing a base for Information Society through assuring rapid and cheep access to the Internet, and developing rapid networks for research and education;
- education and training of human resources for Information Society;
- stimulation of development and use of services specific to Information Society (through promoting electronic commerce, electronic government, electronic health-care services, intelligent transport systems etc.);
- assurance of the security of networks in order to combat electronic frauds, promotion of intelligent cards.

Regarding the information infrastructure, Romania is characterized by low fixed-line telephone penetration rate in the rural area, but high penetration rate of mobile phones. There is a lack of Public Internet Access Points. Electronic banking and banking services for e-commerce must be developed. Television set penetration is high, and cable television services are accessible for roughly half of the households. The National Action Plan includes an Access and Connectivity Program to overcome these shortages.

Romanian population has a low average income level, as a result the affordability rate of Internet accession for citizens and small businesses are low, especially in the case of mobile Internet access. There exists a social program to increase affordability of personal computers for poor children.

Generally citizens have dial-up connections. Broadband connections are rare, but broadband Internet access is increasing. Adoption of Internet by educational institutes, public administration, and healthcare institutions is constrained by budget. Local databases of public administration must be correlated with central databases. In Romania it is necessary to increase the penetration rate of the Internet (the number of hosts per 1000 habitants), and especially the broadband access to the Internet.

The primary and secondary education institutions have not sufficient computers and Internet access. Internet penetration in tertiary education institutions is acceptable. Romania 'produces' and has a lot of well trained ICT specialists, but most of them are in the urban areas (or leave the country to work abroad). Generally the population is not aware of the benefits of using the Internet, and different online services (for example e-administration or e-government services). As a result the National Action Plan includes a Training, Education and Public Awareness Program.

In Romania especially small companies are involved in software developing. Penetration rate of computers and Internet in businesses are acceptable. A lot of businesses have web sites, and/or use the e-mail to communicate with business partners. Many firms present online catalogues and make possible to place online orders, but generally do not accept online payments (just traditional payment methods). But introducing in Romania the 3D Secure System, the number of businesses accepting online payments is increasing. Romanian Government should offer incentives for businesses to adopt ICT technologies in their activity, to invest in ICT equipment and e-commerce solutions, to create value using the Internet. There is a serious need for integrated solutions in this idea, which should be compatible with eventually previous electronic solutions.

The Romanian Ministry of Tourism developed a master plan for development of Romanian tourism in the period of 2007-2026 presented on www.turism.gov.ro, called 'Master Planul pentru Turismul Național al României 2007-2026'. The main objectives of this plan are referring to the necessity of an integrated nationwide strategy which facilitates the development of Romanian tourism. The Master Plan includes an Action Plan for the period of 2007-2013, in order to attract EU financing funds.

The World Economic Forum 2007 placed Romania in position 76 from 124 analyzed countries, based on the criteria of competitiveness in the tourism and travels, our country being considered in this position prior to Ukraine, but well after Bulgaria, and other countries, like Croatia, Czech Republic, Hungary, etc. (taking in view the legal frame, business environment, human, cultural and natural resources of these countries) [6]. This week performance of Romania can be improved by nationwide efforts regarding development of legal regulations especially in the field of environment protection, in infrastructure, in human resources, in services offered, integrating the Internet efficiently in daily operations etc.

The macro environment has an indirect impact on the performance of a tourism organization, because it influences the competitive environment and the business models, too.

2. The impact of the internet on the environment of tourism industry

In the 21 century Romanian tourism organizations must face the following main challenges: economic crisis, globalization, intensified competition for limited resources, need for the sustainable development and management of tourism, operational efficiency, increased business costs, infrastructural lacks, and use the Internet as a marketing tool.

The impact of the Internet on industry environment was studied intensely, and we can mention different aspects of this impact (Afuah and Tucci, 2001), which can be applied to the tourism industry as well, taking in view the five competitive forces of an industry defined by Porter (2001).

The Internet can equalize at some extent the negotiating power of a tourism organization and of its suppliers, because it reduces the asymmetry of information. On the Internet there are available information referring to products, services, prices, terms of delivery etc. of suppliers, and as a result the tourism organizations' negotiating power over their suppliers increases in comparison with the situation in the traditional world. Through the Internet more suppliers can offer their products and services to their clients, tourism organizations do not depend any more on their local suppliers, they can negotiate theoretically with any supplier all over the world, but suppliers can sell their products and services to more tourism companies worldwide.

The Internet can also equalize at some extent the negotiating power of the clients and tourism organizations which serve them with different services. The Internet offers a greater power for clients over the tourism organizations, companies which serve them with products and services, because clients can get more information about competitors' offers, they can easily compare the competitors' offers. Due to the Internet a greater number of companies fight for the clients' attention. Tourism companies can directly offer their products and services for clients. On the Internet tourism organizations can contact different segments of clients: who just visit their web site, who buy online the tourism products and services, who place their advertisements on the tourism organization's web site (other organizations). Those tourism organizations which have more extended marketing networks have greater bargaining power over their clients, because there is a lower possibility for the client to switch to other competitor's tourism product or service.

Regarding the intense rivalry among existing competitors in the tourism industry, we can underline that there exists the possibility of price wars, advertising wars, promotional wars, and the profits for all tourism organizations will fall. The Internet intensifies rivalry among competitors in many cases of tourism products or services, because clients are not dependent on local offers, they can buy from any tourism company from all over the world. Competitors can come from anywhere the world, but the market for the tourism company's products or services becomes the whole world, too.

The Internet increases the threat of appearance of new entrants in the tourism industry, the profits of existing competitors fall, because they have to try to stop the new entrants. New entrants must know the costs and prices of existing competitors in the industry in which they want to get in. This information can be easily obtained through the Internet. New entrants can come from anywhere from the whole world. Regulations and deregulations (including those referring to the use of Internet for business purposes) can increase or can decrease the barriers of entry into an industry, and the profits which can be achieved by a company in an industry.

The Internet increases the threat of substitutes, because offers much information about substitutes, their prices, ways and extent of substitution, etc. Through the Internet it becomes easier for the clients to find and buy substitutes. Another threat is that substitutes can come from all over the world.

We should mention the complementors, which are those companies which offer products or services which are complementary to the tourism products or services of a company from the tourism industry. Complementary products or services increase the demand for the products or services from the tourism industry. The Internet offers much information about complementary products and services, increasing the rivalry among them and the demand for them, as a result increases the demand for the products or services from the tourism industry. Analyzing the attractivity of the industry we can obtain information for a tourism company how through appropriate strategic actions can get profit using its competencies.

Referring to the dynamism and evolution of the tourism industry, we can affirm that a technological change, like the appearance of the Internet, has impact on the dynamism of competition, as competitors continuously try to develop sustainable competitive advantages in order to assure their success on the market. The industry structure will modify with the evolution of the industry, which depends on the evolution of technology. In the launching period of a new technology a lot of organizations make investments in it, new entrants will entry the industry, but also many of them will fail. In the growing stage of the technology companies will fight for achieving standards, establish relations with their clients, try to get brand loyalty, fight for market share. The number of companies who survive will decrease as the technology arrives at its maturity.

For a sustainable Romanian tourism there exists a need for sustainable businesses, sustainable destinations for tourism and responsible tourists. The Internet can play important role in promoting the idea of sustainability and in educating tourists for becoming more aware of, conscientious and responsible for sustainable tourism.

In developing an Internet based business model it is important to identify and to take into consideration those critical success factors, which have the most impact on the costs of an organization and on the distinctive value offered by them. The idiosyncrasies, which form the bases for critical success factors can be the distinction factors between different business models.

The Internet has many properties through which it has an important impact on the business environment, business models and the profitability of an industry (Afuah and Tucci, 2001). As a mediating technology the Internet can connect different entities which are or would like to be interdependent, the Intranet offers the possibility of interconnection inside an organization, the Internet facilitates the exchange of information between different entities distributed in space and time, and because the Internet is interactive, any entity can broadcast information. Through its universality property the Internet can enlarge or compress the world, it can enlarge it because everybody or every organization everywhere from the world can offer its products or services to anybody or any other organization in the world - so geographical segmentation becomes not so important- , but it can compress it because it makes possible for an employer to work without being obliged to travel in a determined workplace - e-working. In the case of the Internet we can mention network externalities or network effect, as a technology or o product/service has network externalities, if its value increases proportionally with the number of the clients, who will benefit of the advantages offered by this. The Internet has this characteristic, because if it is used by more people, it becomes more valuable for them. The Internet can function as a distribution channel (the Internet is an alternative distribution channel for products/services, and also a delivery channel for products/services based on information, which can be easily digitalized). When the product/service can't be delivered through the Internet, information about it can be (information about characteristics, features, prices, terms of delivery etc.). The Internet in some cases replaces traditional distribution channels (effect of replacement), in other cases it extends the traditional ways of distribution (effect of extension). The Internet is a time moderator as it has the capacity to reduce or to extend time. It reduces the needed time for a client to obtain information about a product/service, an organization etc., or the time to buy this product/service. It enlarges time, because for example it extends the time for customers to buy products/services. The Internet is an information asymmetry shrinker, as reduces in some extent the differences in accessing information for business partners. The Internet has infinite virtual capacity, it offers the possibility for sellers to collect much information about their clients, and to offer virtually unlimited information to their customers about their products, services and other related aspects. The Internet is a low cost standard, being opened for anybody, easy to use, and a cheap communication and distribution channel. The Internet is a creative destroyer, which means that it destroys or eliminates other old ones. The Internet creates new industries, it transforms the structure and profitability of existing industries, or it increases the base for competitive advantages in other industries. The Internet is a transaction-cost reducer, because reduces some costs related to transactions, especially those related to information gathering about customers, suppliers etc., to negotiating, to developing, monitoring and finalizing contracts, to delivery etc.

3. The impact of the internet on the competitive environment of Romanian tourism organisations

Romanian tourism organizations implement their business models in a competitive environment. They have to face their competitors; have to protect themselves from the threats of new entrants and substitutes, to create long-term relationships with their suppliers and clients, to find complementors, in order to be successful on the market. In order to be profitable the tourism company must offer value for its clients, value which must exceed the costs of creating and offering it. The Internet can have influence on the value creating and offering process of the tourism organizations, but also can influence the expectations of the clients, and the clients' perceived value.

Analyzing the competitive environment using the clients' demands/value model, we can observe that the Internet can modify for some market segments both the expectations, demands of clients, and what they value when they buy a product or service. Analyzing these changes in expectations, values, a tourism organization can identify market segments which can be served in a differentiated way, and if it has the appropriate competencies, the tourism organization can obtain competitive advantages against its competitors.

Analyzing the competitive environment of the tourism organization using the strategic map for identifying the strategic groups to which is attached the tourism organization; we can analyze the impact of the Internet on the main factors which influences the competition in the tourism industry.

The Internet can eliminate some factors which influenced before the competition, or can create new factors which will influence competition in the tourism industry, or can modify the priorities between the factors which influence competition in the tourism industry. The Internet can also modify the characteristics of a tourism organization from the point of view of a factor which influences competitiveness in an industry, and which defines strategic groups. Because of these changes, in the strategic map could appear changes in the position of strategic groups or in the position of a specific tourism organization in a strategic group.

The Internet amplifies the concept of co-opetitors, which refers to the organization's competitors, suppliers, clients, complementors, potential competitors with whom the organization must cooperate and compete at the same time, because their role in creating and offering value is intensifying.

Competitiveness of a tourism company is influenced by e-readiness of its country, of the industry to which it belongs, of its (actual and potential) clients, and of course of its own organization. First of all the country must be prepared to be e-ready, in order to be able to be part of the global information society and digital economy. But different sectors of national economy differ in the degree of their e-readiness, and also organizations in different industries have various extent of e-readiness. Improving the e-readiness of a country, an industry and organisation, the competitiveness of a company develops, too.

A company must take in view that its industry is one which creates information technology, consumes information technology intensively or it is neutral from this point of view. The tourism industry is one which consumes information and communication technology intensively.

The e-readiness of Romanian tourism companies must be analyzed, too, to get information about the readiness of Romanian tourism firms to adopt e-business and e-commerce solutions, about their communication and information technology infrastructure, IT competencies, understanding of e-business and e-commerce principles by management, their electronic activity which creates value, and the effects of their electronic activities upon the organization and industry value chain.

The e-readiness of Romanian tourism organizations can be described as follows:

- use Internet in different ways and degrees in their activity;
- use different online marketing tools to attract and maintain customers;
- use Internet for communication, information gathering and exchange, purchasing, online marketing, training of personnel;
- Internet has impact on efficiency of internal activities, processes.

4. The impact of the internet on organizations' internal marketing environment

The performances of tourism organizations depend a lot on the characteristics of the value chain, value shop, value network based on which they activate, and on resources and competencies they can use for creating competitive advantage. For this reason Romanian tourism organizations should analyze and understand what impact does have the Internet on their organization's internal environment.

In order to offer different tourism products and services Romanian tourism organizations should operate and combine different activities, which form their value chain. Each of these activities can add value to their inputs, and as a result the tourism organization can obtain sustainable competitive advantage. The value chain of a tourism organization is composed by primary activities (inbound logistics, operations, outbound logistics, marketing and sales, service) and support activities (procurement, technological development, human resources management, infrastructure) (Rusu, 1999).During its activity a tourism organization interacts with its suppliers, customers, other organizations from complementary/related industries, and all of these have their own value chains. As a result every tourism organization's value chain is part of the value system (Porter, 2001a).

The Internet has several characteristics through which it influences the primary and support activities of the value chain (Afuah and Tucci, 2001). Regarding the impact of the Internet on the different activities from the value chain, we can mention the followings (Porter, 2001b):

A. Primary activities:

1. Inbound logistics:
    - Real-time and integrated scheduling, delivering, warehousing management, demand management, inside the organization and along its suppliers;
    - Real-time dissemination of inventory data;
2. Operations:
    - Real-time and integrated scheduling, decision making in plants, information exchange with partners (contract assemblers, components suppliers);
    - Real-time dissemination of information to sales forces and partners in distribution channels;
3. Outbound logistics:
    - Real-time transaction of orders;
    - Automatic personalized specifications of customers and agreements;
    - Customers' and distributors' access to information about product development and delivery status;
    - Integrated collaboration with customer forecasting systems;
    - Integrated channel management (information exchange, warranty claims, contract management);
4. Marketing and sales:
    - Online distribution channels (web sites of companies, online marketplaces);
    - Real-time access of customers to product information, online catalogs, information about prices, terms of delivery, terms of payment etc., online orders;
    - Online configuration for products, services;
    - Personalized marketing based on individual consumer profile;
    - Push advertising;
    - Online marketing research, real-time online feedback from consumers;

- Individualized online access;

5. After sales services:
   - Online support for customer service representatives;
   - Online customer self-services;
   - Real-time access to information related to after sales services;

B. Support activities:

1. Procurement:
   - Planning using the Internet;
   - Purchase system, inventory system, forecasting system linked through Internet with suppliers;
   - Automated procurement cycles;
2. Technological development:
   - Product design in cooperation between different locations of the organization and participants of value system;
   - Accessible knowledge directories;
   - Real-time research and development access to client, sales and service information;
3. Human resources management:
   - Self-service for human resources;
   - Training based on the Internet;
   - Information sharing and dissemination based on the Internet;
   - Online time and expense reporting;
4. Infrastructure:
   - Financial systems based on the Internet;
   - Information and communication systems (including marketing information systems) based on the Internet.

It is important for the managers of tourism organizations to understand that the physical value chain has different nature from the virtual value chain (Kotler and Keller, 2006). The *value chain* model is applicable to mass-production, and even to mass-customization of different products offered by producers.

Beside the concept of the value chain, there exists the concept of the *value shop* (Afuah and Tucci, 2001). Some specialists consider that in the case of service creation and offering the value creation process must be treated differently. Service providers should individualize, customize their services conform to the needs and expectations of their customers, they work in real-time, and try to offer new solutions for their customers, and not fixing a solution which is reproduced in time.

Another concept related to value creation processes is the *value network*, which is a value configuration of an intermediary organization (for example a broker, a market maker, which brings together buyers and sellers) (Afuah and Tucci, 2001). In this case customers must perceive as value to be member of the network owned or operated by the intermediary.
Tourism organizations must adopt one of above mentioned value configurations: value chain, value shop or value network, in order to operate on a specific market. To be able to offer value for their customers tourism organizations need resources and competencies.

In the new economy the tendency for tourism organizations is not to own all the needed resources, but to assure the availability of them when they are necessary. In some cases the Internet can facilitate the assurance of the needed resources, for example through linkages, connections between different organizations. Tourism organizations should use their resources in a way they offer value for their customers, which mean they should develop competencies, taking in view that only core competencies will be the source for sustainable competitive advantage for the organizations. Brick and mortar, click and mortar and virtual (dotcom) tourism organizations also should develop Internet competencies, and traditional competencies, too, in order to maintain their competitive advantage or to create new competitive advantage.

Internet competencies can be used complementary to traditional competencies, as an extension of these. The appearance of the Internet in businesses does not mean necessarily that traditional competencies of tourism organizations (which in a proved way assured for a period of time the success of the organization), must not be thrown away, and must not be eliminated.
Integrating traditional (offline) competencies and Internet (online) competencies any kind of organization can improve its operational effectiveness, or strategic positioning, and as a result its chances for success.

Marketing has two important roles in the value chain (which can be better performed using the Internet):

- It should stimulate the demand for a product or service;
- It should offer inputs (data) for product specifications, including estimation of the demands.

Different factors have impact on tourism firms' competitiveness. Innovation is one of those aspects which can improve competitiveness. Some environments are more favourable for innovation (Afuah and Tucci, 2001), and using the Internet tourism organizations can facilitate innovation.

The Internet can be used to create and maintain a profitable, intense and long lasting relationship with the customers. Internet offers solutions for personalization, individualization and interactivity. It permits for tourism firms to obtain, gather information about general environment, industry, main competitors, customers, clients, so online competitive intelligence can be a source of competitive advantage. It permits to develop creative strategies. In the virtual space clients can configure online the products and services they want, they can place orders, pay online, even they can get online the products/services (which can easily be digitalized).

There exists a need of gathering information about tourists to be able to create their profile. The Internet can be a useful tool in this idea. Through the Internet tourism organizations can offer real-time information about the situation of the tourism destination site for tourists, about the weather, weather forecast, about different events etc., can offer practical suggestions about clothing, etc.

The principles of traditional marketing and strategy remain the same in the online world, but the Internet changes some aspects. Tourism firms can obtain competitive advantage through offering superior value to their customers, building unique resources, and appropriate positioning on the market (in the mind of the customers). But tourism firms must take in view, that due to the Internet the competitive responses arise in real time, immediately, theoretically from anywhere from the world. Internet can be, and probably in short time must be, implemented in any tourism organization's marketing strategy, it can be or it is an essential part of it, in order to achieve synergy of online and offline activities.

Tourism organizations must take in view, that online marketing can have both online and offline effects, it can facilitate both online and online activities, can generate cross-channel marketing effects (online and offline). For this reason online and offline marketing efforts must be integrated and coordinated, managed in an integrated way.

The Internet has an important impact on the value creation process of the tourism organizations, and of their industries. Tourism organizations should develop business models according to their value creation process.

Strategic Internet competencies alone do not guarantee the success, but they are necessary for it.
As a result of an exploratory research based on analyzing the websites and interviewing management members of several Romanian tourism firms, I concluded that these companies are involved in using information technology and the Internet in their activities in different ways and degrees, and they use different online marketing tools to attract and maintain customers, but they do not use intensively the personalization, customization possibilities offered by the Internet.

6. Conclusions

Romanian tourism organizations can use the Internet to face in an effective and efficient way the main marketing challenges:

- Develop a diverse tourism offer around different attractions.
- Increase length of stay and spending.
- Reduce seasonality.
- Support local business development and employment.
- Marketing of tourism destinations and products should respect ethical values.
- Integration of tourism into the marketing strategy of country and destinations.
- Develop and manage sustainable tourism etc.

Each Romanian tourism organization, company should analyze the impact of the Internet on its general environment, its industry environment, its competitive environment, its internal environment, its value chain, value shop or value network, its resources and competencies, because these components of its external and internal marketing environment could suffer changes which can influence the success of the tourism organization on the market.

Not only those companies' activities and competitive position are influenced by the Internet which activate exclusively online, but those companies', too, which activate only in traditional way in the physical world, or those companies', which have both online (in cyberspace) and offline (in the real, physical world) activities.

As a final conclusion we can affirm that the Internet affects the external and internal environment of any type of tourism organization, in a specific way and at a specific extent.

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ASSESSING ROMANIAN MANAGERS' EMOTIONAL INTELLIGENCE USING GRAPHOLOGY

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The present article discusses the utility and use of graphology in assessing Romanian managers' emotional intelligence. For each organization all over the world it should be important to evaluate all their managers' emotional intelligence, as this plays an important role in the success of their work, and as a result in that of the whole organization. Different organizations all over the world collaborate with graphologists having special knowledge and experience in specific domains of graphology. One of the goals of this collaboration is to assess their managers' emotional intelligence. First, the authors present briefly the role and the dimensions of emotional intelligence then they discuss the methods, which can be used to assess the main components of the four core emotional intelligence skills using graphology.

Key words: emotional intelligence, assessment of emotional intelligence, graphology, graphology in management, graphology used for human resources purposes
JEL Classification: M12, M51

Introduction

The most important questions this subject raises are the following:

- What is emotional intelligence?
- Why is emotional intelligence important in our everyday life?
- What is the role of managers' emotional intelligence in management and in obtaining long term success for their organizations?
- How can we assess managers' emotional intelligence?
- How can be developed emotional intelligence?

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- What is graphology?
- How can graphology be used in management?
- How can graphology be used to assess and develop managers' emotional intelligence?

Graphology is a relatively new science, which has an interesting history. Unfortunately, there still exists a misunderstanding on what graphology is and where and how can it be used by individuals or organizations. According to a common definition 'graphology is the study and analysis of handwriting especially in relation to human psychology. In the medical field, it can be used to refer to the study of handwriting as an aid in diagnosis and tracking of diseases of the brain and nervous system. The term is sometimes incorrectly used to refer to forensic document examination.' (Wikipedia, 2009)

If we want to be more specific, we can use another definition 'graphology is the science which based on the analysis of human handwriting makes conclusions referring to the personality and structure of psychic life of a person' (F. Visnyei *et al.*, 2001, 5).

Graphologists know that the handwriting of an individual reflects their emotional status, mood as well as the general and actual state of the individual's physical and psychical health. After a graphology analysis the graphologist makes a synthesis in order to make conclusions referring to the personality traits of a person. A common misunderstanding is represented by the fact that sometimes graphology is confused with forensic handwriting expert work, which has a different character. Handwriting experts analyze the handwriting, too, but the purpose of the analyses made by them is to determine if a specific handwriting is of a specific person, or it was written by somebody else. Of course, handwriting experts can make analysis of written texts made on typewriter, too, in order to determine some later modifications or falsifications.

We can mention that in specific cases the graphologist's and the forensic handwriting expert's work becomes complementary and their mutual application increases the efficiency of problem solving.

Managers at different hierarchic levels should be conscious of the following facts: what graphology is, in which cases it can be used for organizational purposes, which are its advantages and of course which are the limits of this method. They should understand that in order to make better decisions they can rely on the recommendations of a professional graphologist, but they should not forget that the graphologist is not in charge of solving their problems. Decision making still remains the responsibility of managers.

Graphology can be used for different purposes in different domains. It has the following specific uses (Gulyás, 2001; F. Visnyei *et al.*, 2001; Kánya and Gáspár, 2009):

- graphology used for human resources purposes;
- media graphology;
- strategic graphology;
- pedagogical graphology;
- interpersonal relationship graphology;
- graphotherapy;
- graphokontroll;
- forensic (judicial) graphology etc.

There exist several domains where graphology can be applied in order to improve the marketing and the management performance of organizations, for example (Gulyás, 2001; F. Visnyei *et al.*, 2001; Vorzsák *et al.*, 2007):

- Marketing communication - Marketing communication plays an important role in the following fields: attracting and maintaining customers, obtaining customer loyalty, attracting and maintaining suppliers, developing and improving the image of products/services and that of the organization, facing the challenges of the environment in which the organization operates, developing and maintaining competitive advantages etc. The main challenges of marketing communications are to define the content of the marketing messages and to codify them in a form that the target groups are able to decode in a way that assures the organization the efficacy and efficiency of the marketing communication. The application of graphology in the mass media can offer useful tools in the visual codification of marketing messages in order to have the desired impact on the selected target groups.

- Recruitment of employees - Graphology can be used for human resource management purposes in the recruitment procedure. Graphologists can assess cognitive, emotional and spiritual competences, ambitions, commitment to work, tenacious need to produce, creativity and other characteristics of the applicants. As a result they can make recommendations for human resource managers and other managers of the organizations regarding possible applicants.
- Selecting managers/leaders - Graphology can be used for human resource management purposes for helping the selection of managers for a specific function and hierarchic position. Graphologists can assess cognitive, emotional and spiritual competences, ambitions, commitment to work, tenacious need to produce, creativity and other characteristics of the applicants for a specific management function.
- Personnel evaluation - Managers should periodically assess the performances of their employees. Based on the performances of the employees they can offer proper reward systems, they can promote personnel, they can motivate employees to continuously improve their performances, they can reorganize human resources if it is needed. The graphologist can help by assessing the best way each employee can be motivated for these purposes.
- Career planning – Graphologists can help a person who would like to plan their own career, and also can help the management of a specific organization who would like to know whether or not the employees achieved performances based on which they could be promoted in a specific job.
- Team-building - More and more corporate activities rely on team work, and as a result managers should pay attention to team building and team development. Graphologists can help to choose the appropriate team members, who should fulfil specific roles and who should do specific work as a team-member. Sometimes conflicts appear between team members and team leaders should be able to manage these situations. The graphologist can offer clues in order to help team leaders find the appropriate strategies and tactics for conflict management.

- Developing negotiation strategies - entrepreneurs and managers on different hierarchic levels of an organization should have good negotiation skills. Graphology can be used in the improvement of negotiation strategies as well as in choosing the most appropriate negotiating strategy, customized to each negotiating partner.
- Conflict/change management - Organizations try to develop an appropriate organizational structure and corporate culture and they try to harmonize corporate culture with the goals of the organization. An appropriate organizational structure and corporate culture can be an important source of (sustainable) competitive advantage. But conflict situations could appear within each organization and conflict management is important to decrease the negative effects of the conflicts. On the other side, the environment of organizations change rapidly, sometimes unforeseeably and drastically, and organizations should find appropriate ways to face these changes. Changes in the external environment of an organization lead to changes in the internal environment thus the application of change management becomes necessary. Graphology can be used in finding ways to reduce the negative impacts of conflict situations and changes. The phenomenon of mobbing, i.e. the psychical terror at the workplace can also appear. In these cases an employee faces repeated psychical attacks, tease, annoyance and criticism from colleagues or managers. Graphology can reveal the factors that facilitate the appearance of mobbing. Managers have the responsibility of trying to prevent mobbing situations in their organizations.

Emotions in organizations and emotional intelligence of the managers

Conscious leaders recognize that their words and actions have an impact on the emotional and physiological well being of their employees (Goleman, 2007; Goleman *et al.*, 2007; Cândea and Cândea, 2005). Thus they try to motivate their subordinates through their own behaviour. The emotional responsibility of the leaders is crucial, as they fulfil a primary emotional role in the organization. They are considered emotional guides for the members of their work-team (Goleman *et al.*, 2007). Good managers know that emotions play an important role at the workplace, not just in promoting the values shared by the members of that organization or in offering better work performance but also in many intangible aspects, like motivation, dedication to work, commitment, enthusiasm or a high level of work ethic.

A manager from any hierarchic level has the main responsibility for orienting the collective emotions in a positive direction. Besides, they are responsible for eliminating or diminishing the toxic emotions from the organization (Goleman *et al.*, 2007). Each manager should have empathy. If a manager succeeds in guiding the emotions of the employees in a positive direction, the performance of the subordinates will improve.

The emotional status of the employees determines their work performance. Their optimism facilitates cooperation and their honesty leads to the improvement of their performance (Goleman *et al.*, 2007, 26).
Emotionally intelligent leaders and managers are like magnets, because they succeed in attracting and maintaining the best workforce, and can assure good cooperation within different members of the organization (Goleman *et al.*, 2007, 28).

Positive emotions improve mental performances, while negative emotions erode mental performances (Goleman *et al.*, 2007, 30). Optimal work atmosphere facilitates the development of useful emotions, emotional status of the employees, and therefore higher performances and higher commitment can be achieved. This will improve customers' and other stakeholders' satisfaction, which will lead to higher levels of income and profit and better financial performances. All these assure the long term success of the organization.

In an organization led by emotionally intelligent managers, employees share common values and principles, learn from each other, work in performing teams to fulfil their job, make decisions based on cooperation and become emotionally related to each other.

How can graphology help in assessing emotional intelligence? Graphologists can find in the handwriting of any person the graphlogical signs, which reflect different components and determinants of their emotional intelligence. Analyzing these signs graphologists can interpret them in order to formulate conclusions about the different components of the person's emotional intelligence.

Graphology in cooperation with other sciences or complementing these sciences (like psychology, sociology, management etc.), can offer a better understanding of some aspects revealed separately or together and can offer information in order to make better decisions. Through their lifetime each human develops different relationships with different people. The lack of human relationships leads to psychological problems. Primitive sexual relations cannot be described by emotional or intellectual components as they are pure physical relations. In spiritual relationships there do not exist physical or emotional components. They can be characterized only by intellectual components. But the success of human relationships is influenced by the partners' emotional intelligence.

If we analyze the hierarchy of the relationships, we can state that spiritual relations are on the top of the hierarchy in which we cannot find physical or emotional factors only intellectual components. At the bottom of the hierarchy we can find the primitive relations, related to sexuality, which have no emotional or intellectual components, only physical factors. We can affirm that emotions don't play a role in developing sexual or spiritual relationships. Excepting these two kinds of relationships, emotions and emotional intelligence do play an important role in developing and sustaining social relationships, relationships with a partner and intimate kind of relationships. Considering the relationships at the workplace as part of social relationships, we can understand how important emotional intelligence is in developing and sustaining good relationships with our colleagues, as the success at a workplace is highly connected to the quality of the relationships at the workplace.

Emotional intelligence is defined as the ability of a person to use the awareness of own emotions to manage behaviour and relationships with other persons (Goleman, 2007). The 4 core emotional intelligence skills most closely linked to work performance are divided in two groups (Goleman *et al.*, 2007):

1. Personal Competences:
    - Self-Awareness – represents a person's ability to perceive accurately own emotions and stay aware of them as they happen. This includes the way a person tends to respond to specific situations and people.
    - Self-Management – represents a person's ability to use the awareness of own emotions to stay flexible and positively direct own behaviour. This means managing own emotional reactions in all situations.
2. Social Competences:
    - Social Awareness – represents a person's ability to pick up accurately on emotions in other people and get what is really happening. This often means understanding what other people are thinking and feeling even if the person doesn't feel the same way.
    - Relationship Management – represents a person's ability to use own awareness of own emotions and the emotions of others to manage interactions successfully. This includes clear communication and handling conflicts effectively.

There are several psychological characteristics related to emotional intelligence, which must be determined in order to be able to use graphology in assessing managers' emotional intelligence. After defining the psychological characteristics related to emotional intelligence it is important to define the graphological signs related to psychological characteristics of emotional intelligence.

Certified and trained graphologists use the handwriting of an individual in order to determine those graphological signs related to psychological characteristics of emotional intelligence which can be found in the studied person's handwriting. Based on these findings graphologists can assess the emotional intelligence components of the person, obtaining a score for the different psychological characteristics related to emotional intelligence. As a result graphologists can create the emotional intelligence profile of the assessed manager, describing how well the person in question can understand and manage their own emotions and how they can handle their relationships related to workplace.

Romanian organizations can cooperate with Romanian graphologists in order to asses the emotional intelligence of the managers because in Romania the Ministry of Employment, Family and Equal Chances of Romania (Ministerul Muncii, Familiei și Egalității de Șanse) recognized the profession of graphologist (act nr. 792/19.10.2007), based on the request (referring to the updating of the Classifications of Professions in Romania) of Gáspár Jolán Andrea, president of the Association of Romanian Graphologists.[1] The Association of Romanian Graphologists was founded as a private organization in Romania in 2005. The headquarter of the Association of Romanian Graphologists are in Târgu-Mureș, but it has representatives in several counties, for example in Oradea, Bihor county.

Conclusions

Romanian organizations should use the help of highly skilled, certified graphologists in order to improve their activities and management of their businesses.

They should become conscious of the utility of using graphology in order to improve the efficiency and effectiveness of their businesses, management and activities.

Assessing the emotional intelligence of managers should be a priority of organizations in order to have the possibility to select the most appropriate managers and to improve managers' EQ.

[1] Gáspár, Jolán Andrea: Recunoașterea oficială a profesiei de GRAFOLOG, In: GRAFO info – Buletin de informare al Asociației Grafologice din România, Anul I., Nr. 1/2009, p. 9.

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KNOWLEDGE PRODUCTION IN TIME OF ECONOMIC CRISIS: ECONOMIC AND ETHICAL REMARKS ON THE EU RESEARCH AND DEVELOPMENT POLICY

László FEKETE*

Ten years after the unanimous approval of the Lisbon Strategy at a special meeting of the European Council on 23-24 March 2000 in Lisbon, it will be inevitable for the European Commission and the majority of the EU member states to face its fiasco and to account for the reasons of their fundamental policy, governance and economic failures in 2010.
The recent turbulence of the global economy offers some excuses for the underperformance of the main objectives of the Lisbon Strategy in the essential social and economic domains, like job creation, economic growth, and environmental sustainability. Negative growth rates, macroeconomic instability, the contraction of the internal and external markets of the European economy, drop in demand for capital investment, goods and services, sinking corporate revenues, depreciation of corporate assets, increasing private and public indebtedness, falling rate of employment, weakening social cohesion, widening social inequality, and so forth not only deprive the majority of the EU member states of fulfilling the main objectives of the Lisbon Strategy but also drive them into worse social and economic conditions in many policy domains than they were in 2000.

Key words: knowledge production, economic crisis, EU research and development policy
JEL Classification: I25, I28

The disappointing outcome cannot be exclusively ascribed to the recent global crisis because the political commitments of the majority of the EU member states to accomplish either the original or the subsequent and more focused objectives of the Lisbon Strategy were weak and sometimes entirely lacking even in the halcyon years of the present decade.

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The governments of the EU member states neither discussed critically the feasibility of the main objectives of the Lisbon Strategy, nor adhered faithfully to them. The objectives of the Lisbon Strategy were regularly and ritually agreed upon without expressing objections and disapprovals in Lisbon, Stockholm, Gothenburg, Barcelona, Lahti, and Brussels between 2000 and 2008. A few critical reports, like the Sapir (2003) and the Kok (2004) reports, already called attention to the incoherencies of the economic and social objectives, the inappropriate institutional settings, the lack of political leadership and ownership of the whole project, and the underprovision of financial resources for the key areas of the economic and social development but their recommendations did not lead to the careful revision of – as the reporters noticed – this overloaded agenda. One of the most serious shortcomings in professional soundness, political and economic determination, appropriate governance structure and satisfactory financial involvement has affected the national and community-wide innovation, research and development policies from the outset. The attempts of reorganizing the EU budget in order to provide more incentives and financial means to increase research and development expenditures on community level were disapproved (Pisani-Ferry and Sapir, 2006; Pelkmans and Casey, 2004).

Even though, the European Commission confidently emphasized in the *Investing in Research: An Action Plan for Europe* (2003) that: 'All Member States, acceding and candidate countries agreed on the importance of increasing investment in research, and most indicated that they had already put in place policies and concrete measures to that effect, or were in the process of doing so. Many have also set national targets in line with the European 3% objective. For example, both France and Germany have adopted the 3% objective for themselves, and so has a future Member State, Slovenia. Momentum is thus building up.' (Commission of the European Communities, 2003) The strong commitment of the EU member states as well as the European business enterprises to the 3 per cent Barcelona target has not materialized in the figures of science, technology and innovation statistics, yet.

Needless to emphasize, the lack of the solid political commitments and economic efforts of accomplishing the common policy aim in the fields of innovation, research and development entirely undermines the ultimate goal of the Lisbon Strategy, namely, as it was proclaimed in the Presidency Conclusions of the Lisbon European Council in 2000, ‘to become the most competitive and dynamic knowledge-based economy in the world’.[1] Therefore, the majority of the EU member states’ attitude towards the objectives of the Lisbon Strategy characterized by the political, economic, institutional inertia and the art of rhetoric in the fields of innovation, research and development has anticipated the poor outcome of the whole project from the very beginning. Today, the knowledge-based economy and society, as determined in Lisbon, seem to be rather a nice to have agenda for the majority of the EU member states than a vital precondition for the future economic and social development.

The Lisbon Strategy could not bring about any noticeable change in the European innovation landscape, indeed. While, the most innovative countries, like Sweden and Finland, have managed to keep and advance their distinguished position, and few countries, like Austria, Denmark, Portugal and Estonia, have made considerable efforts to improve their overall research and development intensity, the mediocre and feeble positions of the majority of the EU member states have remained unchanged in the global ranking of innovation performance since 2000. In 2007 the gross domestic research and development expenditure of the EU-15 was exactly as low as it had been in 2000 that is 1.91 per cent in terms of GDP. The research and development intensity was reduced in France, the United Kingdom, Belgium, the Netherlands, Greece, Poland, Slovakia and Bulgaria during the same period. Compared to the OECD average of 2.276 per cent of research and development expenditure in terms of GDP, the EU-15 is also outperformed by a significant margin in 2007 because of the higher research and development intensity of the most dynamic global competitors. In addition, the research and development intensity of a few non-OECD economies, like Israel’s, Singapore’s, and Taiwan’s, is substantially above the OECD average. Particularly high rate of economic growth was not matched up to comparable high increase in research and development intensity in countries which have shown very impressive economic performance in the recent decade. Starting from a very low base of innovation performance, the figures of public and

[1] Presidency Conclusions, Lisbon European Council, 23 and 24 March 2000, I. Employment, Economic Reform and Social Cohesion: A Strategic Goal for the Next Decade, para 5.

private research and development intensity have shown certain improvement in some of the new EU member states, like the Czech Republic and Estonia, since their accession, but due to the modest size of their annual GDP and the wide gap of innovation, research and development intensity between the EU-15 and the EU-10 it was not enough to make any statistically significant impact on the stalled trends of the EU-27.

The European Commission also outlines a particularized innovation strategy of the future for the governments of the EU member states as well as the European corporations. In *A European Economic Recovery Plan* (2008), the European Commission opts for the reallocation of public and private research and development expenditures, above all, to the energy, automotive, construction, and manufacturing sectors which are supposed to bring about a major structural transformation towards the low carbon or green economy in the near future. Phrasing the Schumpeterian fear, the European Commission undertakes to chart the uncharted seas of technological possibilities for the future development (Schumpeter, 1950).[2] In the above-mentioned and other recent official documents of the European Union, there are fewer talks about knowledge-based economy, and generally the social preconditions of the production, use, and distribution of knowledge in society; the notions of the low carbon economy and green economy seem to be substituted for these former catchwords as if those would have fallen out of fashion. In this way, the dynamic transformation towards a green economy seems to be rather a technological than a social process directed by committees and experts. Even though, making a breakthrough in greening the European economy mainly relies on the change of a way of life on a scale which presumes the basic alteration of long-term social and economic objectives.[3] However, the Lisbon Strategy does not imply this profound alteration.
Recently, the European Commission reasserts the outstanding impor-

[2] Interestingly, energy, construction and materials, and manufacturing sectors belong to the low and medium research and development intensive sectors in Europe. The research and development expenditures of the largest European corporations in terms of revenues are 0.2-0.6%, 0.5%, and 2.6%, respectively, which are by and large lower figures than their global competitors'. While, the European automobile industry has considerable competitive advantages with its 4.6% research and development expenditures in comparison to its global competitors.
[3] As Lars Josefsson, the CEO of Vattenfall, put it: the change in the use of clean and renewable energy sources "...is not a question of money or technology. It requires a redesign of society." (Fischetti, 2009).

tance of the increase of public and private research and development expenditures and recommends the countercyclical investment strategy in time of economic crisis in its *European Economic Recovery Plan* issued on 26 November 2008.[4] Nevertheless, endogenous growth theory demonstrates that the optimal path for innovation is countercyclical for the countries where the firms face tight credit constraints due to the financial crisis. However, there is no conclusive view in the economic literature about the genuine public and corporate research and development strategy which would be valid for all of the countries and of the enterprises in time of economic crisis: the question is whether the governments and the business enterprises should choose a procyclical or a countercyclical path of investment strategy. In theory, countercyclical budgeting and macroeconomic policy would be desirable to bring under the control of booms and busts in the economy and to undertake countercyclical fiscal measures in the fields of innovation, research and development, especially, in time of economic crisis in order to keep up and reallocate human and economic resources for the future development (Bradley et al., 2009; Baumol and Blinder, 2009). Therefore, it is not so difficult to give a definite answer to this question if we are aware of the fact that discounting the future economic and social development of a country or the long-term economic prospect of a corporation is not a particularly creative idea. To economize on the investment costs of producing new knowledge for the future is not only a shortsighted business and public policy, mainly due to the failure of reallocating limited resources to the most productive uses and of taking advantage of lower opportunity costs of diverting more resources from production to research and development activities in time of economic downturn, but it exhibits an unfair distribution of human and economic resources from the point of view of inter- as well as intra-generational equity.

For the above-mentioned reasons, the Schumpeterian growth theory is all about the countercyclical investment strategy of the countries and the corporations in innovation, research and development; it provides

[4] A European Economic Recovery Plan. Communication from the Commission to the European Council. COM(2008) 800 final, Brussels, 26.11.2008.; For the legal basis of the statement of the European Commission see Consolidated Versions of the Treaty on European Union and the Treaty on The Functioning of the European Union, Brussels, 15 April 2008, 6655/08, 441-442.; See also IMF (2009) „Can Policies Play a Useful Counter-cyclical Role?" In. World Economic Outlook April 2009: Crisis and Recovery, IMF: Washington, D.C. 113-123.

the foundation of a dynamic economic system. Some current economic surveys conjecture an optimistic outlook concerning the behaviour of the most innovative, leading-edge enterprises; the majority of them rather endeavour to increase or at least sustain their research and development activities in order to strengthen their competitive advantages in the forthcoming upturn than to hibernate or take some defensive strategy through the recent downturn (Frey and Callahan, 2008; Leadbeater and Meadoway, 2008; Innobarometer, 2009). In opposition to these optimistic views on the behaviour of the large corporations, the recent quarterly reports of the publicly traded corporations in US stock markets signal a procyclical trend. The current survey for 2097 large publicly traded corporations shows that the corporate research and development expenditures are significantly reduced in the first quarters of 2009. The decline of corporate research and development spending is especially apparent in semiconductor industry, information and communication technologies and services which are generally grouped into **high and medium high research and development intensive sectors** (OECD, 2009). While, it is quite obvious that the countercyclical behaviour of the firms and the governments in the fields of innovation, research and development would be beneficial due to its long-term positive impact on corporate performance as well as the economic and social development of the countries; it is particularly difficult to implement this countercyclical strategy in time of tight credit and budgetary constraints (Voigt and Castello, 2009).

To sum up, the theoretical arguments for the long-term advantages of countercyclical investment strategy in innovation, research and development are sound and quite convincing. In time of economic crisis, as Philippe Aghion (2006) states, '...a natural prediction is that the lower the level of financial development, that is, the tighter the credit constraints faced by firms, the more growth-enhancing such countercyclical policies should be.' However, the empirical evidence attests that neither the majority of the EU member states, nor the European enterprises follow the Schumpeterian growth model in their research and development investment strategy for the future development. The Schumpeterian model of strategic adaptation under recession appears to be the exception rather than the rule among the European business enterprises and the EU member states. The behavior of the majority of the EU member states as well as the European enterprises is patently procyclical, that is to say, they usually invest more in time of economic upturn, and less in time of economic downturn in innovation, research and development which will presumably widen or at most keep up the innovation gap between them and their most innovative global competitors if the latter choose countercyclical investment strategy. A recently published IMF study also demonstrates that the procyclicality of government expenditure in the new EU member states, especially, Hungary, Romania, Lithuania and Latvia between 2003 and 2007 reduces their ability and fiscal space for countercyclical fiscal policy to get out of the downturn (Rahman, 2010). After all, the countercyclical behaviour seems to be the privilege of the most innovative enterprises as well as the most innovative countries in order to create and ensure their position in new markets and generate competitive advantage for the forthcoming upturn. In the last decade, only the most innovative EU member states, Sweden, Finland and Denmark (and Ireland) could produce considerable amount of budget surplus and keep their public debt ratios quite low which provide financial sources for manoeuvring in time of depression.

Therefore, regarding the stalled public and private research and development expenditures of the majority of the EU-27 between 2000 and 2008, it is hard to figure out the countercyclical behaviours of the European business enterprises and the governments in order to spur economic recovery and accommodate in this way to the forthcoming upturn. In most countries and most European corporations, the public and private budgets seem to be kept too tight to realize any significant change in innovation, research and development policy for the future development. Although a profound economic transformation toward knowledge-driven and high-technology industries and structural reforms in different policy domains are even more compelling in time of recession. Up to now, the expanded roles of the governments of the EU member states have been rather manifested in short-term countercyclical economic measures to mitigate the direct and immediate consequences of the economic crisis, particularly, in the banking sector and automotive industry than in long-term fiscal projections on behalf of the future growth and prosperity. The distribution of public spending in many EU member states has displayed long-term rigidity and the lack of willingness to bring about dynamic change in the composition of budget and macroeconomic policy in order to give an impulse to innovation, research and development before and after Lisbon. In spite of the recommendations of the European

Commission, the governments in a few EU member states have already announced the intention of cutting down on the public research and development expenditures as well as higher education spending for the 2010 budgetary year, therefore, it is not early to predict even on the basis of scattered data, uncertain political projects, and newspaper articles that the majority of the EU governments under the pressure of enormous budget deficit, public and private debt burden, and zero or negative economic growth are forced to follow a procyclical investment strategy in this policy domain (Curtis, 2009; Shepherd, 2010; Kitching *et al.*, 2009; Theil, 2008; Le Billon, 2009; Schaeffer, 2009; Solletty, 2010Jha and Sample, 2010).[5] For sure, public and private innovation, research and development expenditures will not remain intact after the procyclical retrenchment measures of the governments of the EU member states. Procyclical innovation, research and development policy will result that convergence in terms of income per capita between the high and the low research and development intensive EU member states, especially, the new EU member states, will be presumably impeded even after the economic recovery begins. The economic recovery will bring about further concentration of research and development activity across Europe and increase regional differences on behalf of the most innovative countries. In the long run, the lack of adaptation of an innovation-enhancing strategy, low research and development intensity, and the recent cut down on the investment costs of innovation, research and development and higher education budget condemn the economy of these countries to a nonconvergence trap. Without the fundamental changes in the distribution of economic resources, economic structure, policy objectives, institutions and education system the new EU member states will not be able to reduce their distance to the global innovation frontier in the coming years (Acemoglu *et al.*, 2006; Aghion and Howitt, 2006).

[5] Les dépenses de l'Etat «gelées» en 2011, 2012 et 2013, Liberation.fr, 06/05/2010.

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THE COMPROMISED TRUST OF NON-EXPERT OUTSIDERS

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Society is generally happy to have experts because expertise is helpful and beneficial for the entire society or some of its members, but does not want non-experts claiming to possess the expertise and mislead the general public nor experts using their knowledge at non-experts outsiders' expense, compromising their trust. In the post-Enron era the shareholders or/and the general public could feel like deceived outsiders of the audit and accounting expert systems. We consider that accounting and audit have some inherent problems that make their tasks impossible to carry out.

Key words: trust, experts, non-experts, auditors.
JEL Classification: M41, M42

The world in which most people live is highly complex, involving interactions between individuals and many systems of which they may have little or no conscious awareness. As no individual can expect to have personal expertise in any more than a tiny proportion of the expert systems which affect their daily lives, we all implicitly place trust in the effectiveness of many expert systems[1] every day (Unerman and O'Dwyer, 2004, 974). The expert systems (professions) are important in any society because they possess specialized knowledge which is not generally held by all members of a society, and they enable members of a society and society as a collective to use and benefit from this complex and important knowledge. Society is generally happy to have experts because

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[1] One definition of these expert systems is: 'systems of technical accomplishment or professional expertise that organize large areas of the material and social environments in which we live today' (Giddens, 1990, 27).

the expertise is helpful and beneficial for the entire society or some of its members, but does not want non-experts claiming to possess the expertise and mislead the general public nor experts using their knowledge at non-experts outsiders' expense, compromising their trust.

The monopoly power of expert systems

Knowledge is power and these small groups of experts (professionals) are powerful because they exercise an enormous amount of control over this knowledge and its use. Professions – among certain attributes like expertise[2], public interest and self-regulation – share the attribute of monopoly, too. Society gives them more power by granting them a monopoly. Every profession promises to use its expertise and monopoly power in the public interest and this promise is the heart of professionalism. Without it, a group of experts are not a profession. According to Carey (1956) the public expects three things from anyone who holds himself out as a qualified member of a recognized profession – competence, responsibility and a desire to serve the public.

There is an asymmetry of power. The non-professionals (non-experts) are at the mercy of professionals (experts). The question that arises is: how can the community (and the individual client) be assured that the power of the professional will not be abused? And if it is, how can the community be assured that there is an effective remedy? In other words, how can the non-professional[3] be assured that the professions are not 'conspiracies against the laity'? (Brien, 1998, 391)

Both accounting and audit can be viewed like expert systems. Auditors, as providers of certified information, play a key role in legitimizing companies and their disclosures. As members of the auditing system of expertise, they allow and facilitate social relations, by interpreting accounting standards and verifying their practical application in the con-

[2] Expertise is a special knowledge, which is acquired through higher education and extensive training and it requires professional judgment.
[3] Unerman and O'Dwyer (2004) have named the non-professionals (non-experts) outsiders to the expert systems.

text of financial disclosures. They rely on technical expertise to determine the contents of financial accounting statements. These accounts require extensive use of subjective judgment in their composition by the experts who operate the accounting and audit systems, while often being regarded by people not trained in the practices of accounting or audit (non-expert outsiders) as an objective portrayal of an underlying economic reality (Hines, 1988).

The investing public has historically relied upon audited financial statements when making investment decisions and has depended upon auditors and accounting profession to confirm the accuracy and completeness of financial information (Kane, 2004). Through audit reports auditors signal stockholders, regulators and others that companies and their disclosures are trustworthy. Thanks to auditors' involvement, faith in the financial system is possible, despite investors possessing only limited financial and managerial information about companies. Thus, on paper, trust in company is highly dependent on trust in auditors (Malsch and Gendron, 2009, 740).

Unerman and O'Dwyer (2004, 975) point out the role of financial accounts in the process of (re)distribution of wealth between investors, managers and employees (among others), and the formation of market expectations affecting capital values in investment markets. According to them, the figures contained in a set of financial accounts will therefore affect the amount of wealth (among other factors) redistributed across time and space between different stakeholder groups, irrespective of whether individual investors are aware of the contents of the accounting statements or the existence, practices or influence of accounting or auditing systems of expertise. Products of accounting and audit expert systems thus have a potentially significant impact on the life experiences of many people. Giddens (1990, 124) call attention to new risks created by the global expansion which has led to the development of 'institutionalised risk environments' – like investment markets. These operate to redistribute risks and outcomes across a vast number of people, and thus have an impact on the life experiences of many, extending far beyond just those actively involved in investing in these markets.

The role of trust in expert systems

The effectiveness of these expert systems relies heavily upon an attitude of trust. We all regularly place trust in many expert systems in which we have little or no expertise. (Many non-expert outsiders to accounting and audit expert systems lack any knowledge with which they could systematically evaluate the reliability of accounts.) Relationships that are correctly described as involving trust contain an asymmetry of power: the trustee has power over the truster. Thus, in cases where there is no vulnerability to another's power, the question of trust does not come up. Trusting another one then, involves a feeling of security about them and a prediction about the behaviour of that person, when that person has the capacity to damage you or something in which you have an investment.

As we have mentioned above, every profession promises to use its expertise and monopoly power in the public interest and this promise is the heart of professionalism. Because recent high profile financial disasters involving accounting fraud have suggested that the auditors involved in monitoring these firms have not honoured what the public has perceived to be their appropriate role, the public has become less trusting of the auditing professions' ability to and/or willingness to protect investor interests (Cullinan, 2004). Auditors have a responsibility to be the 'gatekeepers' to protect the investing public, but many auditors have failed their gatekeeper role with a resulting increase in risk passed on to investors (Satava *et al.*, 2006, 271).

There are many conceptions of trust, one of these is developed by Luhmann (1979) who distinguishes trust from familiarity[4] and from confidence[5] arguing that trust is a solution for specific problems entailing risks; trust implies going beyond basic activities and presupposes a situation of risk, choice and social engagement. The lack of trust can result in an unwillingness to take risks in areas like investment and saving. Brien (1998) consider that trust is what people in positions of vulnerability must do in order to participate in and benefit from a relationship that

[4] Familiarity is an unavoidable fact of life.
[5] Confidence is required to conduct the basics of living.

contains an asymmetry of power, but which promises desirable results that are obtainable in no other way. It is a mechanism we as social creatures use to overcome the power and freedom of others when we have limited knowledge about their abilities. According to Giddens (1990) trust is defined as the stakeholder's faith in the working of expert systems and these systems depend upon trust in their operation. Generally speaking, trust is a mechanism that can reduce uncertainty in context of interaction and facilitate the functioning of organizational systems.

Risk is closely linked to trust because most people are aware that few activities have no risks but trust expert systems to be designed in a manner which reduces risks to acceptable levels. If accounting or auditing practices start to deliver outcomes which negatively affect the life experiences of a non-expert beyond the level of risk that non-expert considered acceptable, the trust placed in accounting and audit systems by that non-expert will be diminished. A layered breakdown of trust held by non-experts, following revelations about the Enron, WorldCom and Andersen accounting and auditing failures, is consistent with developing perceptions among non-experts (who are outsiders to the expert systems of accountancy and audit) of a substantially increased risk to daily life experiences associated with the operations of these expert systems. (Unerman and O'Dwyer, 2004, 972).

To sustain the role of investment markets, audit, and accounting it is necessary to maintain widespread trust of non-experts in these abstract systems. While individuals operating these systems have an important role to play in maintaining this trust in the systems, public awareness of the failings or fallibility of specific individuals is unlikely to pose a risk to public trust in the systems if it can be successfully argued that these individuals are atypical of other people involved in operating the abstract systems, and mechanisms exist to prevent individuals causing significant failures in the abstract systems[6].

Many individual non-expert outsiders to accounting and audit systems had placed implicit trust in the effectiveness of the expert systems of

[6] An example of mechanisms which seek to reassure non-expert outsiders in this manner are the self-regulation and disciplinary procedures embodied in many professional codes of ethics.

accountancy and audit and they expected the system to provide them with some measure of security regarding the companies they had invested in, most usually through their pension fund. The accounting and audit failures has raised consciousness and contributed to an awakening of scepticism and a gradual erosion of trust previously held by non-expert outsiders in the abstract systems of investment markets, accounting and audit.

Problems inherent in the accounting profession

Regarding these outcomes of accounting and audit failures concerning trust placed in these expert systems we would like to argue that these failures are not a new phenomenon - rather inherent elements from the beginning of the accounting profession: 1) the self-interest domination of professional accountants on their public interest commitment; 2) the auditor's client: theory and practice.

1. *The self-interest domination of professional accountants on their public interest commitment*

The word profession is derived from the Medieval Latin *professio* referring to the taking of vows upon entering a religious order. The lineage of modern professions can be traced from this monastic origin and they still retain an element of the denial of self-interest and of social duty. What is certain is that professions have a prestigious, powerful and trusted place in society (Frankel, 1989) and both the public and the law expect high standards of conduct, especially where society allows self-regulation. Even though many individual businesses now have codes of ethics and the public increasingly demands ethical conduct of everyone involved in business, 'their expectations regarding professional behaviour are higher than their expectations regarding business persons' (Jamal and Bowie, 1995). The ethical element in professional conduct cannot be ignored and the need for professions to be aware of ethical issues in the way they conduct themselves is an important element of their recognition. Kerr and Smith (1995) even postulate that lapses in ethical behaviour can endanger the credibility of a whole profession.

This is the traditional view of the professions, the ‘functionalist’ approach. Professions and professionals have, on this (idealistic) view, an altruistic orientation, or rather, a sense of social responsibility.

The alternative economic approach views the professions as a ‘semi-mythic’ construct, fashioned by members of an occupation for the purpose of obtaining social and economic advantages, organised to gain market control of an occupational service by means of monopolistic exclusion of individuals deemed unworthy or unqualified to provide it (Larson, 1977). The professions, on this view, are monopolies based upon self-interest and whatever the alleged altruistic orientation of the profession is merely a ploy to maintain their privileged position.
There is an element of truth in both these views. The nature of a profession may be that of a distinct occupational grouping characterised by esoteric knowledge, whose dissemination is controlled. But it may also be the case that, for some professions at least, the primary motivation in being a profession is self-interest, rather than the altruistic goal of community service that is imputed to them by the functionalist school (Brien, 1998, 397).

The accounting profession, like medicine and law, was regarded as an occupation more heavily influenced by the service motive than entirely by the profit motive. Many of the histories of accounting and auditing professions claim that accountants are professional and they are conventionally seen as applying esoteric skills, knowledge and judgments to complex tasks in the pursuit of their own, and the public’s interest (Zeff, 1972) . Reforming accounting refers to moving to a more professional and moral order (Briloff, 1990). A functionalist model is offered as the reason for professions to adopt codes of ethics which serves to ensure and protect the interests of the client. But the critical interpretations of the functionalist model (Larson, 1977 and Willmott, 1986) argue that a code of ethics was used like a tool by the profession to secure privileges for its members. According to Osiel (1984) and Dyckman (1974) beneath the overt public interest there is a submerged private interest agenda. Dyckman’s concerns also include the lack of effective response to criticisms of practice by professional bodies, inability to find an acceptable theoretical foundation to accountancy practices, and failure to punish accountants who have breached ethical standards. Zeff’s

(1987) comments are similar, concentrating on the issues of accountants responding to competitive pressures by treating management rather than ownership as the client, offering a wide range of non-accounting business services, and lacking intellectual leadership on accounting and auditing problems. According to its critics, therefore, what has happened to the accountancy profession is a loss of its sense of public mission, making it indistinguishable from any other form of profit-based business. The public mission of accountants has always been a smokescreen for economic matters (Lee, 1995). These studies reveal the difficulty of being a professional with an explicit covenant to serve the public interest in situations where there are considerable economic incentives to adhere to self-interest. Lee (1995) concludes that there is a conflict positioned at the institutional level: the professionalization of accountancy has provided institutional structures to permit accountants to maximize their self-interest in a publicly interested way.

The development of accountancy profession into a powerful sector of the modern economy has been accompanied by a persistent public criticism of accountants and their services. Today, in a *"post-Enron"* era, we are witnesses of an intensified criticism that involves doubts about the ability of accountants to resist managerial pressures to misreport. These criticisms have been externalized through the financial press, forcing the institutions of accountancy to respond more publicly. The accountancy profession continues to face the fundamental issue of whether accountants wish to be professionals or members of trade associations.

2. *The auditor's client: theory and practice.*

Auditing is an important professional task carrying heavy responsibility and calling for commensurate skill and judgment. The role of the auditor is so important to the health and strength of the free enterprise system that it could rightly be regarded as one of the keystones in the arches making up that system. Therefore, responding to the question: who is the auditor's client – in fact, not in theory – is one of the most important issues faced by the accounting profession today, when criticisms since audit failures have intensified and doubts about the ability of accountants to resist managerial pressures to misreport have became more obvious.

This is a fairly clear indication of client satisfaction with the work done by the auditor. In the case of public companies the client is seemingly the body of shareholders. In practice however it is the management and the directors with whom the auditor deals when he deals with the company. So it is clearly extremely important for auditors to maintain close relations with their client company's director. In some instances there may be some doubt about just who the auditor's client really is – the shareholders or the directors. The fact is that the ordinary shareholder of a public company has no way of knowing whether 'his' auditors are doing their job properly or not. It is only when a client company really gets into difficulties that the work of the auditor is likely to be called under review.

The role of the auditors is extremely important in the capitalist system and increasingly in the global economy, when the economy require capital that in a very large amount is obtained from outsiders who, although the owners of the enterprise, are largely divorced from its management. If such a system of financing is to operate successfully, and if the securities markets are to function effectively, it becomes necessary for management and directors to supply shareholders with periodic reports containing detailed financial information on how the company has fared since the previous report. These reports along with other information form the basis on which investors make their decisions. Since the management has full control over the company's accounting system, and since management is entitled to select the accounting principles, it is clear that there is a serious risk that, on occasion, management may feel that it is in its own interests to distort or suppress information which shareholders ought to have (Stamp, 1984).
This is the point where the auditors must perform their function, perhaps to make an independent examination of the accounts prepared by the management, and to formulate and express their opinion as to whether or not the accounts give 'a true and fair view' of the company's affairs. The function of the auditor is thus to lend credibility to the financial statements. Without this report, the shareholders would be left in doubt about the reliability of the accounts, and this could weaken and even destroy their confidence in the company, and indeed in the whole capitalist system. By helping to establish and maintain investor confidence in the integrity of the securities markets the auditor contributes

in a very important way to the strength of the capitalist system. It is thus very much in the public interest that the auditor should be seen to be completely independent of management. Indeed, the social function of the large corporation has now become so important that the auditor ought to be seen to be acting with the public interest in mind as well as the interests of the present shareholders of the company. Auditors certainly ought to consider the interests of prospective shareholders.

Stamp (1984) itemizes some difficulties faced by the auditors performing their work deriving from their ambiguous position (difficulty in determining what is in fact 'a true and fair view'; difficulty in sanctioning the directors – qualifying his report – if the auditor is not satisfied with what the directors have done or if the client company is in financial difficulties), and some circumstances under which the pressures to do nothing are obvious. The role of an auditor is compared with that of a Judge, even in the conventional view. But the modern public company fills such an important role in the economic structure and the effective functioning of the securities markets is so important to the free enterprise system, that the auditor's constituency now embraces the whole public interest. An auditor must regard to the interests and requirements of the public at large, including potential shareholders, creditors and potential creditors, employees, labour unions, and government. For this, the complete independence of the auditor and the directors of the company is necessary. However, there are some considerations that make this independence impossible to survive: the auditor cannot be said to be independently remunerated; auditors could own shares in their client companies; they derive very substantial fees from other services, like management advisory services, which tend to make the auditor identify himself with the interests of the client company and its management, and also with some of the decisions taken by the management.

Conclusions

Accountants were historically perceived by the public to be part of a solid, conservative profession with an impeccable reputation for ethical integrity. One of the surveys of attitudes within the business community undertaken for the Canadian Institute of Chartered Accountants in

August 2001 a couple of months before the Enron collapse (Boyd 2004, 379) revealed that accountants had the highest reputation for ethical integrity compared to other professional and occupational groups. The deep contrast between the profession's historical reputation and its post-Enron reputation is the result of some dramatic changes that have occurred in the accounting profession. Various social, political, and economic changes have altered the same environment that facilitated the emergence and dominance of the accounting profession, and, according to Belkaoui (1989), have precipitated deprofessionalization in accounting. For example, the increasing routinisation and computerization of all accounting work; the decreasing loyalty of clients to their auditors, because they have gotten into the habit of seeking the audit that plays according to their rules, known as 'auditor switch' or 'opinion shopping'; the increasing specialization in accounting, that rises to accelerate the decline of homogeneity within the accounting profession and create different subcultures; the expansion from a local to regional, national and international level and the concentration of power and ownership was made without any change in the basic institutional structure of the profession; the transformation of auditing from being the profession's most conspicuous and prestigious service to its later state as a low profit activity within a constellation of other far more profitable services offered by the major accounting firms.[7] Therefore, we witness the professionalization of accountancy criticism and/or the deprofessionalisation of accountancy. The inherent elements of the accounting profession presented above made their tasks impossible to carry out, contributed to audit failures (and indirect to corporate failures) and to an awakening of scepticism and a gradual erosion of trust previously held by non-expert outsiders in the abstract systems of investment markets, accounting and audit.

[7] See Belkaoui (1989) for more arguments to explicate the deprofessionalization of accounting.

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AN ALMOST BRIGHT FUTURE PERSPECTIVE OF YOUNG GRADUATES IN ROMANIA

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The subject of this paper is the analysis of the prospects of Romanian young graduates. The possibilities of fresh graduates, mostly young people in their 20's, can be considered to be a relevant question in any society. First of all, it is an important sign of the general economic and social perspective of a country; furthermore, it is a question that can have a serious influence on the mid- and long-term future.
On the other hand, we believe that the analysis of this subject can show some interesting aspects of the connections of two rather complex spheres, higher education and labour-force market. It can often be heard and read that the adjustment of the higher education offer to the needs of the labour market is vitally important. However, the exact way in which this should be, what practical consequences it can follow and how this adjustment can be properly measured are more complex questions, but we think, having a clear image of the fresh graduates` situation in a country can be a starting point in this process.
In our paper we intend to describe the general situation in Romania, we would like to point out the relevant reasons and factors behind the visible processes and statistics; furthermore, we also try to formulate some suggestions for the improvement of the situation.

Key words: education system, graduates, higher education, Romania
JEL Classification: I23, I25

Changes of education system in Romania

Similarly to the majority of the European countries, higher education has undergone significant changes with the introduction of the so-called 'Bologna-system'. The rather simple, undivided, typically four or five-year long higher education degree programmes were with few exceptions divided

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into bachelor's and master's education, also offering the chance for the most ambitious and talented students to continue their studies with the prospect of receiving a Ph.D. degree. One of the often quoted purposes of these structural changes was that this would facilitate the access to the labour market of those who do not wish to pursue an academic career but to get employed with a proper preparation after 6 semesters. Supposedly some harmonization with the labour market or at least the analysis of its needs or communication with the representatives of the major employers would have been a key element in the process, but there is a chance that these did not happen or not in the way they should have happened.

Even if there are some common directions in the extension of the educational offer among the countries who had adopted the new system in the higher education, we think that it would have been and will be extremely important in the future that the education offer is adjusted to the realistic needs of the labour market. It seems even more necessary if we consider that there is no unified and heterogeneous labour market in the majority of the countries due to serious regional differences, let alone on European level. In some regions the needs of the labour market are shaped by the geographical characteristics (for example in regions rich in mineral resources mining and exploiting industry is a major employer, in water-abundant regions the hydro industry and commercial fishing, in touristically attractive regions an extended tertiary sector and so on), in other regions the qualitative and quantitative dimensions of the labour market are simply shaped by the general level of development of the region.

The social and economic importance of fresh graduates

As we already mentioned above, we think, that fresh graduates are a special social group with an importance that is currently underrated in Romania. We would like to point out some aspects which may be convincing about the relevance of this group.

A) Tuition fee exemption

As for this aspect, we mean that a significant proportion of the students pay no tuition fees at least during some periods of their studies, so their studies are state-funded. In some cases many of them even receive scholarships based on their study results or socio-economic situation, increasing the expenses of the state which are related to education. As this is all public money, the state's own basic interest is that this sort of investment has its proper benefits in such a way that students financed by public money should be employed in the country, where they can reach high productivity and high added value, earn high income and spend it in the country, thus strengthening the macroeconomic demand and contributing to the public costs through their tax payment in a larger ratio. Evidently this can not be realized in the case of all students who are in this category, and of course they cannot be stopped if they desire to emigrate because this is exactly contrary to the idea of the free movement within the community, which is a basic guiding principle of the European Union. So countries, like Romania would only be able to make their young intellectuals and well-trained fresh graduates stay if they devote special attention to this category and try with all their means to encourage the public, state-run employers and the entrepreneurs with various types of positive motivations to employ such fresh graduates in a relatively short time after graduation providing jobs which correspond to their training.

Contrary to the above-mentioned, fresh graduates will leave the country in a continuously growing number. This will happen partly due to the fact that limitations regarding the free movement of labour force within the EU are gradually being reduced towards zero, which means that there will be another 26 countries competing for the very same labour force, especially in sectors which are in need of well-trained labour force throughout the continent. Furthermore, supposedly the similarity of the Romanian language to many South-western European languages also favours emigration and worsens Romania's labour-force maintaining potential. It is quite easy to see through the situation and to draw the consequence that if millions of physical employees could easily integrate in the labour market and society of the Southern-European countries, well-trained fresh graduates, who are also linguistically more skilled and better prepared, will be even more welcomed in the various economic sectors of these countries.

B) Domestically trained labour force, reproduction of intellectuals
Besides the above-mentioned, there is another, equally important aspect: In what measure will fresh graduates be able to find jobs which correspond to their training and degree, where they can take advantage of all what they have been prepared for? We do not only mean whether the value they create in their job will ever get equal to the value of the tuition costs, but whether they will constitute a sufficient supply of professionally trained labour force for the society. Doctors and healthcare workers, technical intellectuals and representatives of various professions keep on leaving Romania in a growing number and this phenomenon gives reason to worry both from the point of view of cost-effective and labour-force supply.

For example: according to the estimations of the Romanian Ministry of Health the number of doctors leaving the country in this year could grow to 2,500, the highest among the last 4 years. In the period 2007-2009 5,500 doctors left Romania: 1,500 in 2007, 2,100 in 2008 and 1,900 in 2009. According to the statistics of the College of Romanian Doctors in 2009 the majority of the certifications that allow working abroad were issued to doctors who wished to go to France, Great Britain, Ireland, Sweden, Germany and Belgium.

Of course we can not exclude that young people who initiate their career abroad would not return home, and we can also imagine that some of them would proceed with sharing their time between a domestic and a foreign job, nevertheless we think that the chance that one would definitively remain abroad is greater in the case of those who are employed for the first time or employed shortly after graduation abroad than in the case of those who start their career in Romania, even if for various reasons they may occasionally consider moving abroad.

C) The effect on the willingness to continue studies in higher education
We think the number in which fresh graduates can find jobs, and in case they do, the kind of jobs available can not have mid- and long-term effects on the general perception of the society on studying in higher education, on getting graduated and on all the advantages and disadvantages that might be related to it. Of course, it is a common view that for example in Romania there are too many institutions of higher education

and that there are much more degrees offered than the labour market could absorb. If it is so, the situation of the freshly graduated and some form of governmental intervention could also have a rationalizing role, but evidently the distinction among the various degree programmes and diplomas and the evaluation of the possibilities that these offer to graduates is extremely difficult.

The expansion of higher education

The topic of this paper was actually offered by the expansion of the higher education systems, a phenomena which can be observed throughout Europe, meaning that there are much more people involved in this sphere than before. This means the increase of the number and size of institutions of higher education, the continuously growing number of students who apply for higher studies, the growing number of professors and other professionals employed in order to keep higher education functioning.

'The institutional diversification regarding private and public universities and the increase of individual demands for higher education has generated rivalry among universities, and the increase of the number of students who pay tuition fee has led to the appearance of the commerce of this service.'[1]

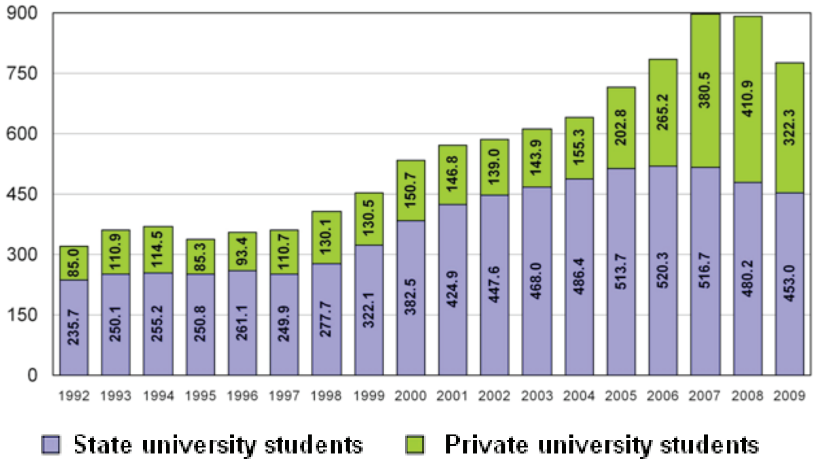
In Romania, at the moment there are[2]:

- 56 state accredited higher education institutions (49 civilian state-owned higher education institutions and 7 military universities),
- 32 private accredited higher education institutions
- 21 private accredited higher education institutions authorized to function temporarily
- 6 post university academic schools

The state budget ensures most of the financial resources for higher education and research, respectively 6% of the GDP in 2009.

[1] 'Strategic orientations towards higher education' www.tuiasi.ro/dga/planuri/orientari/orientari_strategice_pentru_invatamantul_superior.doc
[2] Ministry of Education and Research

Figure 1 **Evolution of number of students (thousands)**



Source: Own collection based on the data published by Romanian Ministry of Education

In our opinion, while the number of the graduates is permanently increasing as a huge supply for the society and labour market, there were not so deep qualitative and quantitative changes in the labour-force market (at least in Romania probably there are not as many new jobs which require a degree as many new diplomas have been issued). So supposedly only a fraction of the graduated young people can find jobs which require the very degree they have. If this is right, we can conclude that the expansion of higher education could be interpreted as a rather autonomous and above a certain level a self-generating phenomena (as a mass-demand for higher education degrees has appeared, as the driving force of the permanent expansion) and not as a process which is neither strictly connected to the real economic development, nor to the trends of the labour market or to changes in demographics or in social structures.

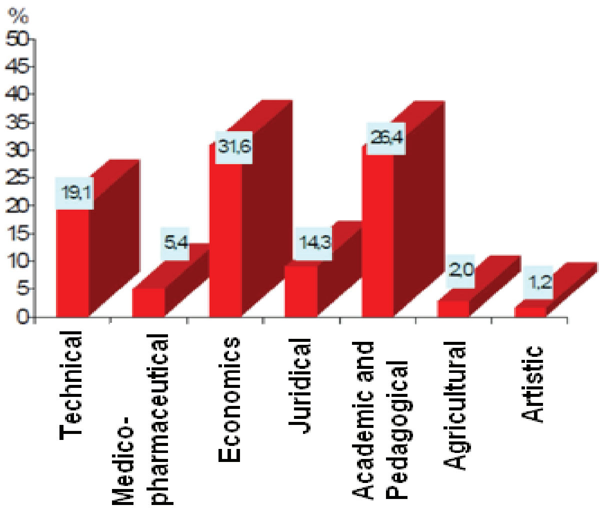
The situation in Romania - the main statistics

In the year 2008 in Romania 260 thousand students became graduates, more then two-thirds of them, 180 thousand graduated in public, state-financed institutions. In the following year, 2009, much less, 109.626

degrees have been awarded. The reason of the decrease is the fact that in the previous year both the members of the last generation who started their studies in the undivided 'pre-bologna' system and the members of the first generation of the new system gained graduation.

If we analyze, based on the data of the year 2009 (considering this year the most relevant due to the exceptionality of the previous year as explained above), the specializations in which students graduated, we can affirm that more than a quarter of all the graduates, 30 thousands received a diploma in some field of economics, followed by about 20 thousand receiving a degree in technical studies, 15 thousands in medicine or pharmacology and about 6 thousands in the field of IT.

Figure 2 **Distribution of students enrolled in higher education, by profiles (2008-2009)**



Source: Own collection based on the data published by National Institute of Statistics

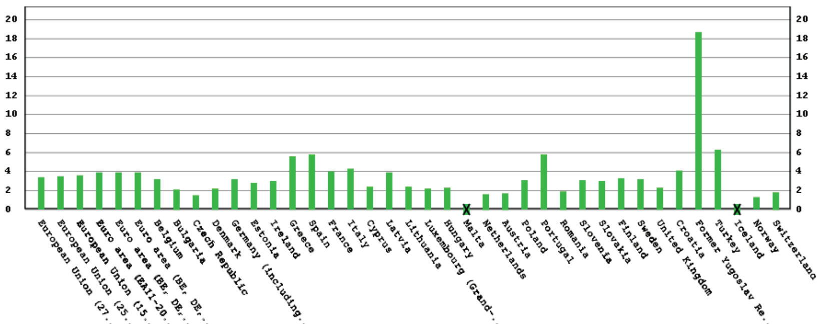
As for the institutions countrywide, the state-financed study places are in highest number in the capital, Bucharest, offering 17 thousand places, followed by Cluj-Napoca and Timisoara with a much lower number of places offered, that is 9 and 6 thousands.

The aggregated national figures show that there were 389,517 students enrolled in higher education countrywide in the academic year 2008-2009. However, only about a third of students, i.e.130 thousands were students of public universities, while 26,000 students pursued their studies in one of the private institutions. Nevertheless, looking at the ratio of the graduates receiving their degree in public and private universities in the year 2008, we can notice that almost 180 thousand students graduated from public, and only about 80 thousand from private universities. This suggests that the expansion of private universities is a rather new phenomenon. At the same time, at the beginning of the year 2009, there were officially only 2 thousand graduates registered as unemployed. Evidently when considering this number, the emigration for employment purposes and the probably widespread unofficial and illegal employment should all be taken into account.

Unemployment among graduates

With an outlook to Europe compared to the Romanian unemployment statistics we can see that among the European countries among the middle-class, these are 2 % better than the European average.

Figure 3 **Unemployment among fresh graduates**



Source: EUROSTAT (2009)

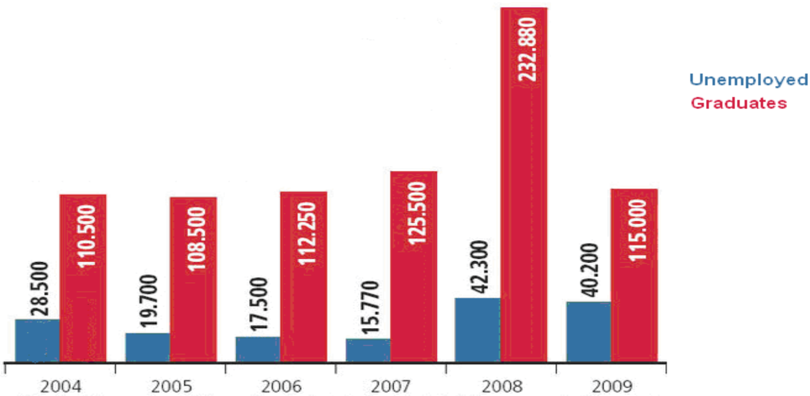
The unemployment rate of graduates has constantly grown in the last four years, extending from 3.8% to 5.67% in 2009, as the number of unemployed graduates is over 40,000 in 2009.

Table 1 **Evolution of the number of unemployed with higher educational degrees**

Year	Unemployed with higher education	Total number of unemployed	Unemployment rate among higher education graduates %
2006	17,500	460,500	3.8
2007	15,800	367,800	4.3
2008	16,460	403,400	4.08
2009	40,200	709,380	5.67

Source: Own collection based on the data published by ANOFM.

Figure 4 **Evolution of unemployment and graduation**



Source: Own collection based on the data published by ANOFM, INSSE, and the Romanian Ministry of Health

Many surveys mainly summarize employers' opinions that on the Romanian labour market there can be identified three major groups which are intensely demanded, and as such their members have the best chances to get employed, often even the possibility of choice and the chance to reach the highest average income. Among them are the graduates of technical sciences, primarily with an IT degree. As for the humanistic sciences, the ones with a degree in applied linguistics are the most

demanded. So it is not surprising that the major employers in Romania are without exceptions multinational companies or affiliated businesses, many of them being in the field of IT.
Considering all these it is worth to examine the costs of various academic trainings (from the side of the institution), which if correlated with the demand on the labour market could lead to the observation of interesting results. The cheapest ones are the degree programmes of humanities and business-economics, the costs of technical, mainly theoretical training are about double. The training in medicine or in architecture turns out to be even more expensive, but the most expensive are degree programmes in arts, especially in cinematography and theatrology. Of course there are far less students receiving a degree in the latter sciences than in economics or humanities, and there is a sharp debate worldwide whether costs and representation of culture and arts can ever be measured by such efficiency calculations and should or should not be compared for example to medicine because originating from its peculiar nature it is a profession with very different social functions. Considering all those mentioned above, it is to be observed that most of the private institutions offer degree programs mostly in economics and humanities, so trainings with relatively low financing and with extraordinary popularity.

As we mentioned above, private universities are in full expansion in Romania. One emblematic example of this boom is the Spiru Haret University which has grown to be the world's 18th and Europe's largest university in terms of attendance, i.e. 300 thousand students.

Possibilities for reducing unemployment among fresh graduates
In the recent past efforts have been made by the Romanian government in order to facilitate the employment of fresh graduates. These were probably inspired by the aspects mentioned above, so we can state that the view that there is a need for special public policies for the improvement of the employment possibilities of this social category is not legitimate and widely accepted. Law no 76/2002 includes some legislative incentives for private employers offering various benefits for 12 months in case of employing fresh graduates. They don't have to pay some taxes related to employment and even receive financial support from the state: 1.5 times the minimal wage which normally mostly covers the salaries of the fresh employees.

Further possibilities

Based on all these, we consider that there are plenty of other possibilities for the future governments which can contribute to the facilitation of the employment of fresh graduates. First of all, it would be necessary to find a way to settle realistic communication between the labour market and the educational offer, between the representatives of employers and the universities, this being the only way to adjust the offered degree programmes to the actual needs of the labour market.

Similarly, we found necessary the analysis of the regionalism in this process. There are numerous regions in Romania where due to various reasons (traditions, natural or infrastructural characteristics) some economic sectors are predominant. It should be emphasized that universities and colleges considering these regions as demographic source of potential students should include into their programmes trainings which correspond to the actual human-resource needs of the regions and education should reflect the local traditions. Thus, the productivity and quality of local economic activities could be significantly improved due to the abundant supply of properly trained labour force and this would bring the possibility of releasing long term practice programmes offering mutual benefits for both students and local companies.

Possibilities of professional practice during the academic training would be necessary in a much extended and much more verified and transparent form. Nowadays it is common to have an obligatory professional practice done for obtaining certain degrees, but there are serious doubts about the actual benefits of such individually organized and not verified periods. Therefore we think that it would be necessary to find the frame of a long-term cooperation between institutions and major employers and smaller businesses meeting certain quality requirements to improve the system of professional practice. Beside the lack of actual professional practice possibilities another problem is that even if graduates are well prepared theoretically they are in lack of some complementary competences which are vitally important in finding a job. The two most common missing competences are the proper knowledge of foreign languages and the adequate PC skills. The improvement of these is necessary as it becomes more and more obvious that these are not extra-skills that can set someone in an advantageous position but rather basic criteria and preconditions in the case of graduates.

Finally, we think, that the adjustment to a rapidly changing economic environment without major social sacrifices is possible only by making the educational system more flexible, offering the employees (not only graduate employees) the possibility of further training and education in order to gain new, necessary competences. In our opinion the recently launched new higher education system could offer the chance, provided that the local implementation is cautious and flexible enough.

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