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Conference Paper

EU2'S REGIONAL ECONOMIC RECOVERY SOLUTIONS UNDER THE GLOBAL CRISIS

51st Congress of the European Regional Science Association: "New Challenges for European Regions and Urban Areas in a Globalised World", 30 August - 3 September 2011, Barcelona, Spain

Provided in Cooperation with:

European Regional Science Association (ERSA)

Suggested Citation: Romeo, Ionescu (2011) : EU2'S REGIONAL ECONOMIC RECOVERY SOLUTIONS UNDER THE GLOBAL CRISIS, 51st Congress of the European Regional Science Association: "New Challenges for European Regions and Urban Areas in a Globalised World", 30 August - 3 September 2011, Barcelona, Spain, European Regional Science Association (ERSA), Louvain-la-Neuve

This Version is available at:

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1. Introduction

The paper is focused on the tutorial of the measures implemented by the latest two Member States in order to save their national economies from the global financial crisis. Moreover, the analysis offers a better understanding of the complex relationship between policy and economy across the national states.

The time period of the analysis is 2007-2010 and it covers laws, ordinances, decrees and economic plans adopted by the governmental teams and the specialists from Romania and Bulgaria.

The impact of the global crisis on the EU member states has to be connected to the European integration process, which is based on a dualist system. This dualist system allows EU members a wide discretion to interpret and enforce the EU regulations. Moreover, the European integration is divided into the Euro area and other member states.

At the beginning, some EU countries considered the global crisis as a pure American phenomenon. This opinion was changed when the EU faced to the decline in economic activity.

But things get worse and the global trade dropped drastically. As a result, the European exports decreased and the European industries faced to a significant contraction.

Some European governments spent high public resources in order to save the banks from bankruptcy, to protect depositors, to unfreeze the credit markets and to support the economic growth. These measures had modest results and the economic recession and financial crisis became significantly. They forced the European governments to create quick political answers.

The European governments worked independent and together, in order to stop the significant decrease of the real and financial profits.

At the beginning, the crisis hit differently the EU member states; the greatest contractions were in Ireland, the Baltic Countries, Hungary and Germany. These contractions were above -4% in 2009. Bulgaria, Poland, Cyprus and Malta were less affected by the global crisis in the same year [1].

The dimension of the crisis impact on the EU member states depends on their initial economic environment and its vulnerabilities. These can be divided into three specific categories. First is that the property market and construction were oversized. During the latest decade, significant increases in the house prices were in UK, France, Ireland, Spain and Baltic countries and they were connected to an optimistic point of view about the construction

sector. On the other hand, some EU member states from Central and Eastern Europe were particularly hard hit by this way to attract revenues to the public budget.

The second category is connected to the economy dependence on exports and the current budget position. Those countries which had a powerful export demand and/or had current budgetary surplus were highly exposed to the world trade contraction. On the other hand, other countries which had high budgetary deficits faced to a flooding capital flows risk. Some Central and Eastern European member states can be included into the last category. Sometimes, the sudden stop of the foreign financing forces the governments to ask for technical assistance connected to the cash flow from the EU, IMF and World Bank.

Third, the analysis has to quantify the financial sector dimension and/or its exposure to risky assets. Some member states (UK, Ireland and Luxembourg) have important financial centres and are exposed to the financial turmoil. On the other hand, the member states which have trans-border banking centres inside the emergent Central and Eastern Europe are likely to be strongly affected. The risks for the European banks on the emergent markets are concentrated especially in Austria, Belgium and Sweden (the last is exposed to the Baltic economies).

Practically, the present crisis is able to activate the adjusting of the current budgetary imbalances across the EU even that is too early to have relevant conclusions.

2. Government measures for economic recovery in Romania

Romania adhered to the EU in 2007. It has the rank 11 as GDP and the rank 8 as purchasing power. At the beginning, Romania considered that its adhering to the EU will guarantee the social, national and economic security of the population.

The problem is that Romania's adhering to the EU was more a political than an economic decision. As a result, the social crisis in Romania is generated by the obligation assumed by the government to achieve the macroeconomic criteria assumed to Brussels [2].

According to Maastricht criteria, the budgetary deficit of a member state has to be less than 3% of GDP. But Romania's deficit was -8.6% in 2009 and -7.4% in 2010. Moreover, the European Commission forecast talks about deficits of -4.9% in 2011 and -3.5% in 2012 [3].

Moreover, the GDP growth rate in Romania was negative during 2009-2010 (-7.1% and -1.9%) and it will recover to 1.5% in 2011 and 3.8% in 2012 (see figure 1).

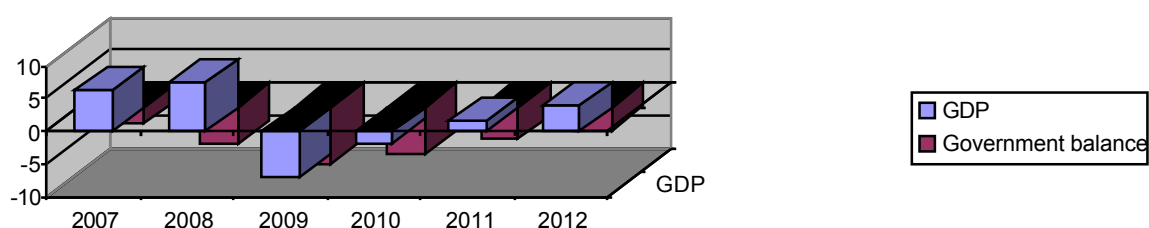


Figure 1: GDP growth rate and government balance in Romania (%)

Source: personal contribution using Eurostat database

The Romanian government motivated that it tries to avoid the same situation as in Greece. As a result, it signed a stand-by agreement (19.8 billion Euros) with the IMF, the World Bank and ERDB on March 2009. In order to receive this loan, Romania has to decrease its budgetary deficit to 2.5% until 2013. This condition was the signal for the Romanian government to start a pain recovery program.

The anti-crisis program in Romania had two important steps: the recovery program from 2009 and the dedicated program from 2010.

The 2009 recovery program was focused on anti-cyclical measures which to be able to avoid installed already precarious situation escalation. The national implemented anti-crisis steps had to be correlated to those adopted by the EU, in order to maximise their positive effects.

The economic convergence inside the EU had to be continued, including the adhering to the Euro area. The short term actions were incorporated into average and long term strategies. The inhabitants' economic interest (purchasing power, ability to return loans, job availability) and the social security had to be protected. Romania had to remain attractive to the FDI during the crisis period. The steps to tackle crisis had to do in a logical order; a made step had to generate or to support the future actions. All these measures and principles were included into 2009 Budget Law. Moreover, the government forecasted a GDP growth rate of 2.5%, a budgetary deficit of -2% and an inflation rate of 5% in 2009. In the same year, the Romania's GDP was forecasted to 144.7 billion Euros and the budget to 51 billion Euros (35% of GDP) [4].

In order to achieve these optimistic results, the Romanian government implemented drastic measures to limit the budgetary expenditures: it blocked the employments in the budgetary system, adopted special measures connected to the "luxury" employees from the public system and their participation in the administrative councils which offered them

important financial benefits. In 2009, the overtime working was not paid; it was compensated by time off. The government was focused on a decrease of staff costs of about 20% aimed at saving jobs than redundancies. The theoretical support for these measures was the idea that the additional revenues in the public sector were greater than the individual wages.

The Romanian government adopted regulations in order to support the economic growth and to limit the crisis' effects. These were divided into economic and social measures. The economic measures were the following:

- allocating a percentage of 20% (about 10 billion Euros) from the 2009 budget for investment in infrastructure (transport, environment, health, education), in order to generate jobs and savings, keeping jobs and new opportunities to pay the social obligations;
- accumulated government debt payment, respecting those due;
- growing the European Funds' absorption using the commitments coordination and the progresses monitoring and the implementation of a inter-ministerial committee led by the Prime Minister;
- tax exemptions for reinvested profit since 2010;
- compensation for the VAT to be recovered to VAT to be paid to the budget, in order to eliminate jam, bureaucracy and wasted time in the system;
- CEC AND Exim Bank's privatization. CEC's privatization had to bring about 250 million Euros, as a capital infusion for the Romanian economy;
- setting up a credit guarantee fund for SMEs;
- using the same funds as in 2008, in order to promote the exports and to grow the public financing of the exports;
- enlargement of the "Jalopy" program, which covered the recycling of 60000 old cars, sponsored by a financial bonus of 950 Euros;
- incorporation of the individual incomes of the institutions and governmental agencies into the general consolidated budget;
- higher taxation for the luxury goods and taxation of gambling, in order to collect supplementary financial resources to the public budget.

On the other hand, the social measures were the following:

- establishing a minimum pension of 87 Euros, which had to be paid into two instalments to those peoples which had a low level of their pensions;
- compensation by 90% in the price of medicines for those retired which had incomes less than 150 Euros;

- during the first three months of technical unemployment, no tax had to be paid to the public budget and the state social security budget;
- covering 50% of the continuous professional training for the employees and the employers;
- growing the pensions and the wages according to the inflation rate.

The Romanian government considered that Romania fitted the European economic recovery plan, including its social component.

The reality was different of the optimistically vision of the Romanian government, at the end of 2009 (see figure 2).

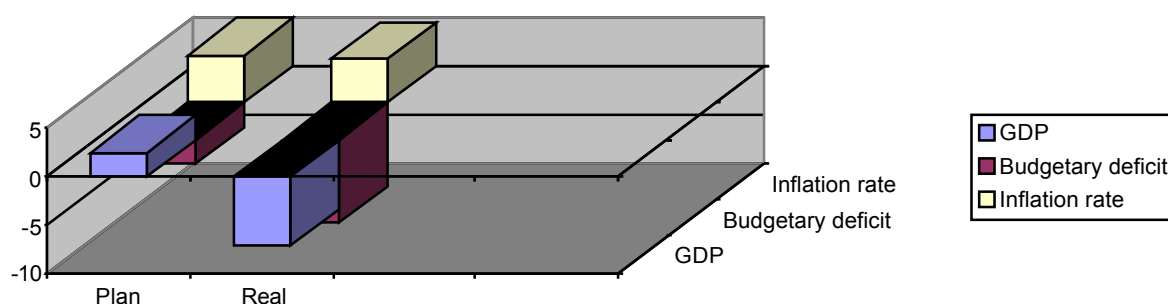


Figure 2: Disparities between economic indicators (government plan vs. reality) in Romania (%)

Source: personal contribution using Eurostat database

In order to accelerate the economic recovery, the Romanian government implemented a new anti-crisis program on June 2010. The main elements of this new programme are:

- the gross earning of the public sector employees was reduced by 25%;
- the pension point value decreased to 150 Euros. The guaranteed minimum level of social pension decreased from 350 lei to 300 lei;
- the veterans, heroes and those persecuted from political reasons' incomes decreased by 15%. This decreased was applied to the allowances and bonuses disabled, veterans and war widows, to the rights to persons persecuted for political reasons and to displaced persons, as well;
- the persons which had performed military service under the General Direction of Labour Service during 1950-1961, heroes of 1989 revolution and those from 1987 received lower pensions;
- the retired from the diplomatic and consular activities, the magistrates, the auxiliary of the courts and court prosecutions, the civil aviation personnel, the deputies and the senators

and the former employees of the Court of Auditors received new pensions, taxed at 90 percent;

- the unemployment benefit decreased by 15%. The same decrease affected the pensions of the military and civilian personnel from the Ministry of National Defence;
- the decrease of 15% affected the children's allowances, the maternity baby, the complementary family allowance, the support for single-parent family allowance and the offered allowances to increase child;
- the decrease of 15% affected the disability aids and the attendant pay indemnities for adults with severe visual disabilities;
- the marriage first aid (200 Euros) was cut out;
- the bank deposits interest was taxed by 16%;
- the student scholarships decreased by 25%;
- free transportation via public transportation;
- additional tax for the second house (33%), for the third house (50%) and more (100%).

All these above measures deepened the recession in Romania in 2010 and at the beginning of 2011.

The VAT increases putted the economy in infusions, because it affected the demand and grew the prices. The government didn't received more money to the budget (10.3% more than in 2009), but the economic activities migrated solidly to the underground economy (see figure 3).

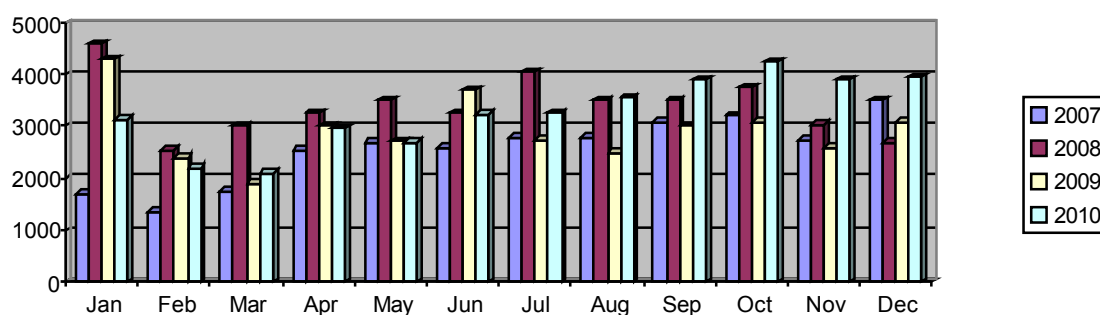


Figure 3: VAT collections trend in Romania (million lei)

Source: [5]

The Romanian government is not able to increase the VAT, because its actual level is one of the greater in the world.

On the other hand, the government modified 11 times the Tax Code in 2010. Still 1st of January 2011, the excise taxes on fuel and cigarettes grew by 3%, for example. As a result, the predictability became a simple notion of dictionary. These changes affected the fiscal stability and, as a result, the competitiveness. Moreover, the excise taxes' growth supported the contraband development and just a little growth of the revenues from excise (see figure 4).

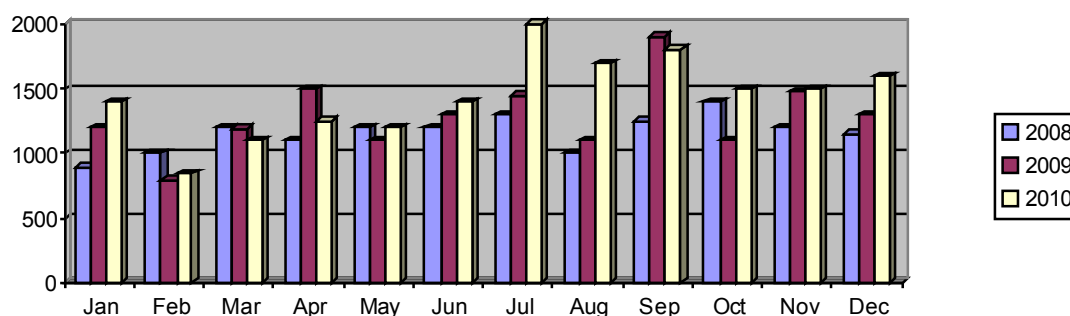


Figure 4: Revenues from excise in Romania (million lei)

Source: [6]

Another controversial was the minimum tax, which was implemented at 1st of May 2009. This tax supported the bankruptcy of more than 100000 companies. These companies increased the unemployment stock and decreased the budgetary revenues (see figure 5).

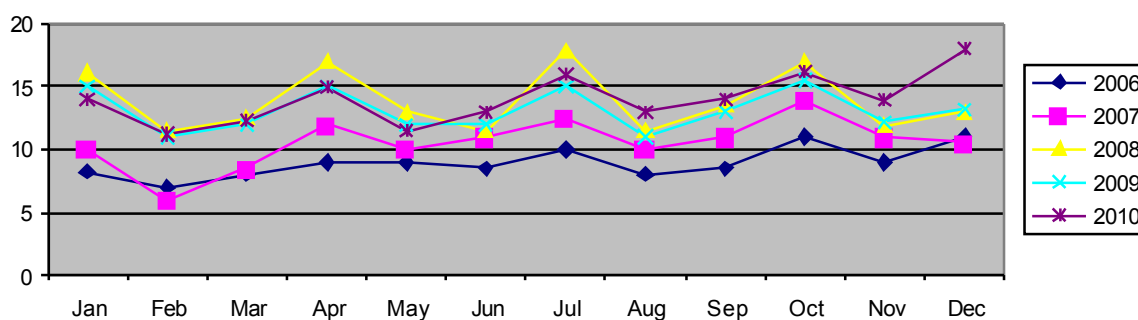


Figure 5: Budgetary revenues in Romania (billion lei)

Source: personal contribution using the Ministry of Public Finance's database

A real challenge for the Romanian economy is its low EU funds' absorption capacity. According to the official reports, the Romania's absorption capacity was less than 10% during 2007-2010. Romania may obtain 30 billion Euros from the EU funds until 2013. The problem

is that Romania was able to attract only 0.6 billion Euros in 2009 and 1.7 billion Euros in 2010 from the EU funds [7].

According to this figure, the worst results had the Ministry of Transports, which attracted only 1.03% from the EU Transports funds for Romania (TR). The best results had the Regional Operational Program (ROP) which used 14.89% from the dedicated EU fund.

The Human Resources Development (HRD) covered 13.36% of the payments, the Economic Competitiveness Growth (ECG) 9.83%, the Environment Program (ENV) 7.06%, the Technical Assistance (TA) 5.27% and the Administrative Capacity Development (ACD) only 4.9%.

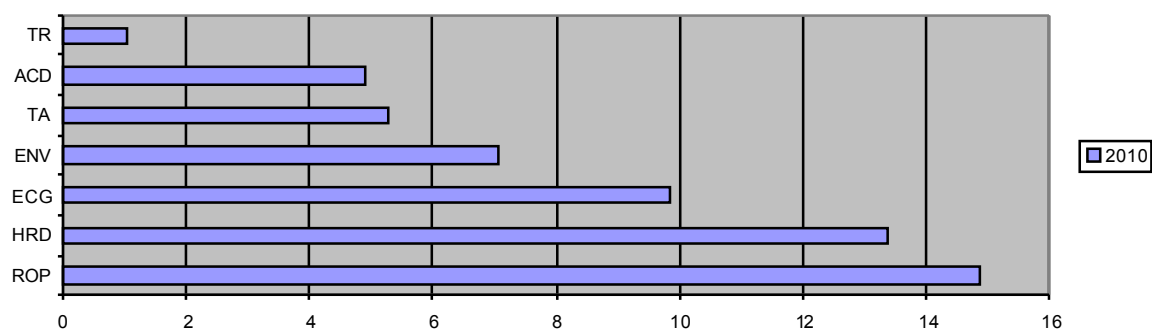


Figure 6: EU funds in Romania in 2010 (%)

Source: personal contribution using the Authority for Structural Instruments' database

Maybe the most unpopular measure implemented by the Romanian government was the wages decrease, which cut practically the consumption. This process was followed by a greater decrease of the budgetary revenues (see figure 7).

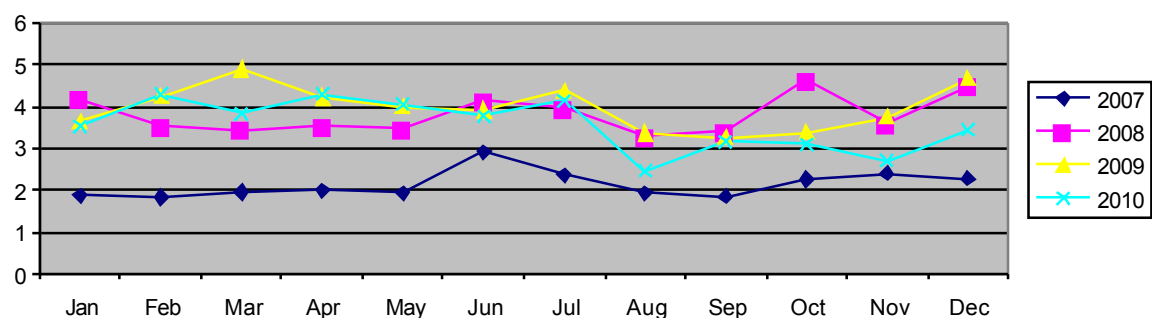


Figure 7: Personnel costs in Romania (million lei)

Source: personal contribution using the Ministry of Public Finance's database

But the greatest mistake of the Romanian government's policy in 2010 was that connected to the investment. The government tried to implement the idea that it inaugurated few kilometres of highway and portions of the belt roads. The remaining money was spent on landscape design, border changes and asphalt on side streets. These investments covered 4.4% of GDP in the first 10 months from 2010. The problem was that the budgetary expenditures grew, even that the government proclaimed that it made savings (see figure 8).

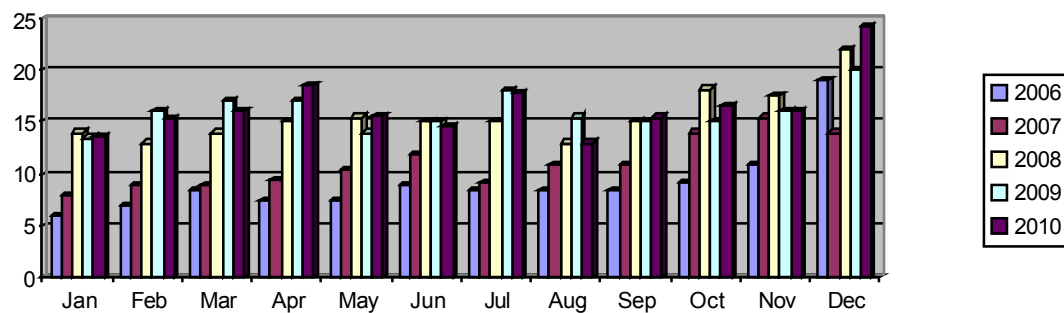


Figure 8: Budget expenditures in Romania (billion lei)

Source: personal contribution using the Ministry of Public Finance's database

The First House program bundled the trade, not the investments. This program supported the selling of old houses and didn't produce VAT. In 2011, this program offers 10-15000 Euros guarantee higher for those who build or buy new houses.

On the other hand, the arrears level grew in 2010, because the government didn't paid its bills, in order to respect the budget deficit targets fixed by IMF. As a result, the government debts cover 12 billion lei (10 billion lei arrears of the public companies). IMF asked Romanian government to decrease to zero the arrears level in 2011.

Still 2010, the exports became the rope for the Romanian economy. The exports grew by 26.7% in 2010 regarding 2009. The greatest exports were covered by Dacia cars made in Pitesti and Nokia mobiles made in Cluj [8].



Figure 9: Romania's foreign trade growth rate (%)

Source: personal contribution using the EU data bases

Beyond the implemented measures, the business environment requires the absence of a coherent message from the government. The government micromanagement and the hazardous forecasts support the general climate of distrust in Romania.

3. Government measures for economic recovery in Bulgaria

Bulgaria adhered to the EU in the same year with Romania, as a free market economy. During the communist regime, Bulgaria was powerfully connected to the Soviet market. As a result, the crash of the Soviet Union caused the welfare decrease by 40% in Bulgaria [9]. Still 2004, the economic growth started to achieve the same rates as in the communist period.

During 2002-2008, the FDI and the domestic demand supported an annual average GDP growth rate of 6%. But the Bulgarian economy entered under recession, as a result of the export demand contraction and FDI decrease. During the present crisis, the Bulgarian government was loyal to the financial stability, decreasing the budgetary expenditures and creating favourable conditions to the business environment and FDI. But Bulgaria was not able to face the crisis without EU financial support.

The GDP growth rates decreased during 2008-2010, but the European Commission forecasts are optimistically for the next two years [10].

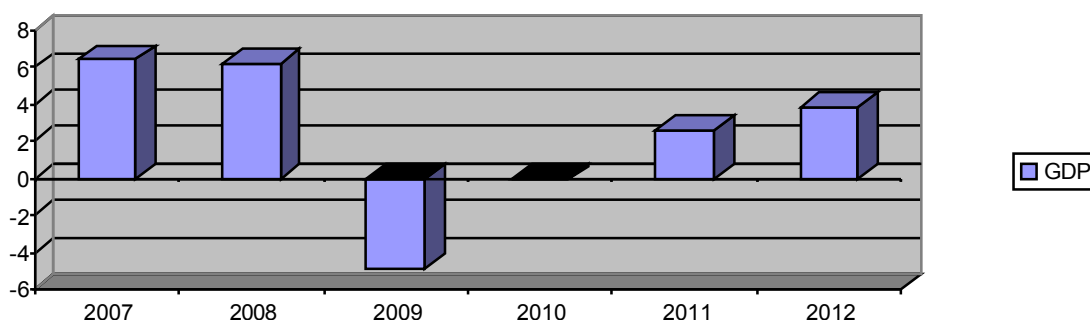


Figure 10: Bulgaria's GDP growth rate (%)

Source: personal contribution using the EU data bases

The Bulgarian government's attitude was proactive in its efforts to face to the financial crisis. The direct influence of the crisis on the Bulgarian bank sector was limited and it didn't ask for the government support intervention measures.

However, the government implemented measures to support the economy, the decrease the expenditures and the revenues increase. The Bulgarian economy recovery is connected to the neighbours' recovery. Moreover, Bulgaria has to change its economic growth model based on exports to another able to promote the sustainable development [11].

The prime-minister Boiko Borissov and its government implemented a recovery package with 48 measures. Some measures are focused on: "luxury tax" on yachts, on cars with engine displacement capacity greater than 1500 cm³ and on interests for those bank deposits of more than 100 000 leva.

There would be no change to the flat tax system or to social insurance contributions. Other measures being put forward included the issue of a bond loan and a cap on the pay of public sector employees.

Further, it was proposed to privatise unwanted state property and to allow the Silver Fund, a mechanism set up some years ago to stabilise resources for pension funds, to invest in low-risk domestic financial instruments.

No tax was imposed on pensions, only working pensioners paid welfare contributions on their income.

The implementing all proposed measures allowed the Government to keep the status quo by the end of 2011, the point at which, official projections say, Bulgaria will emerge from the economic crisis.

The National Council for Tripartite Cooperation, formed by the government representatives, unions and employers' organisations established 60+1 anti-crisis measures

connected to: fiscal support, public expenditures decrease, financial discipline, additional financial resources for companies, households' incomes support, labour market and social security and health system.

The fiscal support measures were focused on the following:

- introduction of a final tax on the goods and cash prizes from gambling;
- changing the method of taxation of insurance premiums;
- changing to 1.1 (from 1.0) the coefficient used in the pre-payment tax calculation for 2010 „CITAct” program;

- introduction the “luxury tax”.

Other measures were focused on the financial discipline:

- recovery of VAT duty owed by companies in the legal time limit;
- establishment of public records for the procurement funds, VAT, excises and European projects;
- immediate legislative review in order to guarantee the repayment period in the name of the public companies as a period without calculating interest on taxes and insurance contributions. Moreover, the access will be easily to the European projects and procurement;
- simplified procedures and shortened time limits for the bankruptcy process.

The Ministry of Finance has to publish monthly detailed information about: the execution sections of the budget revenues and expenditures, including VAT balance; the changes in external debt and the tax reserve situation in foreign currency and current profitability.

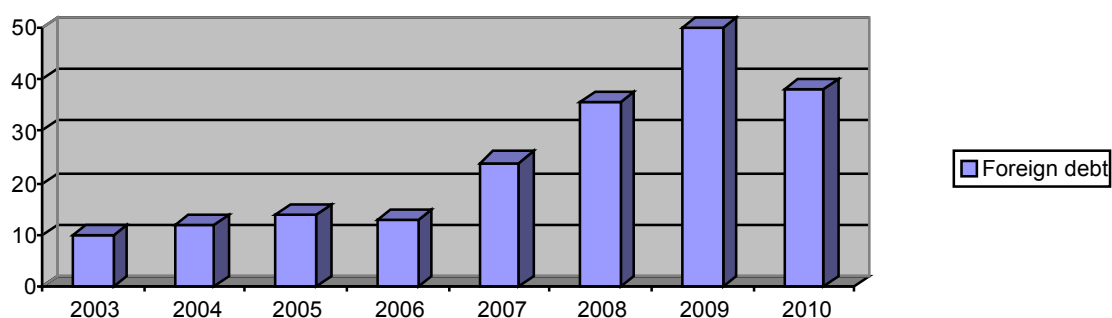


Figure 11: Bulgaria's foreign debt (billion USD)

Source: personal contribution using the EU data bases

Every quarter, the Ministry of Finance collects and publish information about the financial results of all public companies.

Connected to the labour market, the National Agency for Fiscal Administration collects information about unpaid wages and offers resumes with quarterly dates about national and regional economy. The labour structure in 2010 was: agriculture – 7.5%, industry– 27.6% and services– 64.9% (see figure 12).

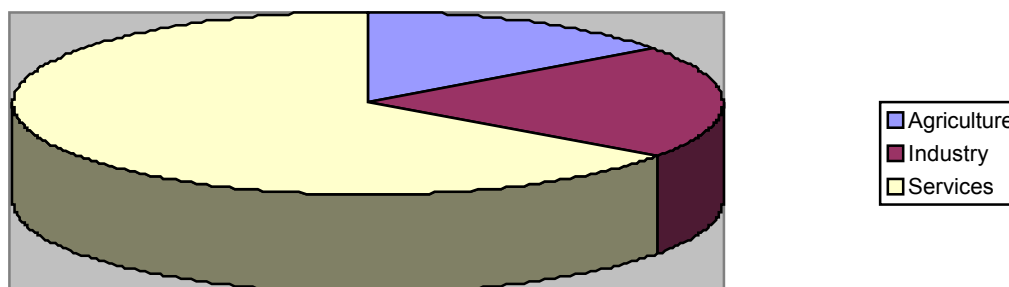


Figure 12: Bulgaria's labour structure (%)

Source: personal contribution using [13]

Other measures were connected to the Social and Health Insurance System:

- temporary suspension of the reducing social security contributions until the end of 2011;
- give up health insurance contribution increase; introduction of electronic cards for each patient until the end of 2011; drastic control measures connected to the budget of the National Health Insurance Fund;
- people without health insurance or without other incomes will pay the insurance contribution calculated according to their income from equity and property.

The 60+1 measure is the prohibition in cash payments over a certain limit.

4. Comparative analysis: Bulgaria and Romania versus the crisis

In 2009, Romania's GDP decreased by 7.1% and the budgetary deficit was 7.2%. On March 2010, the Romanian prime-minister declared that government's economic austerity plans have to be respected strictly "if we don't want to go to Greece".

Similar warnings came from Sofia. Bulgaria had a budgetary surplus when the global crisis got the national economy. This is why Bulgaria finished the 2009 fiscal year with a deficit less than 1% and it had not to lend from IMF, as Romania. On the other hand, Bulgaria's GDP decreased by 4.9% in 2009.

The European Commission forecasts talk about different performances of these two countries in 2011, but the same performance in 2012 (see figure 13).



Figure 13: Bulgaria and Romania GDP trend (%)

Source: personal contribution using the EU data bases

Both countries have a similar evolution connected to the inflation rate, which will be above 2% in 2012 (see figure 14).

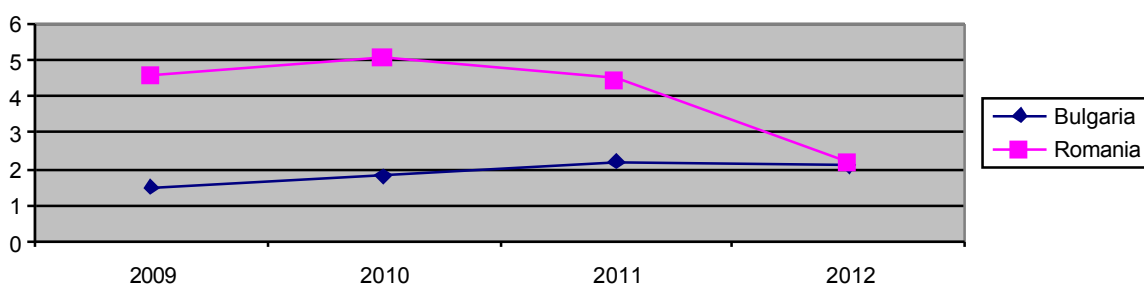


Figure 14: Bulgaria and Romania inflation rate trend (%)

Source: personal contribution using the EU data bases

Moreover, both countries want to adhere to the Euro area in the next 5 years. Like their fellow Romanians, Bulgarians leaders are eager to keep the single system of taxation, as a stimulus for the economic activity.

The public protests and the negotiations with trade unions forced both governments to adopt different positions. As a result, there are differences connected to the economic environment in Bulgaria and Romania (see table 1).

Table 1: The economic environment in Bulgaria and Romania

Domain	Romania	Bulgaria
Profit tax	16%	10%
Income tax	16%	10%
Dividends tax	16%	5%
Wages tax	62%	34%
Tax returns	Quarterly	Quarterly

Profit tax payment	Quarterly	Annual
Filing VAT declarations	Monthly/ Quarterly	Monthly
VAT recovery	Uncertain	45 days of the request
Exchange rate	Jumpy 4.2 lei/Euro	Fixedly 1.95 leva/Euro
VAT rate	Broad 24%	Broad 20%
	Tour packages 9%	Tour packages 9%
	Export 0%	Export 0%
Minimum capital	About 46.5 Euros	About 1 Euro
Net minimum wage	About 139.5 Euros	About 123.7 Euros

Source: DPA

Bulgaria has a better business environment connected to tax and minimum capital. Moreover, the leva exchange rate is fixed and lower than that of the Romanian currency.

But both countries faced to budget cuts in education, health and public administration. These measures are asked by the IMF (for Romania), the EU, in order to adhere to the Euro area and by the anti-crisis plans financed by the EU in Greece and Ireland.

On the other hand, both countries face to a new challenge: the general government gross debt increase during 2007-2010. The EU forecasts about this indicator talk about new increases during 2011-2012 (see figure 15).

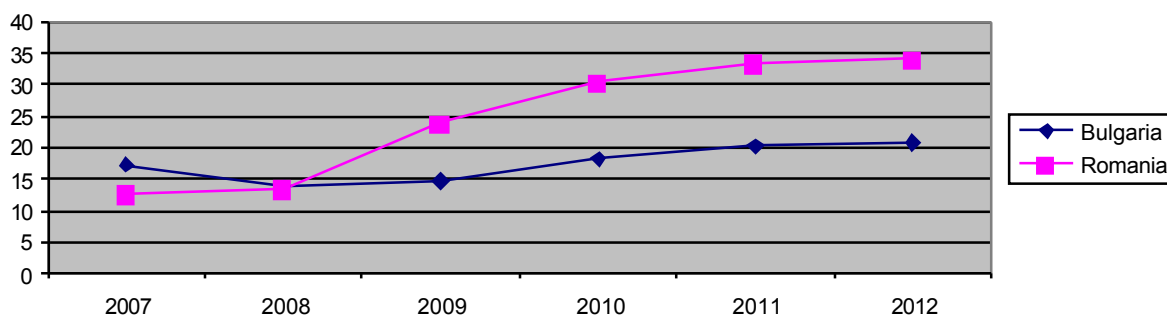


Figure 15: Bulgaria and Romania general government gross debt (% of GDP)

Source: personal contribution using the EU data bases

5. Conclusions

The first question connected to this analysis is if the above economic measures in Bulgaria and Romania are timely. The Bulgarian and Romanian economists are sceptically about the budget cuts and the means to fight against crisis.

A better solution is focusing on the key industry areas with high economic importance and a greater influence on other industries, welfare and social inequality.

Across the EU27 the present global crisis affected powerfully the EU2 countries, even that Greece and Ireland are the "stars" of the recession.

The speculative behaviour of the global investors focused the EU2 states on the area of financial regulation, a critical area to create a sustainable and efficient financial system. During 2007-2010, Bulgaria and Romania had to demonstrate their ability to face the crisis and to save their economies from the national bankruptcy [14].

Both countries were hit by the economic recession and bank crisis and they had to face to the GDP, imports and exports' decreases, social deficiencies and concerns connected to the adhering to the Euro area.

Making everything worse, the popular pressure on policymakers grew by numerous street protests and strikes. The people's dissatisfaction was supported by the inability of the leaders to explain the situation.

Both governments created and implemented anti-crisis plans, in order to achieve the economic recovery and to decrease the public expenditures.

Even that the specialists' forecasts were optimistically, the political passivity and the bureaucratic instability affected the results.

Moreover, the internal tensions between power and opposition parties were putted across some motions of censure which decreased the confidence both states look for the FDI.

The only solution would be a drastic reform of the economic, financial and administrative systems, greater involvement of the state in decisions related to the banking sector and a better financial education for the citizens.

Even is too late now, both states hope to a better future. The above analysis demonstrated that both countries had the same political and economic past, have the same present and will have the same future, as well.

The successfully recovery of Romania and Bulgaria represents a high stakes not only for the EU2, but for the EU27's future.

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