The Economic Crisis and its Effects on SMEs

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Abstract. *Romania has ended a high growth cycle. The world economic crisis is worsening with every passing day and Romania increasingly feels the effects of this economic downturn. The sector of small and medium enterprises (SMEs) is the most dynamic in the Romanian economy, but it will also be one of the first to be hit by the global financial crisis the ripples of which have reached Romania as well. SMEs are now considered the most sensitive sector and worst affected by the economic climate. The economic crisis has prompted the member states of the European Union, too, to adopt packages of measures to counteract the effect of the crisis. Here below I will exemplify with the cases of Romania, the Italian Republic, the Federal Republic of Germany, the Slovak Republic and the Republic of Hungary.*

Keywords: economic crisis; SMEs; Romania; the Italian Republic; the Federal Republic of Germany; the Slovak Republic; the Republic of Hungary; anti-crisis measures; anti-crisis plan; economic recession; G20; the European Union; International Monetary Fund (IMF).

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Romania posted a record economic growth rate of about 7.8% in 2008, but specialists hold that this country is at the end of a cycle of high economic growth. As the economic crisis worsens, Romania increasingly feels the impact of the economic recession.

Considering the scope of the crisis, determined by such factors as the economic unsustainability in Romania, the excessive social measures, the fragility of the stock exchange, the absence of measures to protect Romanian capital and the lack of information for entrepreneurs, the Bucharest Executive has negotiated a financial package, in March 2009, with the International Monetary Fund, the World Bank, the European Bank for Reconstruction and Development (EBRD) and other international bodies. This package is designed to support the economy now in difficulty, by helping to cushion the adverse impact of the crisis.

The financial support package the international financial institutions have granted to Romania will amount to EUR 19.95 billion over the next years. The stand-by agreement with the IMF is worth EUR 12.95 billion. The European Union is to contribute EUR 5 billion, the World Bank – EUR 1 billion, and the EBRD, alongside other international financial institutions, will come up with another EUR 1 billion.

Romania will get the first installment of the EUR 5 billion loan from the European Commission in early July. Half of the money from the EBRD will go to the banks, and the other half will go to the economy, including aid to companies, in the energy sector and infrastructure.

In this context, the Government of Romania has negotiated with the IMF a budget deficit amounting to 4.6% of the gross domestic product (GDP), although in December last year it had targeted a budget deficit no bigger than 2% of GDP. At the end of 2008, in keeping with the data available at that time, the Government in Bucharest had envisioned a growth rate of about 2.5%. However, at the beginning of 2009, the evaluation of the Romanian economy by the IMF experts indicated a negative growth of 4% and a budget deficit of 4.6% of GDP.

The Executive has come up with a program to fight the crisis, worth EUR 4 billion. Its main components are a 20% allocation from the 2009 budget for investment in infrastructure, payment of government debts and backlog subsidies, increasing the absorption of Community funds, and continuing and expanding the old-car buyback program.

As far as small and medium enterprises (SMEs) are concerned, it should be noted this is the most dynamic sector in the Romanian economy, generating nearly 80% of the GDP. SMEs, considered the most sensitive and most affected by the economic climate, will be among the first to be hit by the effects of the world financial crisis, which has spread to the Romanian economy as well.

The financial crisis adversely impacts most of the SMEs, reducing the development rate and increasing the number of bankruptcies. Startups in particular are most vulnerable, lacking the resources to survive the downturn.

Nevertheless, for a small number of SMEs, i.e. those that identify the changes in the market and react promptly, this period may prove favorable. In times of crisis, some SMEs, unlike the big companies, have the advantage of greater flexibility, being able to implement new services and launch new products more easily. Not bound by strategies devised at higher echelons and by the need to get approvals, SMEs can make decisions more easily and thus become much more efficient based on prompt action and solutions adjusted to market circumstances.

The main challenges most SMEs in Romania have to cope with as a result of the economic-financial crisis are sudden rises in the prices of raw materials, energy and food, liquidity and credit related problems, a marked decline in the demand for products and services, considerable variations in the exchange rate, and inflation. This phenomenon is spreading quite rapidly to a growing number of companies.

The adverse effects of the financial crisis are visible particularly in the case of SMEs in sectors like commerce, constructions and real estate.

Declining exports, diminished investment, and the liquidity blockage are the main effects of the financial crisis, with repercussions on companies. According to estimates, over 90% of the more than 600,000 SMEs in Romania feel the pinch.

In the first half of the year, the number of SMEs going bankrupt has doubled over the same period the previous year. This is due to the fact that the credits for SMEs have declined by 30%, which has precluded their development and reduced their solvency.

Studies conducted by the National Association of Romanian Employers indicate that, should the current economic circumstances persist, 25% of the small and medium companies could close down this year and 90% of SME managers plan layoffs this year amounting to 10% of the personnel.

Most of the SME owners, i.e. 83%, have negative expectations about the profit they will make in 2009. 76% of the SMEs surveyed intend to adjust to the current economic situation by downsizing, whereas 16% are looking for investors to recapitalize their business. Over 60% of the SMEs hold that a relaxation of credit would help their business work better, and 34% of these believe that measures should be geared at easing the tax burden. Moreover, 55% of the small and medium enterprises consider that the agreement with the IMF is a good solution, while 34% say it is not.

As far as unemployment is concerned, the initial estimates of the Ministry of Labor, Family and Social Protection for

2009 – indicating the loss of 525,000 jobs – may well be exceeded by a wide margin. The jobless figure could rise to one million by the end of the year, as Romanians having lost their jobs in Spain and Italy return home in droves.

According to a survey the international market research company MEMRB conducted in Romania in early 2009, one of the most important solutions in times of crisis is to reorient to more profitable business areas. Furthermore, the survey shows that nearly 80% of the Romanian companies have taken recession-proofing measures, entrepreneurs cutting costs for services supplied by third parties and utility costs. Another finding of the survey is that the most infrequent initiative among SMEs is the launching of new products and services.

50% of the companies surveyed expect the crisis to end in late 2010. Most of the companies spotted the first signs of the economic and financial crisis in November 2008. Three in four companies in Romania consider the economic crisis equivalent to a drop in the demand for the products or services they supply.

The representatives of the National Association of Romanian Employers believe several measures are needed to save the SMEs, the most important of which are: resuming credits, VAT payment by companies on collecting, deduction of excise duty on gas, electricity and fuel, facilitation of government guaranteed loans, regulation of the price of raw materials by the Competition Council, reorientation of the business to more profitable activities, deduction of social contributions, financing from banks and access to funds from CEC Bank and Eximbank.

Providing support for the SME sector in the context of the current economic crisis is a major solution apt to counter the adverse effects in the process of structural adjustment and economic recovery, generating economic and social alternatives.

In conditions of financial crisis, SMEs can support stability and macroeconomic growth, acting as a growth engine.

That is why action is being taken to release funds to finance small and medium enterprises, to identify solutions to preserve jobs and generate new ones.

The measures proposed for the SME sector in the anti-crisis plan include: tax exemption for reinvested profit, which, besides creation of new jobs, will determine the setting up of new SMEs and stimulate investment by companies that so far have refrained from investing; offsetting the VAT to be recouped with the VAT due to be paid or with other dues to the state budget; capitalization of CEC Bank and Eximbank; making the Counter-Guarantee Fund for SMEs operational; earmarking large funds from the state budget to promoting exports, and increasing the state’s contribution to financing this activity.

The situation of the economy of the European Union is deteriorating in the context of the current financial crisis.

The new member states that are not in the eurozone faced, in the last months of 2008 and in 2009, sizable depreciations of their national currencies in terms of the euro.

Ireland, Greece, Spain, France, Latvia and Romania had already exceeded, in 2008, the maximum 3% deficit, and the European Commission envisages a further worsening in 2009. In the case of Romania, according to the EC, the budget deficit in 2008 reached 5.2% or nearly double the 2007 figure. Ireland posted a 6.5% deficit last year, from a surplus of 0.2% in 2007, Latvia 3.5%, Greece and Spain 3.4%, Spain slipping from a 2.2% surplus to the 3.4% deficit, and France 3.2%. Romania and Latvia not being part of the eurozone, financial sanctions cannot be applied to them but the target date for their adoption of the single currency can be delayed and, in case the EU recommendations are repeatedly ignored, cohesion funds may be suspended.

The economic and financial crisis affecting Europe and not only Europe has prompted the member states to adopt new anticrisis packages, after the initial ones which, focusing more on injecting liquidities to save the banks, failed to produce results. Currently, the measures envisaged are largely focused on encouraging demand based on fiscal incentives and support for certain sensitive economic sectors.

Austria, Belgium, Germany, France, the Netherlands, Luxembourg, Ireland and the UK have taken steps to bail out the banks through capitalization, state guarantees or taking over control of the banks.

France, Germany, Italy, Slovakia, Spain and the UK have also chosen to provide aid to the automobile industry, one of the industries worst affected by the crisis.

To fight the crisis effects, the European Council adopted, in December 2008, the *European Economic Recovery Plan* worth EUR 200 billion, or 1.5% of the EU's GDP (EUR 170 billion provided by the member states and EUR 30 billion from the European Investment Bank), plus funds from the Community budget.

Below I will exemplify with the case of the Italian Republic, the Federal Republic of Germany, the Slovak Republic and the Republic of Hungary.

The Italian Republic, like the other countries in the eurozone, is currently grappling with a marked deterioration of the economy, although its financial sector is still sound enough. The International Monetary Fund forecasts three years in a row when Italy will see its GDP drop: -0.6% in 2008, -2.1% in 2009 and -0.5% in 2010.

In 2008 Italy's economy went down by 1%, this being the poorest performance since 1975, when its GDP had shrunk by 2.1% on the background of the oil crisis. The shrinking of the GDP was caused mostly by the 3.7% reduction of exports, a 3% drop in investment and a consumption decline of 0.5%. Imports in turn went down by 4.5%. According to the

National Statistics Institute in Italy – Istat, in 2007 Italy had posted a 1.6% growth rate.

The measures taken by officials in the Italian Republic are part of the European Commission's recovery plan. The package the Government in Rome adopted includes a bonus for low-income families, in the form of tax credit, and for companies – tax deductions and an increase in the funds for technical unemployment.

On the background of the economic crisis, as Italy's economy stagnates and the public debt exceeds the GDP, the Executive in Rome intends to inject EUR 80 billion in the market in the next two or three years. However, the public spending forecasted for the next years can reach EUR 110 billion, given the European resources and the Italian regional cohesion fund.

On January 12, 2009 the authorities of the Federal Republic of Germany announced an EUR 50 billion package of measures covering two years. Supplementing the package approved at the end of last year (EUR 32 billion), the new package is the largest ever since World War II and is aimed at providing support to Europe's biggest economy.

Germany's stimulus package amounts to EUR 82 billion spread out over two years, i.e. 1.6% of the GDP – the biggest injection of capital in Europe. The scope of the program compares to that of US President Barack Obama's plan worth USD 775 billion (2.8% of the GDP) spread out over two years.

According to this plan, employees' health insurance payments will be reduced, which will equally benefit employers and the employees, and the salary tax (first taxation level) will be cut from 15% to 14%. Moreover, under this plan, EUR 18 billion is earmarked for new investment in the construction and repair of roads, railways, schools and universities. The program also includes EUR 1.5 billion of aid for the automobile industry, and tax reductions of 2.9 billions due to grow to 6 billions as of 2010. Furthermore, in order to stimulate economic activity, guarantees of up to EUR 100 billion are to be granted for loans raised by German companies.

The effects of the crisis are increasingly visible and Germany's position as the world's top exporter is in danger. German specialists hold that Germany preserved its status as the world's top goods exporter in 2008 for the 6th straight year, the surplus trade balance accounting, according to the Federal Statistics Office, for 6.4% of GDP. By late 2008, however, German exports were seriously affected by the crisis, specialists saying 2008 was the last year Germany could stick to its position as the world's no. 1 exporter.

The latest estimates related to Germany, presented in *Financial Times Deutschland*, show that in 2010 the budget deficit could exceed 4% of the GDP.

According to the estimates of Germany's Central Bank (Bundesbank), the biggest economy in Europe is to shrink by 0.8% in 2009, after having significantly slowed down in 2008 under the impact of the financial crisis. The Bundesbank has announced the German economy stands slim chances of recovering faster than the world economy as a whole, which is expected to pick up to a certain extent in 2010.

Several analysts also believe that in 2010 Germany may lose to China its position as the world's third largest economy.

As far as Slovakia is concerned, it boasts a stable business environment and confidence is the economy is high. The growth rate in 2008 was big, rising to over 7%.

Slovakia, having managed to align with the Maastricht criteria, benefits as of January 1, 2009 from the advantages of the single currency, from the stability ensured by this currency compared to the currencies of the countries that have not adopted the euro yet. Transition to the single currency eliminates certain risks, such as the risk related to exchange rates.

In February 2009, in Slovakia the Legislature approved a set of changes aimed at mitigating the effects of the world economic and financial crisis. The changes in point include a reduction of taxes paid by employees, streamlining of administrative procedures and a cut in the bureaucracy companies have to comply with. Another goal is to obtain a positive influence on businesses by improving the business climate. Commercial companies will thus be able to develop their business and create new jobs. Small companies with an annual turnover of up to EUR 200,000 will not have to observe complicated accounting rules, but only to apply primary accounting. Introduction of this limit will benefit the business environment and will not affect state budget revenue. As far as the VAT is concerned, the deadline for recovering the VAT has been reduced from 60 to 30 days for monthly VAT payers. Concurrently, the Slovak Government has decided to focus on stimulating internal demand and accelerating the implementation of structural funds. Plans are being made for opening a financing line for SMEs, jointly with the commercial banks.

According to the European Commission, in 2009 Slovakia will post an economic growth of about 2% of GDP, while many EU member states are heading for recession. In the current circumstances, a risk for the Slovak economy arises from its specialization in automobile manufacturing, which contributed to a solid growth of industrial activity. Automobile production dropped 35.7% in December 2008 from year earlier, after a 16.9% drop in November, the Slovak National Institute of Statistics reports.

The current recession in Hungary, which started in 2008, will affect the Hungarian economy more harshly than specialists initially expected, notably because of the world recession, Hungary's being a small economy, dependent on exports.

In October 2008 Hungary – one of the countries worst hit by the current world economic crisis – avoided financial collapse with the help of a support package worth USD 25.1 billion, coordinated by the International Monetary Fund. Specialists consider Hungary will face the most marked slump in two decades, as exports to Western Europe are shrinking, demand diminishes at the national level and unemployment grows.

Throughout 2008 Hungary's economy grew 0.6%, after having posted a growth rate of 1.1% in 2007 and of 4.1% in 2006.

The Hungarian government's estimations indicate the GDP will decline by 3% this year, that is, more than the figure advanced in previous estimates. Consequently the Executive in Budapest has revised its economic plans, as well as the budget, so as to make up for the diminished revenue. On the other hand, analysts believe the GDP could shrink by as much as 6%.

Therefore Hungary adopted a number of anti-crisis measures. Budget-related measures include reductions and increases in taxes, expenditure cuts, the aim being to diminish the taxes for both companies and employees, as well as higher taxation of consumption and properties. A 4% "solidarity" tax on the earnings of companies and persons with high incomes will be applied as of January 1, 2010, the value-added tax will grow from 20% to 23% as of July 1, 2009, and employees' contribution to social insurance will be reduced by 5%, from 32% to 27%, in two stages.

In the context of the current world crisis, London played host, on April 2, 2009, to the G20 Summit devoted to the financial and economic crisis.

The G20 (Group of Twenty), established in 1999, comprises: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom, United States and the European Union.

The 20 account for 85% of the gross world product, for 80% of world exchanges and for two thirds of the world's population. The G20 meetings are also attended by the director general of the IMF and the president of the World Bank. The Group of Twenty is an informal forum that promotes discussion on themes related to global economic stability, and one of its aims is to help strengthen the world financial architecture and to provide the opportunity for debates on national policies and their coordination to the end of fostering economic growth and development.

The goals of the London Summit of the G20 were world economic recovery and establishment of real action to strengthen the financial system.

The main measures the G20 summiteers agreed on in London were:

- 5,000 billion dollars to be used by G20 to stabilize the world economy by the end of 2010, an effort that will increase the gross world product by 4%;

- Over 1,100 billion dollars granted to international financial institutions, of which 750 billion for the IMF, 100 billion for the Multilateral Development Banks, 250 billion for financing trade with a view to resuming world exchanges in the next two years, coming from special drawing rights (SDR) from the IMF;
- Establishment of a new Financial Stability Board, with a strengthened mandate, as a successor to the Financial Stability Forum; the FSB will include all G20 member state, the members of the Financial Stability Forum, Spain and the European Commission; it will collaborate with the International Monetary Fund in order to issue early warnings on the buildup of macroeconomic and financial risks;
- Institution of strict control over credit rating agencies and hedge funds, avoidance of protectionist measures and increase of credits made available to poor countries – 50 billion to support social protection in the poor countries;
- New regulations on the salaries and bonuses of big corporate managers;
- Banning of tax havens. The G20 leaders decided to put an end to tax havens that do not comply with international tax regulations and refuse to provide the financial information requested by authorities;
- Regulatory oversight of Credit Rating Agencies, that includes registration, so that they should comply with the international codes of good practice, notably in order to prevent conflicts of interest.

A topic much debated in recent months as well as at the G20 Summit was the US plan for overcoming the current crisis: economic recovery based on allocation of supplementary funds from the state budget, an idea categorically rejected by the Europeans, at head with France and Germany, which emphasize regulation and control over the world finances. In case the crisis worsens, the G20 will make additional budgetary efforts and the USD 5,000 billion figure will be adjusted accordingly.

As the International Monetary Fund sees it, economic growth will slow down sensibly in the developed countries, whereas the developing countries and the Third World countries with sustain a major decline in their growth rates. Also, in 2009 China will keep its position as the country with the highest growth rate in the world – an estimated 6.7% (the lowest in two decades), after a 9% growth in 2008. India in turn will post a growth rate of 5.1% in 2009, down from 7.3% in 2008.

According to IMF estimates, the world economy is traversing the worst crisis since World War II, and is to post the lowest growth rate in the last 60 years: a meager 0.5%.

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