

## CONCEPTUAL AND PRACTICAL ASPECTS OF FISCAL POLICY SME SECTOR IN ROMANIA

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### **Abstract:**

*This article relates to the subject of tax compliance and the management of scarce public funds collected through the tax system.*

*Great attention should be paid to the way in which governments can identify ways of ensuring public goods and well-being of citizens by increasing the levels of tax compliance, and the way in which they plan strategies of fostering and developing the private system.*

*Just as actual is the field of SMEs, these representing an important source of entrepreneurial skills, innovation and employment.*

*Support for SMEs is one of the priorities of the European Commission for the purpose of economic growth, because they represent the largest portion of the total enterprises and they employ the largest share of the active population.*

*At the level of the Romania, SMEs are regarded as the key factor for economic growth, innovation, employment and social integration.*

*Flexibility and adaptability of SME sector are essential traits for passing the periods of economic crisis.*

*Romania's public policy recognizes the importance of SMEs, using various instruments, both direct support, through national and European funds, as well as indirectly by shaping a favourable regulatory framework.*

*The present study aims to observe the development of SMEs and the influence that fiscal policy has over them, as well as finding ways to improve. The proposed approach is based on macroeconomic data based on reports from the European Commission.*

**Keywords:** fiscal policy, tax system, small and medium enterprises, fiscal, procurement.

**JEL codes:** E62, E69, M41.

## **1. Fiscal policy**

The strategy of economic reforms and the relaunch of economic growth have as fundamental or national strategic objective the creation of a functional market economy compatible with the states of the European Union.

Any macroeconomic strategy includes setting goals (strategic and tactical), intermediate targets or steps that must be completed in order to achieve the objectives, tools (these depend on the policy used) and indicators, these offer information on macroeconomic policy decisions to increase performance in achieving goals.

The state's fiscal policy is a series of measures and actions relating to the role of taxes in the budget revenue system, tax types, tax procurement and the manner they are used as an instrument for stimulating economic growth, the way in which the tax efficiency is designed into the respective country. It consists of a set of government decisions that aims to influence economic and social activity with the help of the mobility of revenues and expenditures in the public budget.

Fiscal policy refers to the measures used for charging and the use of taxes and charges in the economy.

There are fiscal policy interrelationships with other policies: budgetary policy, monetary policy, customs policy, price policy, labour policy, enterprise financial policy, but the objectives and instruments are specific.

We can define fiscal policy being the totality of means, methods, tools and forms used by the state or other public authorities in order to obtain financial resources. They influence the way economic and financial processes work and development of the entire society, but it is also subject to a number of factors in the economic environment:

- Economic status;
- The relationship between the public and private sectors;
- Citizens ' income levels etc.

### **1.1. Fiscal policy objectives**

The general objectives of fiscal policy are: feeding the budget with the financial resources necessary to carry out the functions of the state;

stabilizing the economy; adjusting economy and restore economic growth, but also a number of other objectives:

- In long-term it aims to prevent distortion of competition;
- In the field of direct taxation is aimed at avoidance of double taxation, but also the ambiguity of laws that allow the creation of tax evasion;
- Prevention of the adverse effects of tax competition, national tax bases seeking favorable tax treatment in other States.

Fiscal policy must follow a few basic directions in order to avoid diminishing incomes that remain available to natural and legal persons for private consumption and accumulation as a result of excessive taxation, namely:

- distribution of tax burdens to be equitable, that is, each to be determined to pay their fair share;
- taxes must be selected so that to minimize the influence on economic decisions taken on other markets and used to correct the shortage in the private sector;
- tax structure should facilitate the use of fiscal policy in relation to stabilization and economic growth objectives;
- the tax system has to permit effective and non-arbitrary management, comprehensive to the taxpayer;
- the cost of administration and of the system of coercion should be reduced.

The transmission mechanism in which fiscal policy affects social and economic activity consists of three stages:

1. legislative;
2. market stage: taxes enter economic exchanges;
3. stage of the effects:
  - financial - with consequences for economic subjects during the economic circuit;
  - general economic - are consequences for all economic subjects propagated in time.

## **1.2. Principles of taxation**

Principles taken into account in the justification of taxation:

- The principle of compulsory;
- The principle of general tax reasoning;
- The principle of the uniqueness of taxation;
- The principle of taxation progressivity;
- The principle of the effectiveness of taxation;
- The principle of taxation veracity;
- The principle of simplicity and accessibility mode of calculation.

Observance of these principles makes taxation to fulfil its functions, in other words, ensure the necessary monetary resources to public needs and redistribution of income.

As a small conclusion, we can say that a tax system is always a compromise between the need of revenues and the care for social justice, for proportionality of payments depending on the capacity of each contributor.

To better understand some aspects of fiscal policy and to know how other states reacted in certain situations, we accessed certain studies carried out by foreign authors, studies which analyse the present situation of SMEs and the effects of fiscal policy.

A first study is "**Barrier Factors and Potential Solutions for Indonesian SMEs**" [1], presented by Maya Irjayantia and Anton Azisb Mulyono in Bandung, Indonesia, at the International Conference for SME Development with the theme "Innovation and Sustainability in the Development of SMEs" (ICSMED 2012). This study finishes the obstacles encountered by Indonesia and the search for solutions.

Research has shown the existence of ten major barriers faced by SMEs: barriers to competition, access to finance, energy, technology, cost of energy, ineffectiveness of production cost, economic factors, skills of the managers, procedures, limiting of sales, raw materials.

Most SMEs agreed that the Government should make more efforts in certain actions to remove barriers to SMEs, such as security standards, improvement and development programs, policies of good financing, rational energy policy, continuous assessment of performance, commitment to eliminate corruption, and many support programs needed by SMEs.

Potential solutions: the Government should maintain the viability of SMEs by creating more programmes for supporting SMEs regularly benchmarked to measure their performance and effectiveness; facilitating access to credit; elimination of tariffs for approval for opening new businesses.

The Government needs to keep the prices affordable for SMEs to energy, such as electricity, fuel and other energy costs. The Government should facilitate SME loans to buy technology.

Since many SMEs have problems with the cost of land, it is expected that the government will provide leasing for land for the business, with a very affordable price for SMEs or provide viable and strategic location for SMEs and to eliminate corruption.

In the study [3] "**Effectiveness of countercyclical fiscal policy: Evidence from developing Asia**" conducted Shikha Jhaa, Sushanta K. Mallick, Donghyun Parka, Pilipinas F. Quisinga from the Asian Development Bank, Macroeconomics and Finance Research Division, Economics and Research Department, Philippines, and presented at the

Queen Mary University of London, School of Business and Management, United Kingdom, 2014, bring into question a much debated topic in the literature, if the problem of fiscal policy or delay long-term economic activity. Business cycle effects of fiscal policy have begun lately to be studied extensively.

For example, according to Spilimbergo & collaborators (2009), the overall evidence from the literature indicates that the multiplier for government spending is higher than that for tax cuts.

To analyse the dynamic effects of unanticipated shocks of government spending and income over economic activity, which may be different in different countries, this paper considers SVAR models with quarterly time-series history from the emerging economies of Asia. It applies the methodology of Mountford and Uhlig (2009) to identify fiscal shocks, alongside other shocks, by imposing restrictions to identify each shock.

Explicit identification imposes restrictions to isolate exogenous and unanticipated changes of these variables through limiting the simultaneous interaction of the tax and non-tax variables. Identification of structural disturbances is based on theoretical restrictions. Ordering of shocks is not relevant in the SVAR whereas restrictions on the IRF signs make the identification of shock. Both revenue (from taxes) and expenditure are identified with a separate restriction, together with the business cycle and monetary policy shocks, which means that the shocks are orthogonal paths and the shocks are uncorrelated.

Therefore, it is irrelevant whether these are orthogonal to the impact the business cycle or orthogonal to both the business cycle and monetary policy shocks. Although you might check the effect of a tax shock by imposing weaker restrictions on identification, such as limiting government spending only to be positive at impact, such identification will hide the presence of other shocks, at the same time, and may not uniquely identify the impact of a fiscal shock. The order in which shocks are determined is less significant for the results.

The study "**What causes changes in the effects of tax policy? A case study of Japan**" [4], written by Higashino Kameda at the School of Policy Studies, presented at the Kwansai Gakuin University, Sanda, Japan showcases the last two decades, during which the Japanese Government has spent a considerable amount of money to counter the severe recessions that have reappeared in the early 1990s. Numerous studies have shown that the effects of these expenditures have decreased over time. However, none of these studies have explored statistically the reasons for this reduction, that implicitly or explicitly were mentioned. The purpose of this study is to

investigate the statistical reasons, using a autoregression vector (ARV) where the causes referred to in the literature are taken as the limit.

If the null hypothesis indicates that the estimated parameters are equal, this is rejected, and it can be concluded that a certain cause does not affect the macroeconomic structure and, in turn, fiscal policy effects, which are compared in each period. Results of this study are: the diffusion index of attitudes towards credit financial institutions and yearly change in the annual average of the quarterly rates of structural primary budget balance of the significant potential GDP rejects the null hypothesis, pointing out that these variables have a clear impact on the effects of fiscal expansion. A second conclusion refers to the results of impulse response functions, these showing that the effects are traditional, although there are some notable differences. In particular, when the lending attitude of banks towards is reserved and the financial situation of the government is poor, the effects of the increase in demand for government expenditure should not be taken into account.

In this respect, the effects of traditional private investment acceleration and non-Keynesian effects are key operative concepts. Private investment situation is similar to that of public investment, although crowding-in and crowding-out effects are relatively weak in the case of public investment.

Negative impulses of real interest rates in hard times are not necessarily consistent with the existence of non-Keynesian effects, however, future fiscal distortions can happen in the case of tax reduction.(Blanchard, 1990; Perotti, 1999). As in the case of public investments, we can say that the effects of rising demand are qualified in the tough times by the fiscal condition. In the summarize of previous studies in Japan, Kameda (2009) mentioned two points: the ability to observe the effects of non-Keynesian growth becomes harder in strict fiscal periods, and the second point is that less good periods range from about 10% to 45% of the total time of the sample.

In the study “**A role model for the conduct of fiscal policy? Experiences from Sweden**” [5], developed by Martin Flodén from Stockholm University, Department of Economics, Stockholm, Sweden, is shown the serious macroeconomic crisis of the early 1990s.

GDP has fallen for three consecutive years from 1991 to 1993, the unemployment rate increased by 9 percentage points, banks have been nationalised and public budget deficits exceeded 10 per cent of GDP. Recovery, however, was quick. GDP growth was about 4 per cent in 1994-1995 and budget deficits were eliminated in 1998.

Growth remained high in the next decade, while public debt has been reduced by almost 50 per cent of GDP. This paper describes and

analyzes the Swedish crisis and policy measures implemented in response to the crisis. [2]

Policy measures include abandoning the fixed exchange rate, fiscal austerity, a new fiscal framework strictly, and several structural reforms in the 1990s.

These policies were appropriate for the management of the Swedish crisis, but the Swedish experiences have limited applicability to the debt crisis, particularly because of the depreciation of the currency in combination with a strong increase in export markets and this was a key ingredient in Sweden's recovery.

The new fiscal framework has most likely contributed to the consolidation of public finances, but the study showed that the budget surplus and a big increase in GDP explain only about a third of the reduction of public debt after 1997.

Sweden has been restored in the mid-1990s, through a series of fundamental reforms. The reforms have included tax reform, EU accession, deregulation of markets, the privatization of public-owned companies and welfare services, stricter legislation for competition, the introduction of a floating exchange rate, an independent Central Bank, a new budget process, and the introduction of medium-term fiscal targets. In the short term the impact of reforms and policy measures is, in theory, less clear and it is hard to disentangle empirically different effects from each reform.

Observations: there is clear evidence that the depreciation of the currency in 1993, in combination with increased productivity and a rapid development of export market begun contributed significantly to the recovery of Sweden.

Although there were clear efforts to consolidate public finances since 1992, substantial reinforcement was implemented in 1995-1997, i.e. after a rapid growth in the Swedish economy. Another observation is that the net public debt has not exceeded 30 percent of GDP, the Swedish crisis was not a debt crisis, but as a banking crisis, combined with a loss of confidence in the economic policies and the effectiveness of the welfare state.

In addition, large public debts in many countries leads to a dramatic aging of the population, Sweden does not face this problem in the 1990s, the high rate of fertility is a result of family policies (Andersson, 2008). These policies include generous parental leave schemes paid.

The show stands out by offering tax incentives for long-term policy, tax policy, flexibility allows to vary through automatic mechanisms throughout the business cycle. The Swedish fiscal measures could help other countries to prevent future fiscal crises. Export-based growth,

currency depreciation and strong foreign demand has been a key ingredient in the recovery of Sweden, thus facilitating fiscal consolidation.

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In the paper **Overshadowing the Turmoil Trends: The Swinging Pendulum of SME's Tax Policies**" [6], Josh Maruša, Cătălina Cozmei, Bucharest University of Economic Studies, Bucharest, Romania, there are considered measures of fiscal stimulation policies that have been adopted by some EU Member States to mitigate the effects of persistent crisis which has affected the entire economy in 2008. The study presents the comparative analysis between Romania, England, Italy, Greece during the period 2010-2012.

Tax facilities are subject to a number of factors, namely: reducing the rate of statutory corporation tax, incentives of accelerated depreciation allowances for capital expenditure, fiscal credits for targeted investment, etc.

In order to combat the visible effects of the crisis in the last quarter of 2008, the EU Member States have taken a number of fiscal measures, even though they were faced with acute shortages. During the economic crisis, the SMEs have faced liquidity problems that have corresponded with reduced operating costs: the freezing of wages, work-time reductions,

temporary stopping of production; dwindling stocks and freezing of investments or in the worst case, insolvency or bankruptcy.

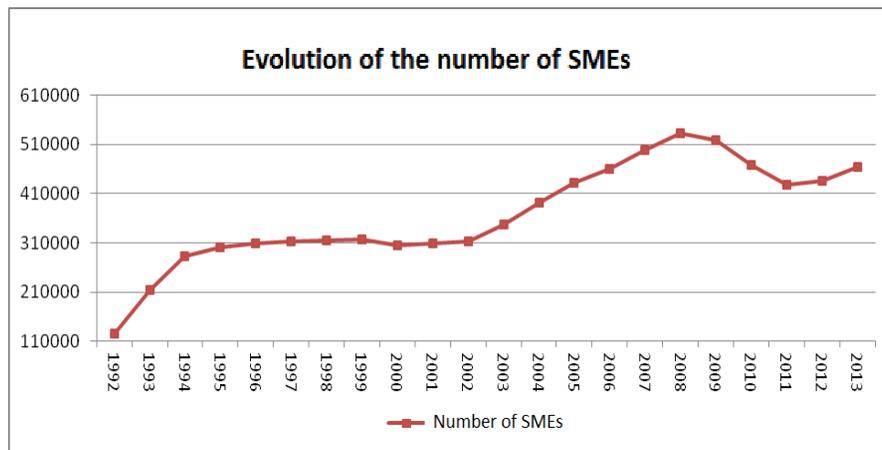
The justification for the size of the business-related tax policy - in the case of Romania, preferential arrangements for SMEs, taking into account the difficulties that SMEs face: financial constraints it encounters in the form of restricted access to bank credit; cost disadvantages arising from lack of economies of scale, but also external positive effects that can be created: the creation and development of innovation jobs.

Given the nature of the SMEs, they cannot develop strategies to avoid taxation. Anti-crisis measures have three directions of action: stimulating demand, improving and facilitating bank loans for SMEs and to stimulate employment (reduction of social security contributions or special programmes for the unemployed).

## **2. Demographics of SME sector**

From the demographic perspective, the number of SMEs had different development until 2002 their number has almost remained constant, followed by steady growth recorded until 2008 and the decline occurred in 2009 due to the economic crisis. In 2008 was recorded the largest number of enterprises. During 2008-2009, the SME sector has been affected by the recession in 2009, the number of businesses records decreased by about 15%, followed by a slight recovery in 2011 by about 20%, and 6% in 2012. 48,000 enterprises were established in 2010, is the smallest number of records and 170,000 de units were closed. The number of liquidations in 2012 decreased by 71746, 2.5% less than in 2011. In 2014 it is expected a steady growth as happened in 2013, and is expected to return to the previous level in terms of crisis on employment and the number of enterprises, but not in terms of value added.

**Chart 1:** *Evolution of the number of SMEs*



**Source:** Own processing based on data from the Annuar

An initiative of the European Union for supporting small and medium-sized enterprises is "Small Business Act (SBA)" [6], including policy measures aiming at the entrepreneurial spirit, public administration, internationalisation. SBA principles were contained in the "Government strategy for developing SMEs 2009-2013" and the "Government's strategy for the development of SMEs and business development 2014-2020". The latter project is financed by European funds.

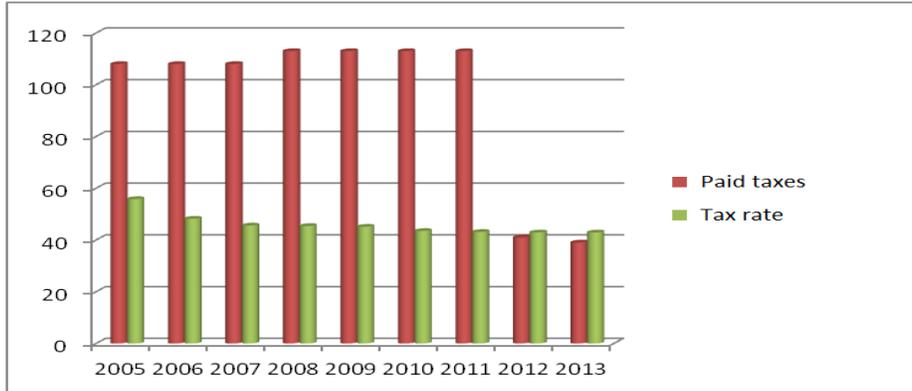
With regard to the performance of the SBA-Small Business Act of Romania, statistics on SMEs are below average in seven of the ten principles (1. entrepreneurship, 2. second chance, 3. think small scale first, 4. responsive public administration, 5. state aid and public procurement, 6. access to finance, 7. single market, 8. competence and innovation, 9. environment, 10. internationalisation) and above average in terms of entrepreneurship. Very poor results recorded in terms of the single market, followed by internationalization.

The Second chance and the Environment chapters falls under the EU average. Substantial obstacle in business development is difficult access to financial resources of SMEs, as well as extremely long period required for receipt of public funds and administrative tasks.

### 3. Evolution of taxes

The number of taxes has changed during the period shown, the major difference was in 2012, from 113 to 41 taxes, but their rate has not changed very much, great difference was observed between 2011 and 2012, from 55.8 to 48.2. Throughout the analysis period tax rate has been declining, in 2012 and 2013 recording the lowest percentage (42.9 percent).

**Chart 2. Evolution of taxes**

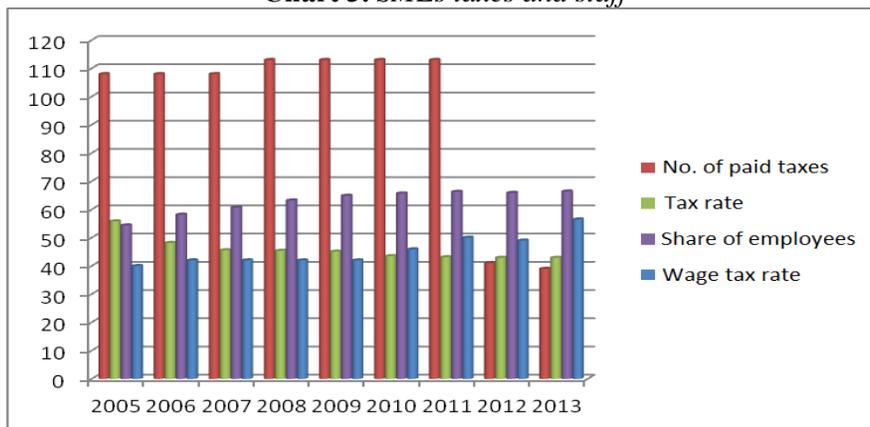


**Source:** Own processing based on data from the European Commission and the Annuar of Romania

#### 4. SMEs taxes and staff

The highest rate of taxes was in 2005 (55.8%) registering through this year and has the lowest share of personnel from SMEs in the years 2005-2013. The number of taxes has fluctuated in period 2005-2013, from 108 rose to 113, in 2013 the number being 39. Tax rate has been declining, and the share of SMEs employees has been growing although wage tax rate increased from 40 percent in 2005 to 56.5 percent in 2013.

**Chart 3. SMEs taxes and staff**

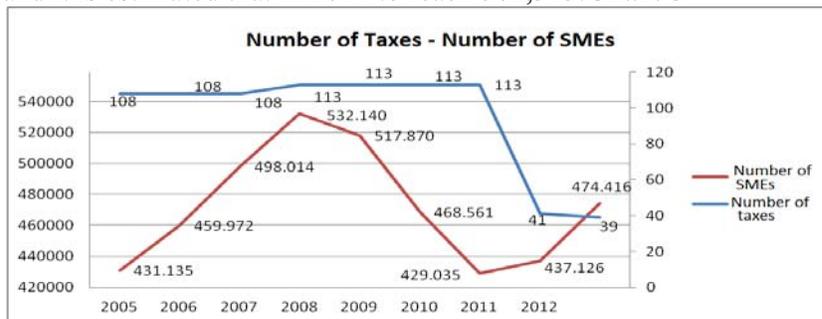


**Source:** *Own processing based on data from the European Commission and the Annuar of Romania*

The VAT increase caused a slump in consumption and sales, so employers have been forced to reduce social costs and decreased the number of employees of SMEs.

#### 4.1. Evolution of Taxes – Number of SME

From the chart can be observed that when the numbers of taxes are reduced, the number of SMEs increase and vice versa. The largest number of SMEs in 2008, this year the number of taxes has increased from 108 to 113, the decrease in the number of SMEs has continued until 2011, when the number of charges has dropped considerably. In 2013 the SMEs have recovered from the loss, and it is estimated that in 2014 to reach 502,313. **Chart 5**

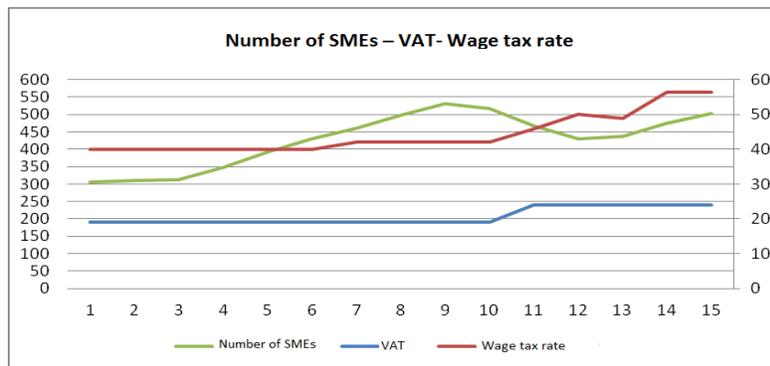


**Source:** *Own processing based on data from the European Commission and the Annuar of Romania*

#### 4.2. Evolution of the Number of SMEs – VAT- Wage tax rate

It is observed that an increase in the VAT rate in 2010 was followed by a decrease in the number of SMEs. Wage tax rate increased during the analysis period at a level of 40% in 2000, in 2009 it was the first increase to 42% in 2010 following the hike, the achieved level being of 45.9 percent, which is adjusted every year, in 2014 reaching the level of 56.5%. In 2009, before the increase in VAT from 19% to 24% was also introduced the reduced VAT rate of 5% for certain products, but has also been kept the old low share of 9%.

**Chart 6** *Number of SMEs – VAT- Wage tax rate*



**Source:** Own processing based on data from the European Commission and the Annuar of Romania

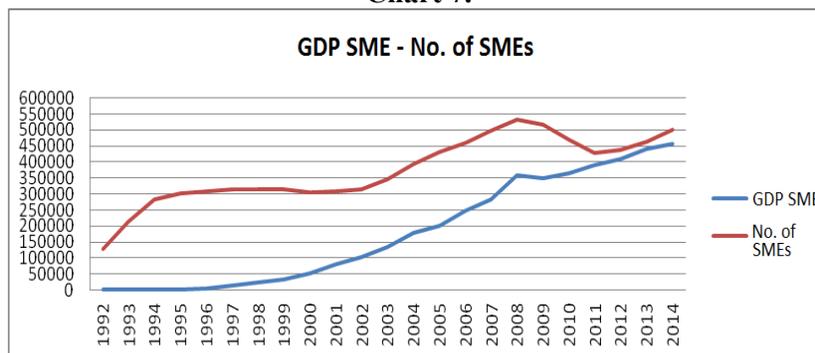
In 2011 the flat-rate tax has been repealed for micro-enterprises, which in the period from May 2009 to October 2010 was required. As a result, the number of micro-enterprises has improved in 2012 in relation to the period 2010-2011.

SMEs benefit from simplified tax reporting measures, due to the costs of compliance and tax administration.

### 4.3. Evolution GDP – number of SMEs

SMEs represent over 90% of all enterprises. Thus, the activity of SMEs has a major influence on GDP. Change in GDP of SMEs is correlated with their modification. The number of SMEs had greater variations within the period set out in relation to the GDP, but keeping roughly the same rate of increase. The result of the factors of influence on the number of small and average is observed in the GDP made by them.

**Chart 7.**

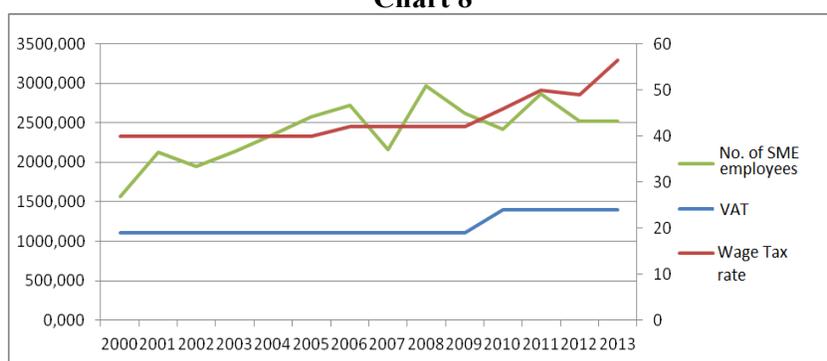


**Source:** Own processing based on data from the European Commission and the Annuar of Romania

#### 4.4. Evolution number of employees – VAT – Wage Tax rate

The number of SMEs had large variations in the period under review, but as we have shown in the first graph, its share in the total number of employees was rising. Wage tax rate increased over the period, but in 2009 it grew up in greater extent in relation to the previous rate of increase, the maximum number of staff after this period was lower than in the prior period. Wage tax rate increase has been accompanied by an increase in the rate of VAT.

Chart 8



**Source:** Own processing based on data from the European Commission and the Annuar of Romania

Although the number of companies has risen, the number of employees has decreased as a result of the VAT increase in 2011, which has led to a decrease in sales of the companies.

#### 5. Conclusions

The impact of the crisis on the SME sector was manifested, by suspending the activity of a number of 133,000 SMEs.

Directions of action of anti-crisis measures: improving and facilitating bank loans for SMEs, stimulating demand and boosting employment by lowering social security contributions or the development of special programmes for the unemployed.

The analysis of the situation of SMEs in Romania reveals a number of inabilities and their vulnerabilities, that appear insufficiently prepared to compete successfully on the domestic market of the European Union. Romanian enterprises are forced to evolve in an unfriendly economic environment, characterized by unstable fiscal regime, the structural imbalances and the banking system reluctant to lending to small businesses.

Budget and reform measures introduced by the Government structure in the years 2009 and 2010 to counter the effects of the crisis and

to support sound public finances have created better conditions to ensure the competitiveness of the economy.

Tax facilities are subject to a number of factors, namely: reducing the statutory rate of corporation tax, depreciation allowances for accelerated capital expenditure, investment targeted tax credits, etc.

### **Recommendations**

The government should maintain the viability of SMEs by creating more programmes for supporting SMEs regularly evaluated to measure their performance and effectiveness; facilitating access to credit; elimination of tariffs for approval for opening new businesses. The government needs to keep the prices affordable for SMEs to energy, such as electricity, fuel and other energy costs. The government should facilitate SME loans to buy technology. Since many SMEs have problems with the cost of land, it is expected that the government will provide the land for the leasing business, with a very affordable price for SMEs or provide viable and strategic location for SMEs, to eliminate corruption.

There must be allocated budgets large enough for financing programmes and direct funding schemes to innovation-oriented SMEs, creating the prerequisites for setting up enterprises with growth potential particularly in research and development.

In order to bring the enterprises back return to the level of 2008, must be regained the confidence of entrepreneurial initiative by creating a favourable ecosystem for entrepreneurs and entrepreneurship in development policies, competitiveness and innovation.

Future government policies should assess how to strengthen the impact on SMEs, the legal framework and the tax effect of public financial interventions of all kinds, as well as programmes for the monitoring and evaluation of activities of enterprises. The policies should be aligned to the European framework of supporting SMEs.

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