

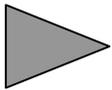
THE PERCEPTION OF SPECIALISTS ON ROMANIAN UNDERGROUND ECONOMY¹**Cristina COVACI VOICU**

Abstract

This paper aims to introduce aspects of underground economy and to test specialists' perceptions on the Romanian underground economy in particular. Using the Delphi investigation method I aim to check whether good research methodology yields correct and coherent results. The scientific fascination of the underground economy has inspired me to tackle this domain and undertake the challenging task of researching it aiming to provide eventually some insights into the main causes of underground economy and its effect on the official economy as well as to understand the perception on this widespread phenomenon.

Keywords: underground economy, globalization, qualitative research

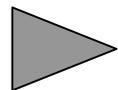
¹ This article is based on Cristina Covaci Voicu's MA dissertation *The Perception of Specialists on Romanian Underground Economy* presented within the framework of the Interdisciplinary Master Programme "English Language Education and Research Communication for Business and Economics", ASE Bucharest, 2008, having Associate Professor Dr. Mirela Bardi and Dr. Liviu Mureşan as academic supervisors.



The international breadth of underground economy

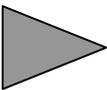
The term “underground economy” is very suggestive and has been preferred to other expressions. It suggests the divide between legal and illegal activity, between what is good and evil in economy. There are various approaches to studying the phenomenon which remains elusive and difficult to define.

For this piece of research, I decided to use the term underground economy, which describes a wide spread phenomenon. I consider the following definition of underground economy to be very good: all the economic activities developed in an organized way, breaking all the economic and social laws, having as purpose to obtain a certain income which cannot be controlled by the government (Popa, Cucu, 2000: 9). The definition takes into account the obvious economic aim of the underground economy, that of maximizing income irrespective of the methods and ways which are used and the heterogeneous activities involved.



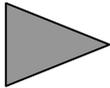
The underground economy in industrial nations

In the western countries, a certain part of each underground economy component is already included in national accounts, except criminal and fraud activities. According to some authors, it seems that in Italy and the USA alone a part of these activities has been included in the official Gross Domestic Product (Blades, 1982). Therefore, a general estimate for the western countries regarding marketable informal activities or the underground economy indicates that these represent almost 15% of the Gross Domestic Product, 13% of which is represented by fiscal fraud and illegal work, and 2% by criminal activities.



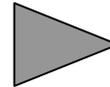
Underground economy in developing countries

Developing countries are characterized by the existence of dual economies, where the underground economy represents the main mode of production and partly determines the level of development. ***The importance of the informational sector could be explained by the strong intervention of the state in economy.*** Although today strong economic liberalization is taking place, the third world states continue to be attached to the idea of stimulating the development by plans and by the implantation of industries which are hoped to be "industrially-stimulating". Such intervention did not integrate the traditional modes of activity. This development model, maintaining a significant part of the economy in the traditional zone, only transformed it into an informal economy.



Underground economy in east-european countries

Before initiating free market reforms, East-European countries already had some form of private sector, i.e. the underground economy. Until 1989 that brought the collapse of communism and of planned economies, these countries had a truly parallel economy, fundamentally illegal. Grossman, one of the pioneers of underground economy studies in socialist countries introduced for the first time the notion of “second economy”. Today, without any doubt, this old underground economy adapted itself to Warsaw, Prague or Bucharest reforms. But it has lost its specificity in comparison to Western countries.



Romanian underground economy

After 1989, the size of the underground economy has become an important issue of concern for policy-makers in Romania. The problem seemed even more serious in relation to Romania's preparation for accession to the EU.

Economists have already established a relationship between tax rates and the amount of tax evasion or the size of the underground economy: the higher the level of taxation, the greater the incentive to participate in underground economic activities and to escape taxes. At the macroeconomic level there are several so-called indirect methods used to estimate the size and dynamics of the underground economy, reported in literature as “Monetary Approach”, “Implicit Labor Supply Method”, “National Accountancy”, “Energy Consumption Method”, etc. Unfortunately, many times there are large differences among the estimated shares of informal or underground economy obtained by various methods. For instance, in the case of Romania the figures range between about 20% of GDP, obtained on the basis of the energy consumption method (Enste and Schneider, 2000) and more than 45% calculated using the monetary approach (French, Balaita, and Ticsa, 1999). Also, the figures (based on the national accounts methodology) reported by the National Institute for Statistics (NIS) increased (mainly due to changes in methodology); from about 5% in 1992, to 18% in 1997 and to 20-21% in 2000-2001. Adding to these figures about 7% of GDP, which represents the estimated average level of self-consumption in the case of a rural household legally non-registered but informal, it results that during the past years informal economy accounted for 25-28% of the national economy.

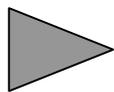
When economists study the key characteristics and mechanisms of underground economy the use of econometric analyses is obviously limited. The main problem is to estimate simultaneously its size and its factors. In this case, establishing correctly the basic hypotheses of the model and, consequently, the variation interval for the state or slow variables will be decisive. Sometimes, in order to

avoid this impediment and to build the econometric model in a classical way, some authors consider the size (or the share) of the real underground economy as known, by using data reported in other studies. Then, ignoring the original model (more often than not a deterministic one) used to estimate the size of the underground economy in those studies and its hypotheses, they independently estimate their own econometric model in order to analyze the relationship between various determining factors and the dynamics of the underground economy sector. In my opinion this procedure is not very accurate, mainly because the input data for the size or dynamics of the underground sector are in fact outputs of the models in the studies used as sources. It is sometimes possible that the conclusions obtained as a result of such a way of using the econometric models contradict the basic deterministic model used to produce data for the size of the underground sector.

As regards surveys, asking directly about the extent to which a person or household are involved in underground activities has no chance to obtain an accurate answer. Only certain indirectly formulated questions in special conditions might have a chance to capture the size of people's implication in underground activities, as it will be shown in this paper.

The fight against underground economy is a recurrent theme in many countries. The dominant method is to increase deterrence. The probability of being caught is raised by more regular and intensive controls, often by the police. Punishment is raised by imposing higher fines and, in severe cases, prison sentences. The target, are both buyers and suppliers of goods and services produced in the underground sector.

I will present the categories of causes that I consider to be primarily responsible for the existence of the underground sector.

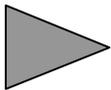


Governance and institutional quality

Both the economic and the political systems affect formal and informal economic activities. The outcome in many countries may be explained by underlying political conditions. Bird et al. (2006) stress that "Countries may tend to achieve an equilibrium position with respect to the size and nature of their fiscal systems that largely reflects the balance of political forces and institutions, and stay at this position until 'shocked' to a new equilibrium" (p. 289). It is worthwhile investigating whether the recent political economy literature on the importance of governance and institutions enable understanding of the level and changes of the underground economy. If citizens perceive that their preferences are properly represented in political institutions and receive an adequate supply of public goods, their identification with the state increases and so does their willingness to contribute.

On the other hand, in an inefficient state where corruption is rampant the citizens will have little trust in authority and thus little incentive to cooperate. A more encompassing and legitimate state increases citizens' willingness to contribute. When the government and the administration have a great discretionary power over the allocation of resources corruption is enhanced. A sustainable tax system is based on a fair tax system and a responsive government. Such a system displays a strong connection between tax payments and the supply of public goods (Bird et al. (2006). Friedman et al. (2000) show empirically that countries with greater corruption have a higher share of unofficial economy. Dreher and Schneider (2006) have also investigated the correlation between underground economy and corruption. They noticed the tendency for underground economy and corruption to be substitutes for each other in high-income countries, but complements in low-income countries. Agents such as the political elite, administration staff, and legislators have discretionary power when institutions are neither credible nor working well. This has as a negative consequence the fact that citizens lose their trust in the authority.

In countries where corruption is systemic and the government budget lacks transparency and accountability the obligation of paying taxes cannot be assumed to be an accepted social norm. Institutional instability, lack of transparency and rule of law undermine the willingness of frustrated citizens to be active in the formal economy. Furthermore, there might be a crowding-out effect of morality among the tax administrators when there are a great number of corrupt colleagues. Moreover, regulatory restraints and bureaucratic procedures not only limit competition and the operation of markets, but also provide a better fundament for corrupt activities. If a country's legal system fails to secure, for example, the property rights or to enforce contracts undermines the quality of the legal economy. If individuals and businesses believe that neither contracts will be enforced nor productive efforts protected, their incentive to be active in the underground economy increases. Citizens will feel cheated if they believe that corruption is widespread, their tax burden is not spent properly, their government is not held accountable, and that they are not protected by the rule of law. This increases the incentive to enter the informal sector. Thus, my first core hypothesis reads as follows: An increase in governance and institutional quality reduces *ceteris paribus* the size of underground economies.



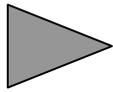
Globalization

Globalization is exercising a dramatic impact on the US underground economy. Increasingly, this new perspective is enabling people who are active in this economy to exploit gaps and differences in law among countries and successfully conduct their crimes undetected. By looking at selected areas of the underground economy and such activities as tax crime, smuggling, trade crime, bribery and money laundering, we may admit that lately there are also some more favourable perspectives on US underground economy.

The underground economy, defined as the whole off-the-books and unregulated activity, is growing in the US, especially in cities with large immigrant populations like Los Angeles, Miami, and New York. The ability to instantaneously transport people, capital, and ideas makes residents of the remotest parts of the world aware of opportunities in the rest of the world. Wide-spread access to technology enables people to create and implement quiet and unobserved ways of amassing wealth, which is the prime function of the underground economy.

The "gray area phenomenon," which denotes the inability of sovereigns to control the conduct of non-state actors and non-governmental processes and organizations in certain areas within their borders, has shifted power from legitimate governments to new, half-political, half-criminal powers. The gray area phenomenon has added an increasingly important political dimension to the underground economy and the need to design mechanisms to control these groups.

The explosion of free trade and economic integration throughout the world and especially in this hemisphere facilitates the international activities of the underground economy and requires more strategic global law enforcement policies to combat them. Unfortunately, our political leaders and academicians have not yet summoned the vision to even conceptualize a comprehensive strategy, let alone start recommending, negotiating, and implementing one. Criminal justice, international law, and international organization theory must be more creatively utilized if the US, other governments, and the world community generally are to contain and control the rising power of traditional and new forms of organized crime and other emanations of the underground economy.



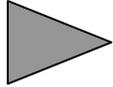
Research methodology

After reviewing the literature in this domain I will state my position regarding this wide spread phenomenon. As my research has shown, there are two major positions in the literature regarding the effects of underground economy on real economy. Some researchers consider underground economy to be totally noxious and the worst phenomenon that affects a country's economy. Others maintain that the presence of underground economy in a country is welcome and offers a helping hand to developing countries. My position is that none of those opinions are to be taken for granted without further evidence. My opinion is that underground economy isn't totally noxious for one country's economy and may be helpful for specific economies and specific categories of people.

I have chosen to undertake a piece of qualitative research for the purposes of this paper. The basic methodological instruments that I will use are questionnaires and interviews. At the beginning of my research I wanted to try and measure dimensions of underground economy in Romania. The reason why I gave up on

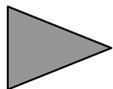
measuring underground economy is to do with the fact that during my research process I realized that both direct and indirect approaches are incomplete and lead to incorrect and incomplete results. I always wondered how a researcher can estimate or measure a hidden phenomenon.

In general, there are two approaches that use different assumptions in the case of measuring the underground economy. These two approaches are called direct and indirect approaches. A balanced conclusion of all considerations above, establishes that underground economy is an elusive, difficult to record concept.



Theoretical aspects of the Delphi investigation method

Any human endeavor which seeks recognition as a professional or scientific activity must clearly define the axioms upon which it rests, or "useful" procedures for accomplishing the various specific aspects of Delphi. The Delphi process today exists in two distinct forms. The most common is the paper-and-pencil version which is commonly referred to as a "Delphi Exercise." In this situation a small monitor team designs a questionnaire which is sent to a larger respondent group, after the questionnaire is returned, the monitor team summarizes the results and, based upon the results, develops a new questionnaire for the respondent group. The respondent group is usually given at least one opportunity to reevaluate its original answers based upon examination of the group response. To a degree, this form of Delphi is a combination of a polling procedure and a conference procedure which attempts to shift a significant portion of the effort needed for individuals to communicate from the larger respondent group to the smaller monitor team. We shall denote this form conventional Delphi. A newer form, sometimes called a "Delphi Conference," replaces the monitor team to a large degree by a computer which has been programmed to carry out the compilation of the group results. This latter approach has the advantage of eliminating the delay caused in summarizing each round of Delphi, thereby turning the process into a real-time communications system. However, it does require that the characteristics of the communication be well defined before Delphi is undertaken, whereas in a paper-and-pencil Delphi exercise the monitor team can adjust these characteristics as a function of the group responses. This latter form shall be labeled real-lucre Delphi.



The need for Delphi investigation method in underground economy field

Internationally, in the last 25 years there has been registered a rise of the interest concerning the research of the mechanism which underlies the development of underground economy and the most accurately evaluation of its dimension. This rise of interest for the underground economy is due to many causes.

Having mentioned the existing approaches of this phenomenon using Delphi method will conduct me to a relevant qualitative research. The reason for which I consider relevant using Delphi methodology in underground economy field is that individuals have different perceptions on the causes and effects of the underground economy over real economy. I found it interesting to observe the perception of a Romanian specialist not only from the economical point of view, but also from the social point of view.

Qualitative research usually involves investigation of knowledge by employing the interviewing technique, archival or other documentary analyses, or ethnographic study. Those methods do not rely on, but can involve some numerical measurements. This type of research involves interpretation of data and may be developed grounded theories. Hence, in contrast to quantitative research, the researcher is not detached from, but positively interacts with, the object of study. To better clarify my choice for qualitative research I will present few aspects regarding to the perception of academics on the quantitative-qualitative dichotomy.

Quantitative research	Qualitative research
Usually tackles macro issues Employs a deductive research strategy Is argued to be rooted in the positivist tradition Is said to be theory-testing and predictive Aims to identify general patterns and relationships	Tends to analyze micro issues Employs an inductive research strategy Is said to be rooted in the interpretive tradition Is said to be theory generating Aims to interpret events of historical and cultural significance

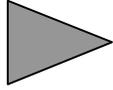
Figure 3. The quantitative-qualitative dichotomy (Grix, 2001:34)

The instruments that I have chosen are the questionnaire and interview method. For the time being I distributed the questionnaire to thirteen specialists in economics. Some of them are working for private and some for public sector.

To apply the Delphi method on underground economy field I designed a questionnaire with eleven questions, (Annex 1), that I considered relevant for testing the perception on the phenomenon of underground economy. According to the method requirements I have chosen respondents from the field of economy. Most of them are specialists in economics and their answers will hopefully indicate that the use of this method was relevant to my research purposes. For this step in my research I considered that thirty respondents are sufficient to obtain relevant results and also to enable me to better redesign the questionnaire for my doctoral research.

Firstly, I distributed the respondents in two major groups. The first group consisted of thirteen respondents from the public sector. The second group is represented by

private sector employees and groups seventeen respondents. In order to get good results, I find it important to test the perception of both categories. I found the majority of the respondents quite open, considering the general reticent attitude about the underground economy topic. The respondents were assured that their names will not be revealed in this paper, so this was probably the reason why they gave open answers.

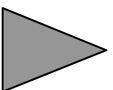


Further economic issues

The underground economy has both negative and positive effects on the official or registered economy. The main negative effect of underground economy is to be found in the policy-making process. A high underground economy creates unreliable official macroeconomic aggregates such as the unemployment rate and the income level. Economic policy decisions that use these official macroeconomics data are likely to be ineffective.

On the microeconomic side, underground economy creates unfair competition conditions for firms. Firms that are operating in the underground economy have no legal regulations and they can implement and set a more competitive price than registered firms. Underground economy firms can sell their services and products at lower prices than the general market price and they can increase their sales volume and profit levels. The underground economy may deteriorate the financial position of social security institutions. Unregistered firms do not pay social security contributions. Underground economy also decreases the tax revenue of governments and by doing so may cause limitation of the social transfer of government towards low-income people. Limitation on social transfers may cause lower living standards for low-income people, which may in its turn increase social tensions in the community.

The underground economy has some positive effects on the official economy. It creates employment in a country's economy. Firms in the underground economy have a lower cost structure than registered firms, and so their labor demand can be higher than that of firms in the official economy. In addition, society welfare levels may increase as a result of the underground economy. As mentioned above, underground economy firms may sell their goods and services at a lower price than general market price, and thus lower prices may increase the purchasing power of society and the general welfare of the public.



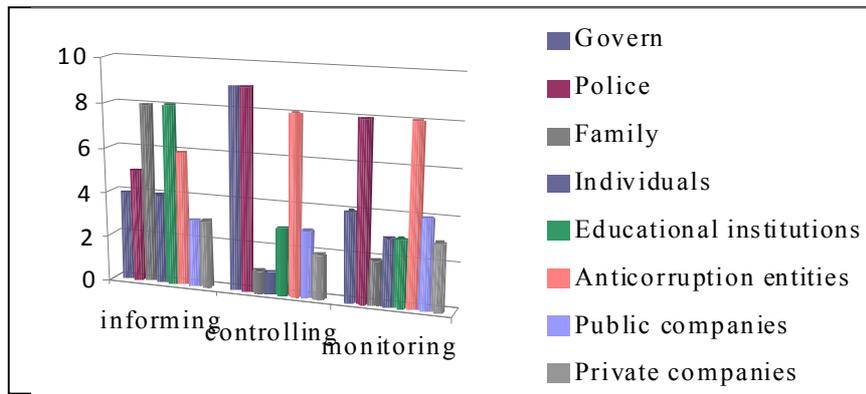
Results of the present research

As I expected from the beginning, I found that both categories had almost the same perception on the spread of the underground economy activities. Thus, the responses confirm the theory in the literature regarding the spread of the main

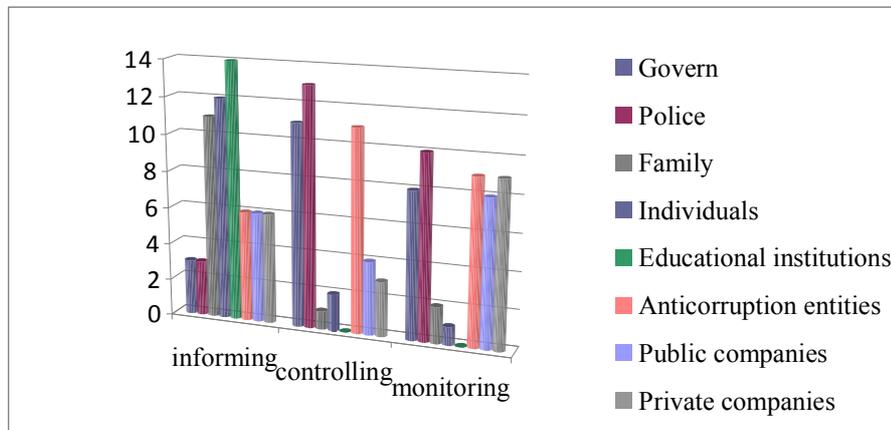
underground activities. Regarding the five main underground activities, the highest impact is attributed fiscal fraud and illegal work, followed by criminal activities, and ending up with house work and voluntary activities. The explanation for this hierarchy is both economic and social. The high-impact activities are considered to be dangerous for the wealth of the nation, while house work and voluntary activities are not perceived to be dangerous. In the subsequent stage of my research I am planning to introduce a question to test how dangerous are underground activities considered to be.

Educational institutions are considered to be the most appropriate authorities to provide information about underground economy. Authorities such as the Police and anticorruption bodies are in charge of controlling and monitoring the phenomenon.

Public sector employee's perception:



Private sector employee's perception:



I think that the attention of political decision-makers should be focused more on those entities that are considered to be responsible for informing, controlling and monitoring the underground economy. The respondents point out the role of the educational system. It is expected to offer information about the components of a country's economy. I think that we should be aware of our responsibility to offer correct information on this topic. I think that the psychological effect of concealing information is to actually empower the underground system.

The information on this wide spread phenomenon is not offered correctly but is often biased, as suggested by the fact that the respondents had opposite opinions on the trends in the Romanian underground economy. It is significant that opinions are not simply different but are actually quite opposite. The public sector respondents believe that the underground economy activities are declining, while the private sector respondents perceive them as growing. Such opposite perceptions come from the fact that the private sector is responsible for the majority of underground economy activity as fiscal fraud is the biggest component of underground economy. The private sector contributes more to this phenomenon, because as I stated before, the underground economy rises when private property is not respected by state institutions.

To conclude, I will discuss the outcomes expected at the beginning of the research program and the obtained outcomes. As a conclusion of this research paper I will analyze and interpret, from an economic point of view, the outcomes of the paper.

When I first started this research process naturally had my own intentions and expectations which I reconsidered and revised during the research.

One of my initial intentions was to measure the dimension of this phenomenon in the Romanian economy. After reading the literature I realised that none of the estimating methods is complete and suitable to measure hidden economic activities. Respondents are not willing to express their thoughts simply because they are afraid of being punished by the authorities. Therefore I decided against trying to measure this difficult-to-record process but decided to test the perception of participants on the Romanian underground economy.

During the research I have been searching for an answer which I only found at the end of the research. I wasn't sure about the most appropriate research methodology. It is quantitative research or qualitative research? I tend to believe that my research is quantitative because in my research diagrams I used and interpreted numbers, percentages and so on. I have found the answer in Grix's book (2001) "Demystifying postgraduate research", which helped me to understand that my research was in many ways qualitative and also helped me to plan the steps of my research.

Another intention of the present paper was to test the perception of specialists on Romanian underground economy. The outcome clearly indicates that the perception of employees from public sector was different than the perception of private sector employees.

Within the qualitative research framework, the main instruments that I used were the questionnaire method and the interview method. I have to mention that my research on this topic will continue with doctoral research in which I am involved at the moment. The research for this paper helped me to better understand the perception of different respondents and to improve the design of the questionnaire used in this paper. Having the responses for the questionnaire I observed that some questions are not so well constructed and needed improvements.

Therefore, a balanced conclusion of all the above considerations establishes that the underground economy is generated by private sector activities and the relationship between private actors and the state.

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