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2. KEY WORDS
Competitiveness, foreign trade, microeconomic analysis, financial discipline, heterogeneity, multifactorial productivity, real convergence, global value chains
3. SUMMARY

The scope of the present thesis is the identifying the main determinants and assessing competitive position of Romanian firms, by three approaches: macroeconomic, microeconomic and the analysis of domestic companies’ positioning into the global value chains. The mentioned approaches are the pillars based on which the thesis offers a holistic framework for assessing Romania’s external competitiveness, explaining the macroeconomic developments and the regional role of domestic companies throughout a disaggregate analysis of firm-level indicators. The tools include, among others, panel Autoregressive Vector models, semiparametric methods for total factor productivity estimation (Levinsohn and Petrin, 2003; Wooldridge, 2009), fixed effects panel regression models, export flows’ decomposition in value added flows (by Koopman et al., 2012 methodology), Hausmann et al. (2007) model for the computation of export sophistication level and matching methods for identification of productivity-external trade causality. The main databases vary from those at country/region/sector level (Eurostat, NIS, World Input-Output Database, World Bank, IMF) to detailed firm-level information, based on financial data (balance sheet, profit and loss account, external trade activity, insolvency) for all Romanian companies (provided by MPF, NIC, NTRO) and information about firms from other EU countries (Orbis Bureau van Dijk, Competitiveness Research Network, Bank for the Accounts of Companies Harmonized).

In the first chapter, Romania’s competitive position is analysed, based on a large variety of macroeconomic indicators. Romania has certain cost and price advantages, reflected by unit labour cost and the increase in export market share. Moreover, in the last years, Romania registered a relatively high growth rate of labour productivity and an improvement of general business environment. Thus, Romania also recorded progress in qualitative (non-price) competitiveness factors, such as macroeconomic stability, ease of doing business, share of medium and high tech products in total exports. Nevertheless, Romania still lags behind European average in terms of labour productivity per worker (half of EU average) and the domestic firms have specialisation in raw materials and low skilled labour intensive industries.

Certain non-price competitiveness aspects hinder Romania’s competitiveness potential and can affect the medium and long term exporting capacity. These are mainly related to infrastructure, the quality of public institutions and business environment, as well as deficiencies of health and education systems. Moreover, some regions from the country exhibit an important gap in terms of competitiveness compared to other European areas. The innovation grade of domestic economy is still low, as reflected by specific competitiveness indices and the modest export sophistication index (computed as in Hausmann et al., 2007). Maintaining price competitiveness is important, but for a sustainable export growth solving structural problems of national economy, reflected by non-price factors, is essential. These latter factors have a higher potential for assuring superior economic growth on a longer term, this conclusion being tested for the case of EU member states in the recent period, through panel VAR models. Efforts for encouraging structural changes through an economy based to a larger extent on efficiency and technology could contribute to the improvement of competitive position of the national economy.

Firm level evidence detailed in the second chapter signals some structural vulnerabilities of the external trade activities. Microeconomic analysis highlights the reasons why Romania is second lowest position in EU in terms of productivity, which translates into medium term difficulties of sustaining the competitiveness of internal business environment and external sales. Efficiency micro-level indicators exhibit a high degree of asymmetry, which maintained in the last years.
There exist a small number of highly productive firms and numerous companies with low productivity level. This heterogeneity also justifies the regional disparities and the modest role in export activities of certain regions/counties. The least competitive regions in Romania (SE Dobrogea, Centre and SW Oltenia) are also characterized by low technological capacities. It is shown that the domestic business model is not based on innovation, as the activity in technology intensive sector in most regions is concentrated at FDI firms. This is worrisome, since Romania has also a reduced share of GDP allocated for innovation expenses. Productivity asymmetry and modest involvement of domestic firms in sophisticated businesses also substantiates Romania’s vulnerabilities signalled by macroeconomic non-price indicators.

Export activities record a high degree of concentration, the top 10 percent companies ordered by export value cumulating 88 percent of the total, while 78 percent is accounted by foreign owned companies. Geographical and assortment diversification of external trade is modest, with more than half of the exporters having a single destination market, while 70 percent export less than 5 product varieties. Taking into account the recent empirical evidence in the field, a higher diversification could contribute to increased innovation and growth opportunities.

The analysis of the mechanism of firms’ adjustment to international conditions confirms the heterogeneous micro behaviour, according to size class, business sector, destination/origin market. The shocks do not have an aggregate effect, the magnitude and transmission channels varying with the performances’ distribution in the economy. Nevertheless, domestic exporters exhibited a rather high resilience on international markets even throughout the recent crisis, an explanation could stem from productivity advantages of these companies compared to the rest of the firms. Other explanations could be the high costs associated with exporting activities, which cannot be recovered (sunk costs), determining companies not to exit the markets even in time of stress, but rather adjusting their prices in order to survive.

Starting from the conclusions of the first two chapters, in the third, the economic and financial performances of Romanian firms are detailed, as well as the mechanism of transmission of firm level behaviour to the financial discipline in the national economy. Firm level analysis by different categories highlights that there are systematic differences among micro performances not only across regions/sectors/size classes, but also within the same category. The market is formed by a low number of very performant firms and a large number of companies with no activity or modest performances (characterized by high indebtedness, reduced liquidity, productivity and profitability). Out of over 600,000 existing firms, around 26 percent (158,000) are inactive, namely these reported a null turnover in 2014. In case of active firms, more than 40 percent (178,000 companies) record net loss. In the last years, in the top of the biggest losses of active firms there are multinationals’ subsidiaries. By analysing these subsidiaries’s performances in other countries, one can notice an alarming pattern: with some exceptions, those companies exhibit the lowest profitability (ROA) in Romania.

The national economy is undercapitalized. The number of active firms with negative equity increased continuously in the last year, due to privately owned companies. Also, inactive firms have an important contribution to diminishing the capital base in the economy, these cumulating negative equity of -18 lei billions in 2014 (2.7 percent of GDP). The necessary capital for firms displaying net losses for fulfilling the legal requirements (50 percent of share capital) is 56 lei billions (8.3 percent of GDP) and 99 lei billions (14.8 percent of GDP) for achieving 100 percent of share capital.

Legislative deficiencies, as well as a general undisciplined behavior generated some phenomena that can affect the real convergence process. In the last 20 years, the average period in which a firm worked with net losses was 3 years, while the average survival period was 6 years.
Companies with a fragile economic stance have a higher probability of entering insolvency, this phenomenon being frequently used in our country, although with low efficiency. Explanations for the main insolvency process’ characteristics derive also from the national legislative framework, whose development and faults are intensively debated within the thesis, also by taking into account other European countries’ experiences. Firms newly entered into insolvency proceedings during 2014 functioned with net loss in 3.2 years in the last 10 years (average values), while the survival period was around 5.4 years. These firms were inactive in 2.5 years in the respective period, having negative equity in 3.7 years. In the last years, the structure of firms entering insolvency was similar with the structure of newly established companies, with the correlation between the two phenomena being on an increasing path. At sectoral level, services and trade can be noticed due to i) the largest number of negative equity companies and with net loss as of 2014, ii) the most numerous inactive firms, iii) the highest incidence of insolvent firms and iv) an important volume of shareholders’ loans to their own companies. Particularly, branches such as food trade, consultancy and management, buildings’ construction, road transport of goods or restaurants are characterized through a high frequency of insolvency cases, correlated with a large number of newly born firms, as well as many companies with losses or inactive.

Persistent losses to a large number of economic agents, as well as inadequate capitalization and elevated insolvency incidence significantly contribute to the deterioration of financial discipline in the economy. Firm-level performances, especially those related to efficiency, are systematically correlated with non-performing loans’ rate of banks. It is shown that the categories of companies with persistent profitability and capitalization problems didn’t have the capacity to manage negative shocks, their problems being transferred into banks’ balance sheets. The most important independent variable for NPL ratio is productivity. Total arrears of active firms with loss and inactive firms cumulate in 2014 9.8 percent of GDP (66 lei billions). The top 500 companies after the biggest net losses in 2014 account for arrears of 23 lei billions (a quarter of total), an important role in generating arrears in the economy being held by insolvent firms. The high value of arrears of undisciplined companies, especially at the consolidated state budget, translate into low investment in infrastructure, institutions, education or health, diminishing potential GDP. Although the elevated number of firms with net losses is a common situation in other peer group countries in the region, Romania is noticed by a higher share of economic agents with profitability problems compared to EU10 average. Profitability distribution as well as other indicators highlight that Romania is among the countries with the highest inequality among top performers and companies in inferior classes of performance. Microeconomic evidence underlines that important progress in real convergence process cannot be obtained unless viable businesses, entrepreneurship and an efficient and performing economic environment are encouraged.

Starting from firm-level analysis, which highlighted that firms involved in significant external trade activities have superior financial performances, in the fourth chapter, we tested the direction of causality between performance and external trade. We seek to validate self-selection hypothesis (only the most performant firms self-select into activities on international markets) and/or learning by exporting hypothesis (the performance advantages of exporting and importing firms being owed to knowledge and technology accessible due to external activities). The analysis of this causality is important also for understanding how positive effects of external trade can further propagate into the economy in growth and development opportunities. Empirical results confirmed the self-selection hypothesis of the top performers in significant external trade flows (and thus with a higher capacity of withstanding shocks). Thus, export promoting strategies might be less efficient if these are not accompanied by strategies and measures for assuring productivity gains at firm level.
On the other hand, the activity on international markets does not have, generally, significant effects on firms’ performances, in Romania being found more evidence for a possible learning by importing hypothesis. As long as exporting does not assume a high degree of knowledge, the opportunities for importing technology, know-how or for increasing productivity due to exports diminish.

Firm level developments offer valuable explanations for macroeconomic phenomena, as evidenced by the fifth chapter of the thesis. Strategies for promoting export performance must be based on an in-depth understanding of microeconomic behavior on macroeconomic results. In formulating solutions for dealing with an external shock, there must be taking into account the transmission mechanism of the respective shock at microeconomic level (depending on productivity, firm size, business sector etc.). Shocks at individual level cannot have an aggregate effect, micro heterogeneity contributing to macro volatility.

Firstly, it is shown that not only certain firms’ categories with structural problems (losses, low capitalization) have a modest role in export activities, but these also have a negative role on the main external competitiveness price indicators, especially on productivity. Thus, the deficiencies in external competitiveness and performance of Romania, as reflected by macroeconomic statistics, are explained by firm-level evidence. Low productivity of firms registering losses, as well as the existence for a long time on the market of inactive firms, negatively impact the domestic economy’s price competitiveness. Both the average and median of labor productivity represent around a quarter of the indicators for profitable firms. Net losses companies are involved to a limited number in external trade activities: only 400 firms out of 177,000 active loss companies recorded significant net exports in 2014 (over 100,000 euros in each quarter), while from inactive firms, none had net exports. On the other hand, these companies are involved in significant or sporadic importing activities, generating a total commercial deficit of 1.9 euro billions. Under these circumstances, the number of firms with a successful business model for export is low, this evolution being manifested also on the grounds of persistent vulnerabilities among SMEs sector: i) weak profitability (especially in case of microenterprises), ii) reduced capacity of generating GVA and iii) low involvement in exporting.

Secondly, the manner competitiveness firm-level indicators’ distribution influences the GVA creation in the economy is investigated. Microeconomic analysis of GVA formation highlights a worrying pattern, due to the high degree of concentration of GVA at a limited number of companies. Active loss making firms generated GVA to a low extent (15 percent of total GVA for active firms in 2014), with the average GVA per firm of 0.36 lei billion, compared to a 1.3 lei billion, the average for profit firms. Moreover, the GVA for loss companies diminished in 2009-2014 with almost a third (compared to a 10 percent reduction for profitable firms in the same period). A relatively important number of firms inadequately allocate resources, these generating negative GVA (around 54,000 firms as of 2014, representing 9 percent of total number of companies, cumulate GVA of -2.2 lei billions). Moreover, a significant number of firms (132,000), the majority being inactive, generated a null value of GVA. Thus, in reality, only 414,000 companies out of 600,700 which report to MPF, have the capacity of generating positive GVA. The results highlight that only a small part of GVA is further distributed in the economy for labor remuneration and for government lenders. Moreover, even though the gross operating surplus has a high share of GVA, numerous economic agents record negative operational result (this being affected by very high other operational expenses), thus not qualifying for paying the income tax. Fewer resources of this kind to the state budget translate into diminished growth and investment opportunities. Since 2000, there were recorded increased discrepancies in GVA allocation, the share of workers’ remuneration reducing to around 27 percent of GVA, in the favor of capital remuneration, which was roughly 70 percent of GVA as of 2014. Labor costs’
evolution during 2000-2014 indicates that i) loss making firms contributed to the deterioration of economy’s price competitiveness, especially before the crisis broke out, on the grounds of increases in average labor costs (despite negative profitability and low productivity) and ii) profitable firms recorded an increase in this type of expenses due to more employees. At sectoral level, the most balanced structure of GVA allocation is recorded in industry (with a share of staff remuneration of 32 percent of GVA), at the opposite end being real estate sector (12 percent of GVA). Corporations and medium-sized enterprises direct GVA to workers to a larger extent than the economy average (over 30 percent), unlike microenterprises, for which the labor remuneration represents 22 percent of GVA. A situation more favorable to employees is also recorded for state companies and technology intensive sectors.

The reduced capacity of firms to create GVA is generally correlated to a high share of expenditures on goods. By imposing the condition that all the companies in the economy to have an expenses’ structure similar to performing firms in the same sector, or assuming that all the firms in the economy generate nonnegative operational profit, GVA increase in this situation would be of maximum 34.5 lei billions as of 2014 (8.4 percent of GVA). These simulations highlight the negative impact of unviable firms on potential GDP, their importance in GVA being however lower compared to their role in employment (for example, the number of employees of loss making firms was in 2014 of over 962,000, respectively over a quarter of work force of active firms). The potential GVA growth’ distribution assuming a greater efficiency of economic activity, disentangled by size, sector or ownership confirm the opportunity cost of maintaining on the markets unviable firms in services, trade and industry mostly in microenterprises and domestically owned companies’ categories. GVA creation concentration to a small number of large firms, mostly foreign, also underlines the necessity of more participants with an important role in economic activity, which would lead to a higher stability and resilience when facing shocks, increased market size and economic growth.

Thirdly, we tested, econometrically, the link between export performance at county level and competitiveness indicators of the firms from the respective region, in order to assess how company-level indicators’ distribution impact the aggregate export volume and sophistication level. Results confirm that county-level export performance is significantly determined by firms’ productivity, even after controlling for county specific features. Not only the average productivity determines aggregate export performance of the county, but the entire firm level indicators’ distribution (skewness and top percentiles).

This result was tested for other European countries. The evidences show that firms’ performance significantly influences national commercial flows. It is shown that only the most productive firms have a durable activity on international markets, those from inferior classes of productivity having a sporadic presence and being more exposed to shocks. Productivity distribution shape has significant consequences on exports’ aggregate dynamics, including in times of crisis, firm level productivity indicators having a vital role in determining companies’ export behavior and survival on external markets. Productive firms concentrate a big part of exports, while shocks in their activity explain, to an important extent, aggregate exports’ developments and current account. Current account adjustment episodes in EU since 2008 can be explained by increased exports of productive firms. Different/disproportioned answers to shock of firms depending on their productivity can explain the diminishing relation between exchange rates variables and export dynamics. A major fault of these variables (e.g. REER) is linked to the hypotheses that exchange rate level is determined only by macroeconomic fundamentals (Altăr, 2010).

Thus, improvement in firms’ discipline and competitiveness indicators (especially microeconomic productivity) could generate positive synergies on export capacities, external
flows’ sustainability and also on banking sector, state budget and further on economic growth potential.

Taking into account the new realities of international trade, productivity and success on external markets depend not only on exporting abilities but also on the capacity of efficiently importing production factors. The sixth chapter realizes an assessment of Romania’s external competitiveness on the lens of domestic firms’ positioning within global value chains. The results obtained by decomposing export flows in value added flows (according to Koopman et al., 2012 methodology) suggest that domestic firms are placed on the incipient part of the global value chain (upstream participation). Low technological and sophistication business model, reduced productivity for an important share of companies and economic activity concentration, predictably imply an unfavourable position of domestic firms in the production chains. This situation also justifies invalidating learning by exporting hypothesis in case of Romania, as indicated by firm level data. Taking into account that Romanian companies’ exports don’t involve a large degree of knowledge, the opportunities for technology, know-how and increased productivity import opportunities diminish. It is shown that global value chains indicators reflect more accurately external competitiveness, bringing into discussion the multiple counted elements in the traditional statistics of balance of payments and which are generally ignored by international trade policies. Also, it is shown that services’ role in exports is underestimated by standard trade indicators. Even in these circumstances, Romania has the lowest share or services in exports’ value added among EU. Taking into account that Romania did not optimally benefit by global value chains’ synergies, ameliorating this situation should constitute a priority for the authorities, as a better integration in the production chains could provide additional export opportunities for Romanian firms. This is also supported by the present situation which indicates an elevated export concentration in industries characterised by a high integration in global value chains.

Based on the indicators for different faces of competitiveness, we formulate possible policy measures for legislative and business environment, fiscal efficiency or solving structural problems. All these measures aim at increasing domestic firms’ capacity (and implicitly of the national economy) of competing on external market by assuring an adequate framework for a good development of economic activity, for punishment of undisciplined agents and for being a pillar of national economy competitiveness and attractiveness. Evidences related to subdued profitability and high frequencies of insolvencies, including of newly established firms, signal that new business should be encouraged on a sustainable basis. Thus, in order to establish a society, entrepreneurs should take specialized courses and an exam based on which they can become firms’ administrators. Early entrepreneurial education is also essential for future revival of business environment.

Another measure that could be taken into account by policy makers could be raising minimum share capital requirement when starting a business, as well as measures for assisting and guiding new established firms, in order to extent their life duration. Currently, we are facing an artificial increase in the life duration of non-viable firms. In this respect, there is a need of special measures for agents that keep working with negative net assets. Taking into account the realities of the national economy, as well as European level practices which highlight that most member states have specific provisions for the loans granted by affiliated entities, the Romanian authorities could i) implement a limit for the ratio between debt to shareholders and affiliated entities to capital (for example, in Czech Republic, this ratio cannot exceed the level of 4) and/or ii) to limit the deductibility of interest expenses to these loans (for example, in Slovak Republic, the deductibility of interest expenses for affiliated entities debt is allowed only if these don’t
Fiscal inspections should be directed mainly towards the categories of firms which display a high risk of evasion, namely those companies with i) a high probability of using black labour, having a low share of employees’ remuneration in GVA (mostly microenterprises), ii) a greater than sector average share of merchandise and material costs in total production, iii) unusually high values for “other operational expenses” (microenterprises, construction, services and utilities) or iv) activate in specific domains with a high insolvency frequency correlated to establishment of new firms and a large number of inactive or loss making companies (food trade, buildings’ construction, restaurants, bars etc.), v) are multinationals’ subsidiaries and record large losses in Romania due to affiliated entities transactions; these kind of evidences can be leads for detecting cases of profits’ transfer in the country of origin of parent company or of profit shifting (the profit is moved to countries with more favorable tax regime).

A greater efficiency of insolvency process through rapid and objective solving of insolvencies, prevention of inadequate usage of procedural mechanisms and identification and sanctions applied to bad practices cases in the insolvency field could contribute to increased firms’ and creditors’ trust that this procedure can act as a satisfying instrument for solving financial difficulties, namely for a more efficient manner of recovering debt. A deficiency of the current system is the elimination of a series of sanctions applied to debtors’ representatives, judicial administrators or liquidators that act in bad faith. Compared to Law 85/2006, the new insolvency code eliminated some provisions that imposed sanctions debtors’ representatives, administrators or liquidators who do not respect the deadlines for introducing insolvency request, who refuse to offer information or they provide wrong data, dismantle assets or rights from insolvent debtors’ patrimony or commit misappropriation facts. Under these circumstances, there must be introduced provisions for reducing potential abuses, these including the usage of insolvency process as a mean for fiscal evasion (insolvent companies had, to the present, an important role in generating arrears to state budget). Communication and publicity system in insolvency field can be improved by i) publishing in national wide circulation newspapers the major cases of agents for which the insolvency is opened, ii) creating a centralized databases with information on all insolvent companies (the current phase) or that enter insolvency, as well as data on administrators/shareholders that are proven to have acted in bad faith or illegal. Limiting the number of companies that a person can own/administrate, especially if a judge court order was issued in which the respective administrator is accused of vicious/illegal practices, including fraudulently insolvency declaration could lead to greater transparency and discipline. These actions could also improve Romania’s competitiveness, taking into account the unfavorable ratio between unit labor costs and labor productivity recorded by unviable firms.

For increasing business discipline, policy makers could offer deductions for timely payments or issue increased penalties for delays or for not respecting contractual clauses/commitments, especially for large taxpayers. For improving economy-wide performances and for long term sustainability of current account, it is necessary to solve firm-level difficulties, since the economic activity, including external trade, depends on a low number of healthy companies. Most Romanian companies (especially those with domestic capital) do not have other competitive strategies than low costs, to the detriment of increasing productivity and diminishing technological and know how gaps. Increasing Romanian exports’ sophistication level through i) production process modernization of domestic firms by means of increasing productivity, ii) product upgrading through a larger specialization in high value added goods, as well as iii) the progress of domestic firms to more advanced production phases (projection, design, services associated with the final good, marketing, branding) or knowledge intensive sectors could exceed 25 percent of EBITDA, similar measures being met in Lithuania, France, Belgium, Denmark etc.).
contribute to competitiveness gains for Romania and moving towards superior phases in the global value chains. In this respect, helping firms in creating their own brand - for example by reimbursing cost with employees, machines and equipment, research and development etc.- simultaneously with an adequate quality of domestic products, could allow national companies to compete by this kind of elements and not mostly by price (as in the present), with beneficial effects on profitability and capacity of facing unfavorable developments. Fiscal incentives offered to firms which effectuate innovation and research and development expenses could have a role in the transition process from a price based competitiveness economy towards an economy based on non-price competitiveness, centered on innovation.

Stimulation of public-private partnerships in research, a better collaboration between companies and universities, especially in industrial field, would be an useful tool in this respect, based on the empirical evidences linked to industry’s capacity of generating GVA to a greater extent than other economic sectors. On the other hand, taking into account the low capacity of creating GVA of trade sectors and the high number of economic agents from this sector, it is highlighted the need of discouraging the creation of new firms and the persistence of unprofitable firms in this area, in favor of creating coherent production chains, with high quality services to amplify industrial capacities. Advancing to superior phases in the production chain imply focusing on endowments such as capital, technology and knowledge. In this respect, measures with positive impact on firms’ capacity of generating GVA and on their productivity could focus on increasing capital stock and reducing its age, for example by encouraging investment (both domestic and foreign); the low stock of capital, as well as low R&D expenses slows innovative capacities and technological progress, needed for sustained productivity gains.

Solving some structural problems have to be priorities for increasing Romania’s competitiveness and productivity, being needed:

- increases in employees’ level of qualification (including vocational) and a better correlation with market demands; improving staff skills would contribute to an increase in productivity and gross value added;
- improving public institutions’ quality and investments in infrastructure, with positive effects especially in hardly accessible regions and underdeveloped;
- commercial, fiscal and accounting legislation’s improvement, including through the alignment to European standards; this would contribute to diminishing the risks from companies’ sector and avoiding misconduct (Georgescu, 2015);
- business environment regulation, reducing bureaucracy and simplifying procedures applicable to firms (licensing, tax payments, insolvency);
- increasing predictability level of legislation.

The present thesis creates a comprehensible framework of external competitiveness assessment for domestic firms, analyzing, beyond traditional macroeconomic competitiveness indicators, the fundamentals derived from firm-level evolutions that determine the aggregate behavior. The corroboration of both approaches offers valuable explanations for domestic economic agents and fundamentals their position along regional production chains. The present evidences allow the identification of the main challenges for the next period, namely i) improving Romanian firms’ performances and financial discipline, ii) consolidating medium and long term exporting capacity, iii) improving general business environment and iv) positioning the national economy towards superior phases within the global value chains (through improving non-price, efficiency and innovation competitiveness factors).