MPRA
Munich Personal RePEc Archive

Solutions available to influence local economic development in Romania

Velicu, Ileana

Spiru Haret University Bucharest, Faculty of Finance and Banking

19 July 2012

Online at https://mpra.ub.uni-muenchen.de/40175/
MPRA Paper No. 40175, posted 20 Jul 2012 03:45 UTC

Solutions available to influence local economic development in Romania

PhDc.Lect. Velicu Ileana-Cosînzeana
Spiru Haret University Bucharest, Romania
Faculty of Finance and Banking

Summary

In this paper, the need for financing through a bank loan is analyzed by integrating the resources in the causal chain: bank loan - jobs - consumption - taxes - local revenues - new sources of investment - local development.

Bank credit is presented as an equally available resource for different "actors" of the local community - individuals, businesses agents and local authorities.

Keywords: bank loans, economic development, resources, local authorities

JEL Classification: O18

Introduction

In conditions where:

- EU funds are limited as value, but also in terms of destination;
- foreign direct investments, although effective, are experiencing a continued reduction in economic crisis and Romanian unpredictable business environment conditions;
- the bond market is in decline, due to the crisis and to the lack of investor confidence in the public domain, especially on long term;
- public-private partnership may bring delays in decision making due to diversity of interests, domestic credit is becoming more involved in local economic development, even if it is considered as an expensive resource.

Review of literature on the subject matter

For local development, the literature highlights in multiple approaches, the realities at local community level. Relevant papers from this perspective are presented by renowned authors, such as: Lucica Matei, Stoica Anghelescu ("Local development. Concepts and mechanisms", 2009), Aurel Iancu ("Romania's economic development. Competitiveness and integration into the European Union", 2003), Valeriu Iuhas ("Regional Economic Development - Economic and Social Implications", 2004), Altar Moisa ("Models to substantiate growth strategies for accession to the European Union", 2002) Roxana Mosteanu ("Financing regional development in Romania ", 2003) etc.

Given the complexity of the processes and phenomena in local development, the authors focused on social aspects within local and general economic context.

Theoretical foundations

Currently, the Romanian economy is characterized by significant demand shortfalls, generating high levels of unemployment and underemployment and a low level of activity in various economic sectors.

Obviously, more extensive areas of the country are getting away from the growth process. This reality is the result of a combined action of several factors, such as aging population, lack of jobs, unskilled labor force, total lack of attractiveness for investors.

The phenomenon of poverty, characteristic of such areas, is amplified by the growing process of social exclusion, which includes access to education and basic services. This phenomenon is present not only in rural but also in mono-industrial urban areas, especially those ones exposed to industrial restructuring.

Content of the article

As we showed in the introduction to this article, in Romania there is a range of non-budgetary financing resources available for local economic and social development. These resources include features or they may be influenced by certain factors that cause a limitation of access. Thus, we mention:

a) European funds have a limited value, as well as destination;
b) Foreign direct investments are efficient, but their level drops continuously, as a consequence of the economic crisis and an unpredictable business environment in Romania;
c) The bond market is falling because of the lack of confidence in the public sector, especially on the long term;
d) The public-private partnership may cause delays in taking decisions due to the divergence of interests;

To explain what we stated before, we analyse the mentioned non-budgetary financing resources:

European funds

The EU decided to distribute structural and cohesion funds for reducing the regional development gaps, which became even larger with the adherence of new countries.

Between 2007 and 2013, Romania receives structural and cohesion funds of 19.2 billion euros1.

Structural Funds function on the principle of reimbursement of expenditure by the eligible beneficiaries. Those who are accepted in the program must finance the projects in advance using state funds or private ones. The discount is made after the assessment of the projects.

The level of grant sustained by European funds varies between 30% and 85% of the eligible expenditure.

Foreign Direct Investments (FDI)

In 2010, in all the member states which are outside the euro zone, the inflow of FDI decreased compared to 2009. The share net inflows of FDI in the GDP dropped from 2.9% in 2009 to 1.8% in 20102. In the Czech Republic, Lithuania and Latvia, there were increases of FDI, but also increases of portfolio investments. In 2010, in Sweden, Latvia, United Kingdom and Lithuania, the outflow of other investments fell from 1.8% from the GDP in the previous year to 1,1% .

[1] The National Strategic Reference Framework represents the national strategic document which settles the priorities for European Regional Development Fund, the European Social Fund and the Cohesion Fund. This framework links the national priorities, settled by the National Development Plan 2007-2013, and the European priorities: the strategic approaches regarding 2007-2019 cohesion and the Lisbon strategy. For achieving the strategic vision of the national framework, The European Commission offers to Romania 19.67 billion euros, of which 19.21 for convergence and 0.46 billion for European territorial cooperation.

[2] Romanian National Bank – Balance of payments and the international investment position – annual report, 2010

Compared to 2005, FDI doubled, reaching over 52 billion euros in 2010.

Table 1

FDI in Romania 2005-2010

Millions Euro

Year	2005	2006	2007	2008	2009	2010
FDI	21 884,00	34 512,00	42 770,70	48 796,70	49 984,00	52 396,10

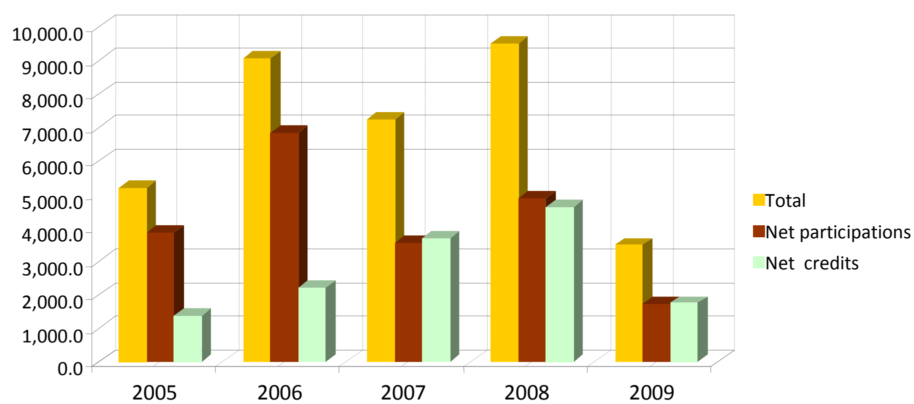
Source: Romanian National Bank – Statistics (2005-2010)

In 2009, the FDI covered 85%3 of the current account deficit.

Taking into account that after the fall of communism, in 1989, Romania had all prerequisites to attract foreign investors, FDI arrived soon. As we stated before, the legal framework was created soon after the adoption of the market economy. Since then, the volume of FDI increased continuously. Between 2005 and 2009, the annual average of net inflows was 6900 million euros.

Chart 1

FDI net inflows 2005-2010



Source: Romanian National Bank – Statistics (2005-2010)

The performance indicators of Romanian companies which received FDI deteriorated slower than the rest of the economy during the crises. These companies have a structure which allows them to absorb shocks better. In addition, they create 40% of the total value added and they generate more than 75% of Romanian exports.

[3] Romanian National Bank – Financial Stability Report, 2010

The contribution of FDI companies to domestic loans is small, as they prefer foreign finance.

Economic activities in which FDI are involved are: industry (24,3% of total FDI), real estate (7,4%), retail and gross commerce (6.2%), IT&C (3.5%).

In 2010, inflows of private capital were supplemented by international financial assistance programmes.

Regarding the origin of foreign investors, Holland, Austria, Germany, France, Greece and Italy were always in top. The share of these countries in the total amount of FDI at the end of the analysed years was between 5% and 20%.

.

Bond market

Municipal bonds have a long history in Romania4. In 1906, Craiova was issuing bonds for internal and external markets. In 1921, Bucharest borrowed 100 000 000 lei by issuing bonds.

Despite its past and its modern legal framework, the Romanian bond market is not popular among investors or issuers.

In a broad sense5, bonds are financial instruments issued by a public entity on long term.

Bonds are a form of borrowing with multiple creditors, on a certain period, with a fix or variable interest, which can be sold to a third party on the bond market. The interest is settled at the issuing moment. The investors who buy this type of security become creditors of the issuing entity.

In the legal sense and in this paper, bonds represent long or medium term securities issued by local public authorities. The reimbursement of the loan is guaranteed by the revenues of the territorial unit.

The main issuers of bonds are the central and local public authorities. The purposes of the borrowing are the cover of budgetary deficit and the financing of important investments for the community.

The increase of local public debt by issuing bonds must respect the legislation. The distribution of these securities to the public can be carried out directly or by using specialized agencies.

---

[4] Robert Zipf - *Obligatiunile Municipale* – Herma, Buharest, 2001, p.XIII
[5] Bond Transaction Guide – Intercapital Invest SA - www.intercapital.ro

Table 2

The evolution of resources gathered by issuing bonds

Millions Lei

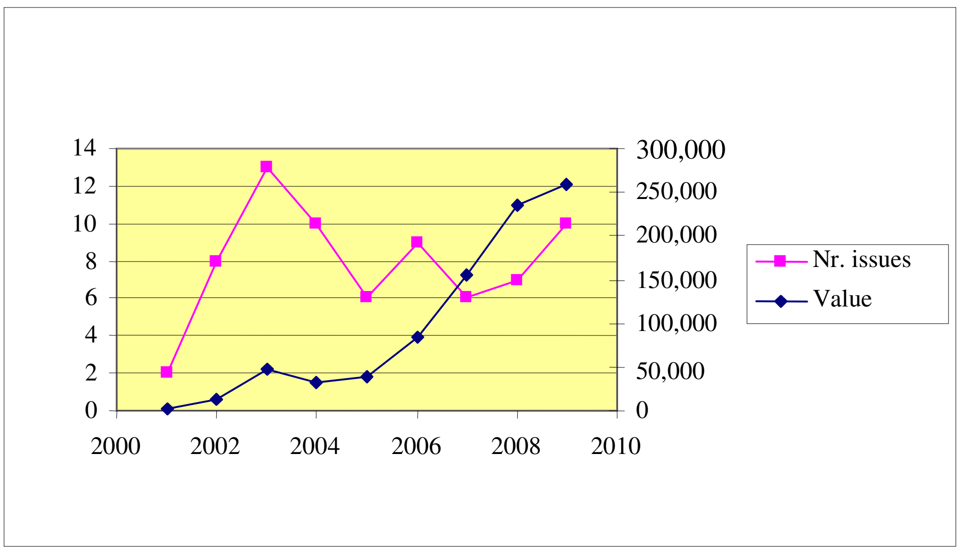
Year	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**TOTAL**
Value	1.50	12.65	46.51	31.79	38.75	84.65	155.00	236.00	258.50	865.35
Nr. of issues	2	8	13	10	6	9	6	7	10	71

Source: CNVM annual report 2001-2009. Author's adaptation.

The annual increase of issued bonds was not constant. This fluctuated from 118.5% in 2006 compared to 2005, reaching an increase of only 9.5% in 2009 compared to 2008. Regarding the number of issues between 2005 and 2009, we notice an average of 7 issues per year.

Chart 2

Bonds evolution



Source: CNVM annual report 2001-2010. Author's adaptation.

Both data and the chart indicate a constant increase of bonds value compared to the number of issues.

Public-private partnership

The public-private partnership is an economic mechanism of association between two partners – the public authority and the private investor – for realizing a project, a public commodity or a public service as they are defined in the Romanian legislation.

The legal framework regulates the initiation and the realization of public-private partnership projects for public works in various economic sectors, with private financing.

As we previously showed, the public-private partnership is an economic mechanism of association between the public sector and the private one, in the purpose of accomplishing a public objective. In such an association, the parties can use their financial resources or other resources like bank loans.

Table 3

Public-private partnerships per regions in 2011

Region	Nr. Of PPP	Town halls	County Council	Other authorities
North – East	5	3	2	-
South – East	4	2	2	-
South	5	-	4	1
South – West	3	-	3	-
North – West	8	4	-	4
West	4	1	3	-
Center	3	2	1	-
Bucharest – Ilfov	8	2	5	1
TOTAL	**40**	**14**	**20**	**6**

Source: Ministry of Public Finance

In Romania, bank loan offered to local public authorities, economic agents and private entities represents an useful financing resource in local economic and social development, even if, compared to other resources, it has a higher cost.

Table 4

Domestic loan in Romania between 2005 and 2010

Million lei

INDICATOR Year	2005	2006	2007	2008	2009	2010
Gross GDP	288 954,60	344 650,60	416 006,80	514 700,00	498 007,50	513 641,00
Domestic loan of which:	63 102,90	95 924,30	157 751,30	215 260,90	246 697,90	270 926,20
Non governmental loan	59 806,30	92 378,50	148 180,70	198 055,70	199 887,10	209 298,00
Domestic loan in GDP (%)	21,83	27,83	37,92	41,82	49,53	52,74

Source: Data from Romanian National Bank – Monthly report, December (2005-2010). Author's adaptation.

In 2005-2010, domestic loan registered a constant increase, reaching 270.9 billion lei in 2010 compared to 63.1 billion lei in 2005. Compared to the GDP, domestic loan reprezented, at the end of this period, more than 50% of GDP.

The non-guvernmental loan had a share of 77.2% in the structure of domestic loan in 2010. This share is lower than in previous years, when its level was over 90%.

Bank loan represents an alternative for financing local development which offers many facilities. It can be used by public authorities, but also by local economic agents and population. The economic efficiency which is expected by using bank loan6 contributes to the reduction of internal and EU development gaps. Thus, the proper usage of bank loan leads to an increasing role of it in local economic development.

An analysis of the existing situation in Romania shows the preference of retail customers for real estate investments, for long-term products and for various other purposes. The history of the economic situation of Romanian population, especial during the communist period, may explain the current behaviour. Unfortunately, satisfying the previous needs through such investments leads to an increase of

[6] Ileana-Cosinzeana Velicu – *The proper usage of available resources for economic development* – Tribuna Economica nr. 39/2011, p.65.

debt towards banks and of imports, but they do not sustain a competitive and balanced economic growth.

Investments in production and services must be stimulated for increasing their share in the economy.

Development of SMEs in Romania is weighted by a number of factors, including: reduced number of local entrepreneurs, the under-development of entrepreneurial culture in the country.

Few entrepreneurs have collaterals to obtain financing. Therefore, many Romanian companies are undercapitalized and are dysfunctional in cash flow. Facilities related to management and technologies are limited and there is also a shortage of suitable space for offices.

In terms of demand, almost half of the rural population lives at subsistence level, resulting in a reduced demand for goods and services for personal consumption.

In Western Europe, private consumption led to the development of SME's and the related growth of employment in recent years. Applying the model of Western Europe, namely, the development of SME's, aims to maximize their potential contribution to a sustainable economic growth.

The obvious local effects of SME development include:

- reduction of unemployment by creating new jobs;
- economic growth by increasing the contribution of SME's to GDP;
- increased contribution to export products with high value added, hence increasing competitiveness of the Romanian economy.

Another essential source of growth and modernization of the national economy is the foreign direct investment (FDI). Foreign investments create jobs, which contribute to lower unemployment, but also provide a market for goods and services provided by the Romanian SMEs. Foreign investors can be attracted by a stable and predictable fiscal policy, by granting tax incentives and by applying quality management standards, which would help to increase the competitiveness of Romanian SME's.

Foreign direct investments have both advantages and disadvantages, subject to certain risks and uncertainties. Romania may have to gain from an influx of foreign capital, but such a trend can be reversed very quickly, sometimes for reasons out of country's control.

Relevant is the situation of FDI in Romania after the economic crisis, as shown within this paper. On the other hand, global economy growth rate influences FDI. If preponderance is given by low value-added industries then the competition of low labor cost countries (China, Southeast Asian countries, etc.) will also affect FDI.

Conclusions

Administrative units (or their subdivisions) are allowed to access loans or to guarantee of any kind of loan, whether the total given by the annual debt installments due on loans and/or guaranteed, the interest and commissions, including the loan to be contracted and/or guaranteed in the year, are within 30% of the arithmetic mean of own revenues (taxes, fees, contributions and other payments, share from income tax rate), less proceeds from asset valorization, on the last three years period, preceding the year in which authorization is requested for repayable funding to be contracted and/or secured.

For public interest objectives in a local community, credit institutions can provide credit products dedicated to social purposes.

We believe that credit institutions can proactively be involved in the preparation of impact studies for a local community. Based on the results and after consulting the local authority for identifying its priorities, banks can approach new economic agents - in category start-up - and can provide credit products in terms of affordable cost. Given the situation of these start-ups, the best offer may include as facility a real guarantee as most of the time they don’t have it.

In order to achieve this, credit institutions can indirectly involve recognized large companies, willing to guarantee on contractual basis (surety) in favor of start-ups, in nature of letters of guarantee or any warranty permitted by the credit institution. If an unwanted event occurs, these companies can takeover the control of start-ups on whose behalf the guarantee was issued.

Another possible option that we consider is the involvement of the state which within the annual limits - such as those set for local authorities, can issue, on a case by case basis, governmental guarantees.

References

1. Iancu, Aurel. "The economic development of Romania: Volume 1 Competitiveness and EU integration", Romanian Academy Publishing, Bucharest, 2003.
2. Iuhas, Valeriu. "Regional Economic Development - Economic and Social Implications", Emia Publishing House, Bucharest, 2004.
3. Matei, Lucica and Anghelescu, Stoica. "Local development. Concepts and mechanisms", Economic Publishing House, Bucharest, 2009.
4. Moisa, Altar. "Models for grounding growth strategies for accession to the European Union - research report", ASE, Bucharest, 2002.
5. Mosteanu, Roxana. "Financing regional development in Romania", Economic Publishing House, Bucharest, 2003.
6. Velicu, Ileana-Cosînzeana. "Efficient use of bank credit in local development", Economic Tribune no. 40/2011