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The Absorption of European Funds Premise of Romanian Business Environment Development

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Abstract: The main **objectives** of this paper is to emphasize the important role played by Structural and Cohesion Funds for business environment development, especially in times of economic downturn when the financial resources are difficult to access. **Prior work** regarding the promotion of good administration of structural funds in new member states was carried out by NGOs. The main **methods** employed for capturing the research evidence consists in comparative analysis of the related work, and also in studying the capacity of absorption of European funds in the case Romania, especially from the SMEs perspective. The main **results** show that European Funds absorption is delayed and negatively influenced by a series of factors. The importance of European financial assistance through Structural and Cohesion Funds is undeniable, especially in times of financial crisis, so **implications** of this study are important to entrepreneurs, especially for SMEs but also to policy-makers, because they can design the procedures of accessing this funds in order to easy this process. The **value** of this paper ensues from the original approach of contradictory role played by European funds for Romanian business environment, because it represents the mirage of overcoming economic crisis.

Keywords: SMEs; economic crises; European financial assistance; cohesion

1 Introduction

Difficult macroeconomic context characterized by negative and unpredictable developments has amplified the instability of Romanian business environment, with a strong negative effect on the SME sector development.

The world economic crisis, although it quickly spread to Europe from the U.S., has entered in our country with a certain delay from the time of launching, due to the low level of openness of the Romanian economy. However, the crisis strikes, and the Romanian business environment has proved to be very vulnerable because of no taking advantage of cohesion and integration mechanisms into European structures.

2 Romanian Business Environment and the Global Economic Crisis

Turbulences in the world economy were felt in Romanian economy by the contraction of domestic consumer demand, the withdrawal of capital flows from abroad and also, by the sudden and sharp fall of foreign trade, both exports and total imports.

2.1 General Effects of Global Financial Crisis in Romania

In our country, the global economic crisis manifested by a substantial slowdown of economic growth (-7.1% in 2009), both immediate negative effects on the *population*, by reducing employment, and *business environment*, by reducing drastically sales volume.

According to the “National Bank Annual Report 2010” *apud* Fundatia Post-Privatizare (2010), global financial and economic crisis has manifested itself in Romania through:

- *Reduction of public procurement*, amplified by the lack of effectiveness in attracting European funds available for the programming period 2007-2013. Reduced access to bank financing sources stopped access to European funds, which for the current programming period, works on the principle of reimbursement.
- *Narrowness of major investment projects*, foreign investors displaying caution in doing business in Romania.
- *Decreasing of exports* due to reduction of export demand on foreign markets.
- *Decreasing of imports* due to diminishing domestic consumer demand.
- *Reduction of people's purchasing power*, both as a result of reduced consumer credit, but also as a direct consequence of the restructuring process in private firms and the government austerity programs in the state sector.
- *Drastic decline of property values*. Falling of real estate market has implicitly led to an significant devaluation of property guarantees related to lending.
- *The accumulation of large external deficits* by raising unjustified government spending during the election year.

2.2 Features of the Economic Crisis in Romania

The effects of global economic crisis has been exacerbated by “our national specificities”, characterized by political teasing, law instability and malfunction of Romanian justice. Romanian business environment has experienced a series of negative extremely diverse situations:

- *contractual indiscipline* by breaching the terms of payment between economic agents;
- *fiscal instability*, driven by the need to collect revenues to the state budget by increasing tax base;
- *the policy of commercial banks* to increase interest rates on loans in progress and to stop the offer for new credit;
- *infringements*, even by *state firms* which are not honored on time payments to private providers or have not complied with the obligations of repayment of taxes owed to economic agents;
- *competition for access to domestic banking market* between the state and the SME sector.

In the category of disruptive factors, related to the external environment, the **legislative instability** and **financing offer** are key factors that increase the vulnerability of the SME sector.

Legislative instability and malfunction of Romania justice are very serious problems facing our country and on which the European Union warned repeatedly. But the aim of this work is SMEs access to finance, especially SMEs access to European funding.

3 Sources of Funding Available to SMES

SME sector development is directly dependent on access to finance. Economic recovery after a period of financial crisis is possible only by making investments. At first glance, the chart of financing sources available to SMEs seems very diverse and includes: private loans, commercial loans, bank loans, leasing operations, micro-credits, European financial assistance, securities issues on capital market, etc. However, loans from banking sources were the main source of financing for SMEs in the years 2007 - 2008, when a large part of banks were specialized in financing the SME sector. The global financial crisis has negatively influenced the supply of credit addressed to SMEs, the downward trend in lending being an issue stated at European level in “Access to finance – Euro-barometer Analytical Report 2009” carried out by European Commission and ECB.

3.1 Internal sources of SMEs funding

Government Strategy for SME Development 2011-2013 provides the system’s strengthening of guarantee funds for SMEs and the increasing accessibility to micro-credit funds.

Table 1 The frame of credit guarantee institutions

Funds that provide guarantees to SMEs	Acronym	Features
Romanian Credit Guarantee Fund	RCGR	It addresses private entrepreneurs
Rural Credit Guarantee Fund	RCGF	It addresses a specialized sector: agriculture. Guaranteed loans submitted by individuals and legal entities (agricultural producers and processors of agricultural products) to manufacture, stockpiling, but also the investments.
Export-Import Bank of Romania	EXIMBANK	Plays a dual role: bank and insurance company for export credit. Guarantees low loans and letters of guarantee contracted by SMEs, both lending for exports but also those incurred for the projects in priority development areas.
National Credit Guarantee Fund for SMEs	NCGFSME	Provides direct financing for SMEs, and guarantees for the financing instruments contracted by SMEs from commercial banks.
Romanian Fund Counter	RFC	It is a financial institution specialized in counter-guarantees granted by financial instruments guarantee funds for SMEs obtained from commercial banks and other sources.

Microcredit enjoys a strong promotion at European level¹, because, in addition to financial services for micro-entrepreneurs, provides guidance and technical assistance. Microfinance lies in providing small loans of up to 25,000 Euros, needed for entrepreneurs for starting a business or for making small

¹ JASMINE European Project (2009 - 2011) aims to develop microfinance institutions in the EU, in order to facilitate SME access to finance.

investments, as well as for adjusting various cash flow problems. Microfinance institutions do not require collateral guarantees and are guided by the “loan cycle”¹ politics.

3.2 European Funds for SMEs

Community financial assistance available to Romania between 2007 -2013 programming period is a great opportunity to be exploited, especially by the SME sector, for economic recovery.

19.67 billion Euros are allocated to Romania by the European Union under the EU cohesion policy 2007-2013. This financial assistance grant is available in Romania through three structural instruments: the European Regional Development Fund, European Social Fund and Cohesion Fund.

Concrete measures for SME financing are provided by the Operational Programme “Increase of Economic Competitiveness” (axis 1, 2, 3 and 4), Regional Operational Programme (Axes: 4 and 5) and “Human Resources Development” Operational Programme (Axes: 3 5 and 6).

Additionally to Cohesion Policy, Romanian SMEs, according to their specific activity, may receive funding under the Common Agricultural Policy through the European Agricultural Fund for Rural Development (Priority Axes 1 and 3 of the RDP), and also under Common Fisheries Policy through the European Fisheries Fund (Priority Axis 2 of OP Fisheries).

4 Absorption of EU Funds and Romanian Business Environment

Starting with 2005, organizations of civic society (e.g. Transparency International Romania, Media Monitoring Agency, Pro Democracy Association, Open Society Institute, Soros Foundation Romania) become involved in activities aimed to increase the transparency, responsibility and the effectiveness of structural funds management.

In accordance with “Transparency of EU funds in Romania; Monitoring and analysis Report of European funding”, a study carried out by Media Monitoring Agency and Pro Democracy Association in 2007, the main *problems identified in the absorption of EU funds* are:

- *Administrative incapacity* generated both by the lack of qualified staff but also by the overload of employee;
- *Corrupt practices and conflicts of interest* manifested by awarding contracts to “Preferred Clients”, or by guidance the potential beneficiaries to certain-“agreed” consulting firms and by the existence of a *developed network of influence peddling* that monopolize the market for consultants or service providers in different areas;
- *Poor information* resulting from the lack of training of persons involved in the process;
- *Lack of transparency*, the opacity resulting from the reluctance of authorities to assist the beneficiaries in obtaining information or from the need to protect their “preferential clients”. It was also noted *the lack of consultations and formal consultation* between the local community and local authorities and between them and the authorities from “the center”, which makes European funds often do not come to meet the real needs of beneficiaries. This situation is due to the *outdated mentality and disrespect for citizens*;

¹ The first loan has a lower value, and after reimbursement, beneficiaries may request another loan, whose value is up to double the first loan, the procedure is reiterating up to a maximum of 25,000 Euros.

- *High rates charged by consulting firms* and the lack of training of personnel working in some specialized companies have generated irregularities and impeded the access to funding, although projects were viable;
- *Media* do not allocate enough space to inform about the European funds, practicing instead, educational and cultural genocide through programs promoted;
- *Bureaucracy*;
- *Scarceness of co-financing funds*.

Meeting the problems identified above, Romania Consultants Association for Accessing European Funds has made a series of “*Proposals for Improving the Absorption of EU Funds*” (www.acrafe.ro):

- *Rapid and “smart” use of reallocation mechanism¹ available to the Romanian authorities* because, for some on specific programs, there are hundreds of projects declared eligible, but who, for various reasons, are on the waiting lists, because there is no money for financing, meanwhile there is unused money in the same program, at a similar measure on the same axis or on a different axis.
- *Launch of all financing measures according to a rigorous annual calendar*, because in the current system, Applicants Guidelines appear, in the final version, just a few days before the start of the session², the beneficiaries not being able to lay their projects due to the short time to obtain new various approvals (terms related to legal proceedings) and time spent on actual development project becomes shorter.
- *Establish a framework of cooperation between Management Authorities and Banking System in order to facilitate funding of projects financed by EU funds*. Nowadays, banks, not knowing in detail the procedure for work or wanting to ensure better risk management projects require different information to beneficiaries under the MA certification, information often rejected by the latter. Consequently, these projects are removed from the funding.
- *Establish a framework of transparency and regularity regarding the issuance and amendment of procedures for accessing the funds*. The dossiers are evaluated by non-transparent rules. Under the argument, “we've realized something, let's change the procedure”, the beneficiary is asked to submit overnight documents and new information which changes the submitted files or the project is downgraded because the criteria for selection are restored on the last minute.
- *Set clear deadlines for response to specific situations arising during the execution of projects and empowering Management Authorities leaders for the terms* in order to address the current situation when to many of the requests submitted for clarification the answers are vague and do not correspond to information requested, occurring in a very long time interval from the date of transmission when the projects deadline submission has already expired.
- *Simplification of procedures documents*. If, in the European Union, most projects are transmitted electronically, the original documents being checked during site visits, in Romania, the project shall be submitted within 2-4 copies on paper and stamp and signature on each page. Also, when calling for tenders for procurements, some documents are requested in original and the releasing costs of such documents are prohibitive for many bidders at the auction and thus restrict competition between providers of certain services.
- *Creating a framework for training and motivation of civil servants involved in the management and evaluation of EU funding projects*. Blockages occurred during the evaluation and

¹ Using 10% margin for reallocation between the axes, to direct money to priority areas where there are viable projects.

² Launch session takes place only once a year and filing period is approx. 4 weeks.

implementation of projects due to the incompetence of experts which are evaluating the project for all phases of its implementation. Many experts have large gaps in understanding the economic phenomena and even the simple understanding of procedural issues, which, theoretically, work daily. This is due either to lack of real competition in filling these positions or to the education system, which has certified such jurisdiction.

5 Conclusion

The importance of European financial assistance through Structural and Cohesion Funds is undeniable, especially in times of financial crisis, but, unfortunately in Romania, the absorption of European Funds is delayed and negatively influenced by a series of factors, such as: low development of administrative capacity, corruption, poor information, lack of transparency, lack of experience of consulting firms, pecuniary embarrassment, bureaucracy and etcetera. The negative effect on Romanian business environment development is very difficult to count. One thing is certain: it is time for a change, a change of our mentality. Some organizations of civic society (e.g. Transparency International Romania, Media Monitoring Agency, Pro Democracy Association, Open Society Institute, Soros Foundation Romania) already started getting involved in activities aimed to increase the transparency, responsibility and the effectiveness of structural funds management. These are only preliminary steps, but we hope that represent “small steps for now and a giant leap for tomorrow”.

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