STABILITY PACT

SOUTH EAST EUROPE COMPACT FOR REFORM, INVESTMENT, INTEGRITY AND GROWTH

ENTREPRENEURSHIP AND ENTERPRISE DEVELOPMENT
ROMANIA

Policy Review

March 2002

Prepared by
Organisation for Economic Co-operation and Development
and
European Bank for Reconstruction and Development
in co-operation with
Ministry for SMEs and Co-operatives, Romania

FOREWORD

The South East Europe (SEE) Compact for Reform, Investment, Integrity and Growth (‘Investment Compact’), a key component of the Stability Pact, has consistently affirmed that the economic revitalisation of South East Europe is dependent primarily on private sector investment within a market economy framework. Through the Investment Compact process, Stability Pact partners support and promote the structural policy reforms that will improve the climate for private enterprise and increase the level of investment.

Within this broad agenda, entrepreneurship and enterprise development are recognised as important elements in creating dynamic market economies. However, the framework conditions for creating and sustaining businesses remains underdeveloped in many SEE countries. Reforming and improving the various elements constituting an environment conducive to entrepreneurship is a priority for SEE governments.

This Enterprise Policy Review was prepared in response to a request by the Government of Romania for Investment Compact support in developing the potential of the small and medium-sized enterprise (SME) sector. Designed to assist SEE countries in stimulating entrepreneurship and enterprise development, the report draws on the complementary experience and skills of the Organisation for Economic Co-operation and Development (OECD) and the European Bank for Reconstruction and Development (EBRD), two Stability Pact partner organisations that have been closely involved in the reform process in transition countries.

The analysis and recommendations in this report provide a framework for initiating new enterprise and investment in small and medium-sized business by the Government of Romania, the key donor agencies and the main SME policy community active in the country. The recommendations, if implemented in the form of an Action Plan, offer scope for making sound progress in improving the business environment for SMEs.

Policy action in the SME field cannot be effective without a supportive general context. The legislative, institutional, regulatory and fiscal instability in Romania has in the past hindered enterprise development. The Government’s efforts to make progress with EU accession, combined with more stable macro-economic conditions, the actions undertaken by the Ministry for SMEs to improve the business environment and a more stable institutional framework, have resulted in a more positive outlook for the SME sector. Implementation of the recommendations contained in this report, as in many other aspects of the transition process, hinges on the establishment of a more stable framework for small enterprise development.

The Stability Pact, through the Investment Compact for South East Europe, will continue to contribute to establishing this framework in Romania and in the region as a whole.

Erhard Busek
Special Co-ordinator
Stability Pact for South Eastern Europe

PREFACE

This report presents the findings and recommendations of the joint OECD–EBRD assessment of the entrepreneurship and enterprise development environment in Romania. In the framework of the Regional Flagship Initiative to support small and medium-sized enterprises (SMEs) launched by the Investment Compact for South East Europe, this enterprise policy review was undertaken by the OECD (Directorate of Financial, Fiscal and Enterprise Affairs) and the EBRD (Office of the Chief Economist), in co-operation with the Romanian Ministry for SMEs and Co-operatives. Funding for this work was provided by the Investment Compact and the European Commission.

Two missions were carried out in July and October 2001. The OECD and EBRD are grateful in particular to the Ministry for SMEs and Co-operatives, our lead co-partner in Romania in preparing this report, the Ministry of Foreign Affairs, and the Country Economic Team of the Investment Compact in Romania, and to a number of ministries, agencies, private sector firms and NGOs which participated in the project and contributed valuable insights and information:

- Altan Tepe Disadvantaged Zone;
- Association of Romanian Businessmen;
- Authority for Privatisation and Management of State Ownership (APAPS);
- Banca Comerciala Romana S.A.;
- Banca Agricola S.A.;
- Business Development Centre;
- Chamber of Commerce and Industry (Bucharest and Constanta);
- Constanta-South and Basarabi Free-Zones Administration;
- Country Economic Team, Investment Compact for South East Europe;
- CRIMM Foundation;
- Demir Romlease S.A.;
- EBRD, Romania;
- Entrepreneurs in Bucharest, Constanta and Tulcea;
- European Commission Delegation, Romania;
- Foreign Investors’ Council;
- Foundation for Assistance and Training in Business, Constanta;
- Foundation for Assistance of Entrepreneurs in Romania, University of Bucharest;
- International Finance Corporation, Romania;
- IRIS Center, Romania;
- Microenterprise Credit Romania S.A.;
- Ministry for SMEs and Co-operatives;
- Ministry of Development and Prognosis;
- Ministry of Finance;
- Ministry of Foreign Affairs;
- Ministry of Industry and Resources;
- National Bank of Romania;
- National Council for Private SMEs in Romania;
- Regional Development Agency for the South-East;
- Romania Credit Guarantee Fund;
- Romanian-American Center for the Development of Small and Medium-Sized Enterprises;
- Romanian-American Enterprise Fund;
- Tulcea County Council;
- World Bank, Romania.

Against the background of economic, social and political changes, the development of SMEs is crucial for the future of Romania. A dynamic SME sector is needed to ensure continued economic growth and to thereby enable economic development, employment generation and improvement of living standards. Accordingly, a review of the state of current policies, institutions and incentives to stimulate the sector is required. This need was recognised by the Romanian Government, which invited the OECD and EBRD to undertake this review as part of the Investment Compact process of helping to reorient SME policy in line with prevailing opportunities, threats and resources in the country.

The main aim of this policy review is to assess the extent of progress in SME development achieved to date by the Romanian Government, as well as by local agencies and international institutions active in the country. The Government of Romania has made numerous efforts to support the SME sector, and the extent of progress can be assessed against the requirements for successful SME development highlighted in the *OECD-UNIDO Forum on Entrepreneurship and Enterprise Development (FEED) Guidelines* (OECD-UNIDO, 1999), as well as in the *Country Fact Sheets* prepared under the SEE Investment Compact by the respective Country Economic Team Leaders (OECD, 2000). The policy review builds on three years of experience in partnership with SEE countries through the Forum for Entrepreneurship and Enterprise Development (SEE FEED) and on the best practice guidelines which were produced to assist entrepreneurship and enterprise development in transition countries. The institutional, political, economic and cultural background features of Romania are factored into the analysis in order to assess where the main impediments to SME development now lie. The analysis in the main body of the report is supplemented by a series of indicators drawn from the FEED guidelines, which are presented in Annex 1.

Another aim of this report is to highlight a number of key SME policy areas where the most rapid and effective progress can be made. This progress can be facilitated through appropriate actions by the government, non-governmental organisations, the private sector, international donor institutions, and through the application of new, and/or re-allocation of existing, financial resources from both local and international bodies. The recommendations in this report are consistent with the FEED best practice guidelines, and it is hoped that, in conjunction with the activities of the international donor community, they will lead to the implementation of a range of new measures and policies that will reflect the crucial importance of SME development to the overall economic development and growth of the country. The OECD and EBRD will continue to work with the Romanian Government through the Investment Compact to support SMEs and to assist in the implementation of the recommendations identified in this report.

This report is an output of one of the regional flagship initiatives of the Investment Compact for South East Europe, a key component of Working Table II of the Stability Pact. The Investment Compact Project Team is co-chaired by Austria and the OECD (see www.investmentcompact.org). The report has been written by Ricardo Pinto and Antonio Fanelli of the OECD and Francesca Pissarides and Elisabetta Falcetti of the EBRD. It has benefited from the advice and guidance of Rainer Geiger, Deputy Director for Financial, Fiscal and Enterprise Affairs (OECD), Declan Murphy, Programme Director of the Investment Compact (OECD), Martin Forst, Head of the Investment, Finance and Enterprise Development Programme (OECD), Salvatore Candido, Director for Romania (EBRD) and Charlotte Gray, Senior SME Specialist (EBRD).

TABLE OF CONTENTS

FIGURES, TABLES AND BOXES

ACRONYMS

APAPS	Authority for Privatisation and Management of State Ownership
BSC	Business Support Centre
CCI	Chamber of Commerce and Industry
CIS	Commonwealth of Independent States
CEE	Central and Eastern Europe
D-Zones	Disadvantaged Zones
DFID	Department for International Development
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
EU	European Union
EUR	EURO
FEED	Forum on Entrepreneurship and Enterprise Development
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FIC	Foreign Investors' Council
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IRIS	Center for Institutional Reform and the Informal Sector
MDP	Ministry of Development and Prognosis
MFI	Micro-Finance Institution
MSEs	Micro and Small-Sized Enterprises
MSMEC	Ministry for Small and Medium Enterprises and Co-operatives
NARD	National Agency for Regional Development
NDP	National Development Plan
NGO	Non-Governmental Organisation
NTRO	National Trade Regulation Office
OECD	Organisation for Economic Co-operation and Development
OSIM	State Department for Inventions and Trademarks
Phare	Poland Hungary Assistance for Reconstruction of the Economy[1]
R&D	Research and Development
RDA	Regional Development Agency
ROL	Romanian Currency (Leu – singular; Lei - plural)
SEE	South East Europe (defined by the Investment Compact as: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Former Yugoslav Republic of Macedonia, Moldova, Romania, and Federal Republic of Yugoslavia: Serbia and Montenegro)
SMEs	Small and Medium-Sized Enterprises
SOE	State-Owned Enterprise
TA	Technical Assistance
UNIDO	United Nations Industrial Development Organisation
USAID	United States Agency for International Development
VAT	Value-Added Tax
WTO	World Trade Organisation

1. Originally the acronym of an EC programme targeting Hungary and Poland, the EU/Phare Programme has become the main channel for the EU's financial and technical co-operation with all of the countries of Central and Eastern Europe.

RECOMMENDATIONS

Good Practice in Enterprise Development

Romania has made considerable progress over the past decade in setting up an extensive policy framework to support the SME sector. A range of institutions, policy instruments, territorial tools, programmes and resources exist, all of which assist small enterprise development in Romania. The challenge for the future is to ensure that these institutions deliver policies in a manner which is effective and consistent with international good practice.

This review represents an analysis of Romania's progress in designing and implementing policies for the development of the small enterprise sector. The template presented in Annex 1 provides an assessment of Romania's position in terms of SME support relative to what is considered good practice, while at the same time highlighting areas where progress has been achieved and areas of relative weakness. This assessment is based on OECD-UNIDO's *Entrepreneurship and Enterprise Development in Transition Economies: Policy Guidelines and Recommendations* (1999) and follows the recommendations made in the OECD's *Fostering Entrepreneurship* (1998a). The OECD and the EBRD have used the template and the analysis provided in this report to determine the set of recommendations presented below.

Overall Assessment and Priorities

The overall policy assessment is that Romania is moving in the right direction in the key policy areas affecting the SME sector. What is now required is a period of stability and fine-tuning in order to focus on policy implementation and make the existing system work more effectively.

The enterprise policy review process has generated a number of priority recommendations that have the capacity to promote SME development in an effective manner. The recommendations selected can be implemented by the Government and related SME institutions without major budgetary implications or reforms. As a package, they offer the prospect of making further progress in unlocking the potential of small enterprise development as the driving force for economic growth in Romania. There are four main sets of priorities for reform, which are discussed in more detail below:

A. Consolidation and Co-ordination of the Institutional Framework for SME Policy-making;

B. Improvement of the Regulatory Environment;

C. Improvement of Tax Policy for Small Businesses;

D. Strengthening the Financial Structure.

A. Consolidation and Co-ordination of the Institutional Framework for SME Policy-making

1. Stability in National SME Institutional Environment

The creation of the Ministry for SMEs and Co-operatives in January 2001 was a political response to the chronic institutional instability at national level. Its creation represented the ultimate institutional step in the area of SME support, and other organisations recognised the importance of this institutional response, given the previous history of continuous shifts of responsibilities and competencies. Also, the private sector acknowledged the importance of raising the profile of the SME sector. One year into its remit, the Ministry for SMEs and Co-operatives is still growing into its role as the key institution setting the SME policy framework. This report highlights a number of issues in need of attention, not least of which are the strengthening of the Ministry for SMEs' human resource capacity and the need for greater interministerial co-ordination.

In the interest of institutional stability and the generation of commitment and momentum in the SME sector, it is recommended that:

1.1 The government should maintain and develop the current institutional arrangement.

1.2 This commitment should be backed up with financial resources for the medium term which are sufficient to meet the staff and other planning requirements for implementing the SME Strategy.

1.3 Equally important is the necessity for continued political commitment to back up the initiatives of the Ministry for SMEs and Co-operatives to improve the environment for SMEs, in co-operation with other key players.

2. Closer Co-operation with Other Ministries and the SME Policy Community

The effectiveness of the current national institutional arrangement relies on close co-operation between the Ministry for SMEs and Co-operatives and other ministries, such as the Ministry of Development and Prognosis (MDP) and the Ministry of Finance. These institutions are interdependent and complementary. Various policy, information, co-ordination, resource and synergistic gains could be made by the ministries through closer collaboration than currently exists.

We recommend that these ministries devise mechanisms for much closer co-operation in the following key areas:

2.1 Prioritisation and programming with respect to Phare, Romanian Government and other EC and international donor resources;

2.2 Creation of a Task Force and proposed SME-oriented Working Group (see also recommendation 2.3 below);

2.3 Strengthening consultation with the SME community;

2.4 Establishment of a regular channel of communication at ministerial and managerial levels to discuss and co-ordinate SME policies, programmes and other activities.

A number of other recommendations can be made:

2.5 A mechanism is needed for regular co-ordination with the Ministry of Finance to deal with the new fiscal treatment of enterprises and new fiscal procedure codes and to ensure fiscal stability, clarity and simplicity.

2.6 There is also a need for regular, perhaps quarterly, meetings of all relevant ministries in order to assess their plans and draft legislation which will have an impact on the SME sector, since current arrangements appear to be too broad to be effective.

These mechanisms would enable the Ministry for SMEs and Co-operatives to obtain regular, early feedback about the likely impact of proposals, suggest alternatives/changes, inform SMEs in advance of possible new legislation, etc. This early-warning and policy-input mechanism would be of value to the ministry's work and thus to the SME sector in general.

For consultation purposes with the SME policy community, the Ministry for SMEs holds bilateral meetings with various organisations, supplemented by more formal Tripartite Council meetings. In particular, we recommend:

2.7 A well structured and resourced secretariat would enable the members of the Tripartite Council to make greater use of this forum for dialogue. Ensuring active participation and an effective two-way flow of information would be beneficial to both the ministry and other representatives of the Tripartite Council.

2.8 Membership of the Tripartite Council should be expanded to better reflect the nature of the SME policy community in Romania, including key players such as representatives of relevant NGOs, other ministries, Business Support Centres and financial institutions focusing on SMEs.

Through the Phare Twinning arrangements, the Ministry for SMEs is in the process of negotiating an exchange of experience with the German Federal Ministry of Economics and Technology focusing on enhancing institutional co-operation. The above proposals would marginally increase the work involved for the Ministry for SMEs, but could substantially improve the quality of input from organisations that are committed to supporting the development of SMEs.

3. Ministry for SMEs: Strategy, Technical Assistance, Capacity-building and Reform

This set of recommendations focuses more closely on the activity of the Ministry for SMEs and Co-operatives, and in particular on the relationship between the SME strategy and the means for its implementation.

The Ministry for SMEs and Co-operatives has produced an SME Strategy based on the Strategy of the Government Programme for 2001-2004, and an associated Action Plan, which will act as the framework for its activities over the medium to long term. Experience in SEE transition countries suggests that such SME strategies need to be attainable, realistic, specific, costed and endowed with a clear time frame. The latter two elements are critical for accountability and evaluation purposes. A clear SME strategy, widely disseminated to and supported by the SME policy community, is an essential tool and should identify the priorities and resource allocations required to achieve its objectives.

3.1 We recommend that targets be directly related to the areas which can be influenced by the activities of the Ministry for SMEs and Co-operatives, rather than broad targets such as providing 760,000 jobs or increasing the SMEs' contribution to GDP. In addition, there should be greater consistency between targets, tools and resources available.

3.2 In this context, the Ministry for SME should strengthen its SME implementation functions with respect to policy-making and programming. The future of the Ministry for SMEs and Co-operatives and its impact depend in general on the human resources available, and in particular on its implementation performance on the SME side. SME policy design and policy evaluation are likely to be even more important functions in the future.

A related issue is the need to provide technical assistance (TA) to the ministry to enable its staff to perform effectively. Given the ministry's pressures, its internal SME development capacity should be strengthened in the following areas:

3.3 Identifying, drafting and developing appropriate legislation/reforms for the SME sector, including the consultation process to ensure that business priorities are fully considered;

3.4 Effective management of the SME policy network, in particular with regard to co-operation with the Tripartite Council and other relevant ministries;

3.5 Promoting growth-oriented sectors, business networks, industrial clusters, etc.;

3.6 Monitoring and supervision of Credit Guarantee Schemes.

The above recommendations for TA are not exhaustive. At the same time, unless the human resource issues are tackled, such as the level of turnover, the ministry's work will not benefit fully from programmes of technical assistance.

Finally, in order to implement the strategy and perform the tasks which have been assigned to the Ministry for SMEs, it needs to attract and retain highly qualified and motivated staff:

3.7 The complexity of tasks performed by the Ministry for SMEs calls for a strong response to the human resource challenges and the development of a diversified skill base, preferably with private sector experience. Measures to attract and retain quality staff are needed in order to off-set the salary differentials, compared with the private sector.

B. Improvement of the Regulatory Environment

4. New Agenda for SME Business Simplification

The regulatory environment represents one of the most important barriers to businesses in Romania, especially small businesses, as recognised by the Ministry for SMEs and Co-operatives in its Action Plan for Removing SME Barriers. A Task Force on Removing Administrative Barriers to Businesses was created and an Action Plan has been approved by the Council of Ministers. The Minister for Development and Prognosis was appointed the co-ordinator of the Task Force. The Action Plan is part of an agreement negotiated with the World Bank, elaborated by the Task Force, which is also in charge of co-ordinating and monitoring its implementation.

It is important, given its specificity, that the SME business simplification agenda is not 'lost'. The Ministry for SMEs and Co-operatives has an important role to play in at least two respects:

4.1 Working as a close and active collaborator in the Task Force with respect to SME-specific issues of the Task Force's Action Plan;

4.2 Identifying other issues (not part of the Task Force's Action Plan) which are of importance to SMEs and which require urgent action, particularly as it is anticipated that the Task Force will have a rolling agenda beyond 2002. Although this smaller, more manageable set of activities could be tackled as a ministry-specific set of activities, as is currently the case via the Ministry for SMEs' own Action Plan, it could also be effectively carried out within the framework of the Task Force.

5. Effective Network of Business Support Centres

Romania has an extensive network of Business Support Centres (BSCs), an important tool for SME development in transition economies since they are one of the principal organisations offering direct services to enterprises, including facilitating access to financing. The BSCs have received substantial donor support. However, external funding for BSCs is expected to decrease substantially in the near future. Three recommendations can be made towards improving the operations of the BSCs and securing financial sustainability:

The original expectation that most BSCs would become financially self-sustainable is proving unrealistic. BSCs are focusing more and more on services such as business planning, training and business consultancy to generate fees, but given the financial capacity of the SME sector and start-ups, it is unlikely that these funds will be sufficient to cover their operating costs. Therefore, BSCs tend to focus increasingly on larger enterprises (i.e. those that can afford to pay for such services) and are thus shifting away from their primary focus on SMEs.

5.1 A decision should be made as to whether BSCs will be partially funded through public support, as often happens in OECD Member countries, or whether they should be left to seek survival by competing on an equal basis with private consultancy firms. If it is recognised that they have a public role, then state and local governments or other financial support may be considered. However, this raises questions relating to funding and accountability.

The Ministry for SMEs and Co-operatives recognises the need to maintain a network of BSCs, which it plans to use to implement training and consultancy programmes sponsored by the ministry. At the same time, the Regional Development Agencies (RDAs) are seeking to do likewise in order to deliver their programmes of support for SMEs.

5.2 Given the limited resources available, the Ministry for SMEs and Co-operatives and the RDAs should work together in order to develop a nation-wide network of BSCs. The Ministry and RDAs should limit their support to delivering services specifically targeted to the small enterprise sector. Other areas of intervention would include the development of entrepreneurship and support to start-ups.

Since a degree of public funding is anticipated for the network, accountability must be guaranteed. The following mechanism is suggested:

5.3 The Ministry for SMEs, in consultation with the RDAs, should introduce a transparent and independent process of evaluating and accrediting BSCs to ensure quality and to cover the national territory. More than one BSC should be accredited per region in order to assure a degree of competition.

5.4 The relationship of the ministry with accredited BSCs should be based strictly on contracts assigned through competitive bids for a defined time period to deliver co-ordinated programmes of information, training, advice and consultancy to SMEs.

5.5 The contractor should put in place a system for regularly monitoring quality and programme delivery by the BSCs. There should be a system of regular information exchange on the performance of BSCs among the Ministry for SMEs, the RDAs and donors (in cases where the BSC is externally funded).

C. Improvement of Tax Policy for Small Businesses

6. Stable, Clear and Simple Small Business Tax System

Romania has relied heavily on fiscal incentives and exemptions in order to stimulate the small enterprise sector, but the approach to the introduction and repeal of these measures has not been systematic and has thus been unsustainable. The unpredictability resulting from frequent readjustments of tax policy has contributed to the inability of firms to plan investments and business decisions. This report makes the following general recommendations:

6.1 Enterprises value a tax system which, in addition to having fair and equitable rates, is a) simple, allowing for easier compliance and lower cost; b) clear, ensuring transparency and reducing the scope for interpretation; and c) stable, allowing for appropriate business planning. The Romanian Government has committed itself to carrying out a major review of the system of tax incentives, and some changes were already introduced in February 2002. In this context, the role of the Ministry for SMEs, in co-operation with the Ministry of Finance, should focus on ensuring that the new fiscal administration is friendly to the SME sector and that the small business community is informed about forthcoming developments well in advance. A simple, clear and stable tax system which is responsive to the concerns of small businesses should be the guiding principle for the new fiscal agenda.

6.2 It would be more effective to focus efforts on the simplification of tax laws and the tax administration system, impacting on all firms, rather than using tax incentives and exemptions targeted at certain types of firms and in certain geographical locations.

6.3 More generally, the use of tax incentives and exemptions for the SME sector in the context of special economic zones and areas needs to be reconsidered. It should be noted that tax incentives, even when very generous, may be unable to influence business location decisions and often do not offset the non-tax disadvantages of locating in under-developed areas. The main impediments, such as remote locations, limited markets, financial constraints, etc., are very significant. At the same time, tax incentives can generate economic distortions and loopholes for tax avoidance. A greater focus on infrastructure upgrades, education and training may be a more efficient use of limited government resources targeted at assisting deprived areas.

6.4 In order to address the widespread issue of substantial delays in VAT refunds, which seriously affect the liquidity of the enterprise sector, it is recommended to pay interest for claims which are not settled within 30 days. The new draft law on VAT constitutes an excellent opportunity to establish such a mechanism and would also strengthen overall confidence in the tax system. It is important to remove the uncertainty for businesses through a clear government commitment to implement and monitor legislation on VAT refunds.

D. Strengthening the Financial Structure

7. Independence of the State Guarantee Fund

A key pillar of the new SME Strategy, as developed by the Ministry for SMEs, is the improvement of SMEs' access to credit. To accomplish this, the Ministry for SMEs has created a new State Guarantee Fund, which is expected to be operational as from May 2002. This State Fund supersedes the eight regional guarantee funds anticipated in the 1999 legislation, which were to be endowed with capital provided by private investors and matched by the government. The inherent risk of a state-run structure is that the allocation of guarantees will not be market determined. In other words, this institutional change risks distorting further the allocation of credit to enterprises and as such is viewed as a setback rather than an improvement. The costs associated with frequent changes in legislation and institutional set-up should be justifiable by an obvious and significant improvement in the management of public funds and in increased efficiency in making bank financing accessible to the SME sector.

7.1 Consideration should be given to allocating the management of the State Guarantee Fund to the private sector. As best international practice has shown, the delegation of the allocation of guarantees to the private sector (be it to mutual guarantee fund-type enterprises or to dedicated private financial institutions) can minimise state interference in the allocation of funds and distortions linked to what is *de facto* a subsidy. The Ministry for SMEs has indicated that minority participation in the Fund will be offered to the private sector. Although this is a step in the right direction, it still falls short of allowing for market mechanism to fully function without government interference.

7.2 Furthermore, it is worth pointing out that guarantees should not cover more than 50% of bank loans to enterprises. The risk with a higher proportion is that banks will relax in the selection of borrowers and will not make the effort to lend to creditworthy enterprises, since the risk of non-payment is covered by a guarantee.

8. Cutting Backlog of Payments

Liquidity problems due to non-payment of state-owned enterprises (SOEs) to their input/service provider SMEs can be a significant problem for the latter group of enterprises, which face difficulties in enforcing payments. It is often one of the major causes of a small enterprise's death. This problem has increased *de facto* in recent years and therefore:

8.1 It is crucial that the budget constraints for SOEs are tightened and that payment of arrears is enforced by law.

8.2 In order to find a long-term solution to the arrears problem, it is necessary to develop a framework for enterprise bankruptcy and liquidation, including SOEs, which adequately protects creditors' rights.

8.3 The Emergency Order approved by the government at the end of January 2002, aimed at modifying Law 64/1995 on bankruptcy procedure, is a good step forward toward increasing efficiency and speeding up implementation. It is also an improvement in the protection of creditors' rights. It must be implemented appropriately and monitored vigorously once it obtains Parliament's approval.

9. Accessibility of Financing Programmes to be Improved

Marketing of SME programmes and credit lines should continue to be advertised through the relevant regional institutions. Currently several programmes dedicated to the provision of financing to the sector exist but are managed by different commercial institutions and NGOs. There exists a central information point for all of these initiatives. The Ministry for SMEs and Co-operatives has published and disseminated a guide to financing programmes for SMEs. This is a positive development, but the information needs to continue to be diffused at regional and local levels. Despite the Ministry for SMEs' previous efforts, it is still sometimes a matter of luck or coincidence whether an enterprise taps the right source.

9.1 Access to financing would be greatly improved by appropriate marketing at municipal, county and regional levels, through RDAs, the network of National Council for SMEs, or chambers of commerce.

9.2 Central co-ordination of this marketing could be undertaken by the Ministry for SMEs and Co-operatives. The updated SME Financing Programmes up to 2003 need to be disseminated as widely as possible in order to maximise the use of existing financing for SMEs.

1. INTRODUCTION

1.1 Introduction

The aim of this section is to briefly review the key trends which have emerged in the last ten years of Romania's transition from a centrally planned system to a market-based economy. It centres on the major macro-economic trends and their impact on the enterprise sector, with particular attention to privatisation and foreign direct investment (FDI). The objective is to provide a broad overview of the economic and political environment as a background for enterprise development policy.

Map of Romania

Source: EBRD (2001a)

1.2 Macro-economic trends

Over the past ten years, the Romanian economy has been characterised by a series of stop-and-go reform attempts that have resulted in a highly cyclical growth pattern (see Table 1). Like most transition countries, it experienced a sharp recession during the early 1990s, followed by a period of steady growth and declining inflation from 1993 to 1996. However, this first phase of economic stability was short-lived as it was built at the expense of large subsidies to state-owned enterprises, rising fiscal and current account deficits, and the rapid accumulation of foreign debt from almost negligible levels.

These imbalances became unsustainable by 1997. At the end of 1997, inflation reached a peak of 151%, prompting the newly elected centre-right coalition government to tighten monetary and fiscal policy. The results of this change of policy were mixed. End-of-the-year inflation declined rapidly to 40.6% at the end of 1998, but economic growth was brought to a sudden halt and the economy plunged into a deep recession.

The real appreciation of the ROL, due to the lack of adjustment in the nominal exchange rate, exacerbated the output decline and contributed to the widening of the current account deficit (up to 7.7% of GDP in 1998). This led to a rapid drawing-down of foreign reserves. The dramatic deterioration of the macro-economic framework and increased difficulty in accessing international capital markets, following the Russian crisis of August 1998, brought Romania close to foreign debt default.

Against all expectations, the Romanian authorities averted a liquidity crisis in mid-1999 and adopted a new set of economic policy measures to stabilise the economy as part of a three-year, Stand-by Loan Arrangement (SBA) with the IMF.

These policies succeeded in reducing the current account to sustainable levels, restoring the stock of foreign reserves to more than two months of imports at the end of 2000 and containing the budget deficit. Moreover, after three years of negative growth and rising unemployment, the policy corrections resulted in GDP growth of 1.6% in 2000. The recovery was led by high industrial output growth (up 8.7% in 2000 compared to 1999) and exports, stimulated by a large devaluation of the ROL. GDP growth accelerated in 2001 (to 5.3%), thanks to a rebound in domestic demand. Household consumption and domestic investment grew at about 6.8 and 6%, respectively, in the first nine months. However, the rapid increase in domestic demand has started to put strains on the current account, as import growth outpaced in 2001 the still remarkable growth of Romanian exports.

Real GDP growth is forecast to slow to 3.5% in 2002 (the government forecast is 5.4%) from an estimated 5.3% in 2001, as a result of a more severe global slowdown post-September 11th and a domestic policy correction. Indeed, the government has announced a package of specific policy measures to contain a trade balance deficit that has almost doubled since 2000.

After the suspension of the previous SBA, the left-wing minority government elected in November 2000 successfully negotiated with the IMF a new 18-month stand-by credit for €415m (the average exchange rate of the European Central Bank for 2000 of €1 = $0.924 is used throughout this report). The fulfilment of the obligations embedded in this new IMF programme will be crucial for the success of the medium-term strategy of the new government prior to EU accession.

In its 2001 Regular Report on Romania's progress towards accession, the EU acknowledged the progress achieved so far but stressed the need for further reform efforts by stating:

"Romania has made progress towards establishing a functioning market economy and although it would not, in the medium term, be able to cope with competitive pressure and market forces within the Union, it has taken measures that would allow to develop its future capacity, provided it keeps to the engaged economic reform path." (EC, 2001a, p.40)

Table 1. Selected Economic Indicators

Romania

	1994	1995	1996	1997	1998	1999	2000	2001	2002
								Estimate	*Projection*
Output and expenditure					*(Percentage change in real terms)*				
GDP[1]	3.9	7.1	3.9	-6.1	-5.4	-3.2	1.8	5.3	3.5
Private consumption	2.6	13.1	8.0	-3.1	-4.6	-4.9	-1.2	6.4	na
Public consumption	11.0	1.0	1.5	-11.6	14.1	-2.5	4.2	-1.9	na
Gross fixed investment	20.7	6.9	5.7	-3.0	-18.1	-5.1	5.5	6.6	na
Exports of goods and services	19.0	17.0	2.0	11.4	na	9.7	23.9	10.6	na
Imports of goods and services	2.8	16.3	8.7	7.5	na	-5.1	29.1	17.5	na
Industrial gross output, unadjusted series	3.3	9.5	9.8	-5.6	-17.3	-8.8	8.2	na	na
Agricultural gross output	0.2	4.5	1.3	3.4	-7.6	5.5	-14.1	na	na
Employment					*(Percentage change)*				
Labour force (end-year)	0.1	-6.6	-4.3	-1.3	-0.7	-2.9	na	na	na
Employment (end year)	-0.5	-5.2	-1.2	-3.8	-3.2	-4.5	na	na	na
					(In per cent of labour force)				
Unemployment (end-year)[2]	10.9	9.5	6.6	8.9	10.3	11.8	10.5	8.6	na
Prices and wages					*(Percentage change)*				
Consumer prices (annual average)	136.7	32.3	38.8	154.8	59.1	45.8	45.7	34.5	23.8
Consumer prices (end-year)	61.7	27.8	56.9	151.4	40.6	54.8	40.7	30.2	18.8
Producer prices (annual average)	140.5	35.1	49.9	156.6	33.2	42.2	51.5	44.3	na
Producer prices (end-year)	73.4	32.0	60.4	154.3	19.8	62.9	48.6	33.4	na
Gross average monthly earnings in economy (annual average)	135.6	50.5	54.2	98.2	60.3	44.3	46.9	48.9	na
Government sector					*(In per cent of GDP)*				
General government balance	-2.2	-2.5	-3.9	-4.6	-5.0	-3.5	-3.7	-3.5	-3.0
General government expenditure	33.9	34.7	33.8	34.0	34.9	35.6	35.1	34.6	na
General government debt	na	17.6	28.1	27.7	27.8	33.6	31.6	29.8	na
Monetary sector					*(Percentage change)*				
Broad money (M2, end-year)	138.1	71.6	66.0	104.9	48.9	45.0	38.0	46.2	na
Domestic credit (end-year)	109.2	123.6	82.1	82.1	95.2	26.8	7.5	31.5	na
					(In per cent of GDP)				
Broad money (M2, end-year)	21.4	25.3	27.9	24.6	24.9	24.9	23.2	24.0	na
Interest and exchange rates					*(In per cent per annum, end-year)*				
Discount rate	58.0	35.0	35.0	40.0	35.0	35.0	35.0	35.0	na
1-week BUBOR	na	na	51.7	102.4	159.0	68.9	47.3	39.3	na
Deposit rate (average)	49.5	36.5	38.1	51.6	38.3	45.4	32.7	23.4	na
Lending rate (average)	61.8	48.6	55.8	63.7	56.9	65.9	53.5	40.6	na
					(Lei per US dollar)				
Exchange rate (end-year)	1,767	2,578	4,035	8,023	10,951	18,255	25,926	31,597	na
Exchange rate (annual average)	1,655	2,033	3,083	7,168	8,875	15,333	21,693	29,061	na
External sector					*(In millions of US dollars)*				
Current account	-428	-1,774	-2,584	-2,137	-2,917	-1,296	-1,347	-2,349	-2,533
Trade balance	-411	-1,577	-2,494	-1,980	-2,625	-1,092	-1,684	-2,969	-3,063
Merchandise exports	6,151	7,910	8,061	8,431	8,302	8,503	10,366	11,385	12,296
Merchandise imports	6,562	9,487	10,555	10,411	10,927	9,595	12,050	14,354	15,359
Foreign direct investment, net	341	417	415	1,267	2,079	1,025	1,051	1,154	1,269
Gross reserves (end-year), excluding gold	536	278	547	2,194	1,375	1,526	2,497	3,960	na
External debt stock	5,509	6,484	8,345	9,502	9,902	9,091	10,602	11,822	na
					(In months of imports of goods and services)				
Gross reserves (end-year), excluding gold	0.8	0.3	0.5	2.1	1.3	1.6	2.1	2.9	na
					(In per cent of exports of goods and services)				
Debt service[3]	na	10.5	13.5	20.4	23.3	28.5	25.3	20.5	na
Memorandum items					*(Denominations as indicated)*				
Population (mid-year, millions)	22.7	22.7	22.6	22.6	22.5	22.5	22.3	22.3	na
GDP (in billions of lei)	49,773	72,136	108,920	252,926	371,194	539,357	796,534	1,127,729	1,444,954
GDP per capita (in US dollars)	1,323	1,564	1,563	1,565	1,859	1,563	1,644	1,743	na
Share of industry in GDP (in per cent)	36.2	32.9	34.2	35.6	27.5	27.8	27.6	na	na
Share of agriculture in GDP (in per cent)	19.9	19.8	19.1	18.8	14.5	13.9	11.4	na	na
Current account/GDP (in per cent)	-1.4	-5.0	-7.3	-6.1	-7.0	-3.7	-3.7	-6.1	-6.1
External debt - reserves, in US$ millions	4,973	6,206	7,798	7,308	8,527	7,564	8,105	7,862	na
External debt/GDP (in per cent)	18.3	18.3	23.6	26.9	23.7	25.8	28.9	30.5	na
External debt/exports of goods and services (in per cent)	76.6	68.9	86.7	95.4	104.0	92.1	87.5	88.7	na

[1] From 2001, growth rates are calculated by the National Statistical Institute using a new methodology in compliance with European standards of national accounting. As a result, the official growth figure for 2000 was revised upwards to 1.8 per cent from 1.6 per cent.

[2] Registered unemployment. Based on ILO methodology, unemployment was lower (8.0, 6.7, 6.0, 6.3, 6.8 for 1995, 1996, 1997, 1998 and 1999 respectively).

[3] Debt service payments on private and public external debt.

1.3 Trends in Private Sector Development

Romania, like most transition economies, inherited from the communist regime an industrial sector dominated by large state-owned enterprises, in particular in the petrochemical and mining sectors. The trade and service sectors were underdeveloped and the financial sector was unable to respond to the needs of the enterprise sector.

A central issue of importance during the transition process has been the restructuring of the large, unprofitable and uncompetitive State-Owned Enterprises (SOEs). Since the start of the transition, various administrations have taken a cautious approach with respect to restructuring because of the fiscal and social costs that this process would entail. To offset the social costs, these governments have followed the strategy of fostering the development of the private sector by accelerating privatisation and promoting FDI and entrepreneurship, in particular new SMEs.

Recently, under the guidance and with the support of the IMF and the World Bank, the Romanian Government has taken a new, albeit gradual, approach to industrial and financial restructuring. The State Ownership Fund was dissolved and replaced by the new Authority for Privatisation and Management of State Ownership (APAPS). A number of key privatisation projects have been completed; Banca Agricola and SIDEX, Romania's largest steel mill, were privatised in 2001. An agreement with the World Bank was reached on a second Private Sector Adjustment Loan (PSAL) programme targeting the restructuring and privatisation of 18 SOEs.

1.3.1 Privatisation

The privatisation process has encountered setbacks in the past. The subsidies to loss-making enterprises have acted as a drag on national finances and hampered the development of the SME sector. Table 2 highlights the fact that the vast majority of privatisations completed have involved smaller enterprises. The process has been complex. Some contracts have had to be cancelled due to the low quality of the strategic investor and, in some cases, the process has not been entirely transparent. There is a very large number of disputes associated with past privatisations, with about 15,000 court cases still pending.

Table 2: Privatised Commercial Companies (1992-1998)

Year	Privatised Companies	Large	% of Total	Medium	% of Total	Small	% of Total
1992	1	0	0.00%	0	0.00%	1	100%
1993	264	2	0.75%	24	9.10%	238	90.20%
1994	595	13	2.20%	110	18.50%	472	79.30%
1995	620	29	4.70%	269	43.40%	322	51.90%
1996	1245	25	2.00%	236	18.95%	984	79.00%
1997	1163	46	3.95%	165	14.20%	952	81.85%
1998	1267	79	6.20%	276	21.80%	912	72.00%
Total	5155	194	3.80%	1080	20.95%	3881	75.30%

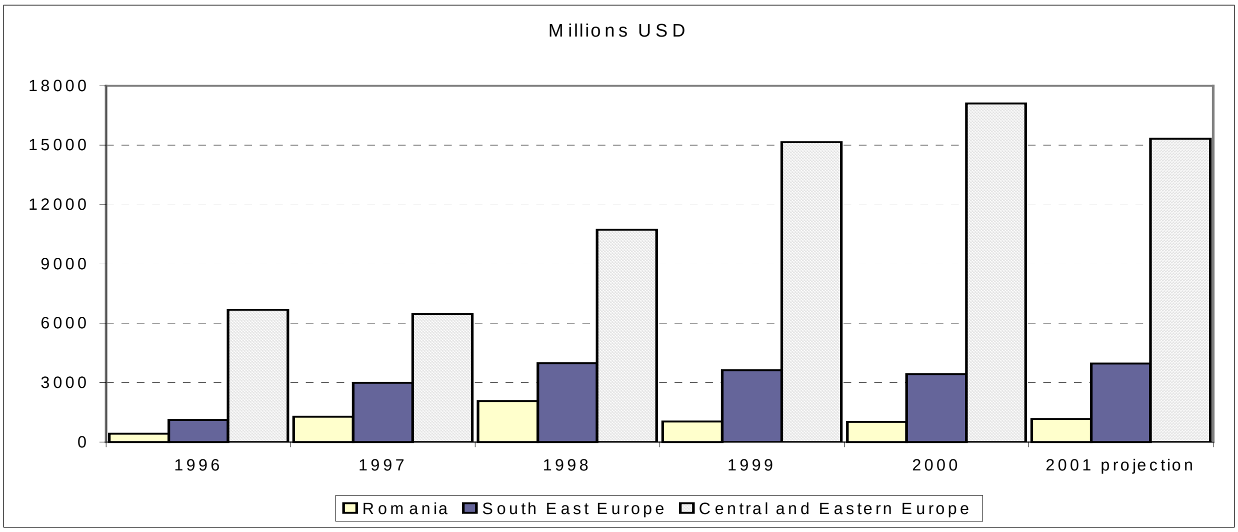
Source: National Institute of Statistics

Following the general and presidential elections in November 2000, the government renewed its commitment to the privatisation process. The Minister for Privatisation now has direct control of the newly created Authority for Privatisation and Management of State Ownership, whose mandate is to improve the transparency and speed of the privatisation process, together with the monitoring of the post-privatisation developments. This is an ambitious task, since the great majority of large enterprises are still state-owned – APAPS holds stakes in about 6,000 enterprises (including strategic firms and utilities), accounting in 2001 for three-quarters of industrial output (see World Bank, 2001, p.9). In 2000, there were 3,149 firms in the privatisation portfolio, down from 5,937 in 1993 (see OECD, 2001, p.50) and there are still over 130 large-scale privatisation projects to be initiated. The government, however, transferred the responsibility of selling state shares in large utilities and key public companies to the relevant ministries, thus reducing the powers of APAPS.

1.3.2 Foreign Direct Investment

At the end 2001 the total net stock of FDI in Romania stood at €8.59 bn (the average exchange rate of the European Central Bank for 2001 of €1 = $0.896 is used in this section), well above comparative data for Bulgaria and Croatia, in line with the relative weight of the Romanian economy in the region. However, cumulative FDI inflows per capita in Romania have been disappointingly low, if compared to the average of Central and Eastern Europe of €385 against €1548. It is just above the average inflows of FDI to member countries of the Stability Pact (€326). Figure 1 shows total net FDI inflows to Romania as a percentage of total GDP since 1996, and compares them to FDI inflows into the whole Stability Pact region (total FDI inflows to Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Federal Republic of Yugoslavia, Former Yugoslav Republic of Macedonia, Moldova and Romania have been weighted by the countries' nominal GDP).

Figure 1. Foreign Direct Investment Inflows (1996 - 2001)



Source: EBRD (2001c, Table A.3.9)

Figure 1 highlights the high variation over time in the level of net FDI to Romania. Inflows picked up in 1997 and 1998, but declined sharply in 1999, when the Kosovo crisis erupted. As in Central and Eastern Europe, the privatisation of large state-owned enterprises and major banks to foreign strategic investors accounts for the bulk of Foreign Direct Investment. The privatisation of the Romanian Development Bank and the sale of 35% of public shares in Romtelecom to OTE, the Greek Telecom Company, explains, for example, the peak in FDI inflows in 1998.

Romania has been relatively successful in attracting small and medium-sized foreign investments, particularly in labour intensive sectors located in the north-western part of the country. These investments are driven mainly by location and relative labour cost considerations. They have contributed to the rebalancing of the industrial structure and to the reorientation of trade flows towards the European Union.

1.3.3 Small and Medium-Sized Enterprises

The emerging private sector is responsible for a significant share of the economy. Its contribution to GDP has increased annually from 15% in 1989 to 65% in 2001, according to the EBRD estimates. In 2000, the SME sector accounted for 57% of the number of employees within the private sector and 41% of the total number of employees within the national economy (Ministry for SMEs, 2001e). The evolution of the private sector's share of GDP as compared to the rest of the region is shown in Table 3.

Table 3. Private Sector Share in GDP (Per cent)

	1989	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Albania	5	5	5	10	40	50	60	75	75	75	75	75	na
BiH	na	na	na	na	na	na	na	na	na	35	35	35	na
Bulgaria	10	10	20	25	35	40	50	55	60	65	70	70	na
Croatia	15	15	20	25	30	35	40	50	55	55	60	60	na
FYR Macedonia	15	15	15	15	35	35	40	50	50	55	55	55	na
FR Yugoslavia	na	na	na	na	na	na	na	na	na	na	na	40	na
Moldova	10	10	10	10	15	20	30	40	45	50	45	50	na
Romania	15	15	25	25	35	40	45	55	60	60	60	60	65

Source: EBRD

It is important to clarify what constitutes the SME sector. Romania's definition of what constitutes micro, small and medium-sized enterprises is set out in Table 4 below. It shows that Romania's definition of annual turnover is more restrictive than the EC's, but it is recognised that "the Romanian SME definition is broadly in line with the EC definition" (EC, 2001a, p.74). The Romanian authorities argue that the definition of turnover is more realistic for the type and size of firms operating in the local economic conditions and this has been broadly agreed by the EC.

Table 4. SME Definitions

Definitions	**Micro**	**Small**	**Medium**
Romania			
Maximum number of employees	<10	<50	<250
Maximum total turnover in million Euro	<8	<8	<8
Maximum capital/voting rights held by non-SME enterprises	25%	25%	25%
EC			
Maximum number of employees	<10	<50	<250
Maximum total turnover in million Euro	n/a	7	40
Maximum total assets in million Euro	n/a	5	27
Maximum capital/voting rights held by non-SME enterprises	n/a	25%	25%

Source: Ministry for SMEs and Co-operatives; EU Directive (1995)

The SME sector has grown very rapidly during the years of transition. The period 1990-1995 can be characterised as having witnessed rapid increases in the number of registered companies. The recession of 1997 to 1999 affected the SME sector and the pace of new registration slowed during 1997-2000 (see Table 5 below).

Table 5. Evolution of Private SMEs (1997-2000)

	1997	1998	1999	2000
SMEs active at year end	367 301	383 931	391 288	395 146
SMEs turned into active SMEs during the year	-	57 265	47 659	44 152
Active companies during the previous year, which became SMEs during the year	-	2 847	2 877	2 922
SMEs turned into inactive SMEs during the year	-	41 387	40 838	40 645
Active SMEs during the previous year which no longer fulfilled the legal conditions to be SMEs	-	2 095	2 341	2 571
Annual growth rate of the private SME sector	-	4.5%	1.9%	1.0%

Source: Ministry for SMEs (2001e, Table 3.1)

An analysis of the composition of registrations based on Chamber of Commerce and Industry data shows that micro-enterprises dominate the SME sector. This is not dissimilar to other countries. Ninety-three per cent of all firms in the EU are micro-enterprises, and 99.8% of all firms are SMEs, accounting for 90% of all employment (OECD, 2000a, p.8).

The high concentration of SMEs in the trade sector (65.7%) reflects the fragmentation of the distribution and retailing industry in Romania (see Table 6). The data also suggest that the service sector, although still relatively underdeveloped, has a good deal of potential for development.

Table 6: SME Industries and Size Categories (2000)

Sector	SME distribution (%)	Micro	Small	Medium
Industry	11.2	79.8	16.1	0.4
Agriculture	1.7	82.5	14.1	3.3
Construction	2.9	71.7	20.9	7.4
Trade	65.7	95.6	4.0	0.3
Tourism	0.5	83.5	11.7	4.9
Transport	2.9	92.4	5.7	1.9
Services	15.1	94.0	5.1	1.0
Total SMEs	100	92.5	6.3	1.2

Source: Ministry for SMEs (2001e)

Turning to the geographical dimension, the share of SMEs varies significantly across regions, from 8.3% in the West, through to almost 20% in Bucharest and Ilfov County, the most dynamic economic region. Table 7 illustrates the geographical distribution of SMEs and share of SMEs with foreign capital.

Table 7: Distribution of SMEs by Region (2000)

Region	Share of SMEs	Share of SMEs with foreign capital
North-East	11.6	4.6
South-East	13.3	6.0
South-Muntenia	11.9	4.4
South-West Oltenia	9.7	3.4
West	8.3	10.0
North-West	13.5	11.5
Centre	11.7	11.0
Bucharest & Ilfov	20.0	49.0
Total	100	-

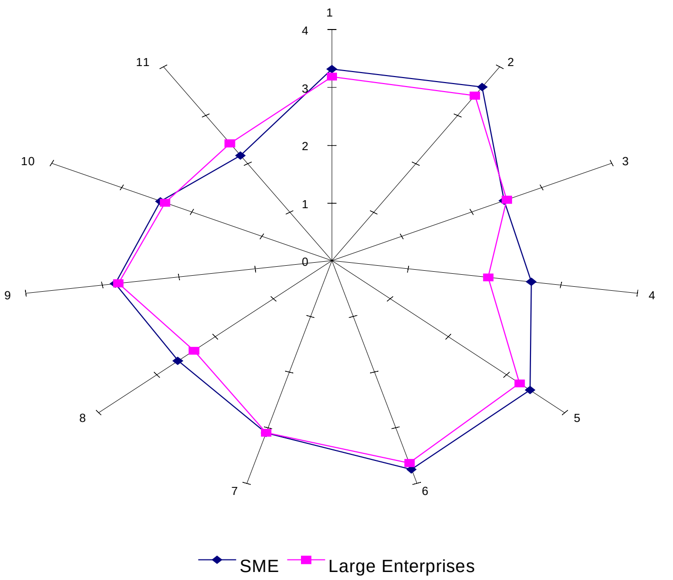
Source: Ministry for SMEs (2001e)

Estimates of the extent of ‘underground’ economy in Romania vary a great deal. The National Institute of Statistics puts the GDP figure at 21%, but this is considered to be an underestimate. Independent research suggests that the figure is closer to about 30% of GDP (Curentul, Romania Libera, 07.09.2001; and CEROPE, 2001), and some estimates put it even higher.

1.4 Key Barriers Identified by Businesses

The main impediments to business development in Romania are considered to be as follows: inflation, taxes and regulations, policy instability and access to financing. These are the conclusions of a survey conducted by the EBRD and World Bank, which confirm the results of similar surveys and studies, such as the 1999-2000 Business Environment and Enterprise Performance Survey (BEEPS). Over 3000 managers of enterprises were asked to evaluate the extent to which each aspect of the investment climate was an obstacle to operation and growth of their enterprise. A score of four represents a major obstacle, while a score of one represents no obstacle. The conclusions of the survey of Romanian enterprises, consisting mainly of SMEs, are basically in line with those of other SEE countries. Figure 2 presents an assessment of the investment climate in Romania. Overall, Romanian enterprises appear to be more concerned about inflation and policy instability compared to the overall SEE average. Also, lack of financing is marginally less important than the tax and regulatory constraints. The BEEPS survey was one of the most comprehensive surveys of businesses in Romania, and the main findings remain relevant to the SME situation in the country.

Figure 2. Assessment of the Investment Climate, Romania (1999)



Micro Environment
1 Finance
2 Taxes and Regulations
3 Anti-competitive Practices
4 Infrastructure

Macro Environment
5 Policy Instability
6 Inflation
7 Exchange Rate

Law and order
8 Functioning of the Judiciary
9 Corruption
10 Street Crime
11 Organised Crime

Source: EBRD (1999) and http://www.worldbank.org.ru/survey/front2.htm

2. POLICIES AND INSTITUTIONS

2.1 Introduction

Romania has had an active SME development policy over the last ten years and a complex institutional base has been built. This section starts with a review of the key players in the SME policy community and of some of the main policies, beginning with the key relevant central government institutions, moving on to the territorial agencies, national non-governmental organisations, international organisations and donors. The section then proceeds to highlight a number of issues with respect to national policy and its implementation, and the analysis of these issues leads to the policy recommendations presented at the beginning of this report. The diagram of the overall institutional framework is presented in Figure 3 overleaf.

2.2 Governmental Institutions

The main ministries and governmental agencies, and other players such as NGOs dealing with SME policy issues, are presented below. The first point to note, as indicated in Table 8, is that the national policy and institutional environment with respect to SMEs has been subject to many changes since the early 1990s. The current arrangement centres around the dedicated Ministry for SMEs and Co-operatives, created in January 2001 primarily to counteract the criticism that while SMEs were considered to be crucial to the country's economic development, the institutional framework had so far failed to reflect their importance.

Table 8: Evolution of SME Institutions

Year	Organisation	Ministry
1990	Department for SMEs	National Agency for Privatisation
1992	Department for SMEs	Romanian Development Agency
1996	Department for SMEs	National Agency for Privatisation
1998	Department for SMEs	Prime Minister's Office
1999	National Agency for SMEs	National Agency for SMEs
2000	Policies and Programmes for SMEs Dept.	National Agency for Regional Development
2001	Ministry for SMEs and Co-operatives	Ministry for SMEs and Co-operatives

Source: OECD

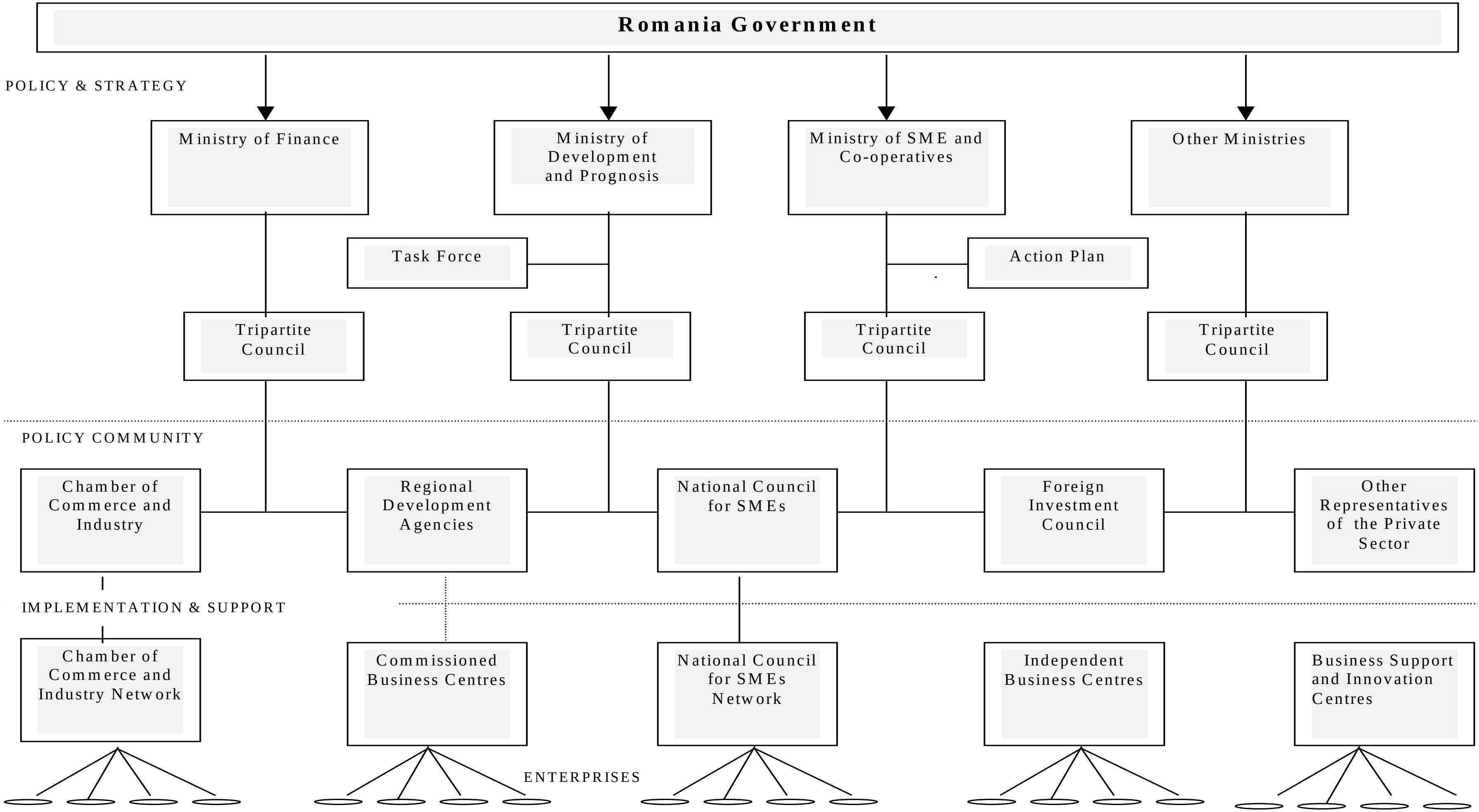
2.2.1 Ministry for SMEs and Co-operatives

Law 133/1999 originally foresaw the creation of a National Agency for SMEs, which was initially merged with the activities of the National Agency for Regional Development (NARD). However, following the last general election, a Ministry for SMEs and Co-operatives (MSMEC) was established in January 2001.

According to the Romanian Government's priorities for the period 2001-2004, the SME sector is expected to:

- Provide 760,000 new jobs during the period in question;
- Deliver a 10% increase in SME exports per year;
- Increase SMEs' contribution to GDP, etc.

Figure 3. Current Institutional Framework



These three priorities represent demanding objectives for the Ministry for SMEs and Co-operatives. Moreover, the collection of more sophisticated statistical data would enable more effective monitoring of the development and impact of the SME sector.

The Ministry for SMEs and Co-operatives has about 40 staff working on SME issues out of 91 staff members in the ministry. Its activities, progress achieved since January 2001, and the issues facing the institutional environment are discussed in detail in section 2.8 below. The ministry's key functions are set out in Box 1 below.

Box 1: Summary of SME Functions and Activities of Ministry for SME and Co-operatives

The ministry's main framework for action relates to Law 133/1999 that sets out the main tasks and functions which it is expected to perform. The ministry's remit (Government Decision 15/2001) includes the following:

- Development of the SME policy and strategy in Romania;
- Elaboration legislation in the field of SMEs;
- Elaboration, implementation and monitoring of programmes for SMEs;
- Assistance to improve services to, and performance of, SMEs;
- Assistance to improve access to financing;
- Stimulation of international collaboration;
- Harmonisation with the EU in the field of SME development.

Since its formation, the Ministry for SMEs and Co-operatives has been working on various activities, including focusing on the following elements:

- Preparation of a national SME Strategy;
- Elaboration of an Action Plan on removing regulatory barriers, which is presented to the government every six months, including the one-stop shop initiative carried out with the Chamber of Commerce and Industry;
- Work leading to the creation of a State SME Credit Guarantee Fund.

2.2.2 Ministry of Development and Prognosis

The Ministry of Development and Prognosis (MDP) was also created in January 2001 through an amalgamation of various functions, such as the territorial responsibilities of NARD. Its main functions are highlighted in Box 2 below.

Box 2: Functions of the Ministry of Development and Prognosis

The MDP's main activities are as follows:
- Socio-economic analysis and prognosis, which includes medium and long-term economic development strategies, macro-economic sector and regional analyses.
- Social and economic development of the regions in Romania, which includes responsibility for the National Development Plan, a key component of the pre-accession process; social and economic cohesion. The ministry manages the Phare pre-accession funds for Social and Economic Cohesion, as well as acting as the payment authority for these funds.
- European integration, which includes contributing to the Romanian National Accession Plan to the EU; preparation for accession; pre-accession funds proposals; harmonisation with the EU in the field of development.
- Stimulation of foreign investments, including close collaboration with the Prime Minister's Department for Foreign Investments and the Ministry of Foreign Affairs' Business and Investment Environment Division; and provision of a variety of services and information for foreign investors.

The MDP is a large ministry with a staff of 290 people, and it performs a central role with respect to the government's economic strategy, in particular in the co-ordination of the National Development Plan, which is based on inputs from line ministries, including the Ministry for SMEs.

In addition, it also has an important operational role. The MDP is the contracting authority/payment agency of the Phare funds, about a third of which are devoted to SME support, much of which is channeled through the national network of eight Regional Development Agencies (see 2.5 below). Through its other activities, such as the centrally funded programmes for assisted areas, such as technology parks and disadvantaged zones (see 2.6 below), the MDP manages programmes of a territorial nature which have an impact on enterprise development.

It is important to note that many of the SME-oriented resources and programming are utilised at regional level through the previously discussed organisations, especially the network of RDAs. At the same time, while the Ministry for SMEs and Co-operatives is responsible for the national policy and strategy making for SMEs, it has little direct influence over the mobilisation of SME programmes and resources.

An example of interministerial co-operation has been the programming of Phare 2001 activities, which concentrate on zones affected by industrial restructuring. The MDP encouraged relevant ministries to prepare project 'fiches', which were then discussed and agreed in working groups. The Ministry for SMEs took the lead by determining the vision and priorities for the programme from an SME perspective, and the MDP concentrated on the implementation and payment issues.

2.2.3 Ministry of Finance

The Ministry of Finance is responsible for setting up, managing and implementing the tax system. One of the important features of this system is the extensive range of provisions and incentives aimed specifically at the SME sector, including special regimes for customs duties, VAT and corporate tax (see section 4 for more details).

There are few countries that place such an emphasis on stimulating the SME sector through a plethora of fiscal incentives (see OECD-UNIDO, 1999). However, the debate in Romania on the impact of fiscal incentives on SMEs is still open. Moreover, an in-depth evaluation of the package of incentives remains to be undertaken, which in any case would prove difficult given the frequent changes to the tax regime over the past ten years.

An important dimension of the tax issue relates to the burden of the tax administration, which may act as an additional cost factor for SMEs. In addition, the timing of tax payments and the speed of the tax reimbursement system have a direct impact on SMEs' cash flow (see section 4.4 below). Although Government Decision 18/2001 requires the Ministry of Finance to advise on all draft laws that modify national revenues and thus the national budget, in practice the limited timescale and lengthy procedures mean that the ministry is not always able to fully scrutinise the implications of draft legislation. Given its central role in tax policy, it is vital for the Ministry of Finance to be closely involved in the development of the relevant SME incentives.

2.2.4 Authority for Privatisation and Management of State Ownership

The Authority for Privatisation and Management of State Ownership (APAPS) was created in 2001, replacing the previous State Ownership Fund. APAPS is now responsible for the privatisation process and works towards securing an enabling environment with respect to prospective Romanian and foreign investors. Its objectives include:

- Sale of the stake held by the state in the companies to be privatised;

- Management of the companies in its portfolio;
- Compliance with the privatisation law and monitoring of the privatisation contracts;
- Restructuring of the companies and granting of financial assistance for upgrading and improvement;
- Transfer to certain public authorities of the management and sale of the portfolio of companies, with a view to accelerating the privatisation process.

The Romanian companies to be privatised cover all sectors of economic activity, and as previously highlighted in Table 2, the vast majority of privatisations involve SMEs. Large privatisations are handled through the head office in Bucharest, while the sale of SMEs is mainly handled by local branches. The results of the first six months of operation of the new body are encouraging. The government, however, transferred the responsibility of selling state shares in large utilities and key public companies to the relevant ministries, thus reducing the powers of APAPS. The institutional framework and transparency of procedures have been strengthened and 58 privatisations took place, including the largest steel mill, SIDEX Galati. Various important companies have been selected for the privatisation process through the Private Sector Adjustment Loan II (PSAL II) programme. However, as previously discussed, progress during 2002 will demonstrate the extent of Romania's commitment to accelerating the privatisation process.

2.2.5 Governmental Organisations Dealing with FDI

In recognition of the need to improve the investment climate and to raise the level of FDI following the reorganisation of economic ministries in 2001, the Romanian Government implemented two main initiatives.

First, an attempt has been made to improve the institutional framework providing support to investors, resulting in the following division of responsibilities:

- Prime Minister's Office: responsible for all large investments (above €10.8m);
- Ministry of Development and Prognosis: responsible for medium investments (€1.08m-€10.8m);
- Ministry of Foreign Affairs: responsible for FDI promotion.

It should be noted that a new draft law currently before parliament should merge the first responsibilities, leading to the creation of a National Agency for Promoting Foreign Investment under the control of the Prime Minister.

Second, the government recently passed Law 322/2001 on direct investment. The law ensures that the foreign investors are treated at the same level as domestic investors, thus bringing Romania in line with international practice. It also introduces a number of incentives for investments over €1.08m, excluding those in the financial sector (see section 4.2.5). These changes have strengthened Romania's capacity to deal with investors, particularly in relation to large-scale privatisation. Nevertheless, it appears that insufficient attention is focused on attracting FDI for SMEs, where Romania has potential.

2.2.6 Other Key National Institutions

Ministry of Industry and Resources: The Ministry is the central body responsible for the elaboration and implementation of industrial policy of Romania and for policies and programmes designed to assist restructuring and growth across a variety of industrial sectors, such as energy, construction, wood, textiles, etc. (see Ministry of Industry and Resources, 2001a; 2001b)

Ministry of Labour and Social Protection: Policies to counteract unemployment remain a priority for the ministry, and it has identified the stimulation of SMEs through self-employment and start-ups as a key tool for employment creation.

Ministry of Education and Research: The ministry is involved in supporting SME research and development, as well as innovation and diffusion activities (see section 6.3 below).

2.3 National Non-Governmental Institutions

There are a number of other institutions and organisations with an important role for the SME sector. This section focuses only on certain main players:

- The Chamber of Commerce and Industry, an important partner for registration and support to businesses;
- Private sector lobby groups, such as the National Council for SMEs, the main SME representative body, as well as the Foreign Investors' Council, representing mainly larger foreign investors.

Other bodies make up the SME policy community, such as employers' associations (e.g. the National Association and the National Union), the Romanian Handicrafts Co-operatives, etc. For the moment, these bodies do not have a significant role in contributing to the formulation of SME policy.

2.3.1 Chamber of Commerce and Industry

The Chamber of Commerce and Industry (CCI) is a non-governmental body promoting trade and industry, both in Romania and abroad, acting in the interests of Romanian traders vis-à-vis public authorities and foreign organisations. It has branches in every county and its activities include:

- Support and promotion to enterprises in the fields of industry, agriculture, trade, tourism and services such as: business consulting; assistance to company formation and operation, including Trade Registry activity; promotion of business contacts; expert assistance in matters of commercial law and arbitration of business disputes;
- Representation of the interests of the business community to policy-making bodies at local and national level, which mainly concern the regulatory environment;
- Training and education, such as courses in business organisation and management; occupational certification, etc.

The CCI also performs an important role in the business infrastructure in Romania. It is responsible for the National Trade Registers Office, a body with which all firms must register. While it is generally acknowledged that the regulatory environment in Romania is excessive (see section 3), the CCI has made some efforts at simplifying registration procedures, including the creation of a one-stop shop in 1996. At the legislative initiative of the Ministry for SMEs, Emergency Government Ordinance 76/2001 was passed, requiring the implementation as from July 2001 of a simplified procedure for the registration and authorisation of new businesses and the establishment of the one-stop shop network in each county. This appears to have been broadly successful (see chapter 3.2.2 below for more details).

The CCI also provides business advice on a consultancy basis, although most of its income represents trade registration fees. The business advice centres operate country-wide and charge relatively low fees to members. The CCI also operates at the level of dialogue on the business environment and on issues in need of redress and exercises policy dialogue with the government, such as through the Alliance for Economic Development in Romania.

2.3.2 National Council for SME Private Enterprises in Romania (National Council)

The National Council is one of the five main employers and professional organisations which constitute the Romanian Employers' Association. The National Council was created in 1992 as an NGO and is the main organisation representing SMEs at the national level, with 72 branches, 55,000 members covering all sectors of economic activity and 23 associated employers' organisations. Its mission is the overall promotion of SMEs by:

- Stimulating the creation of SMEs with local and/or international participation;
- Promoting private enterprises vis-à-vis public sector authorities;
- Promoting SME interests at local, national and international levels.

The organisation's activities include:
- Proposing legislation and other changes to improve the environment for SMEs;
- Representation of SME interests at the main business-government consultations, such as the Tripartite Council (trade unions, employers and government) chaired by the Ministry for SMEs;
- Organisation of training courses, consultancy services and information to private entrepreneurs;
- Organisation of international trade and investment missions;
- Co-operation with financial institutions to increase access to financing;
- Co-operation with international organisations (e.g. EC and EIB).

The National Council was actively involved in both the creation of Law 133/1999 and in the early stages of the activities of the Ministry for SMEs and Co-operatives. Although it continues its involvement with the Ministry via the Tripartite Council (see section 2.8 below), it maintains that this body could be improved to allow for more effective business-government dialogue than is the case at present.

2.3.3 Foreign Investors' Council

The Foreign Investors' Council (FIC) is an association representing approximately 90 foreign investors in Romania, whose purpose is to generate a policy dialogue between policy-makers and the foreign investment community to improve the investment climate, thus stimulating enterprise development in Romania. It is currently chaired by the EBRD. Although the FIC represents mainly large investors, it performs an important role in promoting private sector views and introducing international good practice. For example, FIC's White Book (1999), which identified obstacles to businesses (foreign and local, large and small) covering such issues as accounting, infrastructure, administration, etc., has contributed to raising the government's awareness of the importance of simplifying the business environment.

2.4 International Organisations and Donors

Romania benefits from a wide range of programmes run by multilateral and bilateral donors providing financial and technical assistance to the SME sector in addition to government-funded programmes and bank-lending activity financed from own sources. The key programmes, which are in theory are available to provide financial support (in practice some of these programmes end up providing finance to medium and large enterprises), are listed in Table 9 below.

Table 9: Overview of Existing Financial Support Programmes for SMEs

Project name	Country/ Donor	Total commitment	Project description / objective Terms of sub-loans	Partner institutions
Micro-credit Programme	Romanian Government and World Bank	€3.9m	Loans up to €5,000, maturity 1-3 years	Regional offices of Ministry of Industry
SME credit line	IFC	n/a	Loans up to €542,000, 6 year maturity, grace period variable	Through Banca Romaneasca
Financial Support for SMEs	EU Phare	€5.75m	Loans up to €500,000 and 6 years maturity, grace period 1 year, TC to banks. Financial support to banks through technical co-operation	Through Banca Comerciala Ion Tiriac, Savings Bank and Banca Romaneasca
MARR Fund (Mining Affected Regions Reconstruction Fund)	EU Phare	€3.7m	Loans up to €300,000 and 6 years maturity, grace period 2 years	Through Banca Comerciala Romana
EBRD/EU Facility	EBRD	€30m	Loans between €10,000-125,000, maturity up to 3 years, grace period up to 6 months	Through Banca Transilvania (two facilities of €11m), Comerciala Romana (€20m), Alpha Bank(€10m)
EBRD Trade Facilitation Programme	EBRD	€7.5m		Through RoBank (€3.2m) and Banca Transilvania (€4.3m)
Romanian American Enterprise Fund (RAEF)	US Government and Soros Economic Development Fund	€3.25m	Microloans up to €21,650, maximum 18 months' maturity, 3 month grace period	Through CAPA Foundation, CHF, Opportunity Microcredit Romania
Micro-enterprise Development Programme	German Government (KfW)	€26m	Loans up to € 512,000, up to 80% value of investment, max. 3 yr. maturity, 1 year grace	Through Eximbank
German Romanian Fund (I)	German Government (KfW) and CEC	€5m (including € 770,000 TA)	Loans up to € 52,000, max. 2 years' maturity	Through CEC, Microenterprise Credit Romania & Banca Comerciala Carpatica
German Romanian Fund (II)	German Government and Micro Enterprise Credit Romania	€1.5m	Micro-loans (up to €12,800), small loans (up to €52,000) and micro-trade credits (up to €2,500). Maturity max. 3 years. Grace period max. 3 years	Micro-Enterprise Credit Romania

German Romanian Fund (III)	German Government (KfW) and Banca Romaneasca	€4.3m	Loans up to €52,000. Maturity up to 2 years, grace period up to 3 years	Banca Romanesca
FAER Foundation	Swiss Government (Swiss Agency for Development and Co-operation)	n/a	Loans up to €540-75,800 to finance 50% of investment projects in agriculture, industry and services in rural areas. Maturity 1-7 years	FAER Foundation
LAM Foundation	Swiss Government (Swiss Agency for Development and Co-operation)	n/a	SMEs processing agricultural products & micro-enterprises. Loans €1,100-38,000, maturity of 4 years for agribusinesses, up to 9 mos. for micro-enterprises	Foundation LAM
Micro-credit scheme	UNDP	n/a	Loans up to €10,000, maturity 3 months to 1 year, grace period up to 1 year.	FLD Buzau, FPIPMM, TULCEA, Foundation Elena Cuza, TURNU SEVERIN
Oikocredit	Co-operative Ecumenica de Dezvoltare	n/a	Loans €50,000 to €2m, maturity 4-10 years, grace period dependent on nature of investment	Romanian Federation for the Development of Rural & Mountainous Areas
Programme to provide credit on the basis of Law 1/1991 on social protection and professional reintegration	Romanian Government	Government finances ½ of cost of capital (ref.rate of central bank) for loans to new/ existing SMEs	Loans up to € 1.75m; max. 3 years' maturity and max. 1 year grace period	Banca Comerciala Romana
Credit to agricultural producers and juridical persons on the basis of Ordinance 97/2001 of the Ministry of Agriculture	Romanian Government	n/a	Loans up to 45% of the investment in agriculture, max. 5 years' maturity; no grace period	CEC
Credit to agricultural producers on the basis of HG 645/2001	Romanian Government	n/a	Loans to agribusinesses, size accdg. to reimbursement capacity, max. 1 yr. maturity, no grace period	CEC

Source: EBRD

Given the range of programmes, effective co-ordination plays a particularly important role. At present, despite the volume of financial and technical assistance in the field of SME development, there does not appear to be a mechanism for regular co-ordination of donor activities. However, the Ministry for SMEs and Co-operatives has published and disseminated a brochure on the programmes available to the business community, mainly through the Chamber of Commerce and the National Council for SMEs (see Ministry for SMEs, 2001d). The Ministry for SMEs has also organised roundtable discussions with representatives of the banking sector, international donors, and business organisations as regards the programmes financed from the state budget, and it is envisaged that this dialogue will continue in future.

2.5 Territorial Institutions

Although some of the institutions previously mentioned also have a territorial dimension, such as the Chambers of Commerce at county level and the National Council for SMEs at branch level, other organisations also have a key role to play with respect to economic development generally, including enterprise development specifically, such as Regional Development Agencies and local self-government. These organisations are discussed briefly below.

2.5.1 Regional Development Agencies

The eight RDAs were set up as representatives of the National Agency for Regional Development (NARD) to act as its implementing agents with respect to regional development generally, and the EC resources and programmes (such as pre-accession instruments) specifically. NARD has now been incorporated into the MDP and the MSMEC, but the RDAs remain independent bodies reporting directly to their respective Regional Development Councils. These consist principally of local authorities and counties, which are subordinated to the National Council for Regional Development, a body chaired by the Prime Minister. Although the RDAs' focus is broadly on regional development, using resources from the National Fund for Regional Development, they play a role with respect to SME development. For example, the RDA South-East covers six different counties and is the main implementation arm of the Phare credit scheme for SMEs in the area. It has €1.5m for SME support, €4.5m for Human Resource Support and about €12m for infrastructure. In addition, it has at its disposal €5.01m of national government grants for SME businesses for the period up to 2003. This amounts to a substantive package of measures to assist SME development in their respective locations.

2.5.2 Local Authorities and Counties

According to the principle of devolution of responsibility and autonomy, local authorities and county councils have the scope to formulate measures in support of economic development, including SME development. Some have taken the opportunity to play a role with respect to the creation and development of business support centres, incubators and other business support mechanisms. However, the lack of own financial resources means that enterprise development remains under-funded in most regions. The county councils also have an economic development role, within the context of the development of their larger geographical units, and tend to focus their activities through the RDAs, free zones, disadvantaged zones, business parks, etc. (see 2.6 below).

2.6 Other Policy Tools

Various existing policy tools are focused on stimulating the economic development of certain, usually poor or disadvantaged areas. These initiatives tend to be geographically delineated and include a range of incentives and exemptions designed to influence firms' location decisions. The locations targeted include Disadvantaged Areas, Industrial Restructuring Zones, Technology Parks and Free Zones. All of these initiatives fall within the remit of the Ministry of Development and Prognosis, with the exception of Free Zones which are supervised by the Ministry of Public Works, Transport and Housing. These locations are discussed briefly below. These policy tools are not specifically targeted to the SME sector, but can benefit them either directly or through sub-contracting links with large and/or foreign-owned companies that might be direct beneficiaries.

2.6.1 Disadvantaged Zones

The disadvantaged zones (D-zones) are designated by the government (Government Emergency Ordinance 24/1998 and modified through Government Emergency Ordinance 75/2000) for a period of three to ten years, according to criteria such as high levels of unemployment, isolation and under-developed infrastructure. Currently, there are 29 such areas, located principally in mining zones and benefiting from a mix of grants and fiscal and customs incentives. These zones are funded mainly through a special State Fund (of €6-7 m). The experience of the disadvantaged zones seems to be mixed. A recent evaluation of the D-zones suggests that 20,000 new jobs were created between mid-1999 and mid-2000, implying a subsidy of €1,290 per job created (MDP, 2001).

2.6.2 Industrial Restructuring Zones

Industrial Restructuring Zones are priority beneficiaries of EC economic and social cohesion assistance to areas undergoing a major industrial restructuring process linked to the restructuring and privatisation of large SOEs. The Romanian Government has designated 11 zones according to Government Decision 399/2001. These zones are designed to benefit from a concentration of Phare 2000 and 2001 funds. As these areas partly overlap with D-zones described above, these funds are additional to the incentives granted under the D-zone programme.

2.6.3 Technology Parks

The MDP is charged with the development of business and industrial parks in Romania, however, the Ministry for Education and Research is responsible for technology parks. Originally the government planned to grant fiscal incentives to companies locating in technology parks. However, recently the legislation was revised (Law 65/2001), eliminating the original tax incentives. Although there are some embryonic technology parks (e.g. in Timisoara and Arad), the construction of these parks has remained so far on the drawing board. Approximately 12 initiatives at feasibility stage are seeking to use either Phare resources or the Romanian Government's financial incentives (€27m until 2005), principally geared towards the provision of infrastructure to enable the establishment of such parks.

2.6.4 Free Zones

Law 84/1992 established free zones on maritime and river areas, with their own administrations to co-ordinate the planning, marketing and investment activities within certain delimited geographical spaces. Free zones are available in Sulina, South Constanta/Basarabi, Galati, Giurgiu, Braila and Curtici. They were designed to attract foreign investment, large and small, particularly focusing on modern technology. A number of fiscal and customs incentives operate (see section 4.2.4 below), but, the general perception, in the absence of detailed evaluation of performance, is that they have not been exceptionally effective thus far.

2.7 Business Support Instruments

A number of existing institutions interface directly and almost exclusively with enterprises and entrepreneurs. These organisations are particularly important since they are the only ones which are assisting business with their everyday problems, delivering services such as training, advice, information, planning and consultancy.

2.7.1 Business Support Centres

Romania has a number of Business Support Centres (BSCs), typically providing services such as:

- Counselling and advisory services to enterprises;
- Assistance to enterprises in preparing business plans (including applications for micro-credit);
- Information provision, training and seminars;
- Trade and investment services;
- Income generating services, such as consultancy.

In the course of the 1990s, an extensive network of these BSCs was created throughout Romania by bilateral and multilateral donors, all with slightly different emphases (see Box 3 below).

Box 3: Key Donor-Supported Business Support Centres

- 18 UNDP centres (United Nations);
- 5 CDIMM centres (EU/Phare);
- 5 USAID centres (US Government);
- 3 DFID centres (UK Government);
- 3 Romania – German Foundation centres (German Government);
- 2 ROM-ITA centres, etc. (Italian Government);
- 8 Euro Information Centres (EC).

To these support centres can be added the networks run by the Chambers of Commerce and the National Council of SMEs, both of which have business advisory centres throughout the country. Other initiatives, such as the Phare Active Employment Business Centres, are specifically targeted to the unemployed, focusing on (re)training and self-employment.

BSCs were created to provide services directly to entrepreneurs, focusing on SMEs, and are typically set up as independent bodies with management boards composed of key local stakeholders, including local/district/regional authorities, business people and NGOs. Public authorities and local businesses fulfil an important role, often heading the management board and sometimes providing financial or in-kind support to the BSCs. They generally have a tapered funding regime. Sustainability of the BSCs depends on the capacity to supplement gaps in international support with commercial services (e.g. business plans, training, consultancy) and/or public subsidy. This important issue is discussed in more detail in section 2.8 below.

2.7.2 Business Innovation Centres / Incubators / Private Sector Firms

Under the Phare programme, ten pilot business incubators have been set up throughout Romania. In addition, the Romanian-German Foundation centre in Sibiu can also be considered to be a pilot business incubator. Incubators are also expected to be created through the 2002 activities of the MSMEC. In addition to these incubators, numerous private sector firms provide a plethora of commercial services directed at delivering business services, such as information, consultancy, training, accountancy and legal advice.

2.8 Policy and Implementation: Key Issues

The history of the institutions responsible for SMEs in Romania has been volatile. Since 1990, there have been at least six changes as different institutions were assigned this responsibility or created with this purpose in mind. The latest development, involving the creation of a Ministry for SMEs and Co-operatives (similar in nature to, for example, Croatia), which is not supported by a specialised SME implementing agency, is a radical departure compared to other institutional models adopted in SEE. It is too early to assess the effectiveness of this model, but given the previous changes, what appears to be required is a degree of stability with respect to the leading organisation responsible for SME policy. In this context, it is worth noting the points made in the latest EC Progress Report:

"The new Ministry [for SME and Co-operatives] may well emerge as a dynamic and effective institution. However, what is most urgently required is a period of institutional stability. There have been three different administrative structures responsible for SME policy in the last 18 months. These constant changes have undermined the possibility of making genuine progress." (EC, 2001a, p.74)

The Ministry for SMEs and Co-operatives has increased the focus on SME-oriented activities and has provided a channel for prioritising SME issues at the level of the Council of Ministers. However, a line ministry has been assigned the task of setting and co-ordinating policies for the SME sector. Given the dispersed nature of SME activities, inevitably infringing on areas under the influence of several other ministries, this situation could result in overlapping of roles and functions unless effective co-ordination mechanisms are put in place. Other countries tend to assign this responsibility of policy co-ordination to either the Prime Minister's Office or to the ministry with the overall responsibility for economic policy.

Expectations about the future role of SMEs in the Romanian economy and the Ministry for SMEs' demanding remit (see 3.2.1 above) do not appear to be matched by the personnel and other resources. Of a staff of 91 in the Ministry, about 40 have functions relating to SME issues, and about 20 appear to focus specifically on SME issues. These figures suggest that the ministry is understaffed in the main area on which its performance will be judged, although the ministry does have plans to rebalance the distribution of staff. Moreover, the turnover rate of SME staff in the ministry, while partly reflecting the fact that it is a relatively new institution and that salaries on offer in the public sector are low, nevertheless represents a challenge which needs to be met.

A national strategy for SME development was prepared from the Strategy of the Government Programme 2001-2004. The Action Plan resulting from the SME Strategy was integrated in the National Plan for Development, which was approved by the Council of Ministers in December 2001 and subsequently published in the Official Gazette. The SME Strategy highlights the priorities set out in Box 4 below.

Box 4: Priorities of the SME Strategy

1. Improvement of the Business Environment for the Stimulation of the SME Sector by:
- Improving the institutional framework and public-private dialogue;
- Simplifying and improving the legislative framework;
- Reducing bureaucratic barriers to SMEs.

2. Development of Economic Activities and Increase in the Competitiveness of SMEs by:
- Improving access to financing for SMEs (e.g. credit guarantee fund – €1.73m over next three years and micro-credit);
- Creating a friendly tax system, aimed at stimulating investment;
- Developing business infrastructure and a national market for consulting services for entrepreneurs;
- Improving access to business information;
- Facilitating access to public procurement.

3. Improvement of he SME Access to External Markets by:
- Elaborating a strategy to support SMEs with export potential;
- Supporting regional collaboration;
- Supporting SMEs via international fairs and exhibitions;
- Providing training on marketing techniques for external markets;
- Supporting access to information on external markets.

4. Promotion of an Entrepreneurial Culture and Stimulation of New SMEs by:
- Supporting training programmes focused on entrepreneurship;
- Supporting entrepreneurs' access to consulting services;
- Improving managerial education in secondary schools and universities;
- Involving mass media in generating a positive image of entrepreneurs.

Source: Ministry for SMEs and Co-operatives (2001a)

A budget to implement the strategy for 2002 has been approved but does not appear to be entirely consistent with the ambitions of the strategy due to budget constraints. As previously discussed, the ministry does not manage directly substantive SME-oriented programmes financed by external donors such as the EC and World Bank. As explained earlier, the MDP is the contracting authority for the Phare Programme for Economic and Social Cohesion, which has an SME component for which project "fiches" are elaborated by MSMEC. It is crucial to ensure close and effective collaboration between the two ministries, and it appears that this crucial link is in need of strengthening. The monthly meetings (including other ministries such as Industry and Resources, Labour, etc. as well as other representative organisations) are not sufficient to deliver the level of co-ordination required.

One of the noteworthy features of the institutional framework in Romania is the absence of an SME implementing agency, as compared to the institutional model common in SEE. This is not necessarily a weakness, as long as the Ministry for SMEs and Co-operatives is able to operate effectively through the network of existing organisations engaged in the SME area.

Given the priorities established by the government, the Ministry for SMEs and Co-operatives has focused on improving the business environment in order to stimulate the SME sector. An improved environment for business can have a significant impact on stimulating economic development without engaging significant resources. This objective can only be achieved by working with existing SME organisations. In this respect, an example of the type of effective action required is the collaboration between the Ministry for SMEs and Co-operatives and the Chamber of Commerce and Industry in the introduction of one-stop shops (see next section of the report).

A further issue concerns the mechanisms for ensuring effective consultation with the SME community. Currently, the main mechanism for consultation and dialogue is through the Tripartite Council, consisting of seven representatives from the Ministry for SMEs and Co-operatives, seven employers' organisations, and five trade unions. This is a constitutional requirement that can be a useful vehicle for dialogue both in terms of existing and new legislation and of developments affecting the SME sector. Further progress is required in order to build up an effective partnership between the government and the SME community, for example by ensuring that the Tripartite Council is an effective mechanism for consultation.

Below the Ministry for SMEs and Co-operatives and national policy-making, the institutional structure at territorial level is well developed in Romania. The issue is not so much the lack of organisations but that the degree of co-ordination and co-operation among the various institutions at both local and national levels needs to be improved.

Various important interfaces are in place, for example between central government and RDAs and between RDAs, local authorities and others, etc. One of the most significant is the interface between Business Support Centres (BSCs) and entrepreneurs or firms. In this context, the issue of sustainability of the large network of BSCs has to be resolved. Although many BSCs have been largely set up with donor support and have received substantial training and other input, they have not been able to secure financial sustainability through income generation, as originally anticipated. There is a danger that they will simply terminate their activities or increasingly respond to the necessity to survive by providing services to enterprises willing and able to pay for training and other consultancy services, namely large firms and international companies. From a peak of about 120 such organisations, only about 40 continue to operate as originally conceived, implying that they will increasingly abandon their original mission, namely to support the SME sector.

The Ministry for SMEs and Co-operatives has a plan to support a network of BSCs in 2002 and beyond. The ministry intends to select a network of accredited BSCs to provide training and consultancy to SMEs with respect to such issues as business plans and market studies. The budget available for this task (€30,000) is insufficient and further support is required. A possibility for enhancing the sustainability of these institutions could come from the RDAs since they are looking to support BSCs so that they can deliver their SME support programmes and projects. This could be achieved through the establishment of contractual relations between the BSCs and the RDAs, as discussed in the recommendations.

3. REGULATION

3.1 Introduction

Creating a stable and enabling regulatory environment is a prerequisite for both encouraging start-ups and expanding existing enterprises. The regulatory environment is one of the major barriers to business, particularly in transition economies. This is also the case in Romania, and various studies have highlighted the main failures of the regulatory environment:

- FIAS (1999) Romania – Administrative Barriers to Investment;
- Foreign Investors' Council (1999) White Book – Investment Climate in Romania;
- IRIS (2000) Red Tape Analysis: Regulations and Bureaucracy in Romania (and the updated version of the Red Tape analysis dated 2001).

This section analyses the main areas of the regulatory environment which appear to be problematic for enterprise development, such as registration, licensing, intellectual property rights etc. It also reviews the implications of the latest policy initiatives taken by the Romanian Government, such as the recently created Task Force for Business Simplification.

3.2 Regulatory Constraints

3.2.1 Regulatory Environment

The uneven pace of economic liberalisation, an often conflicting political agenda, and slow institutional development have produced a complex and inconsistent regulatory environment. Government Ordinances and Emergency Ordinances are used as a matter of course and do not always allow for proper discussion and consideration of alternatives. The regulations (or norms) for the implementation of legislation are often not produced on time and often contain gaps and contradictions. The result is confusion and inconsistency. Much of the legislation requires further modification in order to overcome the deficiencies of haste and lack of consultation. At the last count, there were about 533 legislative items which had an influence on businesses (IRIS, 2000, p.31).

In the absence of a stable and consistent legal environment, it is difficult for investors to stay ahead of changes in laws and regulations – in some cases investors find it difficult to comply due to unworkable provisions (FIC, 1999, p.3) and in others loopholes give rise to an increase in unfair competition, which can badly affect enterprises at the smaller end of the spectrum.

Frequent changes in regulations and legislation affecting businesses are to some degree an inevitable consequence of changing environments, such as in transition countries. Romania's current effort to upgrade its regulatory systems to EU standards is one valid explanation of the continuing volatility of the regulatory and legislative structure.

3.2.2 Company Registration

Businesses in Romania can be registered as one of five different types (Chamber of Commerce and Industry, 2001):

- Limited liability companies (SRL);
- Joint stock companies (SA);

- Branches (registered in Romania with limited power to do business on behalf of a parent firm);
- Representative offices (do not have a legal identity separate from the parent firm);
- Partnerships (such as general partnership *('Societate in nume colectiv'*), limited partnership *('Societate in comandita simpla'*) and partnership limited by shares *('Societate in comandita pe actiuni'*). Other forms of partnership are consortia and joint ventures (*'asociere in participatiune'*).

Businesses must register with the Chamber of Commerce and Industry's National Trade Registration Office (NTRO) in Bucharest or through the network of offices in the 42 counties. Until recent reforms, the registration process was complex and time-consuming, resulting in major compliance costs, and was the object of complaints from the business community. In July 2001 the government overhauled the system and simplified the procedure for registration and authorisation of new businesses through Government Ordinance 76/2001, including the main approvals. As a result, one-stop offices have been located at the Chamber of Commerce and Industry Trade Registration Offices. Companies now only have to present a single application form (plus associated papers), and certification from the key relevant bodies is expected to be issued within 20 days. The registration reform has also been associated with the introduction of a unique tax code/identification number. The Chamber of Commerce and Industry (CCI) co-ordinates the process of registration and certification with all relevant organisations (health, labour protection, environment, fire and sanitary/veterinary permit). Following a number of initiatives, the Ministry for SMEs and Co-operatives together with the Secretary General of the Government have acted as the initiators of this registration reform, which has been well received by the business community.

The CCI has had to invest heavily in IT, software and staff in order to make the reform work and is confident that this system, including the unique registration code for tax purposes, is a major improvement on past performance in this area. The situation has improved significantly both in terms of time taken, transparency and costs incurred. However, the reform is still relatively recent and will require some time and adjustment to overcome the initial operational teething problems:

- The deadline of 20 days from the point when all the files are completed is proving to be difficult to attain in economically dynamic areas. The CCI argues that additional investment is required from the relevant public authorities in order to reach the deadlines. The target of 20 days could be improved over the medium term, especially once the backlog of work has been cleared. In certain OECD countries, such as the UK, USA and Australia, there is a single procedure for registration, which takes one working day to allow companies to begin operations (OECD, 2000a, p.18).
- The capacity of the Trade Registration Offices has been put under pressure by the need to issue the new unique registration codes for all businesses within one year. The deadline has now been extended to 18 months but the registration backlogs remain.
- The supporting documentation that is required (lease agreements, signed and notarised documents, etc.) remains extensive and could be further simplified. Romania might also benefit from the experience of other countries, where a single page registration form suffices, minimal supporting documentation (deposit and articles of incorporation) is needed, court involvement is not required, and strict time limits for completion of the registration process are enforced.

3.2.3 Permits, Licences and Certificates

In addition to the company registration process, most business activities require some form of special licensing for activities associated with health and safety (such as food production), public trust (such as insurance) or public needs related to utilities (such as waste treatment) (see FIAS, 1999, p.10). If procedures for obtaining such permits are vague, complicated or time-consuming, they can act as a strong deterrent to business development, a stimulus to rent-seeking activity, and generally an encouragement to businesses to act in a non-competitive manner.

The process can vary from public authority to public authority. The report prepared by IRIS (2000, pp. 10-20) suggests that the procedures are often opaque, slow and subject to corrupt practices, resulting in unnecessary complexities and burdens for businesses. For example, numerous forms are required to obtain ‘operational authorisations’ from municipalities throughout Romania, involving cumbersome, time-consuming procedures, various inspections, reviews and regular renewals.

Further work by the IRIS Center has proved that reform is possible to achieve in Romania without carrying out modifications of national legislation or other major efforts (IRIS, 2001). By working with certain local authorities in a competitive manner (29 municipalities involved, 14 active in the process, with four winners - Cluj, Giurgiu, Iasi and Timisoara), the ‘Five Steps to Simplified Business’ programme has demonstrated the ability to:

- Eliminate the Operating Authorisations, thus reducing paperwork, delays and costs;
- Reduce the time taken to process local approvals (e.g. waste water), including enabling approvals to be processed simultaneously (e.g. fire and environmental authorisations);
- Increase the transparency in processing local approvals (e.g. via public hearings, filing of complaints etc.); and
- Reduce the time taken to process construction permits (using the concept of one-stop shops), etc.

Some municipalities may resist introducing such procedures, fearing a potential loss of control and sources of revenue. The enlargement of the tax base resulting from encouraging firms to locate in the municipality should compensate for the potential reduction of unnecessary licensing fees. The Action Plan of the Task Force for Removing Administrative Barriers to Businesses covers this issue. This is a positive development and it is important that the Ministry for SMEs continues to encourage and support municipalities in introducing the proposals being elaborated by the Task Force.

3.2.4 Land Acquisition and Title

The process of land acquisition is complex. Land can be either publicly owned, for example by State-Owned Enterprises (SOEs), or privately owned. Publicly owned land can only be sold by a government decision; otherwise it can be leased for up to 49 years. SOEs can sell land, but a cumbersome procedure must be followed. Private investors can likewise buy and sell land, but land records (cadastral registry) are still incomplete and land ownership records through the courts are not always reliable. The result is that reportedly 70% of issued land titles are under litigation, tax information is not reliable, co-ordination is lacking between local courts and cadastral offices and, as noted by FIAS, the same land can be sold by different notaries to different buyers (1999).

The end result is that the commercial risk that firms contemplate when making property investment decisions is high, especially since the issue of restitution has also not been fully resolved. In the absence of a reliable property title, banks may be unwilling to extend loans backed by mortgages, increasing the difficulties for SMEs in raising funds. This situation can only begin to be reversed once a reliable cadastral system exists, associated with a reliable land/building title recording system and appropriate administrative arrangements (see also IBD, 2001).

3.2.5 Customs

Romania is a member of the World Trade Organisation (WTO) which imposes certain obligations, as does the process of accession to the European Union. Overall, progress has been made in the simplification and consolidation of customs duties, computerisation, adoption of compatible systems in areas such as tariff nomenclature, customs procedures and documents, customs surveillance systems, etc.

The recent ‘EC Progress Towards Accession’ reports stress that progress has been steady in this area (EC, 2000, p.79; 2001a, p.89) but that there is still some way to go and, in particular, the customs procedures are still considered to be unnecessarily slow and bureaucratic. They need to be further simplified, and information on procedures still needs to be disseminated effectively and regulations interpreted consistently. Recently, there has been some progress in combating fraud and corruption. Clear and consistent rules, freely and easily available information on procedures, abolition of internal rules which are unavailable to some but not others, better training of customs officials and more competitive salaries will have a positive impact.

3.2.6 Judicial Systems and Bankruptcy Law

The working of the legal system is essential to business operations, such as ensuring that contracts are enforceable by law and recourse to courts is fast and reliable in the case of disputes. Two issues recur with respect to entrepreneurs' views of the judicial system in Romania: it is widely considered to be too slow and erratic in reaching judgements, and it is open to external influence. There is a strong perception among entrepreneurs that the court system cannot adequately enforce securities, contracts, bankruptcy and other commercial laws (UNDP, 2001, p.13). All of these incapacities generally undermine confidence in the judicial system and sap the economic vitality of the country.

Progress has been made as a result of the increase in the number of judges to speed up the court process, an improvement in the recruitment and training process of judges, and increases in judges' salaries. The Code of Civil Procedure has been amended to accelerate court procedures and reduce unjustified delays. As a result, the number of files pending in courts has started to diminish. By reducing the commercial courts' caseload, the resolution of cases in the court system is accelerating. Recently the scope for out-of-court settlements through arbitration has been introduced, which should assist enterprise development.

Romanian company law has a high degree of compatibility with the EC's, and a recent Ordinance on Commercial Registers and Bankruptcy adopted in January 2000 has further advanced this process. The bankruptcy law is considered to be fairly comprehensive, allowing sufficient scope for liquidating failed businesses or reorganising failing businesses. It has a balanced approach with respect to debtor and creditor rights and responsibilities, but two main points are worth noting: the law places a great deal of responsibility on judges, as well as on administrators (and others such as liquidators, attorneys and accountants). In addition, both entrepreneurs and commercial banks argue that bankruptcy procedures take too long, estimating two-three years in the best case scenario. The banking sector, with its own bankruptcy procedures, argues that in practice the balance is more in favour of debtors than creditors and that this situation, combined with the weaknesses in the legal system, discourages commercial lending to enterprises and explains, at least in part, their conservative attitude to SMEs (see section 6 below). A new draft law which should speed up bankruptcy procedures has recently (6 February 2002) been presented to parliament.

3.2.7 Labour Laws

Generally speaking, the regulations of the Labour Code are consistent with international practice and are not seen by businesses as being overly restrictive with respect to hours of work, benefits or termination of employment. Although this is broadly the case, little progress has been made in the process of harmonising with the EU on such important issues as: equal opportunities, health and safety at work. Although legislation exists on social dialogue, much legislative activity still takes place without adequate consultation and dialogue (EC, 2000, p.59). The Ministry of Labour has presented a draft of a new labour code, but it remains to be implemented.

3.2.8 Payment Arrears

The State-Owned Enterprises (SOEs) have had a culture of not paying suppliers and contractors on time, rooted in the loose financial constraints. *De facto* this practice operates as a hidden subsidy with disruptive cascade effects for the rest of the economy. The result is a huge stock of payment arrears (including taxes, wages and suppliers), amounting to about 45% of GDP in 2000 (EBRD, 2001c), up from an estimated 36% of GDP in 1998 (CEROPE, 2001, p.15).

In addition to drawing a subsidy from state finances, SOEs also starve off private sector companies to which they owe money. If liquidity problems do not manage to render an SOE bankrupt, it certainly can do so for SMEs. This extremely high level of arrears is a major factor behind the high and increasing death rate of SMEs, since smaller firms are disproportionately affected by fluctuations in cash flow, have a more limited client base and limited access to bank-financed working capital. Based on meetings with entrepreneurs, consensus exists on the need for rapid reform in this area. It is crucial that the budget constraints for SOEs be tightened and that payment of arrears be enforced by law. In order to find a long-term solution to the arrears problem, it is necessary to develop a framework for enterprise bankruptcy and liquidation, including SOEs, which adequately protects creditors' rights. Amendments to the current bankruptcy legislation, aimed at increased protection of creditors' rights and at speeding up bankruptcy procedures, have recently been presented to parliament. However, it remains to be seen whether, once parliamentary approval is obtained, these changes will be effectively implemented.

3.2.9 Corruption

The level of corruption in Romania is seen as being both widespread and systemic, resulting in weak legal systems, undermined public confidence and ultimately weaker economic performance (EC, 2000, p.18). This situation is underlined by the Global Corruption Report (Transparency International, 2001), which places Romania in 69th position, behind such countries as Moldova and Bulgaria.

A recent study of the informal economy in Romania (CEROPE, 2001) cites a number of areas offering scope for rent-seeking activity, such as:

- Incoherent elaboration and enforcement of legislation (bureaucracy leading to corruption);
- Deficiency in legislation relating to property and contractual rights;
- Legislation on consumer rights biased against the final consumer;
- Delays and disputes associated with the restitution process;
- Problems in enforcing the land cadastral system;
- Existence of major payment arrears;
- Difficulties in the process of obtaining bank credits;
- Limited scope offered by the privatisation process, etc.

According to a World Bank/USAID-funded study conducted in 2000, this informal economy translates itself into the payment by small businesses of 5% of their revenues in bribes. Equivalent statistics for medium and large enterprises are respectively 3% and 2% of revenue.

The government is well aware of the problem and has made the fight against corrupt practices one of its priorities. The most high profile recent development to counteract these activities is a law passed in May 2000 which created a new institution, the Anti-Corruption and Organised Crime Unit, to co-ordinate policy and action in this area. Its responsibilities and co-ordination capacities, relative to other bodies operating in this area, remain to be fully clarified, however. The law also resulted in measures designed to penalise anti-competitive behaviour by firms; prohibit improper awards of contracts and opened up the scope for everyone to be liable to corruption charges, including politicians. The full implementation of the November 1999 statute for public officials and of the activities of a Public Service Agency will help. However, ultimately, the frequent changes in laws, rules and regulations, combined with the built-in scope for arbitrary interpretation of rules by public officials, continue to hinder the process of combating corruption.

3.3 Task Force on Removing Administrative Barriers to Businesses

The Ministry for SMEs and Co-operatives has developed an Action Plan on Removing Administrative Barriers in recognition of the potential impact that these barriers can have on SME development. Some of the measures contained in the Action Plan have already been implemented, the most important of which was the introduction of the one-stop company registration office. Given the preceding analysis, it is worth highlighting the key points of the Action Plan (see Box 5 below).

Towards the end of 2001, the issue of improving the business environment gained in significance and the government decided to extend the scope of activity beyond the SME sector. For this purpose, the government established in October 2001 a Task Force on Removing Administrative Barriers to Businesses and agreed on a new Action Plan, which received the endorsement of the Council of Ministers. This new initiative came in response to a request from the World Bank to accelerate the process of reform and the endorsement and implementation of the Action Plan. The government understood the importance of closely linking the improvement of the operational environment for private sector companies with the privatisation and restructuring of SOEs, thus tackling one of the sources of instability in the national economy. The World Bank is supporting this policy through the Private Sector Adjustment Loan (PSAL) II programme and has structured the disbursement of the loan according to a number of benchmarks, including the implementation of the Task Force's Action Plan (see Box 6 below).

Box 5: Ministry for SMEs: Action Plan for Removing Administrative Barriers to Businesses

Issue	Action(s)
1. Company registration	Establish a one-stop office within the Chamber of Commerce and Industry to simplify registration procedures; Modify Company Law no. 31/1990 to simplify administrative formalities regarding company registration
2. Approvals, authorisations and licenses	Issue minimal compulsory approvals and/or authorisations for company registration provided through one-stop offices in Chambers of Commerce and Industry; Prepare a project to reduce the number of documents and simplification of procedures for granting licenses
3. Legal framework	Review the legal framework to increase coherence and eliminate ambiguities; Harmonise Romanian and EU legislation; Prepare a law regarding the organisation and carrying out of economic activities by natural persons; Publish a legal guide for entrepreneurs
4. Taxes and duties	Simplify taxes and duties and tax exemption for re-invested gross profit; tax system and accountancy report for micro-enterprises; Exempt from custom duties imported industrial equipment and raw materials necessary for SME activities; Review the taxation system in order to encourage investment; Review the fiscal regime and elaborate the Fiscal Code for unification of tax legislation; Improve procedures for collection, follow-up and report of payments of taxes and duties; Improve VAT reimbursement system
5. Financing SMEs	Allocate funds from the State Budget and establish the National Guarantee Fund for the development of SMEs; Increase credits for SMEs and re-payment of due credits; Develop training programmes for financial management
6. Information system	Support the creation of the national network of consultancy and information centres of SMEs; Publish information materials for entrepreneurs; Create and maintain a database for statistical data of SMEs and the Ministry's Website to provide on-line information; Prepare the Annual Report regarding the SME sector and organise the Annual Forums for SMEs

Note: The Ministry for SMEs has recently updated the Action Plan for the year 2002 (see Box 6).
Source: Ministry for SMEs, 2001c

The Minister of Development and Prognosis is in charge of co-ordinating the activities of the Task Force, which also includes a range of important governmental and non-governmental organisations, such as the Ministry for SMEs, Chamber of Commerce and Industry, IRIS Center, National Council of SMEs, Foreign Investors' Council, CEROPE and the National Association of Importers and Exporters in Romania. A consultant appointed to provide the secretariat function and to ensure momentum and technical assistance for implementation of the Action Plan has been made available under the PSAL II loan.

Box 6: Task Force for Removing Administrative Barriers: Revised Action Plan

Issue	Action(s)
1. Communication between government and business	Identify problems and possible solutions; Appoint Working Group (WG) to deal with these problems; Use FIAS to monitor progress; Publish results on a regular basis; Carry out a public awareness campaign to promote timely government actions; Set up Contact Group (CG) within MDP for monitoring and communication; WG/CG to monitor all government laws, decisions and ordinances prior to approval (to secure greater transparency in administrative activity, related to the 'sunshine law' [see below])
2. Lack of involvement of business community in business-oriented decision-making	All ministries/agencies to hold compulsory consultations with business associations (until a 'sunshine' law is adopted); Assess the above process every 18 months; Set up a database of businesses and business associations; Micro-enterprises to choose between paying profit tax or paying turnover tax the first three years of operation
3. Relationship between other authorities and entrepreneurs	Design / implement a best practice code for customs officers; Auditing authorities to publicise aim and duration of inspections; introduce minimum periods between inspections Perform only one check of a specific issue, with the period of further checks to take into consideration the results of previous checks; Set up a database consisting of audited companies, reviewed topics, audit period, etc. to which all auditing authorities will have access; Draft a law on administrative transparency, enabling businesses (and others) to comment on proposed developments, including public hearings; Carry out an inventory of activities requiring special approvals; Undertake a study on inspection/monitoring/auditing bodies in Romania based on checks focusing on specific issue and time periods; Public authorities to develop clear timetable and standard application forms; Implement a limit of 30 days for the issuance of permits and approvals; Train judges in commercial litigation; introduce new postgraduate commercial law programme; Supervise judges for impartiality, integrity and speedy resolution of commercial cases; Develop and support commercial courts with infrastructure investments; Maintain a database on non-tariff and tariff regulations; Generate transparency in the selection of customs offices; Implement regulations to simplify customs procedures
4. Accounting standards	Translate the 2001 International Accounting Standards; Develop and disseminate norms associated with financial auditing
5. Approval / authorisation process	Establish a unique code for all companies (to be completed by May 2002); Implement commercial consulting services for registering and authorising firms and entrepreneurs; Assess Trade Register reports to update the records following (re) registration; Set up a database on status of land to accelerate issuance of Urban Certificates; Publish procedures for building approvals; Introduce a single approval for sanitary, labour, environmental protection and the fire brigade; Publish an investor's guide to urban planning; Set up a pilot project to test whether the General Urban Plan can speed up approvals; Set up a pilot project to test costs of obtaining local authority approvals; Undertake a study on the 'silent approval' procedure; Undertake a study on duplicate information requested from entrepreneurs and solutions; Carry out an inventory of authorisations, approvals, and duplicates and aim to

	reduce by 50%; Draft improvements to bankruptcy (exit) procedures; Set up a programme to strengthen the judicial system and legislative framework (bankruptcy, banking, commercial courts, etc.)
6. Procedures for VAT refunds	Establish a neutral VAT regime and a limit of 30 days for VAT refunds; Introduce and enforce penalties for delays (using National Bank of Romania's interest rate) beyond the set time limits;
7. Information for businesses	Set up Website on loans, grants, contracts and other opportunities; Hold monthly meetings of multinational and bilateral donors with respect to business-oriented issues
8. Residence visas	Grant business visas to OECD Member countries not currently eligible for them
9. Fiscal Code	Develop, translate and disseminate the Fiscal Code
10. Transfer of know-how	Implement a Website on the Task Force's Action Plan; Publish draft legislation on taxes, incentives, etc.; Project participants to acquire FIAS know-how
11. Communication with foreign investors	Establish the Romanian Investment Agency to promote and co-ordinate all investment promotion activities
12. Corporate governance	Establish core principles of corporate governance, such as: a. Annual reports of state owned enterprises, free of charge to the public; b. Boards of administration of public companies not to include ministers, state secretaries, general directors of governmental agencies, members of parliament, members of local authorities, prefects, sub-prefects, etc.; c. Performance contracts for board members and management; d. Public companies to have no right to grant loans to board members, management, high state officials and relatives
13. Post-privatisation	Establish an Arbitration Committee to solve privatisation problems that create additional costs for both new owners and administrators

Source: Task Force for Removing Administrative Barriers

The Task Force's Action Plan sets a very demanding agenda. It is expected to be implemented during 2002, although its activities can and probably will be extended with the Prime Minister's approval. The Action Plan has also allocated actions, institutional responsibilities and deadlines for completion. This process should be supported, as it offers the potential of removing some of the most important barriers to businesses. The establishment of the Task Force offers the opportunity to further co-ordinate the work conducted for the SME sector.

4. TAXATION

4.1 Introduction

In all countries, the tax system plays an important role in shaping the environment for enterprise development. Over the last decade Romania has made extensive use of tax policy measures and overhauled its tax systems several times, most recently in January 2000. This section starts by briefly reviewing the key features of the tax regime and the tax administration system in Romania and concludes with a number of considerations about the impact of the current regime on the development of the SME sector and its sustainability.

4.2 Enterprise Taxes

4.2.1 Profit Tax

The current standard rate of corporate profit tax is 25%, having being reduced in January 2000 from 38%. Romania is now applying a profit tax rate which is roughly in line with other countries in SEE. Companies can deduct most business expenses, but business representatives complain about frequent changes to what is deemed to be deductible and the lack of clarity over tax provisions on deductible items. The current legislation allows for two special treatments applied at national level: there is a special tax rate (6%) for profits arising from export associated with self-manufactured goods and services; there is also an exception for micro-enterprises. Under the Stand-by Arrangement with the IMF, agreed in October 2001, the Romanian Government committed to approve a new profit tax law that will unify existing regulations under several laws and eliminate distortionary tax incentives. The draft law prepared by the cabinet includes a schedule for aligning the reduced profit tax rate for exporting activities with the 25% standard profit tax rate.

4.2.2 Value-Added Tax (VAT)

The standard rate of VAT is now 19%. Exports of goods and services are zero-rated, as are goods entering free zones. Law 17/2000 also provides for VAT tax exemptions on some exported goods and services; Law 133/1999 also determines that imported goods are duty-free. Such goods are also exempted from VAT. The VAT regime is broadly in line with EC principles. Progress has been made on the VAT front with the introduction of Emergency Ordinance 17/2000 and the norms under Government Decision 401/2000, but further reform is needed in order to secure full compatibility with EC norms. The new VAT law, currently discussed by the chamber of deputies and expected to become effective in April 2002, envisages the elimination of customs duty and VAT exemptions for investment goods and raw materials imported by SMEs, currently granted under Law 133/1999. As a transitory compensatory measure, the government will introduce a VAT suspension scheme. Moreover, the government committed itself under the agreement with the IMF to regulate all customs duty exemptions exclusively through the customs duty tariff and to ensure that they are uniform for all economic agents. Serious delays in VAT refunding continues to be experienced, causing problems to enterprises in a high inflation environment, especially to smaller enterprises.

4.2.3 Employers' Contributions

The issue of employer contributions is of key importance to enterprises, especially to micro and smaller enterprises. The level of employer contributions amounts to almost 40% of the gross salary and includes the items identified in Table 10 below. A reduction in social security contributions will only be achievable on a tax neutral basis if efforts to broaden the tax base are successful.

Table 10: Employers' Contributions

% Monthly Gross Salaries	*Destination of Contribution*
23.33 %	Pension Fund
5%	Unemployment Benefit Fund
7%	National Health Insurance House Fund (payment made by withholding and direct transfer to the territorial house)
2%	Risk and Accident Fund for Disabled Persons
0.75% or 0.25%	Commission payable to the Chamber of Labour for keeping and filing information
Total: 38.08% or 37.58%	

N.B. Not all of the above taxes apply to every enterprise.
Source: IMF

Employers argue that there are too many different funds to deal with. The 'special funds' (24 at the last count) are often created through Government/Emergency Ordinances and result in the proliferation of administrative arrangements and require contributions from firms, even if the relationship is indirect (see UNDP, 2001, p.9). This reduces transparency and at the same time increases the compliance costs for firms. Consolidation into a single rate payable by employers would be a progressive development. Payment procedures are complex and onerous. Firms must submit documentation of financial contributions to local chambers of labour on a quarterly basis and pay the contributions on a monthly basis to the Ministry of Labour and Social Protection. Forms must also be filed with local authorities. Employers highlight the burden associated with unnecessary and duplicated paperwork and the associated costs to them (see also section 4.4.1 with respect to tax payment procedures).

4.2.4 Other Key Taxes and Exemptions

The current tax system includes a number of taxes administered at the local level, special taxes, as well as a variety of profit taxes, VAT and customs duty exemptions and incentives, often linked to the enterprise location and status. These measures add to the complexity of the system, making it difficult to determine the effective tax burden for enterprises. These taxes and incentives are mentioned briefly below:

Local taxes: A number of local taxes fund municipal budget revenues, such as building, land, vehicle, construction permits, publicity and advertising, and holiday resort taxes.

Disadvantaged Zones: Incentives include exemption from customs duties and VAT for machinery, equipment, imported raw materials, as well as exemption from payment of profit tax.

Free Zones: The tax incentives include exemptions from profit tax and excise duty for economic activities performed within the free trade zone; exemption from customs duty for goods introduced within the zone; and exemption from VAT for operations carried out within the free zones.

Foreign Direct Investment (FDI): Law 332/2001 offers incentives for investments (except in the banking and financial sectors) over €1.08m such as: customs duty exemptions for equipment, etc. imported as part of the investment; VAT suspension for the above mentioned goods; and a deduction for profit tax purposes of 20% of the investment figure.

4.3 SME Tax Issues

In order to stimulate the SME sector, the Government has always provided a number of exemptions and incentives to smaller enterprises. Law 133/1999 (and subsequently Emergency Ordinance 297/2000) introduced a package of financial and fiscal incentives, the main provisions of which are set out in Box 7 below.

Box 7: Financial and Fiscal Incentives for Private SMEs

Art. 22 - Imported machinery, installations, industrial equipment and know-how are exempt from customs duties for SMEs that import these in order to develop their productive and service activities and that pay for them from their own funds or through loans obtained from Romanian or foreign banks.
Art. 23 - The reinvested gross profit share of SMEs is tax-free.
Art. 24 - (1) SMEs benefit from a profit tax reduction of 20 % if when they create new jobs, the average number of employees increases by at least 10 % in comparison with the previous financial year.
(2) The provisions of the previous paragraph are applied under the following conditions:
a) the profit tax reduction is applied during the period when the newly hired labour force remains within the enterprise and the numbers do not decrease;
b) the newly hired labour force represents at least 10 % of the existing labour force at the point of recruitment.
Art. 25 - SMEs do not have to pay customs duties for certain products and for certain imported raw materials needed to produce those products. The exempted product list is approved annually by governmental decision.
Art. 26 – (1) SMEs benefit from a reduction of 75 % in profit tax for exported production.
(2) The provisions of paragraph (1) do not apply to the export of primary resources. *[A 5% tax on profits from exports was implemented instead.]*
Art. 27 - In order to simplify the income tax system of natural persons, family associations and SMEs, a taxation system is to be applied based on the turnover from the previous year *[subsequently abolished]*.

Source: Law 133/1999, Chapter IV; Emergency Ordinance 297/2000

The effectiveness of these incentives is compromised by the uneven implementation of the law. There is often a considerable time gap between the promulgation of the law and the issue of detailed provisions for implementation. For example, the Ministry of Development and Prognosis and the Ministry of Industry and Resources, in consultation with the Ministry of Finance, is responsible for specifying the list of items exempted from customs duties.

A second issue concerns the design and co-ordination of tax policies. Tax incentives and exemptions are often introduced by emergency ordinance without adequate consultation with the Ministry of Finance. The result is that fiscal incentives often have to be readjusted or even abolished *ex post facto* as they prove to be ineffective or unsustainable.

For example, the recently introduced turnover tax for micro-enterprises (Government Ordinance 24/2001) stipulates that the taxation for micro-enterprises (up to nine employees and with an annual turnover of up to €100,000) at 1.5% of their total. Organisations such as the IMF have been critical of this measure and its tax erosion implications, as it may conflict with the government’s aim of reducing the budget deficit. The IMF in particular has suggested several changes to the draft legislation, *inter alia* a reduction in the turnover ceiling. It is anticipated that a new profit tax law will enable owners of micro-enterprises to choose between the turnover tax and the normal profit tax for the first three years of operation.

There therefore appears to have been an over-reliance on a range of fiscal incentives for SMEs. Such measures are sometimes introduced haphazardly; there is little evaluation of impact; and in certain cases the SME sector may actually be disadvantaged by the measures due to the uncertainty that they create. However, there will shortly be a very different stance with respect to the fiscal treatment for SMEs. In its latest Letter of Intent signed with the IMF, the Romanian Government has undertaken a set of major fiscal reform commitments driven mainly by a desire to ensure that national revenue performance improves (see IMF, 2001b, pp. 3-5), such as:

- Approval of a new profit tax (by the end of 2001) which unifies existing regulations under different laws and eliminates distortionary tax incentives by replacing profit tax reductions and exemptions in Law 133/1999 and the tax allowance in Law 189/2001 with a uniform 20 % investment tax allowance; in addition, undertaking not to introduce tax holidays or new discretionary tax incentives;
- Elimination (by end of 2001) of customs duties and VAT exemptions for raw materials imported by SMEs under Law 133/1999 and a commitment that all customs duty exemptions will be regulated through the customs duty tariff and will be uniform for all firms;
- The new VAT law will substantially reduce the number of VAT exemptions subject to the zero rate and will abolish the automatic link between customs duty tax holidays and VAT exemptions, except for a few cases; reduce delays in VAT refunds to no more than 30 days (see 4.4 below); and introduce a uniform system of VAT suspension for investment goods, which will replace VAT exemptions and tax holidays for investment goods under several laws;
- Abolition of the 2% payroll tax to finance the special education fund and reduce by 1% the special fund for handicapped persons (now incorporated in the state budget);
- The new excise tax law will codify excise taxation in 2002, and gradually increase the rates to EU standards; reform of personal income taxation; and a possible reduction in the VAT rates will be undertaken in the period 2003/2004.

It is anticipated that a new law will shortly be passed which will abolish all SME-specific incentives. The incentives will be restricted to three main elements, applying to all firms:
- Profit tax: a fiscal credit of 20% for investments made by firms;
- VAT: postpone payments of VAT (up to 60 days for certain imported raw materials; and 120 days – 12 months for imported new capital equipment/goods);
- Customs duties: exemptions for imported new capital equipment/goods; and exemptions for imported scarce raw materials.

This represents a major reversal of the activities of both the SME lobby groups as well as the activities of the Ministry for SMEs since its inception in 2001. The focus in future should be on a few effective incentives which are then not constantly added to, revised or abolished. Stability, clarity and predictability are as important for enterprises, especially smaller ones, as the incentives and exemptions themselves. The Ministry for SMEs and the SME lobby groups have to mobilise their efforts based on this new tax agenda in order to ensure that SMEs are not disadvantaged. The Ministry for SMEs has already taken some steps in this regard by surveying international fiscal arrangements for SMEs. This action now needs to progress to the setting of a new fiscal agenda in co-operation with the business community and the Ministry of Finance. In the light of the expected changes in the fiscal treatment applied to SMEs and other enterprises, the development of a mechanism for regular co-ordination with the Ministry of Finance would appear to be required.

In this context, some of the tax policy guidelines for small businesses established by the OECD-UNIDO guidelines (1999) are worth highlighting, as illustrated in Box 8 below.

Box 8: Policy Guidelines and Recommendations on Tax Policy for Small Businesses

1. Create a positive and enabling business environment for small and medium-sized business and recognise that tax policy plays a fundamental role in that process.
2. Develop tax policies on the basis of a partnership between small and medium-sized businesses and the government, recognising that government will collect more revenue if the enterprise sector succeeds and flourishes.
3. Provide a fiscal climate that promotes the small and medium-sized business enterprise sector by simplifying the rules applied to these businesses, reducing the compliance burden, and promoting transparency and stability in the tax regime.
4. Promote tax compliance by the small and medium-sized business sector by encouraging and supporting the organisation of the sector to better represent its viewpoint and by facilitating participation by the sector on a regular basis in the government's consultative process on tax legislation.
5. Review tax incentives to ensure each incentive is cost-effective, fair, and properly targeted.
6. Consider the use of presumptive taxation (tax base inferred from simple indicators) for the smallest businesses.
7. Co-ordinate small and medium-sized business tax policies with other small and medium-sized business government policies to ensure internal consistency and minimise burdens for such businesses.
8. Develop a system to monitor implementation of recommendations.

Source: OECD-UNIDO (1999, pp. 13-17)

4.4 Tax Administration

The Ministry of Finance determines policy, law and the structure for tax administration. Certain taxes are administered by central government and its regional offices (although local authorities may also be involved), such as income tax, profit tax, VAT, etc. Other taxes are established and administered by local authorities such as property tax, land tax, and building tax. Until recently, new firms had to register separately with the central and sub-central fiscal authorities, but this has now been combined with company registration through the Chamber of Commerce and Industry's National Trade Registration Offices at county level. The unique code, combining registration and tax, is required for payment of profit tax, salary taxes and VAT.

4.4.1 Tax Payment Procedures

Payment procedures are difficult to follow due to their complexity and the lack of information. Although some progress has been made through the decentralisation of tax administration, in a recent survey entrepreneurs highlighted that difficulties included simple issues such as determining exactly which taxes should be paid by them and the actual procedure which would be followed (IRIS, 2000, p.20).

The tax payments include those in respect of local taxes, employer social security contributions to special funds, profit tax, VAT and employment tax. Some must be paid locally and others nationally. Some have to be paid monthly, others on a quarterly basis and still others on an annual basis, with some differences depending on the region in which the firm is based (IRIS, 2000, p.20). In addition to the sheer time involved in completing the relevant forms, some firms, rather than using the postal service, wire or internet, still prefer to deal with all payments in person so as to avoid delay, loss of paperwork and other complications. Companies are required to file balance sheets for national statistics purposes in addition to their filing requirements under company law. An example is the payroll and inspections regime, where firms must complete four separate payroll forms on a monthly basis, even though the information required is very similar.

Firms must deploy staff resources in order to comply with these administrative requirements and keep abreast of the frequent tax changes, with the burden falling disproportionately on smaller firms. This situation adds to the incentive of operating in the grey economy and provides scope for rent-seeking activity.

4.4.2 Tax Auditing

Companies with an annual turnover of more than €50,100 are required to be audited by a registered tax auditor. The auditors assess whether the company's financial statements have been prepared legally and if they agree with these statements. However, instead of a single authority conducting fiscal audits, a bewildering number of agents are involved in auditing private firms, such as:

- Ministry of Finance (Fiscal Control; Fiscal Control of State Institutions; and the Financial Guard);
- Administrators of the 24 special funds;
- Court of Accounts, which checks state institutions.

The right to audit accounts of any company at any point deemed necessary; the numerous agencies involved; the unannounced nature of some of the audits; and the practice of negotiating fees means that firms are audited on average 27 times a year by the various authorities, often more than once by a particular authority (IRIS, 2000).

This imposes unnecessary and unpredictable compliance costs on private sector firms. The recommendations made by FIAS (1999) and the IRIS Center (2000) are fairly consistent: there should be a single authority conducting audits, which would result in stability, predictability, accountability, and lower compliance costs; the basis for audit and inspections should be predetermined and standardised; fees should not be negotiable and open to interpretation; and training is urgently required in this area.

4.5 Taxation: Key Issues for SMEs

There have been various positive developments with respect to the tax system in Romania since January 2000. Overall tax compliance has been increasing and tax procedures have been gradually simplified and improved. However, there is still some way to go before a stable and transparent tax system is in place. The practice of introducing tax changes by use of emergency ordinances should be phased out. Tax policy should not be adjusted more than once a year, when the annual budget is determined, unless required in response to major internal and external emergencies. Entrepreneurs already having to deal with the market uncertainties place high value on the stability of the tax system.

The last decade has witnessed extensive use of tax incentives and exemptions by the government in order to accelerate the pace of private enterprise development in Romania. This policy raises issues with regard to targeting and sustainability. Targeting tax incentives in a highly dynamic transition economy and implementing them through an inadequate tax administration is very difficult. In order to limit the scope for fraud and abuse, the tax administration tends to introduce heavy administrative arrangements and conduct frequent tax auditing, thus detracting from much of the potential benefit of the tax incentives.

Given the precarious national budget situation in Romania, it is particularly important for the Ministry of Finance to be able to evaluate the impact of various tax measures and their sustainability over the medium term. Efforts have to be made to break up the vicious circle whereby line ministries introduce incentives, often responding to pressure groups, through emergency ordinances which subsequently have to be revised by the Ministry of Finance, thus adding to the chronic instability of the system.

There is currently little or no evaluation of the impact of these fiscal measures. For example, the new turnover tax for micro-enterprises has a substantial potential impact in terms of loss of tax revenue. This may impact on the macro-economic environment and may result in perverse effects, such as holding back companies from expanding above the employment and turnover thresholds or creating incentives for under-reporting of turnover and multiplication of companies.

The tax administration system has improved. The recent creation of a unique tax code was an important step forward. There are at least three other developments which could improve the fiscal environment. First, the proliferation of special funds, with their tax requirements and own administrative arrangements, adds to the burden of enterprises. There is a need for the 24 special funds to be reviewed, reformed and/or discontinued. In the Letter of Intent signed with the IMF in October 2001, the Romanian Government made a commitment to start this process.

Second, the VAT payment and reimbursement procedure is problematic and in need of reform. The payment procedure does not match the cash flow reality that confronts smaller enterprises, so more flexibility over the payment terms may be more appropriate. The time required for VAT refunds should be reduced to 30 days, as suggested in the IMF Letter of Intent, since more timely tax refunds will help all enterprises, especially exporters, and stimulate greater use of domestic inputs.

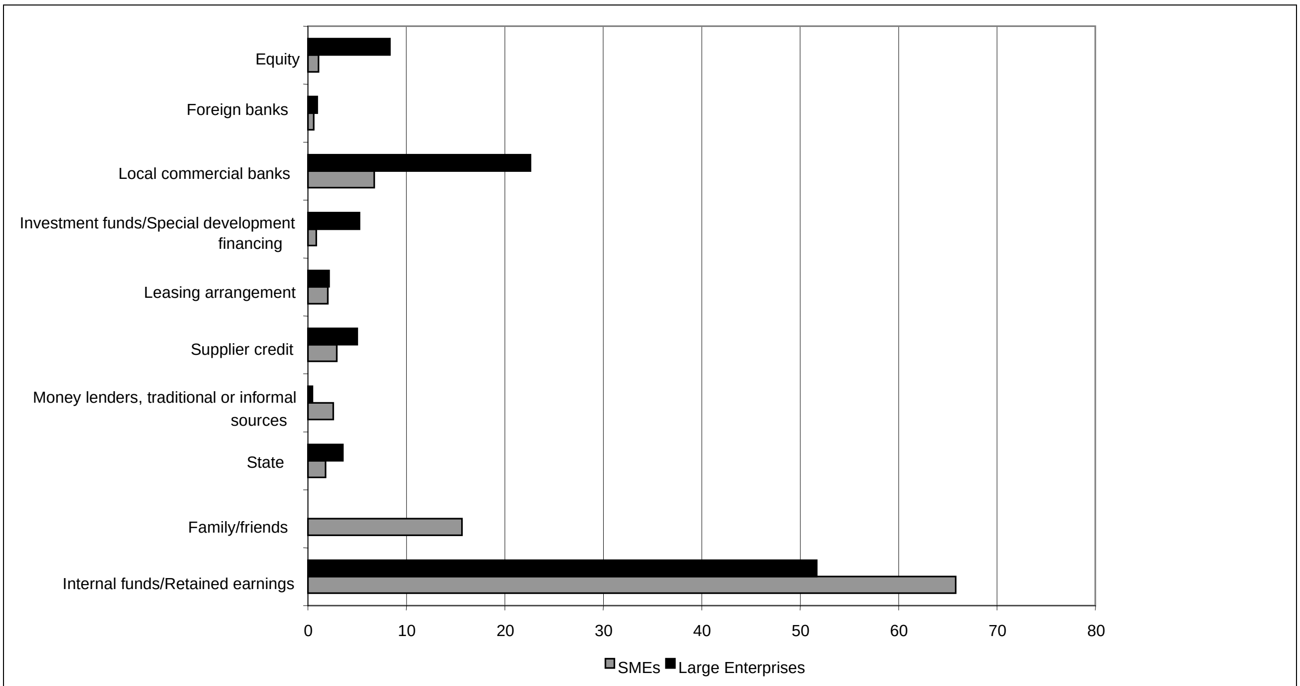
Third, in order to increase the levels of foreign direct investment in Romania’s SMEs, the network of double taxation agreements with all the major investment partners has to be extended and monitored regularly.

5. ACCESS TO FINANCING

5.1 Introduction

Results from the joint EBRD/World Bank Business Environment and Enterprise Performance Survey (BEEPS) show that among the sources of capital tapped by the enterprise sector, internal funds, related earnings and family and friends appear to be by far the most common, as shown in Figure 4. Local commercial banks only serve a very small fraction of the SME sector, with other sources being even less relevant. The survey results do not, however, explain why this is so, whether this is due to a liquidity problem or to excessively high costs, nor allow us to judge whether weak domestic activity contributes, from the demand side, to the low levels of enterprise financing from institutional sources.

Figure 4. Sources of Financing for Enterprises, Romania (1999)

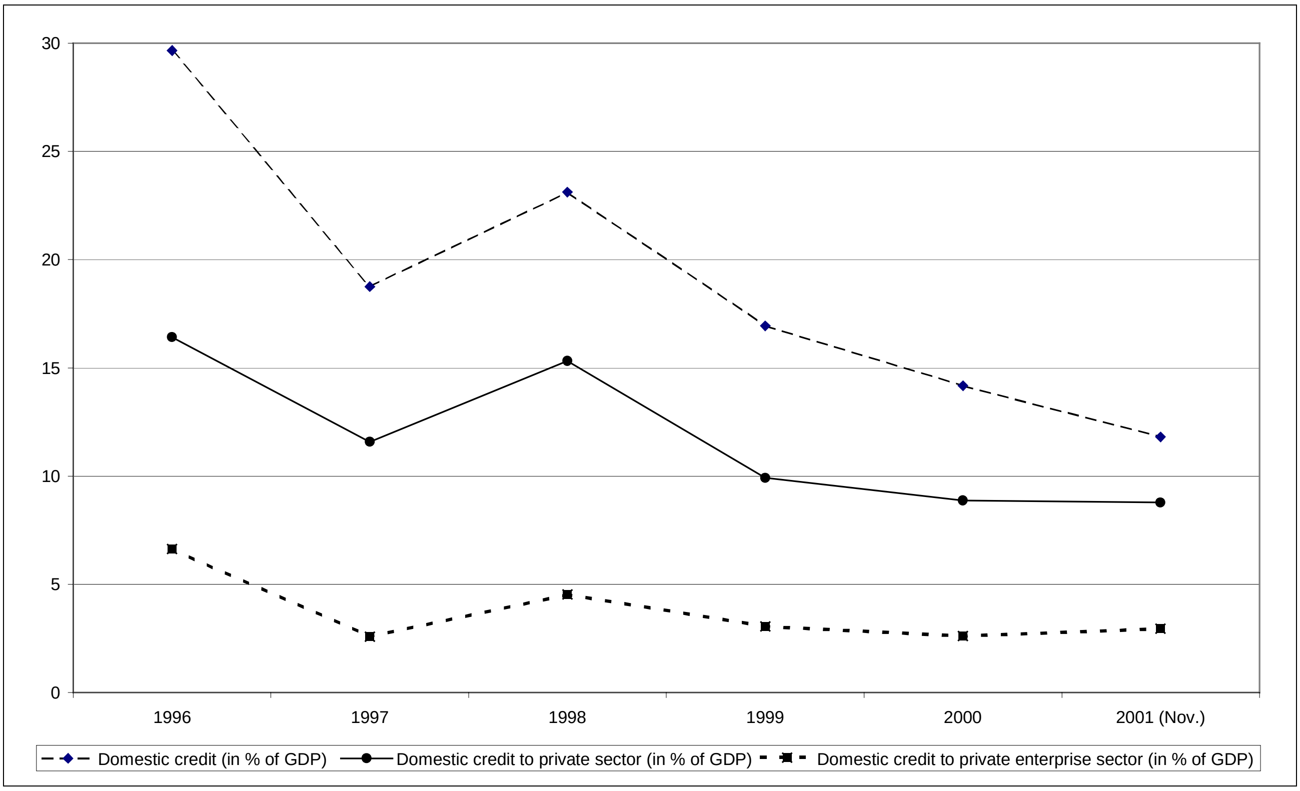


Source: EBRD/World Bank (1999).

5.2 Banking Sector

As a consequence of the hyperinflation crises of 1991-93, the level of monetisation of the economy dropped by two-thirds, with broad money accounting for just over 21% of GDP in 1993. The situation did not improve throughout the past decade and this ratio still accounted for only 23% at the end of 2000 (and an estimated 22% at end November 2001). This single factor more than anything else helps explain the extremely low degree of financial intermediation in the economy, with domestic credit accounting for only 14.2% of GDP at the end of 2000 (11.8% at end November 2001).

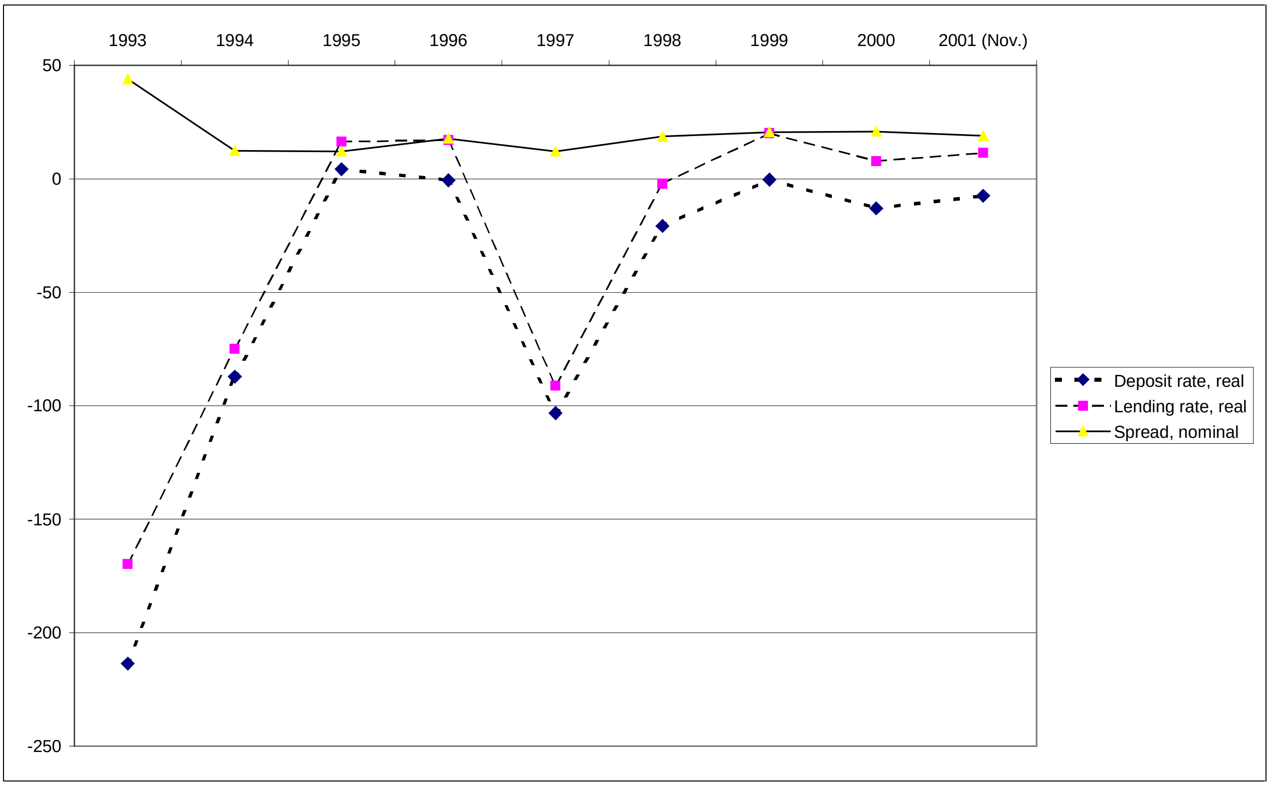
Figure 5. Domestic Credit in % of GDP, Romania (1996 – Nov. 2001)



Source: Monthly Bulletin of the National Bank of Romania (2001)

Figure 5 outlines the big gap between domestic credit generally and domestic credit to the private enterprise sector. Although this gap has been narrowing over recent years, it is still very high at over 10% of GDP at end of 2000. It is also worth noting that the narrowing of the gap was mostly brought about by general monetary tightening of the monetary stance in 1997, rather than by an increase in bank lending to the private sector. In this respect, it did not help that interest rates on deposits of non-bank clients have been negative for most of the past decade (tantamount to taxation on holdings of domestic currency), and are still negative at the moment (see Figure 6). On the other hand, lending rates have been consistently very high in nominal terms and positive in real terms (except for 1993 and 1996-97), while interest rate spreads have been consistently high and widening since the mid-90s.

Figure 6. Interest Rates Applied by Banks to Non-Bank Customers, in Real Terms, and Interest Rate Spread



Source: Monthly Bulletin of the National Bank of Romania (2001)

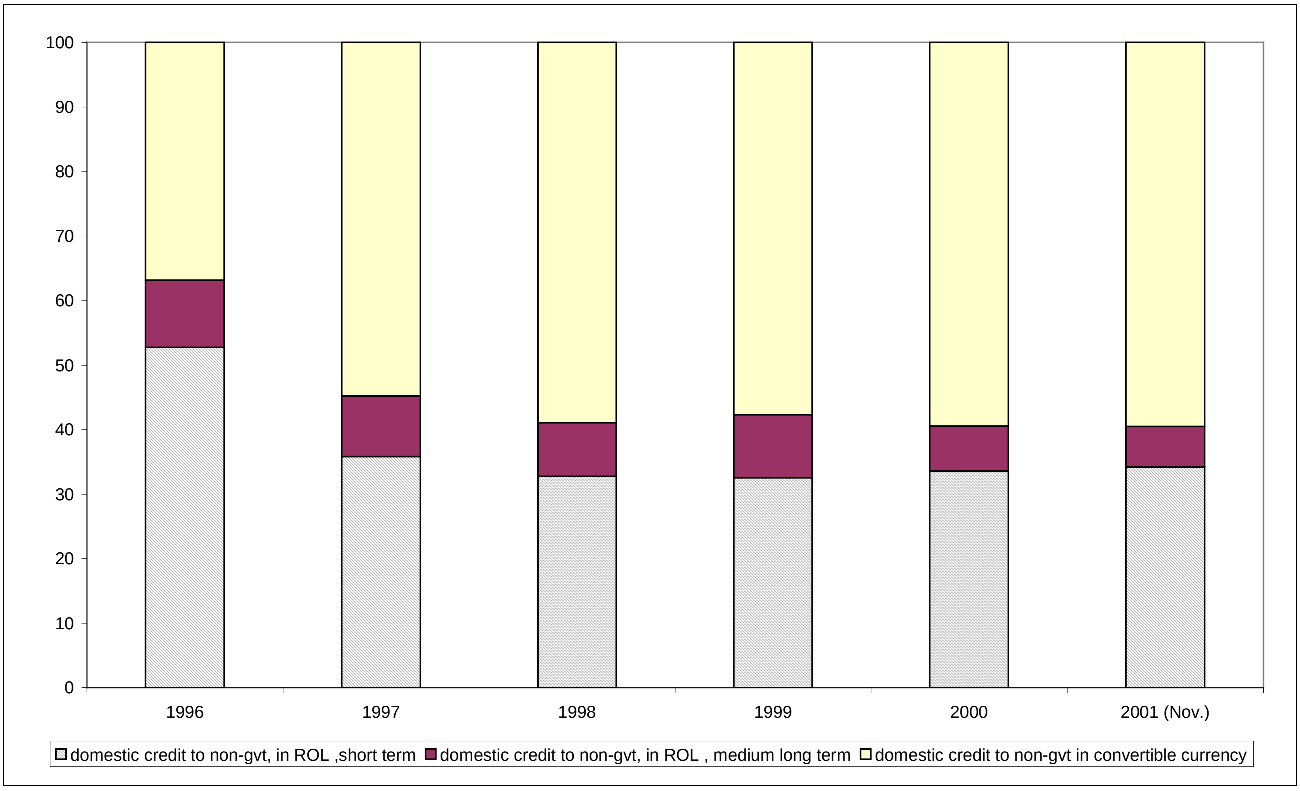
At the same time, short-term deposits with the central bank (NBR) and government T-bills have often offered much higher returns than the banks could have achieved by lending to enterprises, on a much lower risk profile, thus offering a much more attractive alternative for the use of banks' funds. At the same time, T-bills (as well as other segments of the capital markets which recently developed) have also offered an alternative to bank savings to depositors, although the market capitalisation of these different savings opportunities is still very low.

The accumulation in the past of non-performing loans, which only recently were removed from the banks' balance sheets (and transferred to the newly set up agency for recovery of non-performing bank assets), made the banks unable to extend new credits.

In addition to these factors, the very poor level of bank lending to the enterprise sector can also be explained by the poor contract enforcement and ability to collect debts. This makes banks unwilling to lend and is evidenced by the high amounts of collateral requested alongside a loan offer (120-200% of the sum of loan amount and interests due) which reflects both risks and costs connected to debt collection.

By looking at the characteristics of bank lending to the non-government sector (see Figure 7), it is worth noting that as of September 2001, almost 60% of the total is denominated in convertible currency, up from 37% in 1996. Also, over 84% of domestic currency loans are short-term. This is typical of a country characterised by high general uncertainty and highly variable interest rates, which pushes banks to be more conservative as regards to maturity of loans and to shift the risk (in the case of convertible currency loans) onto the final borrowers.

Figure 7. Maturity and Currency of Domestic Credit to Non-government (in % of total)



Source: Monthly Bulletin of the National Bank of Romania (2001)

While the elements discussed above depict a situation in which the private enterprise sector is inadequately served by the banking system, recent developments in banking reform bode well for the future. In particular, it is worth noting that following the 2001 privatisation of Banca Agricola to a consortium including Raiffeisen Bank and the Romanian American Enterprise Fund, more than two-thirds of total assets of the banking system are in private hands and about 55% is foreign-owned. Of the three remaining state-owned banks, Banca Comerciala Romana is currently preparing for privatisation in 2002. Moreover, the cleaning up of the bad loans of two large state-owned banks (Bancorex and Banca Agricola), enhancements to banking supervision and tightening of regulation, as well as substantial capital injections into the banks' balance sheets, have contributed to strengthening the banks' financial position and vastly improving the quality of their loan portfolio. These elements are the necessary (but not sufficient) pre-conditions for banks to be able to engage in lending to the enterprise sector.

In October 2001, the Romanian banking system comprised 41 banks, 33 of which were locally incorporated. Total banking assets amounted to over €11.9. The first banks to enter the SME sector in the 90s were Banca Romanesca, Banca Transilvania and Banca Ion Tiriac. They suffered, however, from lack of specific experience in lending to SMEs, and their efforts mostly consisted of administering donors and IFI credit lines, generally extended under the recourse clause, with the participating bank bearing the project risk and offering the credit at market rates. For various reasons, the experience of Romanian banks with foreign credit lines is very mixed, with under-utilisation of funds granted in some cases due to very specific targeting of the credit lines, in others to poor project design or implementation. Romanian Credit Bureau data shows that the average loan amount extended under the banking system is €249,000.

Government intervention resulted in a micro-credit programme managed by Banca Ion Tiriac and Mindbank, with capped rates for SMEs (50% of reference rate set by the central bank).

5.3 Relevant Commercial Banks for SMEs

- Romanian Commercial Bank (BCR). This is the largest bank, with 31% of total banking assets and a large network of 272 branches in the country. It is state-owned but currently preparing for privatisation. Despite the fact that this bank's policy is to focus on the private sector, half of its loans are to the government. The bank manages two SME-specific credit lines (MARR Fund, €3.1m and EBRD, €20m, the first instalment of which is fully disbursed). Since signing the EU/EBRD credit line, BCR has actively entered the micro and small segment of the enterprise market (at end of October 2001, at least 28% of its loans were classified as micro-loans).

- Romanian Development Bank (RDB). Following its privatisation in early 1999, RDB is 51% owned by Société Générale and is today the second largest bank in Romania (16% of total banking assets). It implements credit schemes from own funding and/or from foreign banks.

- Savings Bank (CEC) had originally been established as a savings institution and was transformed into a savings bank in 1996. It is state-owned. A restructuring plan has been agreed with the EU in preparation for its privatisation. CEC, which once had a monopoly over household deposits, now accounts for only 9.8% of total banking assets. It administers credit lines from Phare and KfW and some of its SME portfolio is financed from own funds. It is not yet authorised to work in foreign currency.

- Import-Export Bank of Romania (EximBank) is Romania's eighth bank in terms of assets, and is 73% state-owned. Its mandate is to support Romanian trade, mainly exports, and it offers a range of services to do that. In addition, it administers two SME programmes: the World Bank's Industrial Development Programme and KfW's SME Development Programme.

- Banca Agricola (BA): The size of the bank has been reduced significantly following the transfer of bad assets to the Agency for Banking Asset Recovery. Yet BA is the fifth bank in the country in terms of assets and enjoys an extended branch network (225 branches). About 15-20% of its loans are in the agribusiness sector. Despite its wish to enter significantly in the SME sector, the bank has not yet engaged in this activity in a significant way.

- BancPost is the fourth largest Romanian bank (4.24% of total banking assets) and was privatised in early 1999 through the sale of 45% to GE Capital (subsequently taken over by Eurobank, Greece) and the Portuguese Investment Bank. The bank incorporates the retail banking franchise of the Romanian Post Office, but has also a corporate client base, with 35% of its loans granted to the SME sector. It administers its own credit line for investment projects in the SME sector and credits to SMEs according to Law 1/1991 on social protection of the unemployed and their professional integration.

- Banca Comerciala Ion Tiriac is the sixth largest (private-owned) bank in Romania, with EBRD having a 5.87% stake. The bank has 29 branches and seven sub-branches. Although BCIT is a universal bank, aiming to provide a complete range of banking services, the corporate portfolio focuses mainly on export finance for SMEs. It administers SME credit lines from Phare and foreign banks and is supported by a USAID guarantee programme for SMEs borrowing from BCIT.

- ROBank was founded in 1995 and commenced operations in 1996. It is owned by the British Balli Group, the Anglo Romanian Insurance Group, and Turkish investors. The bank is one of the particularly dynamic and well-run small banks (its assets account for less than 1% of the banking sector's assets) which concentrate above all on corporate and institutional business, but are also considering expanding their business activities. ROBank has nine branch offices. It benefits from a €3.2m line from the EBRD Trade Facilitation Programme.

- Alpha Bank, formerly Banca Bucuresti, is a private-owned medium-sized Romanian bank (ninth in terms of assets) in which EBRD is a shareholder. It has nine branches in various locations. The bank has built a good portfolio of credits extended to Romanian private entrepreneurs (mostly micro and small credits) and is considered a successful case of a fast expanding small private bank. The EBRD has signed a €10m credit line under the EU/EBRD SME Facility, which is expected to become operational in March 2002.

- Banca Transilvania is a medium-sized private-owned Romanian bank with headquarters in Cluj-Napoca in Western Romania (the eleventh largest bank in terms of assets). BT is regarded as a well and prudently managed organisation. Its main clientele concentrates on the SME sector (e.g. in manufacturing, transport, appliances, trade, distribution, etc.). At present, BT has 32 branches, five agencies and five foreign exchange offices. At end October 2001, at least 38% of its loans were classified as micro-loans. It also benefits from a €4.3m line under the EBRD Trade Facilitation Programme. Banca Transilvania also benefited from two SME Facilities extended by the EBRD under the EU/EBRD SME Facility for a total amount of €10.8.

- Demirbank Romania, previously a small joint-venture bank between IFC, Demirbank Turkey and several Romanian investment funds, is currently 82% owned by Italian Unicredito. Since November 1997, the bank has been using IFC funds to provide a full range of commercial banking products for medium-sized Romanian companies and has enjoyed a line under the Trade Facilitation Programme of the EBRD. Demirbank Romania has 11 branches.

- Banca Romanesca is a small private Romanian bank with a focus on SME finance. The bank has 15 branches. It administers SME credit lines from the Romanian American Enterprise Fund and IFC, Phare, and World Bank and provides finance to SMEs also from own funds.

- Bank for Small Industry and Free Enterprise (Mindbank) was set up in 1990 as a bank dedicated mostly to the SME sector. Its shareholders are the Organisation of Handicraft Co-operatives, foreign and Romanian private investors, MISR Romanian Bank and some other banks and private companies. It has 11 branches.

There are also a number of credit co-operatives, which are independent, apolitical NGOs, whose main purpose is to provide mutual support to members. After the collapse of Bank Co-op (the bank for the country's co-operatives, established in 1989 as a private bank, with a network of 200 branches) and of FNI (the largest mutual investment fund) in 2000, the sector suffered a severe setback. They have been regulated since then under the 14th August 2000 Emergency Ordinance, according to which they can provide loans and banking services. In July 2001, the National Bank of Romania accepted the organisation or re-organisation of five credit co-operative systems (Aurora Romana, Concordia Romana, Creditul Popular, Creditcoop and Creditul Romanesc), grouping together 943 credit co-operatives, 795 already existing and 148 to be created. The provisional licences have in-principle acceptance and allow the companies to continue in the authorisation race. Their issuing is the first of a three-stage process that will entitle the co-operatives to full authorisation. The co-operatives in the authorisation race are not yet under the supervision of BNR and are not members of the Bank Deposit Guarantee Fund, meaning that savings with them are not guaranteed. Credit co-operatives will be allowed the fund if able to pass the authorisation test.

5.4 Guarantee Institutions

In order to deal with the high collateral demanded by commercial banks in their lending to SMEs, the government of Romania decided to set-up two guarantee funds, the Rural Guarantee Fund and the Romanian Loan Guarantee Fund.

- The Rural Guarantee Fund was set up by the government in 1994 with funding from Phare (€9m) and has a capital of €90,180. Shareholders are the Ministry of Agriculture and five commercial banks. Its mandate is to facilitate access to credit for enterprises in the agribusiness sector by provision of guarantees (70% of loan amount for long-term loans, 50% for short-term loans and 30% for leasing contracts) capped at €175,000 for long-term loans to SMEs.

- The Romanian Loan Guarantee Fund was set up by the government in 1993, funded by Canada and Austria. Its founders were Bancorex, BRD, BCR, Banca Agricola, the National Agency for Privatisation. It is now completely private-owned (69.5% of the share capital is owned by commercial banks and the rest by financial and insurance companies) operating as a joint stock company. Its mandate is to provide guarantees (up to 70% of loan value, capped at €501,000 to loans extended by commercial banks to privately owned enterprises.

- FDL Buzau, a UNDP-funded NGO, introduced a loan guarantee programme in 1997 with PHARE funding (Active Employment Measures). The fund's objective is to create new jobs. The value of the guarantee can cover up to 100% of the loan amount (including accrued interest). The highest guarantee amount can reach the ROL equivalent of €10,200. For each €, Lei 2,700 (€0.14) equivalent loan, the borrowing enterprise is obliged to create one job. The guarantees are intended to finance small investments and working capital. The guarantee accompanies the loan throughout its life; loan terms are from three months to one year. The guarantee fund is the only such programme in Romania implemented by an NGO.

Through Ordinance 23, 1999 the government introduced the legal basis to set up regional guarantee funds, with capital provided by the private investor to be matched by the government. However, following the initial investment from the private sector in these regional guarantee funds, funds from the state budget did not materialise and the regional funds never became operational. The introduction of a new law in January 2001 (Law 133), paved the way for dismantling the pre-existing regional loan guarantee agencies, replacing them with a public institution, the National Credit Guarantee Fund for Small and Medium Enterprises, equivalent in mandate but not in structure. The Fund, created in December 2001, is 100% state-funded, although private minority participation is envisaged. A budgetary allocation of €1.7m has been made. Successive budgetary allocations will bring its social capital to €6.5m by the end of 2002 and an expected €30m by 2006. The Fund will have branches in each county and will give guarantees for credits obtained by SMEs. The Romanian Bank for Development / Société Générale, acting as the advisor to the Ministry for SMEs, has recommended that the guarantees should be issued for up to 75% of the credit for investments, leasing contracts and letters of guarantee, 60% of the credit granted for working capital, and for start-ups 80% of the credit obtained for investments, leasing contracts and letters of guarantees, and 70% for credits granted for working capital. It is unclear why the government has decided to change its strategy on how to best provide guarantees to SMEs borrowing from banks. There are some concerns regarding the frequent changes in the legislation governing sources of finance for the SME sector. Moreover, it is unclear how a purely state-funded guarantee institution, operating independently from the banking system, can ensure the efficient use of funds from a commercial and economic point of view.

5.5 Leasing

The current legislation regulating leasing activities in Romania has been in place since 1997 (amended in 1998). In addition to the leasing activity of some commercial banks, some dedicated leasing organisations exist under the aegis of the National Union of Leasing Companies (an independent NGO set up in 1996). The main organisations in the field are Planet Leasing, Leasing Danubius, Dunarea Leasing SRL, Demir Romelease SA, Romania Leasing SA, International Leasing SA, Leasing House, Romanian-German Foundation and Saxonia Foundation.

5.6 Equity Funds

The venture capital market is still in its infancy. Private equity funds operating in Romania are estimated at a total capital of around €325m. The capital available for private equity investment is raised abroad either privately or is provided by IFIs. The market is heavily dependent on the perception of western institutional investors of the country's risk and outlook. Generally, due to high transaction and monitoring costs, equity funds tend to be attracted by medium and large-size enterprises, thus only marginally responding to the long-term finance needs of SMEs. There are few regional equity funds operating in Romania, but they are generally attracted by large investments and tend to only consider projects jointly with other strategic investors. Exit from equity funds is mainly limited to sales to strategic investors, given the very early stage of development of the capital market and the lack of interest of portfolio investors in Romania. Competition is virtually non-existent, as equity funds are *de facto* the only providers of long-term finance to the enterprise sector in Romania.

The following are the main equity funds operating in Romania:

- **SEAF (Small Enterprise Assistance Fund)-Romania** This fund was established in 2000 and it currently has €8.7m in capital, provided by IFC, the Black Sea Development Bank and USAID. SEAF-Romania became operational at the end of March 2001 and following its first investment of €650,000 in Totalsoft, a producer and distributor of software, it financed other investment projects ranging from €108,200 to €1.08m. The fund also supports SMEs by offering marketing assistance and financial planning services.

- **Romanian Post Privatisation Fund** was established in 1995 by GED Capital Development SA, EBRD, EC and the Romanian government (Post Privatisation Foundation) to invest in private or recently privatised companies. Investments can range between €0.3 and €4.4m for a period of four to eight years and must not constitute a majority investment in the company. The fund has made several investments in the SME sector.

- **Danube Fund** is a regional fund set up by Alpha Bank (Greece), EBRD, IFC, Bankers Trust and other private investors, to take equity positions in private companies in the range of €540,000-€2.7m, for four to six years. It does not take majority positions in the investee companies. It has made eight investments in larger companies out of a total of ten in the region.

- **Romanian American Enterprise Fund** was set up in 1994 with funds from USAID. It takes equity positions from €54,100 to €541,000 for three to six years and extends convertible loans to SMEs which have a chance of becoming viable (the fund is not targeting high-return companies). The fund takes an active role in management and training in the companies in which it invests. However, the equity programme is almost completely disbursed and it is facing exit difficulties, which will impede recycling of funds to new clients.

- **ORESA Ventures Romania S.R.L.**, a wholly-owned Romanian subsidiary of the Swedish ORESA Ventures S.A., was set up in July 1997. Its mandate consists of investing its €27m capital in Romanian private enterprises. Equity positions cannot be majority and range between €1.08m and €5.4m for up to six years. The Fund seeks returns of at least 35% per annum and targets companies that have the potential of becoming market leaders in the country.

- **Romania and Moldova Direct Fund,** set up in December 1998 by IFC, DEG, Archer Daniels Midland and International Equity Partners, makes majority investments in larger companies. The investments range between €1.08m and €3.2 for up to five years.

5.7 Micro-financing

Commercial banks are not active in this sector, witnessed by the fact that the average loan amount for the Romanian banking system is €248,900. It is only through dedicated donor programmes encompassing a substantial financial incentive for the commercial banks that the financial needs of micro-enterprises have been addressed. Credit co-operatives offer an alternative to bank lending for micro-enterprises but, following the collapse of Bank Co-op and of the largest and best known Romanian investment fund (FNI), they have significantly slowed down their lending activities. Finally, pawn shops offer loans with maturity between five and 30 days at 1% rate per day. Micro-enterprises thus have to resort mainly to family/friends and retained earnings as a source of financing. Only the best established in this group of enterprises can alternatively use suppliers' credit.

There are a number of NGOs set up by foreign donors which extend relatively small loans (€325 - €8,660) to small entrepreneurs and low-income households. Their activity was hampered in the past by unclear legislation, which impeded lending activities outside the banking sector, with the exception of non-interest bearing loans. These NGOs had to circumvent the legal constraint by requiring clients to pay administrative fees for the loans received.

- **CAPA/World Vision** operates under the umbrella of the organisation that finances it, RAEF, with funds from USAID. RAEF is a private investment fund, with capital from the US Government. One of its objectives is to support the development of the private sector in Romania. A sum of €1.62 has been granted to the fund to finance the creation of a micro-loan programme. Target borrowers are existing micro-enterprises with development potential. In addition to credits, the programme offers borrowers consulting services throughout the life of the loan. Individual loans vary between €2,700 and €16,200 and are made in ROL. The average loan amount is €8,660.

- **FLD Buzau** created in 1993 by UNDP with support from local authorities, RDA and NAP, has as objectives to: 1) develop the private sector (mainly SMEs) in Buzau County and contiguous counties, and 2) promote local development through different programmes implemented together with local authorities. The micro-credit scheme was introduced by the FLD centre in December 1997. Targeted borrowers are the self-employed and family associations. Loans are characteristically the ROL equivalent of €1,082 per loan (but can reach up to €2,165 per loan).

- **Co-operative Housing Foundation (CHF) Romania** has been active since 1994, operating in the western part of the country and implementing alternative credit mechanisms, SME development, quality-of-life improvement for low and moderate-income families and community financial institution development. CHF has used a network of NGOs to reach its objectives.

- **RAEF** (see equity funds section) is also managing a micro-loan programme. Loans to micro-enterprises are extended in amounts up to €216,450. Partners in this programme are the Co-operative Leasing Foundation and Opportunity Micro-Credit Romania. By October 2001 RAEF had financed more than 800 projects under this programme, with an average maturity of 11 months, with 5% arrears over 30 days. This programme is scheduled to be transferred to Banca Romanesca, a shareholder in RAEF.

A few other programmes that have developed variations of micro-credit activities in Romania have been supported mainly by the Swiss Government (LAM, FAER, ELMOL and ROMCOM), the German Government (FAMD), and the Open Society Foundation.

In 1999 MCR SA was established as a finance company, owned by a German investment company, Internationale Mikro Investitionen (IMI), to test this segment of the market for a group of international investors interested in setting up a micro-finance bank along the model of similar institutions in South East Europe (e.g. FEFAD, Albania). After 18 months of successful operations[2], this group of investors (Commerzbank, IFC, EBRD, DEG and IMI) decided to go ahead in transforming MCR into a fully-fledged dedicated micro-finance bank. The bank will have initial capital of €9.7m and will acquire the existing portfolio of MCR. Its strategy will be to accelerate the growth of the micro-loan portfolio on a commercial basis and to initiate traditional banking business, such as deposit-taking and offering of various banking services, so that the micro-finance bank can reach sustainability and independence from donor funds.

As a structural benchmark for the IMF Stand-by Arrangement approved at the end of October 2001, the central bank is currently preparing additional regulation of loan classification and provisioning, according to BCP8 and international best practice. The new regulation will introduce additional criteria for downgrading the assessment of borrowers' capacity to repay, based on their financial condition and creditworthiness. If introduced in the current draft form, the legislation would seriously hamper bank lending to SMEs in terms of both the quantity of credit offered and the pricing of micro-loans (to compensate for increased provisioning). This would also have an effect on commercial bank lending to the SME sector as a whole. The central bank, together with the IMF, is currently consulting with representatives from commercial banks and IFIs active in the sector on how to change the current draft to a final version which does not add further obstacles to the provision of financing to the lower end of the enterprise spectrum.

2. As of end May 2001 the average credit was € 6,540 extended to enterprises with fewer than ten employees. Performance of the portfolio was strong with only 0.5% of loans in arrears over 30 days.

6. FOSTERING ENTREPRENEURSHIP

6.1 Introduction

Businesses are created and grow by virtue of the creativity, drive and determination of entrepreneurs. Although it is not unusual for the conclusion to be arrived at that "… entrepreneurship often develops despite governments" (Smallbone and Welter, 2001, p.261), government and related institutions nevertheless have a role to play in the promotion and development of a more entrepreneurial culture. This culture can convert itself into a greater willingness to take on risk and thus generate a higher rate of business start-ups. This section focuses on the issues which help change public perceptions, generate a less risk-averse attitude to business start-ups and thus a greater spirit of enterprise in Romania, such as secondary and tertiary education and training issues, research and innovation, public promotion initiatives and award schemes for successful and innovative businesses.

6.2 Educational Issues

Government departments, educational institutions and indeed businesses recognise that a greater emphasis on entrepreneurship and the development of an entrepreneurial culture are needed, and they are beginning to pay more attention to this issue. From an educational perspective, at the moment the policy focus in Romania seems to be exclusively on higher education, rather than primary, secondary or vocational education.

The Ministry of Education and Research has identified a number of priorities which are designed to strengthen the university-business relationship during the period 2001-2004. The effort focuses on:

- Quality issues with respect to education, research and management;
- Co-operation between universities and enterprises;
- Adaptation of academic qualifications to the needs of the economy;
- Improvement of the academic, administrative and financial management of universities.

These policy priorities are of importance in developing a more entrepreneurial spirit, but there is a lack of comparable commitment at the lower education levels. In other countries, it is not unusual for there to be a focus on 'enterprise education' which goes beyond the now standard objective of producing a well educated and highly skilled labour force (see also OECD, 2000c). A focus on enterprise education implies an examination of the nature and content of the national curriculum, introduction of entrepreneurship competitions, interaction between local businesses and schools (e.g. job-tasters and placements), etc. The (re)training of teachers so that they are better able to pass on entrepreneurial skills to their students is of critical importance. An example of such an entrepreneurial scheme is the YESS!/Mini-Society and Entrepreneur Invention Society initiatives "… designed to foster and integrate the process of invention and the knowledge, skills and attitudes of entrepreneurship… this programme has a significant effect on students' entrepreneurial thinking, entrepreneurial application skills (including pricing and marketing), occupational aspirations and originality" (Kourilsky and Carlson, 1999, p.197). The authors highlight the following key areas:

- Identification of market opportunities and generation of business ideas (services or products) to meet the opportunities identified;
- Obtaining and using resources, taking into consideration risk factors, in order to realise the identified opportunity;

- Creation of a business in order to implement the business idea arising from the identified opportunity. (pp. 194-5).

In terms of the activities at higher education level, in common with most countries, the tertiary level is neither very focused on the needs of businesses nor geared towards the needs of entrepreneurs. Although courses are beginning to appear which deal with issues such as management and marketing, no course specifically on entrepreneurship exists at present. However, a number of universities are beginning to introduce modules which focus on certain specific needs which assist in the process of developing a greater business or management orientation, such as business planning, business management, marketing, etc. A process is underway which will continue to increase students' opportunities to come into contact with enterprise-oriented courses, although much depends on the experience and commitment of the trainers/teachers themselves. The Ministry for SMEs and Co-operatives' programme for 2002 includes resources to be used in co-operation with higher education institutions to assist in the development of courses stimulating entrepreneurship, as well as in the organisation of conferences, seminars and other events designed to raise the profile of enterprise development in Romania.

Regarding more specific courses and institutions, an organisation specifically focused on the issue of entrepreneurship is the International Centre for Entrepreneurial Studies (ICES) based at Bucharest University. The ICES in an independent think-tank focusing on a range of activities related to entrepreneurship, such as training courses for entrepreneurs and independent policy papers on such issues as industrial clusters and tax reform as well as pilot initiatives, such as implementation of business incubators.

In addition, there are three private institutions with links respectively to Canadian, French and American tertiary education establishments and offering MBA courses. In addition, the Open University is associated with a long-distance learning MBA course. Increasing inter-university contacts through such EC programmes as TEMPUS are fostering greater collaboration which assists the process of developing new courses more focused on various dimensions of entrepreneurship. These are positive developments, but a greater focus on entrepreneurship *per se* would appear to be in order, supplemented by business competitions and programmes geared towards encouraging graduates with good business ideas to start up enterprises. Such activities are often sponsored in other countries by local and international firms, as well as by programmes such as Phare and national programmes.

Countries such as the USA, Canada and Britain have an established tradition of developing entrepreneurial courses at tertiary education level (as well as at primary and secondary levels). Much can be learned from this experience with respect to the two main target groups, namely university students and practitioners, both of which have very different motivations for undertaking such courses.

6.3 Research and Innovation

The level of resources available for research and development (R&D) has been declining, both at state level (represented less that 0.5% of GDP in 1998 and projected to be 0.25% in 2001) and private sector level (where business expenditure on R&D was estimated to be less than 0.4% of GDP in 1998). Nevertheless, there is a policy to improve the situation, as exemplified by the Government's National Plan for Research, Technology Development and Innovation, covering the period to 2005. Among the priority programmes highlighted are: innovative products, up grading technology and quality standards, scientific and technical co-operation at international level, as well as sectoral focuses, such as biotechnology and information society. The plan also provides research and innovation support to SMEs themselves through, for example, the RELANSIN programme (with a budget of €330 until 2003), which seeks to promote innovative activities such as the implementation of advanced technologies and development of new technologies, services and products.

The development of education-enterprise links (as well as business-business links) is important to encourage in Romania so as to generate new productive opportunities and to assist technology transfer and general innovation. An issue stressed by the Ministry of Education and Research is the need for greater co-operation between universities and enterprises. There has been some progress in this area in Romania, and the following are illustrative of such co-operation:

- Politecnica University and Turbomecanica S.A (Bucharest);
- University of Targoviste and Cos S.A. / Upet SA (Targoviste);
- University of Bacau and Machine-Tools S.A. (Bacau);
- University of Baia Mare and Angred S.A. (Baia Mare);
- Timisoara University and Solectron S.A. and Continental AG (Timisoara), etc.

These links are important in enabling graduates to gain first-hand experience by solving various technological problems and in enabling research and practice to come together, thus resulting in innovation and technology transfer.

Additional measures are being implemented, designed to generate commercial opportunities which are also accessible to new, small and growing firms, for example through the EU's Fifth Framework Programme. This includes SME-specific measures delivering potential benefits such as: assistance in solution of technological problems for product and process development; access to foreign partners and markets; help in sharing the risks and costs of research; creation of new contacts and networks and experience of European R&D.

A national Contact Point Network has been created in Romanian universities, research organisations and businesses. This network is supplemented by over 50 Business Innovation Centres and a network of Innovation Relay Centres based in seven universities throughout the country, specialising in promoting innovation, encouraging exchange and providing advice, training and consultancy services (EC, 2001b). These networks will help stimulate opportunities for research and innovation, as will the Ministry for SMEs' aim of encouraging the creation of more business incubators.

6.4 Training Initiatives

Processes such as the globalisation of the world economy, technological innovation and change, and increasing competition call for better, on going professional training and qualifications to underpin business success. This is particularly the case for SMEs, which often operate in specialist or niche markets and need to stay at the 'cutting edge' of developments. In addition to educational issues, there is also a need to stimulate the provision of shorter courses, tackling such issues as: business planning, starting businesses, taxation, marketing, applications for credit, etc. A range of target groups exist, such as: small entrepreneurs, women entrepreneurs (see USAID-CCI, 2001), the unemployed, pre-start-ups etc. These courses are typically provided by private sector firms, business support centres, universities, Chambers of Commerce and Industry offices, etc.

It is also important for public officials to better understand the notion of entrepreneurship and the role played in the national economy by entrepreneurs in employment and wealth generation. This should result in a better attitude and more responsive support to entrepreneurs. Key groups that might benefit from such awareness-raising include: civil servants at national, regional and local authority levels, university and school teachers and others in the public domain such as fiscal/audit bodies. The benefits arising may take some time to cascade down, but this would be worth the effort, given the current nature of the Romanian business environment and some of the key players therein.

6.5 Promotion of Entrepreneurship

The attitude of the general public to entrepreneurs is generally still negative in transition economies such as Romania as an inheritance from the past regimes. The legacy of the communist system, which discouraged such entrepreneurial activity, combined with recent experiences such as the uneven effectiveness of the privatisation process, means that the public's attitude to entrepreneurs and entrepreneurship is all too often equated with opportunism and dishonesty. Likewise, the private sector feels that the attitude of the public administration, whose mandate is to assist entrepreneurial activities, is often indifferent rather than helpful.

The Ministry for SMEs is committed to cultivating a more entrepreneurial culture in Romania. Its SME Strategy, highlights the need to support the improvement of the business culture by generating a more positive attitude by society towards businesses and entrepreneurs. Three approaches are suggested: information campaigns, media reporting and publications for entrepreneurs.

6.5.1 Information Campaigns

The first approach involves government-led information campaigns (TV, press and radio) designed to generate a more positive attitude towards:

- The importance of SMEs to the Romanian economy (jobs, wealth generation, GDP, etc.);
- The importance of the entrepreneur (personal risks as well as rewards, work ethic, innovation, etc.);
- The role that entrepreneurship can have to support certain groups such as women, long-term unemployed and minorities;
- Highlighting ways of becoming entrepreneurs and support infrastructure available;
- An emphasis on using entrepreneurial role models.

It is sometimes desirable for government not to be overly associated with these initiatives. Such campaigns are often conducted in close co-operation with the private sector and fronted by personalities (from the acting profession, sports and/or entrepreneurial figures) who are well known, respected and considered worthwhile emulating.

6.5.2 Media Reporting

The mass media often tend to focus on the negative or the controversial. Cases of unorthodox and controversial business practices tend to gain circulation and may entrench the public's negative perception of business people. The SME Strategy requires a clear approach, combined with a long-term perspective, in co-operation with the enterprise/SME policy community to highlight positive developments and success stories in the business environment.

6.5.3 Publications for Entrepreneurs

Information provision through publications focusing on enterprise activities is important to business people, especially those running small firms. Currently, the most significant of these publications is the National Council for SMEs' 'Revista IMM', which is a rich and up-to-date source of information, analysis, data, interviews and developments in the legal and regulatory environment. The National Council has offered the Ministry for SMEs a regular slot to continue promoting itself and its activities vis-à-vis the SME policy community and represents an opportunity to improve media reporting, as previously discussed. The National Council is able to publish 10,000 copies of the Revista IMM, but this only reaches a fraction of entrepreneurs. Efforts could be made to enhance the print-run of Revista IMM and encourage a wider range of business-oriented newspapers, magazines and other publications to develop over time in Romania.

6.6 Award Schemes

It is important to improve the public perception of entrepreneurs and entrepreneurship activity at large (see section 6.5 above). For this reason, it is good practice to promote award schemes designed to reward successful and/or innovative businesses, thus highlighting to the public what is possible to achieve and encouraging people to emulate successful entrepreneurs. Romania is quite advanced in this respect, with three such award schemes:

- National Council of SMEs: organises the annual National TOP awards for private companies. The awards are based on official gross profit data and cover such categories as: implementation of new technology, job creation, production of high quality exportable output, investment for local community development, promotion of hi-tech in SMEs, dynamic young entrepreneur and dynamic woman manager.
- Chamber of Commerce and Industry: provides awards on the basis of balance sheets, turnover and gross profit. Successful companies are classified in 20 fields of activity and awards are made at national and branch levels.
- State Department for Inventions and Trade Marks (OSIM): awards creativeness trophies to companies involved in registering inventions and protecting industrial property.

The above schemes are positive initiatives and link up with other award ceremonies such as the annual banking awards, which include a ‘lending to SMEs’ category. The awards are generally high profile events which help to raise visibility and have a positive potential impact on public opinion.

The value of these awards is directly correlated with the degree of confidence in the transparency of the awards procedure, the information used to identify innovative or successful companies and the credibility of the selection panels. All efforts should be made to secure full confidence in awards and in the methodology used for their attribution, if they are not to achieve the opposite effect for which they are intended.

In addition, the Ministry for SMEs may wish to consider ways of rewarding ministries, agencies, local authorities and other public bodies for introducing initiatives which materially assist entrepreneurs and entrepreneurial activity at the national, regional and local levels. The interface between the public administration and entrepreneurs is of crucial importance as it may act as a deterrent or cost factor to potential and existing firms. If such a public award scheme were to be sufficiently high-profile, it could provide an incentive for changing public sector practices at various levels of government.

6.7 Good Practice in Fostering Entrepreneurship

Box 9 sets out what the OECD considers to be the broad policy guidelines for fostering entrepreneurship in all economies, not just transition economies. Many of the policy recommendations highlighted below have already been discussed in previous sections of this report and together form the framework for enabling Romania to push ahead with the agenda of stimulating a greater culture of entrepreneurship.

Box 9: Broad Policy Guidelines for Fostering Entrepreneurship

1. Examine the overall institutional framework within which economic activity takes place to establish whether it provides maximum scope for entrepreneurship to flourish. In particular:

– Identify and dismantle remaining barriers to competition which limit the incentive on enterprises to innovate and perform more dynamically. Promote competition in all sectors of the economy, including the provision of public services. Provide effective protection of intellectual property.
– Examine whether current regulations governing financial institutions and/or financial markets inhibit or facilitate the availability and optimal allocation of finance for entrepreneurial activities.
– Allow scope for flexible employment contracts to be negotiated, with remuneration arrangements and working conditions that are well adapted to the needs of dynamic enterprises. Relax employment protection measures that inhibit restructuring or discourage entrepreneurs from taking on new workers.
– Examine the costs of complying with government imposed administrative or regulatory requirements and identify where reductions could be made, either by removing the requirement to comply or by reducing the administrative burden involved (including through better co-ordination between different government agencies).
– Examine the overall effects of the tax system on entrepreneurship, and identify any particular features which act to discourage entrepreneurs or the financing of entrepreneurial activity. Ensure that the tax system is transparent and that compliance is straightforward.
– Review and simplify the registration procedures required to create a business. Ensure that firms are able to close quickly should they wish to do so.
– Ensure that personal bankruptcy legislation provides an appropriate balance between encouraging risk-taking and protecting creditors.
– Re-examine the effects that social insurance provisions may have on encouraging or discouraging would-be entrepreneurs.

2. Ensure that specific programmes designed to foster entrepreneurship operate as part of an integrated and coherent strategy that complements the framework conditions. In particular:

– Avoid policies that stem from a too-narrow definition of entrepreneurship (e.g., that entrepreneurship is only about start-ups or only about high-technology) and which may divert attention from getting the broader economic policy settings right.
– Widen the target population for entrepreneurship programmes, where possible, to attract the participation of women, the young and minorities.
– Undertake regular and comprehensive evaluation of programmes, and ensure that evaluation findings are acted on.

3. Improve the effectiveness of entrepreneurship programmes by drawing on the knowledge of sub-national levels of government. In particular:

– Ensure that resources for programmes to foster entrepreneurship are decentralised where appropriate in order to bettor tailor programmes to the specific needs of an area and its businesses.
– Provide regular opportunities to exchange information at a national level on the experiences of local authorities in designing and implementing entrepreneurship programmes.

4. Seek to identify and implement low-cost and effective programmes with minimal distortionary effects on market incentives. For example:

– Promote public awareness of entrepreneurship and examine the role the education system could play in developing entrepreneurial skills and attitudes.
– Increase opportunities for the unemployed to create their own jobs through self-employment schemes.
– Facilitate networking among firms in order to foster a culture of mutual co-operation and risk-taking.
– Promote the entrepreneurial non-profit sector by contracting-out where possible the delivery of public services which meet pressing demands in economic and social development.

Source: OECD, 1998a, pp. 28-30

REFERENCES

CEROPE (2001)
Underground Economy in Romania, Bucharest.

Chamber of Commerce and Industry (2000)
Pro Business Romania CD, 4th Edition, Bucharest.

Curentul, Romania Libera, 07.09.2001.

European Commission (2000*)*
2000 Regular Report from the Commission on Romania's Progress Towards Accession, Brussels.

EC (2001a)
2001 Regular Report from the Commission on Romania's Progress Towards Accession, Brussels.

EC (2001b)
Report on the Candidate Countries' Measures to Promote Entrepreneurship and Competitiveness Volume II, Commission Staff Working Paper, Brussels.

EBRD (1999)
Transition Report 1999. Ten Years of Transition, EBRD, London.

EBRD (2001a)
Romania Investment Profile 2001, EBRD, London.

EBRD (2001b)
Transition Report 2001, EBRD, London.

EBRD (2001c)
Country Strategy for Romania, EBRD, London.

EBRD/World Bank (1999)
Business Environment and Enterprise Performance Survey (*BEEPS)*, available on http://www.worldbank.org.ru/survey/front2.htm

FIAS (1999)
Romania – Administrative Barriers to Investment, Washington, D.C.

Foreign Investors' Council (1999)
White Book – Investment Climate in Romania, Bucharest.

Integrierte Beratungsdienst (IBD) für die Wirtschaft Romänien (2001) *Das Wirtschaftsklima in Rumänien 2001*, Köln.

International Monetary Fund (2000)
Romania Staff Country Report No. 00/159, Bucharest.

IMF (2001a)
IMF Approves 18-month, US$383 Million Stand-By Credit to Romania, Press Release, IMF, Washington, D.C.

IMF (2001b)
Romania – Letter of Intent, Memorandum of Economic and Financial Policies, Technical Memorandum of Understanding, IMF, Washington, D.C.

IRIS (Center for Institutional Reform and the Informal Sector) (2000)
Red Tape Analysis: Regulations and Bureaucracy in Romania, Bucharest.

IRIS (2001)
Red Tape's New Image, Bucharest.

Kourilsky, M.L. and Carlson, S.R. (1999)
Entrepreneurship Education for Youth: A Curricular Perspective, in Sexton, D.L. and Smilor, R.W. (1997) Entrepreneurship 2000, Upstart Publishing Company, Chicago.

Pohl Consulting & Associates (2001)
Assessment Report on SME Financing in Romania, Phare report, Munich.

Ministry of Development and Prognosis (2001)
Analysis of the Activity of Disadvantaged Zones (during the Period July 1999 – June 2001), Bucharest,

Ministry of Industry and Resources (2001a)
Industrial Policy of Romania, Bucharest.

Ministry of Industry and Resources (2001b)
Action Plan for Implementation of Industrial Policy of Romania, Bucharest.

Ministry for SMEs and Co-operatives (2001a)
Draft Strategy of the Ministry for SMEs, Bucharest.

Ministry for SMEs and Co-operatives (2001b)
The Development Strategy for the Small and Medium Sized Enterprises Sector, Bucharest.

Ministry for SMEs and Co-operatives (2001c)
The Action Plan for the Removal of Certain Barriers which SMEs are Confronted With, Bucharest.

Ministry for SMEs and Co-operatives (2001d)
SMEs, Financial Programmes 2001-2002, Bucharest

Ministry for SMEs and Co-operatives (2001e)
Statistics on the *SME Sector During the Period 1998-2000*, Bucharest

National Agency for Regional Development (2000)
The Private Sector of Small and Medium-Sized Enterprises in Romania: Report 1997-1999, Bucharest.

National Bank of Romania (2001)
Monthly Bulletin, N. 411, November 2001, Bucharest.

National Institute of Statistics (2002)
Number of Privatised Commercial Companies, According to Sizes, During, 1992-1998, Bucharest.

OECD (1994)
Improving the Quality of Laws and Regulations: Economic, Legal and Managerial Techniques, OECD, Paris.

OECD (1998a)
Fostering Entrepreneurship, OECD, Paris.

OECD (1998b)
The Tax/Benefit Position of Employees, OECD, Paris.

OECD (1998c)
Romania - OECD Economic Surveys 1997-1998, OECD, Paris.

OECD-UNIDO (1999)
Entrepreneurship and Enterprise Development in Transition Economies: Policy Guidelines and Recommendations, OECD, Paris.

OECD (2000a)
SME Outlook, OECD, Paris.

OECD (2000b)
Financing Newly Emerging Private Enterprises in Transition Economies, OECD, Paris.

OECD (2000c)
Reviews of National Policies for Education - Romania, OECD, Paris.

OECD (2000d)
Labour Market and Social Policies in Romania, OECD, Paris.

OECD (2001)
Corporate Governance in Romania, Paris, OECD.

OECD-EBRD (2001)
Entrepreneurship and Enterprise Development in the Former Yugoslav Republic of Macedonia: Country Assessment and Action Plan, Paris, OECD.

Smallbone, D. and Welter, F. (2001)
'The Distinctiveness of Entrepreneurship in Transition Economies', *Small Business Economics*, Vol. 16, pp. 249-262.

Stability Pact: South East Europe Compact for Reform, Investment, Integrity and Growth (2000)
Country Fact Sheets: A Summary of the Current State of Investment and Business Environment and Key Policy Reform Priorities in South East Europe, OECD, Paris.

Stability Pact: South East Europe Compact for Reform, Investment, Integrity and Growth (2001)
Stability Pact: The Investment Compact for South East Europe, OECD, Paris.

Transparency International (2001)
Global Corruption Report 2001, Berlin.

UNDP (2001)
Promoting Entrepreneurship and Investment in the Romanian Economy: Issues and Options, Country Office, Romania.

USAID Romania and Chamber of Commerce and Industry (2001)
Romanian Businesswomen in the Third Millennium, Bucharest.

World Bank (2001)
Country Assistance Strategy of the World Bank Group for Romania, Report No. 22180-RO, Bucharest.

ANNEX 1: GOOD PRACTICE INDICATORS OF SMALL ENTERPRISE DEVELOPMENT

The OECD-UNIDO report, 'Entrepreneurship and Enterprise Development in Transition Economies: Policy Guidelines and Recommendations' (1999), examined a number of factors which together hinder the effective development of SMEs in transition economies. A series of workshops identified a set of guidelines for implementing good practice in entrepreneurship and enterprise development in these countries. The analysis provided in this annex is based largely on the above report.

The template presented below consists of six sets of key good practice indicators which are important for transition economies, such as Romania, to implement:

1. Institutional Framework for SME Policy;
2. Rule of Law and Regulatory Environment;
3. Tax Policy for Small Businesses;
4. Financial Instruments for New and Small Businesses;
5. Innovation and Entrepreneurship;
6. Summary of Advisory Services and Support Measures.

In the template each indicator is assessed separately based on progress achieved to date (as at March 2002). A brief analysis bears in mind that the situation in Romania, as in most transition economies, is in a constant state of flux. The first column highlights the good practice indicator in question and the second column provides a brief analysis. The sources of information included entrepreneurs in Bucharest, Tulcea and Constanta, representatives of the Ministry for SMEs and Co-operatives and various other ministries; as well as other local sources.

1. INSTITUTIONAL FRAMEWORK FOR SME POLICY

1a. ENTERPRISE DEVELOPMENT STRATEGY

Indicator	Comment
1.1 Is there a clear definition of micro, small and medium enterprises consistent with the EC's definition?	Yes, there is a clear definition which is used for statistical and policy purposes. The definition is largely consistent with the EC definition, other than turnover, due to the fact that the level of business activity is somewhat lower than the EC average. The SME chapter of the *acquis communautaire* is now temporarily closed, suggesting that the EC accepts this definition.
1.2 Is there a government-approved SME strategy with specific, measurable, achievable, realistic and time-bound objectives?	There is an SME strategy, and its objectives are included in the Action Plan of the Ministry for SMEs, approved by the Romanian Government at the beginning of 2002 and published in the Official Gazette. The strategy is oriented towards attaining medium-term objectives based on the Governmental Programme; these objectives are partially within the scope of the ministry to deliver. The SME strategy could be made more specific, measurable, attainable, realistic and tangible, allowing the ministry to judge progress and success.
1.3 Are there specific support measures (see Section 6 below) in the SME Strategy?	A number of specific support measures are identified in the Strategy and Action Plan, such as the national SME support programme, the financing programme for SMEs in priority sectors of the national economy, as well as programmes to foster exports, establish business incubators, support entrepreneurship, and provide advisory services. The exact mechanisms for implementing these support measures are not always clear and neither are the resources available in the medium term, although some are based on multiannual programmes (until 2006).
1.4 Does the SME Strategy seek to co-ordinate bilateral and multilateral support?	Some effort is made to co-ordinate bilateral and multilateral support, especially in terms of the Phare SME programme carried out in co-operation with the Ministry of Development and Prognosis. Closer co-operation with this ministry is required in future, in order to maximise the benefits for the SME sector in terms of non-Phare donor and IFI resources. There is no mechanism for regular co-ordination with the donor and international community with respect to SME resources and programmes.
1.5 Is there a mechanism for regular review and up-dating of the SME Strategy?	The SME policy community anticipates a process of consultation with respect to the SME Strategy; with a view to regular review and updating of the SME Strategy. The process currently is that the Ministry for SMEs reviews the strategy as it updates the Action Plans on an annual basis.

1b. INSTITUTIONAL FRAMEWORK

Indicator	Comment
1.6 Is there designated and clear ministerial responsibility for development of a national SME policy and strategy?	Yes, the Ministry for SMEs is clearly in charge of determining SME policy and strategy. However, there is a need for greater co-ordination between the various ministries, such as the Ministry of Finance and the Ministry of Development and Prognosis, in order to implement the SME Strategy effectively.
1.7 Is there a defined and adequate budget for the implementation of the SME Strategy?	Resources are currently allocated on an annual basis for the Ministry for SMEs' operations, but this is considered to be insufficient to meet needs.
1.8 Is there an inter ministerial forum / high-level official forum with respect to systematic co-ordination and assessment of potential legislation/regulations/taxes affecting small businesses?	No such mechanism exists except for the Economic and Social Council, which is a large, general forum. The existing inter ministerial arrangements involve too many players to provide a focused forum for systematic co-ordination and assessment of issues affecting small businesses.
1.9 Is there an effective mechanism for reviewing the impact of existing laws, regulations and taxes on small businesses, including in the private sector?	No regular mechanism exists, although laws often call for regular monitoring of impact. The Task Force and the Ministry for SMEs carry out this activity on an ad hoc basis.
1.10 Are evaluation measures routinely incorporated into new government initiatives and measures?	No. For example, the Ministry for SMEs does not have a policy evaluation department, although this might be a useful development for the future. In this context, the World Bank has expressed its willingness to help develop the policy evaluation capacity through technical assistance under the Private Institutional Building Loan II (PIBL II).
1.11 Is consultation (communication and consultation) with the private sector and other related enterprise interests routinely undertaken?	In principle this is done through the Tripartite Council which meets on a monthly basis and includes employer representatives. However, it meets irregularly and the private sector and SME representatives feel that this forum could be improved. Papers are not always circulated in advance and thus the Ministry for SMEs is not in a position to make the most of this consultation opportunity. An effective mechanism for dialogue with SMEs could be developed through better use of existing arrangements. Ad hoc meetings are also held with representatives of various members of the SME policy community, such as the Chamber of Commerce and Industry.

1.12 Is there an organisation(s) responsible for the implementation of government policy for SMEs?	Unlike many other SEE countries, there is no separate implementation mechanism in Romania. The Ministry for SMEs must determine policy and implement it. The ministry recognises the need to enhance the SME team in order to be adequately staffed and thus be in a position to implement its remit.
1.13 Does the implementing agent have necessary organisation, strategy, skills and resources to undertake its remit?	There has not been a dedicated implementing agent since the abolition of NARD. The Ministry for SMEs has created a policy and implementation department, but this department is experiencing a high level of turnover with respect to experienced staff. The number of staff is insufficient and the skill levels need to be raised if the remit is to be more effectively undertaken. A programme of technical assistance would help, especially if the level of turnover is stabilised.
1.14 Is there a mechanism for reporting on progress on a regular basis?	The only mechanism is the Tripartite Council and the monthly ministerial meetings. Neither forum is very effective in terms of assessing progress in implementing the SME Strategy.
1.15 Is there a geographical distribution of business support initiatives in relation to the population?	An extensive but declining network of business support initiatives exists. Originally the number of operational centres were about 120, but the number has declined to about 40 as financial sustainability is proving to be problematic. The current trend is for the centres to either close down or become private sector consultancies, concentrating on the large and medium enterprise sectors, public sector tenders or international companies. Very little or no work will focus on micro and small businesses unless the plans of the Ministry for SMEs and the Regional Development Agencies to assist Business Support Centres are realised and adequately funded.

2. *RULE OF LAW AND REGULATORY ENVIRONMENT*

Indicator	Comment
2.1 Is there a single company registration form and is it easily available?	Yes, there is a single form for the simplest form of company registration but in practice other forms are also required, such as for verification of company name, etc. It is possible to register companies through a Website (http://www.biroulunic.ro). Company registration unifies both fiscal and registration numbers.
2.2 Is there a single point of contact for issues relating to registration, taxation, licensing and regulation of enterprises (e.g. one-stop shop)?	Generally yes, a nationwide network of one-stop shops has been created throughout the Chamber of Commerce and Industry's Trade Registration Offices at county level. Businesses can receive a wide range of information and operation certificates are issued within 20 days. However, at this point in time these shops cannot be considered as comprehensive one-stop shops.
2.3 Is there a system for government to inform enterprises routinely and fully of proposed changes prior to their introduction?	Some consultation takes place between certain ministries and some business associations, but there is no regular and general consultation of the business sector prior to the adoption of legislation. Proposals exist, such as the publication of draft legal acts before their adoption and consultation with the business community in order to eliminate duplication, redundancy, ineffective legislation, etc. as part of the Task Force's Action Plan. This is an area which needs to be further developed and it is anticipated that the World Bank PIBL II will finance this activity.
2.4 Is there a government-approved programme for reducing administrative/legal barriers with measurable objectives, time scales, responsibilities, etc.?	Yes, the Romanian Government's overall general Action Plan (2001-2004) attempts to do this. Other examples of work programmes in this area are the new Task Force on Removing Administrative Barriers to Businesses and the Ministry for SMEs' own Action Plan to Reduce Barriers.
2.5 Is there a mechanism enabling regular and systematic assessment of the administrative and legal barriers and compliance burden and costs to enterprise development?	The main mechanism is the recently introduced Task Force on Removing Administrative Barriers to Businesses. It is led by the Ministry of Development and Prognosis and funded by the World Bank's PIBL II agreement. Its scope of activity is comprehensive and includes all enterprises. In addition, the Ministry for SMEs carries out its own Action Plan on Removing Administrative Barriers, which has met with some success in the last six months. It is important to co-ordinate the Task Force's Action Plan and that of the Ministry for SMEs so that the SME agenda is not lost.
2.6 Have effective bankruptcy laws and procedures been introduced?	Law 64/1995 and Emergency Ordinance 58/1997 (bank bankruptcy is dealt with separately by a 1998 law) mean that the relevant law is comprehensive. However, as far as bankruptcy is concerned, the procedure is generally considered to take too long and places too much emphasis on the judge and his staff. Law 64/1995 was modified in February 2002 to speed up bankruptcy procedures, protect creditors and increase clarity. Recent draft amendments designed to improve the bankruptcy procedures were presented to Parliament in February 2002. The PIBL I is also financing a study to highlight recommendations for improving

	bankruptcy procedures.
2.7 Is there an independent arbitration system allowing for out of court settlements of disputes?	There is the Court of Arbitration affiliated to the Romanian Chamber of Commerce and Industry. However, the court system generally is considered by enterprises to be too slow and costly, and rulings and appeals can have inconsistent outcomes.
2.8 Is there regulation/legislation penalising late payment to SMEs?	Payment arrears, especially by State-Owned Enterprises, is one of the most serious problems of the business environment. The stock of payment arrears amounted to about 45% of GDP in 2000. This situation starves smaller firms of liquidity and amounts to a subsidy to SOEs. Some legislation is in place, but enforcement is weak and discretionary.
2.9 What is the estimated percentage of the informal economy?	Estimates vary from 21%-40%.
2.10 What is the corruption index for this country?	According to all evidence available, very high levels of corruption exist exceeding those of neighbouring countries such as Bulgaria and Moldova. This situation represents a major barrier to business development.
2.11 Are there procedures for liquidation of collateral?	Costs of liquidation of collateral are very high due to weaknesses in the legal administration. However, procedures were improved in 2001, and commercial banks are now entitled to execute debt enforcement on a fast track.

3. *TAX POLICY FOR SMALL BUSINESSES*

Indicator	Comment
3.1 Are the major tax laws changed frequently?	Yes, Romania has a track record of frequent tax changes, which is often highlighted in private sector surveys as an important factor hindering business development. Three features of the tax system hitherto have been: a large number of fiscal incentives and exemptions; poor targeting; and frequent changes. Some measures are introduced through Emergency Ordinances that may then be subsequently changed or abolished, resulting in business planning problems. Frequent discussions with the EC and IMF on the impact of measures have resulted in a new fiscal situation with respect to enterprises. Following the latest Letter of Intent signed with the IMF, it is anticipated that all exemptions and incentives for SMEs will be eliminated in February 2002. A new agenda is opening up with respect to small enterprises and fiscal issues. Scope exists to begin generating a simpler, clearer and more stable fiscal system in Romania.
3.2 Is there a transparent tax system where laws and regulations are easily available?	Laws and regulations are published in the Official Gazette after being passed into law. However, information (e.g. norms) is not always easily available, can be ambiguous or badly drafted. Not all fiscal measures are fully considered by the Ministry of Finance; and a major concern relates to the late publication or absence of guidance on the implementation of laws.
3.3 Are tax forms (registration, returns, exemptions, etc.) free?	All forms are available free of charge through the total network of more than 100 tax offices. Entrepreneurs argue that these norms are not always easy to obtain and should be accessible by internet.
3.4 Are advance rulings/interpretation notes regularly circulated to enterprises?	Not necessarily, although they are published and available in advance through the Tripartite Councils. The Ministry for SMEs attempts to disseminate information through newspapers, magazines, etc. Information is not circulated directly to firms. However, through representative bodies such as the National Council of SMEs, attempts are made to disseminate information to SMEs via their business publications and branch operations.
3.5 Are there simplified taxes for small non-incorporated businesses (accounting profit measures)?	There are special procedures for natural persons. They use a simplified book accounting measure and pay global income tax four times a year. Tax is paid in advance (anticipated tax) and there is an end of year reckoning.
3.6 Are there simplified tax rules for small incorporated businesses?	Micro-enterprises (fewer than 9 employees) have simplified rules based on a turnover tax (see 3.9 below).
3.7 Are businesses and their representative bodies routinely consulted on tax legislation?	The main mechanism for consultation is through the monthly Tripartite Council, which includes employer representatives, occasionally with the Chamber of Commerce and other relevant ministries. Consultation with the business community will become an increasingly important part of the Ministry for SMEs' role.

3.8 Is there regular evaluation of the administration of tax rates / incentives / allowances for enterprises?	Although the Ministry of Finance has a special department dealing with evaluation, regular evaluation of fiscal incentives for enterprises is not standard practice and is rarely undertaken.
3.9 What percentage of annual net profits (accounting measure) do SMEs typically pay in tax?	0-9 employees and turnover of up to €100,000 (micro-enterprises): 1.5% of total revenue 9-249 employees: 25% of gross profits
3.10 Which taxes apply to enterprises and how frequent are payment/reporting obligations (monthly, quarterly)?	Turnover income tax: quarterly Business profit tax: quarterly VAT: monthly Property tax: quarterly Customs duties: as required Excise tax: monthly Withholding tax: monthly

4. FINANCIAL INSTRUMENTS FOR NEW AND SMALL BUSINESSES

Indicator	Comment
4.1 Is there a stable and competitive banking system (EBRD Banking Reform and Interest Rate Liberalisation index)?	The EBRD score for banking reform and interest rate liberalisation assigned during summer 2001 was -3. Since then, several changes in the regulatory and supervisory systems have been introduced, which are expected to strengthen the banking sector as a whole.
4.2 Is there a good supply and access to long-term credit for enterprises?	The supply of long-term credit to the enterprise sector is very poor. Domestic credit as a percentage of GDP is very low (11.6%) and decreasing. The little access that enterprises have to loan finance is concentrated on short-term financing to the large enterprise sector.
4.3 Is there a good supply and access to short-term credit for enterprises?	Two-thirds of non-governmental domestic credit in local currency is allocated as short-term credit to private enterprises, whereas only 6% of the total is provided to private enterprises at medium and long-term maturity (data as at November 2001). The supply of short-term financing to the enterprise sector is, however, still small compared to well-functioning market economies and also to the other transition economies which are currently candidates for EU membership.
4.4 Is there a good supply and access to credit co-operatives / credit unions for enterprises?	The financial sector in Romania includes approximately 2,000 credit co-operatives, with aggregate total assets of €125m. However, the collapse of the largest of these co-operatives, FNI, the largest and best known Romanian investment fund (with 300,000 depositors and net assets of €173m) sent another shock wave through the semi-formal part of the sector. This only served to deepen public mistrust of financial institutions in general, caused by the failure of the pyramid scheme "Caritas" in 1993, in which 4 million Romanian investors lost their savings. Most credit co-operatives are now undergoing an extensive transformation process aimed at forming larger conglomerates or at closure. They will be licensed, monitored and supervised by the National Bank of Romania in the future.
4.5 Is there a good supply and access to micro-finance for enterprises?	In the formal financial sector, only MCR and the banks participating in the German Romanian Fund are engaged in significant micro lending. The World Bank is preparing three micro finance instruments for the mining sector, under the Social Sector Development project and the Financial Support for Agriculture project.
4.6 Is there a good supply and access to equity financing for enterprises?	The funds operating in Romania do not target the SME sector as such, since their minimum investment size is between €0.54-1.08m. Given the fact that the funds cannot take majority positions in investee companies, the size of such companies is larger than what would normally be labelled SMEs. Generally, SMEs in Romania rely on own funds and family/friends for equity at start-up level and for expansion purposes.
4.7 Is there a good supply and access to leasing financing for enterprises?	Many small companies provide leasing financing to enterprises. The quality of the service is difficult to judge.

5. INNOVATION AND ENTREPRENEURSHIP

5a. DEVELOPMENT OF BUSINESS SKILLS

Indicator	Comment
5.1 Is there advice and training at national, regional and local levels on start-ups and self-employment?	The National Agency for Employment has active labour market policies focused mainly on the unemployed. The vocational courses which are delivered include a focus on self-employment and thus also on start-ups. Some advice and information is also available through the Business Support Centres and government institutions such as the Ministry of Education and Research. The Phare programme (2001 and 2002) focuses on grants for start-ups, young entrepreneurs and micro-enterprises. Other grants and loans exist to stimulate pre-starts and start-ups, such as the World Bank's programme to support start-ups in the mining sector. The Entrepreneurship Development Programme (EMPRETEC), co-funded by UNCTAD also focuses on the business skills of potential and existing entrepreneurs and improving.
5.2 Are there active labour market policies encouraging the unemployed to generate start-ups and/or become self-employed?	The National Employment Strategy 2002-2004 includes measures encouraging the unemployed to generate such activity. The National Agency for Employment undertakes such training for the unemployed. Geographically-defined policies also exist, such as in the Disadvantaged Zones, but it is unclear how coherent and co-ordinated these policy and associated resources are.
5.3 Are there flexible employment regulations with respect to hiring, firing, wage determination etc?	The labour market regulations are determined by the Labour Code and are generally considered to be flexible and reasonable. A new Labour Code is being prepared which is expected to be implemented in 2002.
5.4 Are there equal opportunities policies covering gender, race, religion, etc.?	Two laws are being prepared: one will ensure equal opportunities with respect to gender issues; and Government Ordinance 137/2000 is modelled on Directives 2000/43/CE (on equal treatment regardless of racial, or ethnic origin) and 2000/78/EC (equal employment opportunities).

5b. TECHNOLOGY AND INNOVATION POLICY

Indicator	Comment
5.5 Are there technology / innovation policies and initiatives?	The Ministry of Education and Research has a National Plan for Research & Development and Innovation covering the period 1999-2005. The focus is on raising the competitiveness of entrepreneurs, especially SMEs, through the introduction of new products, technologies and services. Programmes to stimulate innovation include: new-knowledge based economy

	(e.g. BIOTECH, NANOTECH, etc.); fundamental research (e.g. CERES); and international co-operation (CORINT). Further support is provided through EC programmes, such as the Fifth Framework programme.
5.6 Are there technology transfer and diffusion policies and initiatives?	The Ministry of Education and Research has a department focusing on Technology Transfer and Innovation (TTI) and has developed a number of policies and initiatives in this area, including a focus on SMEs. It focuses on developing legislation to enable TTI to occur.
5.7 Are there links between further education establishments and SMEs to commercialise Research & Development?	As discussed in the body of the report, five such programmes exist. The 49 state universities are encouraging greater development of private sector-university research partnerships throughout Romania. The Ministry of Education and Research has a number of other policies and initiatives in this area.
5.8 Is there protection of intellectual property rights with respect to new products, processes, designs?	The legislation is considered to be reasonably comprehensive. Romania observes the various international conventions with respect to copyright (Law 8/1996), industrial property and patents (through the Office for Trademarks and Patents via Law 64/1991), trademarks (Law 84/1998), drawings and industrial models (Law 129/1992). However, infringements of various sorts (piracy, copying, counterfeiting, etc.) remain a common occurrence. The weakness relates mainly to enforcement capacity.

5c. ACCESS TO BUSINESS INFORMATION AND MARKETS

Indicator	**Comment**
5.9 Is there a Website/brochures with relevant information (starting businesses, import and export regulations, customs duties, taxation, employment, financial information) and registration forms for SMEs?	Various useful Websites exist dealing with specific issues (such as the Ministry for SMEs, Ministry of Finance, Ministry of Development and Prognosis, Chamber of Commerce and Industry), but there is no comprehensive source for this information. The Ministry for SMEs does publish a useful brochure on SME financing programmes on a regular basis.
5.10 Are there business (regional, sectoral, etc.) networks for exchange of information, contacts and lobbying?	Information not available, other than for the Chamber of Commerce and Industry's county network, the National Council for SMEs' network and those of the Employers' Associations.
5.11 Is there business information through advisory centres, Euro-Information centres, etc.?	Yes, a network of Business Information Centres has been established; a Contact Point Network (research organisations and businesses); as well as an Innovation Centre Network (seven centres). This is in addition to the information provided through the Business Support Centres.
5.12 Are there trade exhibitions, fairs and missions organised regularly focused on servicing SMEs?	Yes, through the Chamber of Commerce and Industry, as well as the National Council of SMEs. There may be other organisations engaged in this activity.

5d. ENTREPRENEURIAL DEVELOPMENT

Indicator	Comment
5.13 Are there policies and programmes to foster start-ups and pre-starts?	Some programmes exist, such as the EMPRETEC programme previously discussed in section 5.1 above; other programmes are included in the Ministry for SMEs' Action Plan for 2002 (see Box 4).
5.14 Are there policies and programmes to foster high-tech enterprises with links to universities?	Yes, through the Ministry of Education and Research – at least five such business/university links exist at present. All universities in Romania are attempting to develop these links.
5.15 Can entrepreneurs restart businesses after going bankrupt without encountering much greater obstacles compared with the original start-up?	No major obstacles exist; however, Law of Commercial Companies 31/1990 applies to founders of companies that are debarred from starting companies for reasons such as: fraudulent management, breach of trust, forgery, cheating, embezzlement, bribery, etc.
5.16 Is there an adequate discharge procedure that does not take too long to be completed?	Law 94/1995 states that the bankruptcy procedure can be closed and the debtor discharged only in those cases where the person was not found guilty of fraudulent bankruptcy or fraudulent payments.
5.17 Are these government-supported programmes to encourage the formation of inter-firm networks (at national and regional levels)?	No
5.18 Are there secondary and vocational education courses promoting entrepreneurship?	There is no focus on entrepreneurship education at secondary and vocational educational levels at present. This should become a priority in future.
5.19 Are there higher education business courses and programmes (MBAs, management courses)?	Various courses incorporating elements of business development exist and are increasing. There are three established MBA programmes and one long-distance MBA programme. However, there are no higher level education courses focusing on entrepreneurship *per se*.
5.20 Are there high profile award programmes to raise the profile of successful business people?	There are three such award schemes: the Chamber of Commerce and Industry, the National Council of SMEs and the State Department for Innovations and Trademarks. Additionally, the banking awards include an SME category. No award schemes focus on the public sector and improving the environment/interaction with the business community.
5.21 Are there campaigns to promote public awareness and improve the image of entrepreneurship?	Not at present, but the Ministry for SMEs plans to undertake such a campaign, backed up with conferences in 2002.
5.22 Are there training programmes for public national, regional and local officials to raise awareness of the importance and role of entrepreneurship?	No

6. *SUMMARY OF ADVISORY SERVICES AND SUPPORT MEASURES*

Indicator	Status	Number	Comment
6.1 Are there Business Support Centres?	Yes	Approximately 40	From a high point of about 120 internationally funded and supported initiatives targeted at the SME sector, an estimated 40 such BSCs remain operational. The number is likely to decrease further unless a mechanism is found to assist them. Their focus will increasingly be on providing commercial services to survive, rather than on support to SME activity. In addition, the National Council of SMEs operates 24 centres and there are 8 Euro-Info Centres.
6.2 Are there regional development agencies?	Yes	8	The RDAs coincide with the eight regions in Romania. They are independent bodies reporting to their regional committees. They have substantial resources to implement SME programmes.
6.3 Are there business incubators?	Yes	12	Various business incubators have been funded by World Bank, UNDP and EC resources. The Ministry for SMEs' strategy plans to add to this network of business incubators.
6.4 Are there free trade/enterprise/duty-free zones?	Yes	7	The Romanian free zones are experiencing various degrees of success in attracting investment.
6.5 Are there science / technology parks?	No	0	Only embryonic initiatives exist at present, with about 12 at various stages of feasibility.
6.6 Are there industry / service cluster initiatives?	No		
6.7 Are there business consultancies, etc.?	Yes	400+	There are numerous private sector business-oriented consultancies with various degrees of competence and activity.
6.8 Are there business training organisations?	Yes		In addition to higher education establishments, private sector firms have also been established, but this is unquantified.
6.9 Are there business accountancy services?	Yes		Unquantified
6.10 Are there business law services?	Yes		Unquantified