

# IMPROVING THE ECONOMIC ACTIVITIES IN THE LESS FAVOURED AREAS OF ROMANIA

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**Abstract:** *This paper deals with finding solutions for improving the economic activities in Romania’s undeveloped areas, which still represent a major problem for this country’s economy. During 1999 and 2009, these areas were considered tax havens, due to some facilities accorded by the Government and the EU (headage compensatory allowances\*, tax deductions, non-refundable funds). Many had the opportunity to invest in those regions, but no positive effect was to be seen. Tulcea County (Danube Delta area), coal mine regions, rural areas and the North-East area (Suceava and Botoșani county) are considered to be Romania’s less favoured areas.*

**Keywords:** *less favoured areas, non-refundable funds, tax havens, economic growth, economic activities*

**JEL classification:** *E60*

## Introduction

Nowadays, every less favoured area from Romania represents a major problem for regional development, having a negative impact on Romania’s economy. It is proven that long-term growth strategies for less-favoured areas require especially the development of infrastructure and national institutions, which kept those areas backwards. Since 1999, open trade between countries has been considered to stimulate the economic growth, both at national and regional level. This growth was often suppose to trickle down to less favoured areas. In other words, this was considered a process whereby the economic gains from economic growth would pass down throughout the entire society, eventually giving rise to development.

*\* The objective of these schemes is to provide a reasonable level of income for farmers where natural production conditions are least favourable so as to conserve the countryside by the prevention of further depopulation of rural areas. Compensatory allowances are payable to farmers for the keeping of cattle, sheep and goats. (www.europa.eu)*

People living in less-favoured areas represent around the globe 40% of the rural population, suffering from chronic poverty. In what Romania is concerned, a study from 2010 reveals that closely 33% of the population of Romania is living with less than 200 Euros a month.

Less-favoured areas are defined as „remote regions with limited natural resource base, where problems of chronic poverty and resource degradation tend to be the same. In the same time these areas have a limited agriculture potential, with poor infrastructure and service suport”.

However, it is necessary to distinguish the concept of less-favoured area with development potential. This area would be an ideal place where investment especially in infrastructure and tourism can be productive and sustainable.

A large number of implementing directives comprise the current classification of the LFA of each European Member State into three types:

-*Mountain areas* (rural areas around the Carpathian Mountains) where altitude, climate and slopes, reduce the chance of

investments. The major problem for this areas still represents the process of deforestation, the lack of mountain resorts, and the lack of infrastructure.

-LFAs which are marked by poor soil conditions (especially low agricultural productivity), low population densities or even depopulation tendencies. In Romania Tulcea county (Danube Delta area) could be considered an area with a low rate of investments, low soil productivity mainly because the Danube.

-LFAs which are related to small areas with specific handicaps relating to the environment, landscape development, low agricultural activity, low tourism development. This area in Romania may be found in the North-East of the territory, including Botoşani and Suceava county. This area represents a major undeveloped region of Romania, mainly due to migration to other countries or even in more developed areas of Romania.

To find solutions in order to develop the less favoured areas, some objectives must be established: finding an economic balance between regions, finding new ways to attract new investors, developing agriculture, industry and especially tourism to enhance the value of the local resources, inforce the cooperation between the regional areas.

Two important elements always play an important role for less-favoured areas: defected political institutions and poor infrastructure (poor infrastructure often implies a long transport duration or difficult communication between a LFA and other regions). These two elements are especially revelevant because of their link to the effects on the economic growth. Moreover, the political environment has a strong impact on the economic growth of the less-favoured area, meaning that in Romania the funds accorded by the Government to regions are not equally distributed.

### **Less-favoured mountain areas, and rural areas**

The less-favoured mountain areas, which represent aproximately 29,93% of Romania's territory are the homeplace for 2.400.000 romanians. The economic activities from these areas are mainly those related to the wood and furniture industry, agriculture and animal breeding. In the areas surrouding the Carpathian Mountains, due to the numerous protected areas, tourism is not well-developed, excepting the winter season when the winter resorts are full of tourists practising the winter sports.

A major problem for this area represents the process of deforestation, which causes numerous landslips and floods. It is well know that there is a lack of modern woodland planting that affects negatively the imagine of this area. Once a tree is being planted, it needs around 40 or 50 years to grow to maturity.

The forests offer important resources for the economy of this less-favoured area. Excepting wood, mushrooms, seeds, forest fruits, firtrees, mineral waters represent significant resources.

On a short term, tourism and especially mountains resorts should be considered strong points for developing the local economy, especially during the winter. In addition, due to the speed of falling waters coming from the mountains, hydro-electric power plants could offer to this area a new opportunity to attract new investors, becoming an area stong enough to generate new workplaces and greater amount of „green-energy”.

The less-favoured areas from the mountains (mainly the rural areas) in Romania are characterised by a scattered population and very low quality infrastructure – for example, only 33% of rural residents are connected to a water supply network and only 10% to a sewerage system, while only 10% of rural roads are considered of „adequate standard” with asphalt cover. The basic social infrastructure (health and education systems,

finance) is much less developed than in urban areas. These factors have a negative impact on the quality of life in the rural areas, increase migration, create environment problems, hamper economic development and exacerbate health.

In what rural tourism is concerned, this represents a significant potential which is not sufficient valorised. The tourism sector in 2009 in the rural areas, showed an increase in the number of accommodation structures and accommodation capacity. The development of rural tourism in rural areas depends on the specific of each region, agricultural products, ethnographic regions and folklore. It also depends very much on the existence and especially the quality of the tourist pension, different types of recreation activities, practising agriculture and in some areas winegrowing and animal breeding. For example the specific tourism for Bucovina (North East less favoured area) is religious tourism, in Maramureş it is the architecture and folklore, while in Transylvania the spotlight is the recreational and cultural tourism, food and wine. The mountain and forestry areas in Romania ensure the opportunities for practising tourism, in particular the so called eco-tourism which could be an alternative income, generating in this way different activities that could offer potential development, due to the unique landscapes, native hospitality, well-conserved traditions and food.

Noteworthy modernization, development and innovation are mandatory for Romania's tourism, together with creating modern and competitive tourism products. The main reasons why tourism is not that well developed in these areas are that there is a lack of organisation, promotion, information as well as qualitatively low tourism infrastructure.

The mountain and rural areas are affected by the significant lack of infrastructure which retrains both the economic development and the most important: the quality of life. The roads are the most important transportation

routes, but the quality and development of rural road and traffic is a long way behind the European standard. The undevelopment of the road blocks the economic growth, and interferes with other difficulties concerning the medical and educational services. The road represents the key element for the economic development among the fields of human, social and economic development.

Water supply is another key for the quality of life, as well as in a direct relation to the development of economic activities in rural areas. As an interesting fact in the less favoured areas of Romania only 33% of the rural inhabitants have access to the public water network.

As opportunities for development it is important the exploitation of wood, not exceeding the annual operating capacity, exploiting accessory products (berries, herbs, mushrooms, pine cones), extend forestry product processing industry taking into account regional sustainable development, increasing mechanization of forestry products and create a system to record the number of the cutten trees.

Attracting investors requires a modern infrastructure, forest road development, execution of simple pathways for wood processing machinery. In addition, the mechanization of woodworking would be a step forward in what development of mountain areas is concerned.

#### **North-East less favoured area**

The underdevelopment of this area appears to be correlated with rising unemployment, the prevalence of rural activities and failure to attract foreign investors. The North-East area is marked by the dependence on agriculture, and especially its proximity to other disadvantaged regions (Ukraine and Moldavia). It is the only region in the country with positive natural growth, the share of young population is high, and as positive aspects there is an effective education system in the large cities and skilled labor.

As weakness points, the rate of poverty is

high along with the rate of migration to the outside region, there is a lack of openness to change and especially modernization, the crime rate is higher than in the developed regions. To these are added the aging population of the region, undeveloped spirit of entrepreneurship, poor business support infrastructure, poor implementation of product quality assurance system, the low level of industrialization of wood, insufficient promotion of the region's investment potential, lack of cooperation between universities and the poor quality of public services, the lack of specific knowledge in business development, namely the creation of new jobs.

From an economic perspective, there is already a development of the activities related to the exploitation and wood processing, good financial banking and insurance infrastructure, and a large number of specialists in forestry, trade and public services. The industrial structure is fragile mainly due to the usage of outdated technology, having a negative impact on productivity and economic efficiency.

In terms of tourism there is a high share of private ownership in the tourism sector, the existence of spa and national cultural centers, along with the existence of developing the religious tourism (the presence of monasteries), mountain sports (hiking, skiing, paragliding), and the existence of traditional folklore events of the region.

The road infrastructure is poorly developed between East-West areas of the region, there is also a low percentage of upgraded roads, together with the density of railway lines being unequal in accordance with the distribution of the electrified railways.

Furthermore, the small number of cities with natural gas distribution systems, underdeveloped telephone network in rural areas, poor infrastructure development for leisure activities and outdated water treatment and waste management systems, are the main things to be changed for developing this deprived area.

As geographical influence, the winter contributes to disadvantage the area as many investors fear the harshness of the winter cold weather (in transport, industry).

The North-East region may become a major area of concern for investors, EU supporting less favoured areas. There is a legislative framework regarding the development of this area, providing many facilities to investors, including potential experienced staff for research.

As opportunity, it should be taken into account the privatization and restructuring of state-owned companies, the legal framework of local government involvement in regional development is being favorable to this region. Accelerating the economic recovery and sustainable development represents the key objectives to ensure the overpassing of the actual life condition. Development involves creating the necessary infrastructure to promote the business environment, supporting SME<sup>41</sup>s, developing entrepreneurship, rural development.

In connection with development, the industrial potential should be reevaluated in order to promote existing and new branches of industry. Building up a business infrastructure should help the development of the profitable activities for the less-favoured areas, having a positive impact on the deprived area only with a strict control of the local authorities (in the occurrence of phantom companies without creating new jobs, or poorly paid) and support for access to new technologies, efficient and clean.

Therefore, to ensure the development of the region, it is required effective cooperative ventures to develop effective managerial skills and support technology development.

Although, being a less-favoured area with limited natural resources, human resource is considered a valuable treasure of this region.

Investing in human resources is a priority of any regional development strategy. Just by raising the educational standards and human

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<sup>41</sup> Small and Medium Enterprises.

resource training system, economic recovery could be achieved, raising the standard of living.

Priority strategic directions in the upcoming years should focus on upgrading old roads, upgrading rural telecommunications infrastructure, modernization of water systems, municipal waste by attracting European funding grants. economic growth is the most important indicator of the development of a region. In this way creating a competitive economy is a decisive factor in the evolution of an area or industrial enterprise.

There are assumptions that can form the basis for economic recovery, namely:

- existence of an industrial infrastructure in almost all sub-branches (machine building, chemical, petrochemical, food, textiles, medicines, wood, etc.);
- existence of a well-trained personnel.
- existence of companies in the industry, which benefited from consistent and fresh capital.
- dynamics of small and medium enterprises.

### **Tourism development in the NE disadvantaged**

Tourism is a priority, and by the enhancement of existing targets, improving the quality of tourism services, responding to the actual requirements of customers, the image of tourism could be improved by creating a positive image of tourism in the area.

The region presents many opportunities for various and complex recreational activities: religious-tourism, supported by the existence of an impressive number of churches and monasteries, historical monuments throughout the region; cultural-historical tourism, the existing museums, famous castles and a great cultural heritage and folklore of the region.

For the economic progress, namely tourism, following investment in tourism, agro-tourism support, upgrading roads in mountainous areas can sketch some results:

- Increase the number of visitors to the North-

East region, and investing money in upgrading areas.

- Increase the volume of private investment in tourism.

-Increase the volume of requests for construction of vacation homes that bring additional revenue to local budgets.

-Creating a positive image that offers prospects for large-scale business and investment.

-Working with the media, advertising that will help promote the area.

-Improving the financial situation of the disadvantaged population.

-Scale applications for sponsorship grants for construction of new technologies in the health system.

### **Financial facilities given to the less-favoured areas.**

To assist disadvantaged areas, the Romanian government has proposed that by 2013, these areas should be given various grants and tax breaks to help economic development.

For new investments made in a deprived area, investors can benefit from one or more of the following features:

-full refund of customs duties for machinery, equipment, equipment, vehicles (excluding cars), other depreciable assets which are imported to carry and operate investments in the area, as well as raw materials, spare parts and / or imported components necessary to achieve performance in the area

-exemption from profit tax during the lifetime of the deprived area

-financing special programs, approved by Government Decision

-finance companies investment projects, through co-participation of the state to the social capital

-discounted rates for car transport, inland waterways and rail

-reducing income tax by up to 50%.

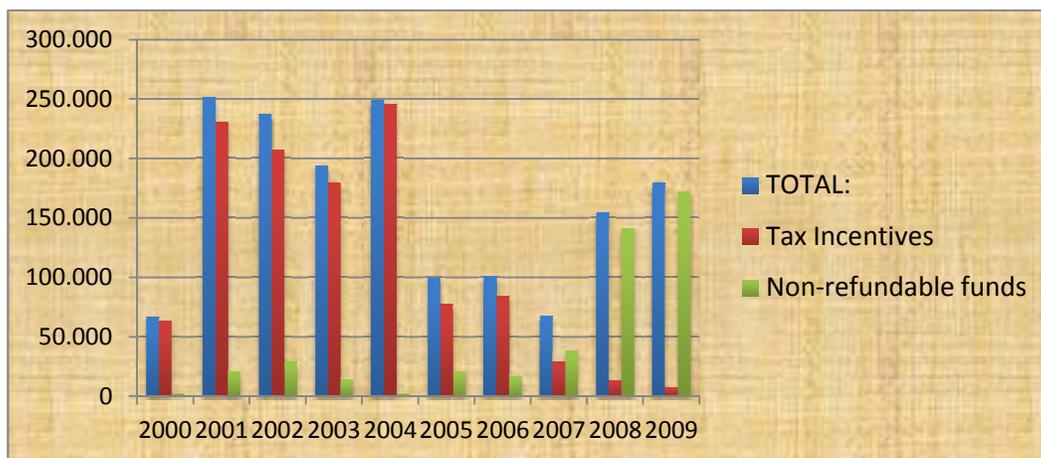
These measures taken by the Government, aim at equalizing currently considered disadvantaged areas, with already developed regions of Romania.

**CASE STUDY: THE IMPACT OF STATE AID TO ROMANIA LESS-FAVOURED AREAS -ROMANIAN GOVERNMENT AND COMPETITION COUNCIL 2000-2009**

Regional development policy is an essential component of the reform process in Romania, mainly aimed at reducing economic and social imbalances accumulated, preventing the emergence of new imbalances and support the overall sustainable development of all regions of the country.

Evolution of regional aid in Romania during 2000-2009 (RON)

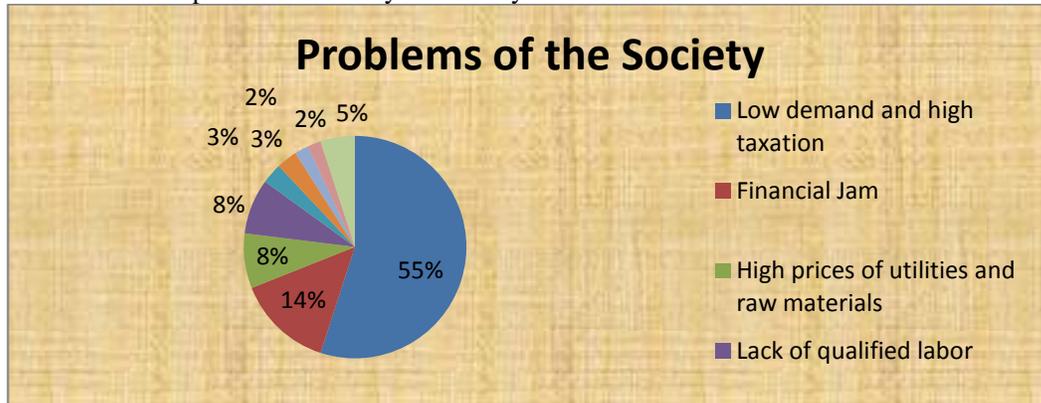
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
TOTAL:	66.384	252.017	237.110	194.155	249.353	99.644	100.948	67.582	154.226	179.376
Tax Incentives	63.800	230.957	207.568	179.476	245.957	77.391	84.162	29.080	13.206	7.130
Non-refundable funds	2.584	21.060	29.152	13.719	2.098	20.944	16.655	38.502	141.020	172.246



The general trend of decrease in the volume of such aid by 2008 is because the vast majority of aid was granted as tax incentives. Since 2007, new schemes have been initiated with the objective of regional state aid, in full compliance with EU rules.

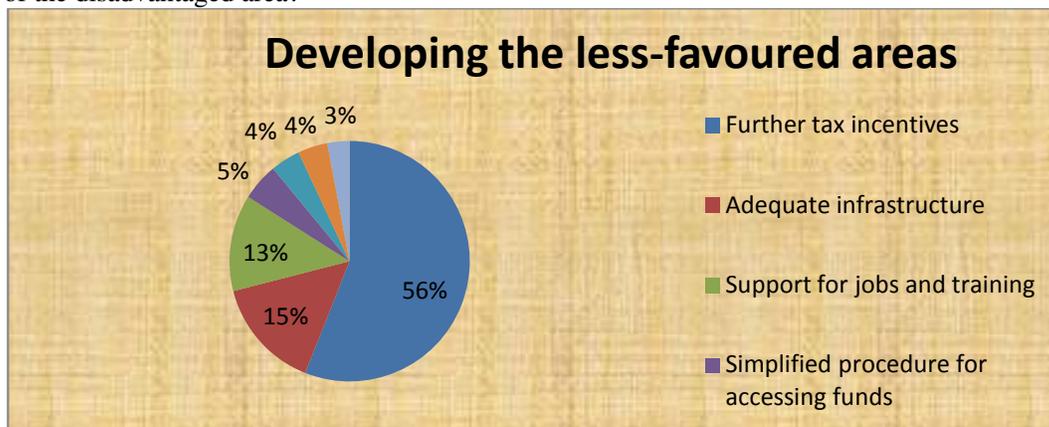
Also while checking operators in June 2010 (a total of 109 from disadvantaged areas), a study was conducted on two questions:

1. "What are the problems faced by the society?"



So it may be noted that the majority consider that there is a low demand due to the current crisis, followed by those who believe that there is a huge financial jam and the high prices of utilities.

2. "What measures do you think the state should take in order to raise the social-economic level of the disadvantaged area? "



**Conclusion**

Disadvantaged areas in Romania were considered tax havens, the ghost business having prospered without bringing any positive aspects to the less-favoured region. A 2010 study, conducted by Pro TV campaign, showed that 33% of Romanians live with a wage of about 200 euros per month. Between 1998 and 2010 there were approximately 160 cities declared disadvantaged, where many companies tried to move its headquarters to

the enjoyment of the exemptions (about 6 billion RON). Companies wishing to relocate their headquarters in these areas had no such development project, creating a monopoly on the labor market, taking advantage providing extremely low wages for people who were willing to work.

Moreover, an investor from a deprived area is required to engage minimum 2 employees residing in that area, which would lead to lower unemployment in the disadvantaged

region. State aid to disadvantaged areas led the companies to develop diversified economic activity, the population has become more responsive to the conversion process. Most companies have relied exclusively on these grants from the government instead of continuing research and finding its own funds, tax incentives were an additional cost for Ministry of Public Finance, who had to make numerous tax inspection. For the best possible structural funds for the development of disadvantaged areas is recommended to promote information campaigns in both economic agents and local authorities. The authorities also need to simplify legislation for obtaining grants. Attracting investors outside the LFA can be achieved by creating industrial parks along with investment in local infrastructure.

Linked to the yield, most traders have noticed a decline in profit in 2005, the period during which state aid stopped, increases recorded in 2006 and 2007, followed by a period of declining profits, because of the decreased number funds granted. Migration factor (or even interregional migration in other European countries) resulted in a decrease of GDP especially the North-East region. However, there are positive signs, as investors obtained licenses in less-favoured areas, have created an estimated 44,300 new jobs (Source: The Competition Council in the year 2009), representing about 5.3% of the total unemployment number.

Less-favoured areas in Romania could easily disappear if the political factor would not have direct impact on the funds granted, only changing legislation and eliminating regional bureaucracy, would lead to an improvement in the economic situation of each region.

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