

SUMMARY

Study regarding

THE SOCIAL AND ECONOMIC IMPACT OF THE STATE AID GRANTED TO UNDERTAKINGS THAT OPERATE IN ROMANIA'S FREE ZONES

BUCHAREST

December 2011

The development of commerce and the alignment of the national economy to the worldwide globalization process lead to the creation of some strictly confined areas on the Romanian territory, for which specific rules were implemented, rules that were similar from a customs point of view to other existent areas in Europe and throughout the world.

It was considered that the existence of some free zones will lead to a business development, a creation of work places and finally, to an increase of the local welfare and not only.

In order to stimulate the execution of investments, there were created support measures for the firms which wished to operate in these locations, which consisted in total or partial exemptions from the payment of tax profit and royalties owed for leased buildings.

According to its attributions, throughout time, the Competition Council has monitored the way the state aid scheme unfolded, collecting information on the investments realized and the aids granted, asking the grantor to recover the amounts that were over the maximum admissible level of intensity.

According to the provisions of article 4 – The policy in the competition field – of Annex VII to the Treaty on the accession of the Republic of Bulgaria and Romania to the European Union, Romania has to send to the European Commission information regarding the eligible costs of the investments made, effectively supported by the beneficiaries and also regarding the total amount of state aid granted to the beneficiaries according to the provisions of Law no. 84/1992 on the regime of free zones.

Considering that the period of time in which these aids can be granted will end on the 31st of December 2011, the Competition Council wished to carry out a study regarding the effects of the implemented support measures.

The purpose of this impact study was to realize an ex-post analysis of the impact of granting state aid having a regional development objective which will allow, in the future, the grantors of state aid to correctly evaluate, ex-ante, the effects of such measures on the economic and financial situation of the potential beneficiary and on the region in which it's carrying on its activity, while still maintaining a normal competitive environment.

The Competition Council would like to use the results of the research in order to improve the governmental policy in the regional development field by granting state aid.

The current impact study represents the result of the monitoring activities taken by the collective of competition inspectors within the Directorate of Reporting, Monitoring and Controlling State Aid within the Competition Council.

BENEFICIARIES

The action of monitoring state aid was aimed at a number of 28 beneficiaries of state aid.

The undertakings monitored carried out their activity in 5 free zones: Arad Free Zone (2 undertakings), Braila Free Zone (2 undertakings), Constanta Free Zone (5 undertakings), Galati Free Zone (2 undertakings) and Giurgiu Free Zone (17 undertakings).

The beneficiaries of the state aid measures have mostly carried on their activity in the following sectors: commerce, services, transport and depositing, constructions and processing industry.

A number of 3 companies are large enterprises, while the rest are SMEs.

For 5 undertakings, the instance decided to open the insolvency procedure, these presently being in different stages of this procedure. Of the 5 undertakings, for one of them it has been decided to close the insolvency procedure, with the company being radiated from the Registry of Commerce.

INVESTMENTS MADE

The undertakings analyzed within the present impact study have spent **14.225.891 USD** in order to realize the necessary investments for carrying on the activities in the free zones and considered eligible according to the provisions within the regional state aid field. The majority of the investments were represented by buildings built on the leased lands, with the rest of the expenditure representing equipment, setting up the terrain/infrastructure etc.

In Table 1 it is presented the breakdown of the investments made taking into consideration the free zone in which the beneficiaries operated.

Table 1 – The value of the investments made in each of the free zones

Free Zone	Total INVESTMENTS		No. of firms	Average investment per firm
	USD	%		USD
Constanta FZ	9.279.670	65,23%	5	1.855.934
Giurgiu FZ	4.232.105	29,75%	17	248.947
Braila FZ	475.713	3,34%	2	237.857
Galati FZ	202.560	1,42%	2	101.280
Arad FZ	35.843	0,25%	2	17.922
Total	14.225.891	100%	28	

Source: The Ministry of Public Finance; beneficiaries questionnaires .

It can be observed that the enterprises located in the Constanta Free Zone account for 65.23% of the total investments made, with the 5 undertakings having an average investment of 1.855.934 USD compared to an average investment of 248.947 USD in the Giurgiu Free Zone.

The value of the investments made, taking into consideration the sector of activity of the beneficiaries, is presented in Table 2.

Table 2 – The value of the investments realized taking into consideration the sector of activity

Sector of activity	Total INVESTMENTS		No. of firms	Average investment per firm
	USD	%		USD
transport / storage / other activities related to transport	8.563.798	60,20%	6	1.427.300
services	3.109.308	21,86%	7	444.187
commerce	1.746.854	12,28%	11	158.805
processing industry	630.279	4,43%	2	315.140
constructions	175.652	1,23%	2	87.826
Total	14.225.891	100%	28	

Source: The Ministry of Public Finance; beneficiaries questionnaires

The enterprises in the transport / storage / other activities related to transport sector account for 60.20% of the investments made, the most in any sector.

STATE AID GRANTED

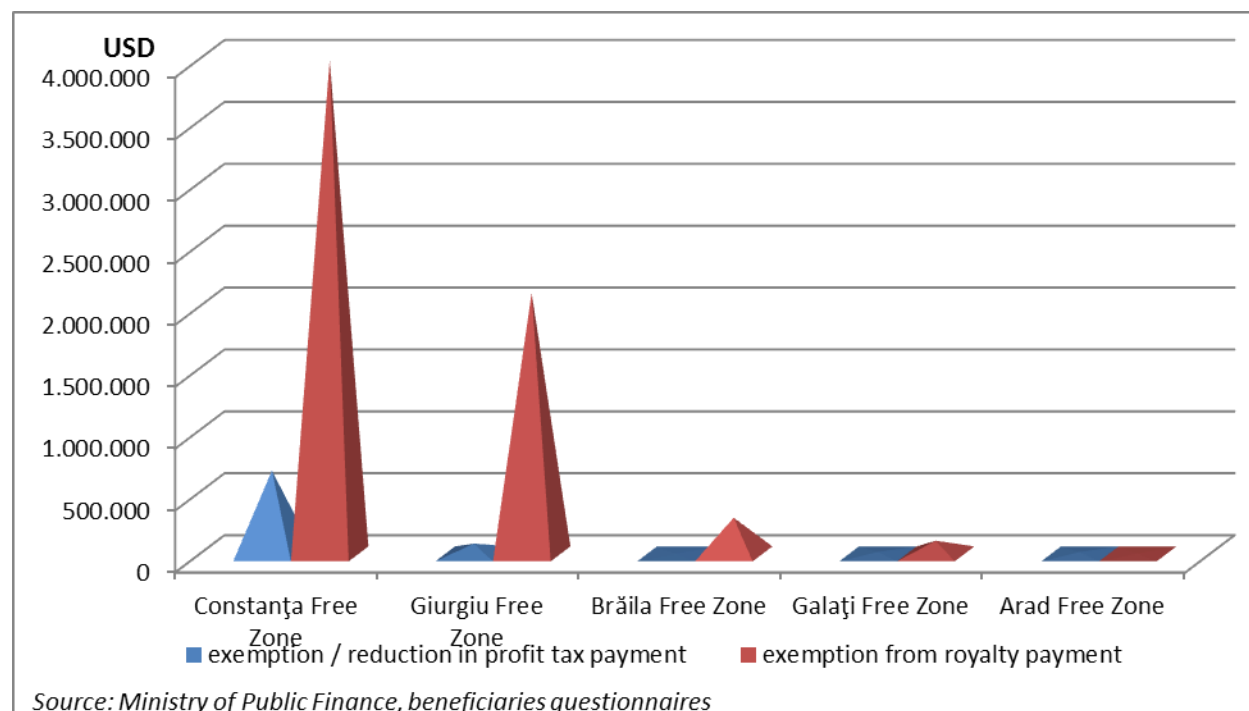
State aid has been granted under the form of total exemptions (2003-2006) or partial exemptions (2003-2004) from paying profit tax to the state budget and the exemption (2003-2011) from paying the royalties afferent to the leasing contract signed between the undertakings and the Free Zone Administrations in which they were carrying on their activities.

The support measures were granted up to the limit of the intensity of state aid, calculated as a ratio between the quantum of the aid and the value of the investments made.

The total amount of the state aid granted is **7.295.916 USD**, out of which 6.501.439 USD represent exemptions from paying royalties and 794.477 USD represent exemptions from paying tax profit.

The amount of the state aid granted, related to the free zones in which the undertakings carried out their activity, is presented below (Figure 1).

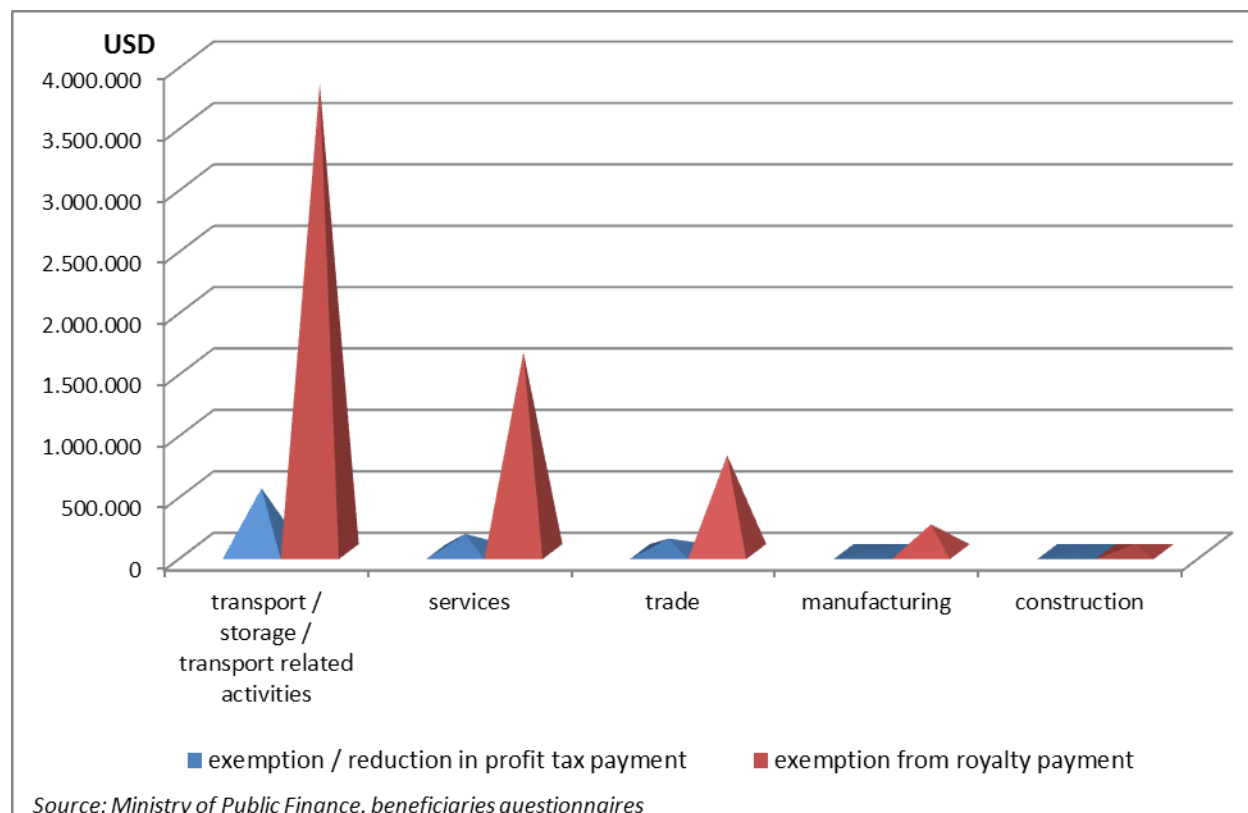
Figure 1 – The amount of state aid granted in each of the free zones



More than half of the state aid was granted in the Constanta Free Zone (63,92%) because of the larger quantum of expenditure made by the undertakings in order to make investments.

Figure 2 shows that the largest share (59,32%) of aid was paid to the companies that have worked in the transport / storage / transport related activities.

Figure 2 - Amount of state aid paid, by sector of activity



Companies in the transport / storage have made significant investments, given their specific activity, which has translated into substantial amounts of state aid (mostly in the form of exemption from royalties).

THE INTENSITY OF THE STATE AID

The aid intensity is an indicator calculated as the ratio of state aid and costs incurred by the beneficiary to achieve the goal set at the time of granting the support measure.

In the case of the state aid granted to the companies from free zones, to determine the intensity level, was used the value of the investments made in the free zones.

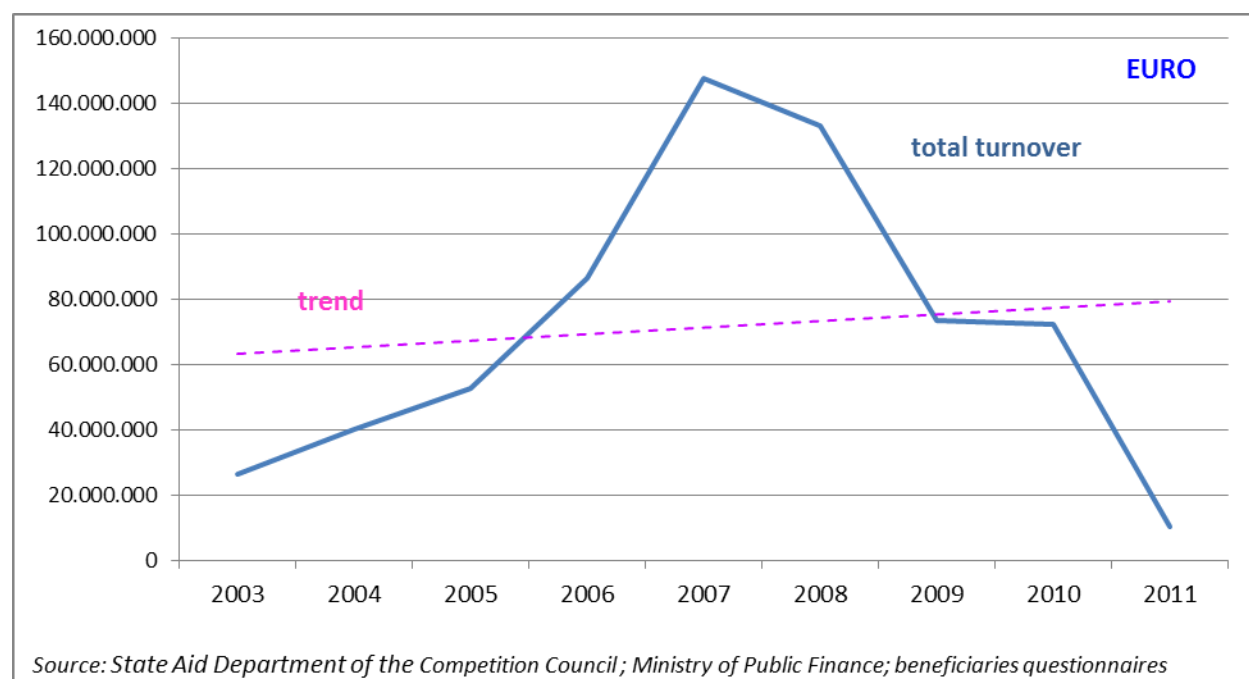
The data sent by the Ministry of Finance showed that, taking into account the total State aid (including in 2011), the 28 companies analyzed did not receive aid over a maximum intensity of 50% for businesses large, 65% for SMEs. The granting of the aid was stopped for one company after the issuance by the Competition Council, in 2006, of a recovery decision for amounts that exceed the maximum level of intensity.

The average intensity calculated as the ratio of total state aid granted and the total investments is 51,29%.

THE TURNOVER

The evolution of the total turnover, during 2003 – 2011 (forecast), expressed in euro, is presented in Figure 3.

Figure 3 – The evolution of the total turnover during 2003 – 2011



An increasing evolution is observed during 2003 - 2007, followed by successive reductions, the first, minor (10%) in 2008 and the second, major (45%) in 2009. The interval 2009 - 2010 was characterized by a relative stagnation of the

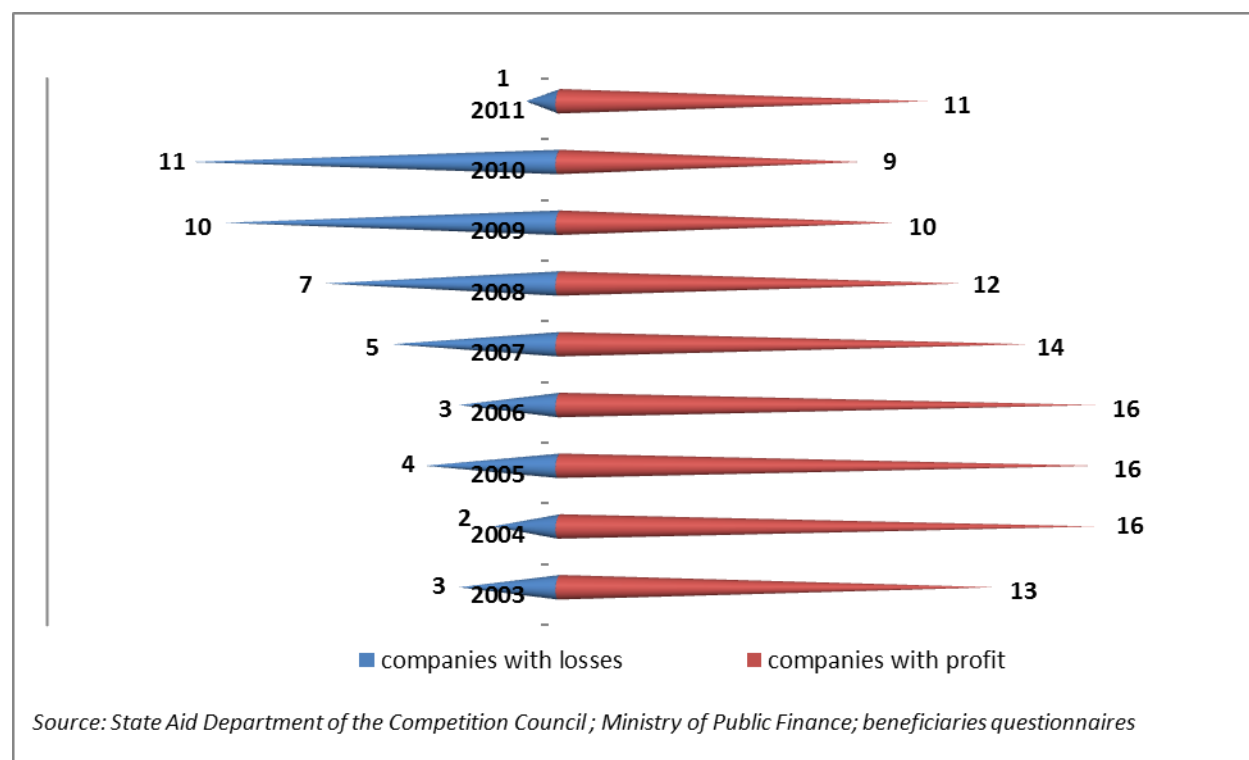
level of total turnover. The year 2008 is when the onset of the crisis in Romania, which explains to some extent the negative evolution of companies.

67% of firms saw declines in the value of turnover in 2010 compared to that obtained in the first year of activity in the free zone (considered after entry into force of Government Decision 1900/2004), which points to a negative trend of the companies monitored.

PROFIT AND LOSS STATEMENT

Figure 4 presents the number of companies with profit or loss in the period 2003 to 2011 (forecast).

Figure 4 – *The evolution of the number of firms with profit or loss, during 2003 – 2011*



It is noted that during 2003 - 2009 most of the companies have completed the financial years with positive results. In 2010, the situation was reversed, 11 companies with negative results and 10 showed a profit. For 2011, 12 companies thought they would end with profit the period.

In all the free areas the firms scored positive and negative results. This could mean that the location was not a factor in obtaining a particular financial result.

OUTSTANDING DEBTS TO THE STATE BUDGET

According to the situation presented on September 30 by The National Tax Administration Agency, there are 8 companies that record outstanding debt to at least one of the state budgets.

The number of outstanding companies and the value of the unpaid obligations at September 30, 2011, are presented in Table 3.

Table 3 – The situation of enterprises with outstanding obligations to the state budget on September 30, 2011

State Budget		Social Security Budget		Unemployment Budget		Health Budget	
No. firms	Outstanding debts	No. firms	Outstanding debts	No. firms	Outstanding debts	No. firms	Outstanding debts
8	1.193.399 lei	6	268.542 lei	3	7.053 lei	6	99.072 lei

Source: Department of State aid of the Competition Council, The National Tax Administration Agency.

For some outstanding tax obligations The National Tax Administration Agency initiated enforcement proceedings to recover outstanding amounts.

THE EVOLUTION OF THE NUMBER OF EMPLOYEES

For most of the companies, during 2003-2010, the number of employees decreased. Only for four companies was an increase in the number of employees at the end of the period analyzed versus the debut. For the other firms, staff size fluctuated in time, the management choosing to dismiss or, conversely, to employ personnel.

The total number of employees, broken down by the free zones where the beneficiaries have activated, is presented in Table 4.

Table 4 - The situation of the total number of employees from every free zone during 2003 - 2010

	2003	2004	2005	2006	2007	2008	2009	2010	No. of firms	Average number of employees / company in 2010
FZ Constanta	918	995	836	740	698	702	511	434	5	87
FZ Giurgiu	795	957	1,019	885	544	529	310	259	17	15
FZ Galati	149	188	152	239	310	269	290	328	2	164
FZ Braila	13	22	7	3	3	3	2	2	2	1
FZ Arad	1	9	12	20	62	117	96	94	2	47
Total	1,876	2,171	2,026	1,887	1,617	1,620	1,209	1,117	28	40

Source: The Competition Council State Aid Department; questionnaires to the beneficiaries; the Ministry of Public Finance.

It can be noticed that there is a general decreasing trend of the total number of employees in every free zone. Taking into account the number of companies which carried on their activity within every zone, for 2010, in the Galati Free Zone there is the highest number of employees (164 per company), followed by the Constanta Free Zone (87 per company). The Braila Free Zone is at the opposite having only one employee per company.

ACQUISITIONS, MERGERS AND CONCENTRATIONS

In the questionnaires submitted to the state aid beneficiaries, the Competition Council also asked for information on the changes regarding the stockholders and on the eventual acquisitions of stocks from other enterprises.

On this occasion it came out the fact that from 2003 until present only one company has changed its stockholders with more than 50%. This concentration was authorized by a Competition Council Decision¹.

THE EFFECTS ON THE COMPANIES

Most of the beneficiary companies considered that there were positive results of the state aid measures in favor of the enterprises that carried on their activities in the free zones, materialized in the following stimulating effects: new

¹ The Competition Council Decision no. 88 from 24.11.2008 on the economic concentration due to the acquisition of exclusive control of S.C. Romtrans S.A. by SCHENKER & Co Aktiengesellschaft

investments, creation of new jobs, development of companies, expenses decrease, profit maximization, cash-flow increase, the decrease of the debts to the banks or the possibility of carrying on the company's activity. There are a few companies that were unsatisfied by the effects of the support measures, considering that they were insignificant.

Taking into account that the regional state aid could reach up to 50% from the total value of the expenses caused by the investments (65% for the SMEs, that represented almost 90% from the total number of beneficiaries), it can be considered that the supporting effect on the economic activity is more than present for the beneficiaries of these measures.

Despite these facts, at the end of the period during which state aid can be granted to the companies that carry on their activities within the free zones, an important number of beneficiaries (18%) entered in an insolvency procedure. One of these companies even finished the insolvency procedure and in 2011 it was erased from the Register of Commerce.

There are different opinions between the representatives of the Free Zones Administrations. On one hand it is considered that there were positive effects on the beneficiaries' liquidities, which also allowed keeping the investments in the free zones. On the other hand there were opinions which claimed that the state aid didn't help very much their beneficiaries.

THE EFFECTS ON THE SECTORS AND THE AREAS IN WHICH THE COMPANIES CARRY ON THEIR ACTIVITIES

In general, the representatives of the companies and those of the Free Zones Administrations consider that the activities carried on within these zones support the regional development both by creating new jobs and by increasing the incomes (and the taxes due for them), of the consumption, by new investments, etc.

Maintaining these companies' activities in normal circumstances resulted in keeping or supporting the activities of the downstream and upstream companies.

The fact that the companies continued to carry on their activities had different effects: maintaining the competition on the market, keeping the jobs,

obtaining revenues redistributed as taxes (130.3 million USD), investments, salaries and dividends.

The state aid granted to these enterprises represents about 5.6% of the current taxes paid by them.

CONCLUSIONS AND PROPOSITIONS

Taking into account the presentation made so far, the most important effects of the state aid measures can be classified as follows:

Positive effects:

- supporting free initiative in free zones;
- realizing investments in the area;
- creating new jobs, even though, overall, the number of employees decreased at the end of the analyzed period;
- employing *qualified* personnel (over 60% of total personnel);
- paying taxes to the public budget (the total state aid granted represents about 5.6% of the taxes paid).

Negative effects:

- many companies relied too much on the fiscal facilities existing within the free zones and they requested for these facilities to be maintained during the following period of time without trying to identify other support measures in order to develop their activities;
- the effects of the state aid were temporary: 35% of the companies that had been interviewed were determined to renounce at their activities after the fiscal facilities end;
- state aid consisting of exemptions from the taxes payment determine a high cost for managing the scheme comparing to the state aid consisting of grants;
- the economic activity within the free zones didn't vary at all. The main activities carried on were storage and trade. The production didn't have an

important weight in the total activities for which the Free Zones Administrations gave licenses;

- a minimum engagement of the local authorities in the development of the free zone;
- the state aid didn't draw major investments in the free zones;
- the fact that the number of companies carrying on their activities within the free zones (measured by the number of concession contracts effective in 2011) is higher than the number of the companies that benefited by state aid, seems to emphasize that the existence or non-existence of some state aid measures in the free zones is not a determinant part in the companies' decision to use the free zone custom regime.
- The poor delimitation from a facility point of view (excepting the custom facilities) between the free zones, the deprived areas and the industrial parks.

PROPOSITIONS

Taking into account all the above, we think that it is necessary for the reorganization of the measures taken by the public authorities for supporting the Romanian free zones in order to maintain this trade system used at international level and to create the premises for new investments and the creation of new jobs.

In our opinion, these are the main actions that should be carried on by the public authorities:

- (a)** Drawing up a national strategy regarding the maintenance and the development of the free zones, mentioning the role this structure would have in the national economy;
- (b)** An active implication of the local authorities in knowing the realities of the economic environment in the area, the identification of the development and innovation opportunities and the encouragement of those that contribute to that;
- (c)** Building by the local authorities of the infrastructure needed within the free zones based on the community funds or in a public – private partnership;

(d) Extension of the Free Zones Administrations attributions regarding to:

- Advising the companies on the financing possibilities from budgetary/ community funds existing at a national level;
- Receiving funds, within the state aid schemes, for new investments.

(e) If it is deemed necessary the implementation of a state aid scheme for the companies which would carry on activities within these areas, the state aid should consist in grants and should depend on new investments and on creating new jobs;

(f) Transforming some parts of the free zones into industrial parks, in order to eliminate the supplementary taxes associated with the free zone customs regime for the companies that don't carry on extra-community trade.