

# Systems of Regional Development Financing: From Classic Mechanisms to Modern Resource Mobilization Channels

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**Abstract.** *The first buds regarding the nature and architecture of regional development blossomed with the genesis of the classical, neoclassical and Keynesian schools of economic thought. We believe that the natural recognition of research in the field took place when the creators of the various schools of thought mentioned, as well as the subsequent ones, decided that a region designates a space, a territory that has a major impact on economic, cultural and social activities carried out within it. Among the widely circulated conceptions with major significance in the coagulation of regional development, we recall: the classical and neoclassical conceptions; the concept of focus on exports; the concept of circular and cumulative causality; the conception of concentration poles or development poles; centre-periphery concept; Marxist conception; the concept of endogenous development; the concept of development in stages; institutional conceptions. Worthy of mention is the fact that all of them have the final goal of ensuring the economic and social well-being of the inhabitants of the respective region by: consolidating and diversifying economic activities, stimulating the growth of demand, stimulating and promoting investments made by the private sector and in the general infrastructure, creating new places of work and the development of human capital, the reduction of unemployment, the promotion of social inclusion, the development of institutional capacity, the superior valorisation of resources, the promotion of decentralization. We believe that, in the coming decades, as community institutions are strengthened, the conceptions aimed at the progress of regional development will "coagulate" giving birth to a more complex theory capable of responding to the requirements regarding the process of simplification and monitoring of the legislation that governs regionalization mechanisms. The multitude and, above all, the complexity of the objectives aimed at ensuring the achievement of the final goal generate difficulties in the process of choosing regional development financing systems, systems whose evolution and decoding we dedicate our effort to. More significant, on which we will focus our attention, we believe to be: budget financing; bank lending; the structural and cohesion funds offered by the European Union.*

**Keywords:** regional development; budget financing; bank lending; structural funds and cohesion funds

**Classification JEL:** F15, F36, G10, G21, H00

## 1. Budget funding - where is it heading?

Identifying funding sources, in order to ensure the sustainability of regional development strategies, an area of acute difficulty in the period that the member states of the European Union are going through. In the case of Romania, in the period 2014-2020, they came to a large extent from the public budget and non-reimbursable European funds. As such, one can safely conclude that without their own involvement, state entities cannot offer a regional development strategy, however modest. In our opinion, the public budget,

regardless of its size, represents the most reliable and available source of financing for any country. As a rule, its positive or negative role in reducing the disparities that characterize the progress of the regions as development entities, involves the use of a set of indicators, the most common being: the budget deficit or surplus, the public debt and the level of the gross domestic product.

• The evaluation of the data provided by EUROSTAT and the National Institute of Statistics for Romania, regarding the mentioned indicators, leads to the following conclusions:

- budget deficits characterize the entire period under review (2007-2020);
- Romania recorded a budget deficit higher than the European average (4.3% in 2017 compared to 6.7%);

- the level of Romania's public debt registered an increasing trend: concretely, the level of the indicator increased compared to 2006 by about 6.20 times. Worth mentioning is the fact that in all the analysed years the public debt fell within the ceiling set by the Maastricht Treaty, namely 60% of GDP;

- the GDP level, starting from 2014, registered a positive trend, increasing from 3.4% to 7.3% in 2017. It is also worth mentioning the trend achieved by the other EU states, with the mention that in these evolution was slower. I believe that the positive evolution of GDP dynamics can be attributed to the European funds accessed during the 2007-2013 period, whose positive impact began to manifest with a gap of several years. This finding demonstrates that, along with public budget resources, the funds absorbed during the mentioned period contributed to Romania's economic growth with repercussions in regional development. In our opinion, the impact induced by budget financing on the progress of regional development requires a rigorous evaluation of some synthetic indicators such as the amount of subsidies allocated from the state budget to local budgets, the level of GDP and the revenues and expenses related to the budgets of the eight development regions from Romania. Our approach especially targets the South-West Oltenia region, the evolution of the mentioned indicators, in the period 2017-2018, appearing as follows:

- the level of subsidies granted of 9,045 million lei out of a total of 12,316 million, places it in fifth place: the level of subsidies, very different, is generated by the existing disparities;

- the GDP level increased from 34016.9 million lei recorded in 2007 to 63927.8 million lei in 2017. Despite the fact that the level of subsidies places it in fifth place, that of GDP assigns it the last place in comparison with the other regions. In relation to the aforementioned, we can state that local budgets do not have the capacity to ensure the financial sustainability of the process of eliminating existing disparities;

- the fragility of sustainability requires a rigorous analysis of the evolution of revenues and expenses, especially of the budget of the Southwest Oltenia region. With regard to the evolution of the revenues of the local budgets related to the eight regions, an upward trend can be observed, in 2018, compared to 2007, the level was higher by 35.63%. The growth rate was in the range under analysis between 28.99% and 41.81%, but the interregional differences were maintained, an aspect revealed by another indicator, namely the share of subsidies from the central budget in the total of local budgets (the margin of variation oscillated between 5.88% and 18.54%). It is also worth mentioning that, throughout the period under observation, almost all regions, except for the Bucharest-Ilfov region, registered an increasing trend. It is also worth mentioning that, throughout the period under observation, almost all regions, except for the Bucharest-Ilfov region, registered an increasing trend. Also, that the highest degree of dependency was virulently manifested in the South-West Oltenia region (18.54% of total income). The increasing trend in the level of subsidies leads us to accept the hypothesis that:

- ✓ The eight regions failed, to a greater or lesser extent, to cover their budgetary needs from local revenues;
- ✓ Regional authorities have promoted ineffective policies regarding the identification of new funding sources;
- ✓ Local entities failed to coagulate effective strategies regarding revenue collection;
- ✓ The ranking regarding the subsidies attracted confirms the level of development of the eight regions and the existing and increasingly accentuated disparities.
- We believe that the approach also requires the evaluation of the degree of coverage of expenses on account of own revenues. A financially autonomous administrative-territorial authority has, in our opinion, the ability to organize itself independently and establish its own development strategy. Only in this way can it eliminate or at least mitigate the economic, social and cultural disparities that separate it from similar entities.

In the interval on which we focused our analysis (2007-2018), the level of expenses related to the budgets of the eight regions registered an increasing trend, the exceptions being specific to the years 2010 and 2016. Another significant indicator is the level of the share of expenses related to each region in the total local expenses registered at national level. Based on the available data, the following conclusions can be drawn:

- ✓ Only the Bucharest-Ilfov region managed to reduce the level of local expenses; in the other regions there was an increase, it is true modest, in the level of expenses in the total of local expenses registered at the national level. The trend of this indicator signals the fact that local authorities have not been able to implement effective policies regarding the efficiency of the resources attracted.

- ✓ The way in which the authorities are involved in the financing of regional development also involves an analysis of the evolution of the structure of expenses related to local budgets at the national level. From the point of view of the targets pursued in the current research, it seems to us that the evolution of expenses related to projects with financing from non-reimbursable European funds and capital projects is significant:

- ✓ The share of the first category of the mentioned expenses registered an increasing trend from 0.78% in 2009 to 15.78% in 2015. The evolution of this indicator reflects the way in which European funds have influenced Romania's regional development strategy;

- ✓ With regard to capital expenditures, the level of their weight fluctuated in almost all the investigated years (from 20.43% in 2007 to 13.58% in 2013). The evolution of the indicator reveals the difficulties of the regional authorities in terms of making the expected investments. Or, without investments, the intra-regional gaps cannot be eliminated, often becoming more pronounced.

In conclusion, taking into account the major implications generated by the progress of regional development, we believe that for the coming years, new actions are required aimed at: prioritization, in terms of the allocation of resources from the public budget; building new indicators to be used in quantifying the results obtained through the funds allocated from the central level; promoting the autonomy of local budgets.

## **2. The involvement of bank credit in the financing of regional development policies**

Bank credit is one of the most common financing mechanisms. But, unlike the others, it involves much higher costs, charged by the banking institutions. Currently, its architecture includes two components, one internal and the other external. The strong point of the credit is that it can be accessed quite easily, of course if the applicants are eligible.

Bank credit is used in the financing process both as an independent source and, most of the time, as a complementary source. In our opinion, for Romania, the objectives of the research should take into account the following aspects: the degree of involvement of banks in the financing of regional development; the banks' product offering in the absorption process; the range of risks assumed by the banks involved in the financing of European projects; the range of loans drawn from international financial institutions.

- Even if most projects are financed in a significant proportion from European funds, during the implementation period the need for complementary resources appears to pay advances to the various providers of services, products or works. Precisely for this reason, the only solution to unblocking the projects remains the support of the banks that the beneficiaries of the projects can receive. Without this involvement of the banks, many viable projects with a significant contribution to the progress of regional development could be abandoned. At the same time, we believe that the involvement of banks in the crediting process generates favorable consequences in terms of increasing the profitability of engaged financial institutions, increasing interbank competition, with visible effects in the evolution of economic growth. We believe that a measure that would encourage the involvement of banks would be represented by achieving the harmony of the norms of the management authorities with those of the banks, regarding the evaluation of projects. In this way, the bankability of the projects could be verified from the stage of conception and, consequently, their sustainability ensured from a financial point of view. The implementation of this measure would give banks greater confidence in lending activity and, at the same time, would contribute to reducing the risks to which they are exposed.

- The offer of banks that support applicants or beneficiaries of projects financed from European funds is quite varied: loans intended for SMEs, micro-enterprises, local public authorities, NGOs, etc., which have as their object the financing of ineligible expenses and the co-financing of eligible expenses. As regards the adaptation of the banks in order to make the process of absorption of funds more efficient, the efforts made by CEC BANK S.A., BCR, member of ERSTE GRUP, BANCA TRANSILVANIA S.A. are visible and UNICREDIT BANK S.A., which created special departments.

SWOT analysis of bank offers intended for beneficiaries of European funds confirms that bank credit represents the complementary financing mechanism of regional development, rather difficult to obtain and which often involves high costs, but at the same time indispensable. Also, despite the mentioned aspects, it represents the safest complementary financing mechanism existing on the Romanian market. At the same time, it should be stated that it represents the mechanism that, compared to other financing systems, guarantees to a significant extent the success of the financed project. The mentioned leads us to affirm that efforts should be intensified to increase the "appetite" of economic operators in the process of attracting this source. Among the possible solutions, we consider the most important to be: subsidizing a significant part of the volume of interest related to loans intended for projects that contribute to regional development; improving the legislation regarding the involvement of banks in the regional development process; the creation of development financing programs to be managed and administered by the competent authorities in collaboration with the banks.

- In the context generated by the progress of the economy in recent decades, no one can dispute the fact that banking activity is subject to a multitude of risks. Consequently, banks are forced to implement coherent risk management strategies, involving in this sense personnel with extensive experience. Only in this way, risks can be identified, measured, reduced and, often, eliminated. The systemic nature of the risks requires that in the process of their management, indicators such as the degree of indebtedness of the debtors, their ability to absorb shocks during crediting periods and, last but not least, the possibilities of repayment in the event of bankruptcy should be evaluated. We believe that, for a rigorous risk assessment, banks must build several

scenarios to identify the most effective solutions leading to their elimination or to the elimination of the effects induced in the course of the financial intermediation activity.

- The reality confirms the fact that Romania in the last decades had the possibility and the opportunity to benefit in supporting the implementation of the regional development process, the growth and diversification of the economy and the financing mechanisms offered by the main international financial institutions, namely the World Bank Group, the International Monetary Fund, the Bank European Agency for Reconstruction and Development, the European Investment Bank and the Organization for Economic Cooperation and Development. Concretely, Romania benefited from numerous and substantial loans, as well as financial services in order to align its economy to the level of developed economies. We believe that a mix between the two financing mechanisms, namely European funds and funds offered by international financial institutions, represents the optimal financing solution for the national economy.

### **3. Non-reimbursable European funds – major source in the financing process of regional development**

If the funds offered by the European Union, especially the non-reimbursable ones, are really a major lever in promoting regional development, we believe that answers are required to several questions, among which the most relevant can be mentioned: is financing through the funds offered by the European Union useful? What are the limits of the absorption capacity of the member countries? Can the impact induced by accessing these funds on economic growth be quantified? We are of the opinion that, only when we have the answers to these questions will we highlight more rigorously the need to use these resource attractions and we will be able to anticipate the future steps to be taken in the regional development process.

- In relation to the answer to the first question, we consider that the following aspects should not be omitted:

- ✓ the non-reimbursable European funds represent those resources allocated to the member countries in order to fulfil the objectives promoted by the cohesion policy;

- ✓ European funds represent one of the most effective financing mechanisms available to member states. Their allocation is correlated with a rigorous regional development policy, which specifies how they can be used;

- ✓ The advantages of using European funds consist in their efficiency, effectiveness and economy compared to classical funding sources. Concretely, within the development policies of a member state, the stages aimed at identifying needs and priorities, designing solutions, estimating the need for human, material and financial resources, creating documentation in order to obtain financing must be prepared professionally and within the predetermined deadlines. All these aspects must be included in the regional development strategy of the member state. In fact, it is worth mentioning that the attraction of European funds does not involve high costs, namely administration, management, risk, insurance costs, with the interest costs that classical attraction involves. Attracting European funds only requires applicants to ensure co-financing, a requirement that, in certain cases, also appears in the case of bank lending.

- The answer to the second question, namely to the limits of the absorption capacity of European funds, is a complex and highly controversial one. It should not be omitted that the absorption policy, especially of Romania, was influenced by a multitude of factors, the most significant being the macroeconomic situation, the ability to ensure the financial sustainability of the co-financing imposed by the European Union and, last but not least, the administrative, institutional and the legislation in the field.

- ✓ Regarding Romania's absorption policy, from the point of view of the macroeconomic situation, no one can dispute the positive impact of attracting European

funds on the economy. Any infusion of funds, larger or smaller, contributed along with other financing mechanisms to the increase in the volume of GDP, respectively to the level of economic growth. Thus, even if in the financial year 2014-2020 the absorption was only 38%, the economic growth was positive. We believe that the effects of attracting European funds on the main macroeconomic indicator will be more correctly identified only in 2023, the last year in which settlements will be made on the financial year 2014-2020.

✓ In relation to Romania's ability to ensure the financial sustainability of the co-financing imposed by the European Union, naturally this factor has repercussions on the absorption policy. I believe that these were not achieved according to the estimates from the strategic documents and the forecasts included in the public budget.

✓ The administrative, institutional and legislative capacity in the spectrum of regional development constitutes another important pillar that influences the absorption of European funds. Unfortunately, reality has shown that Romania did not take into account the mistakes of the member states for a long time, what criteria to take into account in the process of coagulation of the optimal administrative framework and, at the same time, of the ideal legislative support in order to facilitate the absorption. Romania learned more from its own mistakes, which had negative repercussions on the promoted policies.

- Evaluating the impact of attracting European funds on economic growth, especially regional development, is a particularly important concern both for Romania and for the other European Union member states. From the point of view of structural and cohesion funds, three types of analyses: ex-ante evaluation, intermediate evaluation and ex-post evaluation. The purpose of the ex-ante evaluation is to identify the potential impact of the allocated funds on the member states' economies. The intermediate evaluation is carried out during the absorption process, offering solutions for reviewing the adopted strategies. The ex-post evaluation investigates the impact of the funds attracted and contributes to the construction of future forecasts and strategies. Regardless of the type of evaluation chosen, it includes case studies, surveys, stakeholder consultation, macroeconomic modelling, cost-benefit analysis, etc.

Current investigations are based on the use of macroeconomic quantification models, especially in the case of the use of ex-ante analysis, frequently encountered being the Hermin model (Herom in the Romanian version), the Quest model and the Rhomolo model. Their main strength is represented by the fact that they offer the possibility to predict, over a longer and more credible time horizon, the reaction of significant sectors of a state's economy and, of course, to quantify the intensity of this reaction to the infusion of attracted funds. In practice, with the positive evolution of the economies of the member countries of the European Union, several studies based on econometric models were carried out. According to John Bradley, "the expansion of structural funds since the late 1980s presented the European Commission and internal decision-makers with design and impact assessment challenges. Such policies went beyond demand-side stimulation and aimed to promote real convergence, mainly through productivity and supply-side mechanisms. Research suggests that macro-models are potentially capable of extracting pure Structural Funds policy impacts from the background of all internal and external shocks affecting the economy at the same time. However, such results provide only imprecise, lumpy impact estimates, and the challenge remains to reconcile bottom-up analysis with top-down macroanalysis"

In conclusion, the use of macroeconomic simulation models in quantifying the impact of European funds on regional development represents a viable solution in order to anticipate the trend of an economy. At the same time, it should not be overlooked that using them in a wrong way represents a real trap in terms of the impact induced by them in the evolution of economic growth.

The assessment of the impact of European funds on the trend of the Romanian economy and, implicitly, on regional development, was a priority both for the competent authorities and for the European Commission. The agreed models were developed based on the principles considered when building the Herom and Quest theoretical models. Their selection was determined by the fact that both aim at three directions which, analyzed in parallel, provide an overview of a state's economy:

- ✓ The first of the models concerns aspects of supply, demand and income distribution;

- ✓ The second concerns infrastructure, human resources and the private environment.

The use of the two models, according to the opinion of established specialists, attests that the funds allocated to Romania had a positive impact on economic growth, despite the deficiencies and blockages that appeared regarding the process of their absorption, induced by the institutional system and, especially the legislative one.

#### **4. Final conclusions**

The partial aspects derived from the scientific approach undertaken reveal that, in the conditions in which the proposed solutions are not implemented, the economy of a state stagnates, and may even go into recession. That is precisely why, I think that these solutions should be turned into priorities, especially for Romania. Also, that they should be corroborated with the priorities assumed by the European Commission for the 2021-2027 programming period, respectively: the promotion of innovation, digitization and the development of SMEs; eliminating carbon emissions, promoting renewable energy sources, combating climate change; development of transport networks; promoting social rights, job quality, competence, education, equal access to medical services, social inclusion; supporting development strategies carried out at the local level, sustainable urban development. We believe that, only in this way, the regional development strategy that will be promoted by the competent institutions in Romania will generate positive effects that will be felt on the economic and social level, in the conditions where the administrative-institutional and legislative framework and, last but not least, the political one will support it.

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