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Regional patterns of private enterprise development in Romania

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41st Congress of the European Regional Science Association

Regional Patterns of Private Enterprise Development in Romania

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Abstract

This paper aims at uncovering and explaining regional patterns of private enterprise development during the transition to a market economy in Romania. Using available data at regional level, we find different regional patterns of entrepreneurship intensity for new private firms, self-employment and new firms with foreign private capital. Our empirical analysis suggests that home ownership, education, R & D knowledge spill-overs, railway density and potential cross-border traffic have a significant influence on the regional pattern of private enterprise development. Wage and unemployment may play a role as push-factors. Unemployment seems to be indeed a significant determinant of self-employment but not for the case of new private firms. Finally, after controlling for regional geographical characteristics, we find that geographical location matters for entrepreneurship intensity in the case of the north-west region and capital city.

Key words: location patterns of private firms, regional development, transition economies

JEL classification: R12, P23, P27

1. Introduction

The successful transition to a market economy relies on the emergence and development of a sound private sector. International evidence and results from transition economies suggest that private firms perform better than the state-owned firms (EBRD, 1997). Recent studies on transition economies show that privatised and new private firms outperform the state owned firms. A number of these studies focus on the relationship between privatisation and firm performance¹ while a growing number of studies bring evidence that the performance of the *de novo* firms is significantly better than that of state owned and even privatised firms².

The existing literature on the development of the private sector in transition economies is growing. Issues addressed include the legal and institutional framework, the profile of entrepreneurs and their firms, constraints and prospects for future development, shortcomings of the private firms and of government policy, needs for assistance and policy recommendations³.

A special attention in the recent literature on the development of the private sector has been given to the *de novo* firms. Results from transition economies suggest that *de novo* firms are indeed one of the main sources of economic growth (EBRD, 1997, p. 70). For example, in Poland, between 1992 and 1995 the *de novo* sector accounted for two thirds of the industrial output increase (Gomulka, 1997).

As we have already mentioned, many studies have documented the strong performance of the *de novo* firms compared with state and privatised firms. Although in reality there are factors⁴ which could explain this strong performance, the results of surveys should be interpreted with caution due to the sample selection bias. Thus, the conclusion that new private firms are very dynamic could be influenced by the fact that due to the high turnover of the small firms, “good“ firms are rather included in samples because they have survived, whereas “bad“ firms are omitted. The success of the new firms is also related to filling large niches for small and medium sized enterprises left by the command system. Finally, the new entrepreneurs have chosen the promising sectors and locations whereas state-owned and privatised firms have inherited their sectoral orientation and geographical location. (EBRD,1997, p. 72).

A recent study by Berkowitz and Cooper (1997) indicates, however, that the performance of start-ups varies widely across countries. They suggest that there are two vastly different equilibria emerging in transition economies: a high development equilibrium: start-ups supply higher quality goods than transforming SOEs, aggregate supplies are ample and start-ups are a growth engine; low development equilibrium: start-ups provide lower quality goods and the overall of goods is lower; in this paper they develop a dynamic model which explains how features of the transition can push an economy to either the high or low development in the long run: the speed with which bureaucratic interference is eliminated and the speed with which entry by private firms occurs; conclude that delayed entry by start-ups can substantially increase the likelihood of the high development outcome, especially when bureaucratic interference is persistent.

Another subject largely discussed in relation to the development of the private sector is about the small and medium enterprises (SMEs) and policies to support them. Discussion focuses on access to markets and financing (OECD, 1996), entrepreneurship and SMEs (OECD, 1997), the role of the FDI in SME development (Peitsch, 1997), SMEs and regional development (Petraikos, 1995). Acknowledging the job creation role the SMEs sector plays, these studies conclude that an active support for the SMEs sector is needed through promoting a positive entrepreneurial climate and the creation of support structures.

The profile of entrepreneurs and entrepreneurship in transition economies is widely documented in a number of recent studies⁵. The elite of the new private sector and entrepreneurial networks are analysed. One interesting finding is that ambiguity of the legal and institutional frameworks have been used to the benefit of the private entrepreneurship, being a precondition for the redefinition of assets⁶.

Along with the new private firms, an important part of the private sector is constituted through privatisation. One of the most important elements of the institutional change, privatisation is largely documented and debated in a number of studies. The analysis is concerned with preconditions, privatisation plans and policies, results (Earle et. al, 1993, Dyck and Wruck, 1998), the impact of privatisation on labour productivity (Earle and Estrin, 1998), the FDI role in privatisation (Smith et. al, 1997, Cornelli and Li, 1998).

In spite the rich literature by now about the private sector in transition economies, the case of Romania is not enough documented and analysed. The existing papers deal with a specific aspect but there is no comprehensive analysis until now. Thus Earle (1998) analyses the privatisation process and its results while in Palade (1996a and 1996b) and OECD (1997) the development of the SMEs sector is discussed. The legal and institutional framework and the size and characteristics of the private sector are analysed in Zaman (1997). Korca and Oprea (1997) describe the profile of the Romanian entrepreneur and discuss institutional barriers.

This paper analyses the regional dimension of enterprise development during the transition to a market economy in Romania. The question we address is the following: What combination of factors explain the current regional pattern of the development of the private sector?

The motivation of this research is twofold. First, there is a real need in Romania for policy measures to create an enabling environment for the development of the private sector including the regional and local dimensions. Second, the European Union's enlargement, including Romania's accession, make it necessary the rethinking of its regional policy. Our study aims at contributing to these two important policy making processes as well as the academic debates on regional development in transition economies. To our knowledge this is the first paper bringing empirical evidence on the regional dimension of the private enterprise development in the case of Romania.

The rest of the paper is organised as follows. Section 2 analyses the regional characteristics of the private sector in Romania. Section 3 describes the data, model and variables used in the regression analysis. The results of the estimated models are explained in Section 4. Finally, in Section 5 we present our conclusions.

2. Regional characteristics of private enterprise development

Recent evidence suggests that spatial factors play an important role in the development of the private sector in transition countries. Historical and central planning spatial patterns as well as geographical location have contributed to the existing regional disparities of entrepreneurship intensity (OECD, 1996; Levitsky, 1994).

This section aims at explaining the current regional pattern of private enterprise development in Romania. Using available data at regional level we uncover a number of regional determinants of private entrepreneurship. As a proxy for entrepreneurship intensity at the level of regions we have computed the number of new firms with private capital/ 100000 inhabitants, self-employed/100000 inhabitants and new firms with foreign capital/100000 inhabitants as a stock during the period 1990-1997 and for 1997. The results are shown in Figures 1-6.

First, one can notice different regional patterns of entrepreneurship intensity for new firms with private capital, self employed and new firms with private foreign capital. The new firms with private capital are concentrated in the capital city, west and north-west regions and south-east counties bordering the Black Sea. This distribution suggests that the proximity to the west and north-west borders and, respectively, the Black Sea harbour areas may play a role in the development of the private sector. In the case of capital city, the high concentration of new private firms may be explained by agglomeration effects described in Krugman (1991).

Second, the number of self-employed is more evenly distributed across regions. There is little overlapping with the distribution of new firms suggesting that in the case of individual entrepreneurs, other factors explain this distribution.

Third, the regional distribution of new firms with foreign capital shows a high concentration in the capital city, the west regions and the main Black Sea harbour area. External economies of scale and proximity to international connections seem to be important in this case.

To better explain the determinants of the regional pattern of the private sector in Romania we have performed a multiple regression analysis.

3. Data, model and variables

Using regional data⁷ for 1997 we have estimated a number of models explaining the regional pattern of the private sector in Romania. The estimation method is Ordinary Least Squares (OLS). The general model is of the following form:

$$Y_i = \alpha_0 + \sum_{k=1}^m \alpha_k X_{ik} + \varepsilon_i$$

$i = 1, \dots, 41$ corresponding to 40 counties and the capital

$k = 1, \dots, m$ corresponding to explanatory variables

ε = error term

Table 1 shows the variables used for the different estimations and their description. We first used as dependent variable the number of new firms/100000 inhabitants (PRIV), and second the number of self-employed/100000 inhabitants (SELF).

WAGE is a proxy for the willingness to start a new firm. Given the low wage level in state-owned enterprises, one can expect that this is a push factor for the development of the private sector. As a measure for wage we use the average monthly nominal net wage at the regional level. This variable might be endogenous and therefore, we use the one year lagged values. The lower the wage, the higher the number of new start-ups. Therefore, the expected sign for this variable is negative.

U is the rate of unemployment at regional level. The unemployed as a result of firm restructuring could be absorbed in the emerging private sector or become self-employed. The expected sign is positive.

GRP is a proxy for the regional level of development. Developed regions have developed business infrastructures and thus a higher potential for the development of the private sector. The expected sign is positive.

URB is the share of population living in urban areas and is a proxy for agglomeration economies and thus potential external economies of scale. The expected sign is positive.

HOWN is the percentage of home owners at the regional level. We use it as a proxy for access to finance. Collateral is required to guarantee for credits necessary to start up new firms. The expected sign is positive.

EDU is a proxy for human capital at regional level. We use the UNDP education index calculated for the annual Human Development Report. This is a weighted average of adult literacy (contributing 2/3) and gross rate of school attendance (contributing 1/3). The expected sign is positive.

SCIE is a proxy for scientific knowledge spill-overs from research institutions. We measure it with the number of R & D personnel/ 100000 inhabitants. The expected sign is positive.

INFR1 and INFR2 are proxies for physical infrastructures facilitating the development of the private sector at regional level. INFR1 is the density of public roads per 100 km² and INFR2 is respectively the density of railways per 1000 km². The expected signs are positive.

NAT is a dummy variable controlling for the existence of minorities in different regions. It takes value 1 for counties having minorities more than 10% and 0 otherwise. We use this as a proxy for potential cross-border traffic.

IND and DIV are dummy variables for the economic specialisation of counties. IND takes value 1 for the industrial counties⁸ and 0 otherwise. DIV takes value 1 for diversified counties and 0 otherwise. The omitted category is county with agricultural specialisation. If the coefficient of these variables are statistically significant it means that there is a economic specialisation variance between counties.

REG is a dummy for geographical regions⁹.

4. Regression results

Table 2 reports the results of selected estimated models from a number of trials which we do not show all here.

We first estimated a number of models with random effects assuming no variation of the entrepreneurship intensity between counties (equations 1-5) . We find that home ownership, education level, scientific potential, the density of railways at regional level and potential cross-border traffic have a significant contribution in explaining the number of new private firms at regional level. The estimated coefficient are positive as expected.

Wage and unemployment variables have the expected signs, namely negative and, respectively, positive but their coefficients are not statistically significant. The agglomeration effects captured by the urbanisation rate appear positively associated with the entrepreneur-

ship intensity but with no significant impact. Also, our estimates show that the level of development is not significant. Other than expected, the coefficients for this variable are negative suggesting that the number of new private firms is high in districts with a low gross regional product and those activities have a low-added value. These results are consistent with our findings on the de novo private firms in Romania reported in Traistaru (1998).

Equations 6 - 8 include fixed effects for regions. We introduce dummy variables for the economic specialisation of counties assuming that the entrepreneurship intensity is different among the counties with different specialisation profiles: agricultural, industrial, diversified.

After controlling for fixed effects the findings reported above remain. The factors having a significant impact on the development of the private sector at regional level seem to be home ownership, the education level, potential scientific knowledge spill overs, physical infrastructures expressed as the density of railways at regional level, and potential cross-border traffic expressed as the existence of minorities above 10 %.

To further investigate the effect of regional variance, we estimated eight restricted fixed effects models. The results are reported in Table 3. Home ownership is significant for all geographical regions excepting the west, centre and capital city. The education level is significant except for the capital city while the scientific potential remains significant with the exception of the north-west region. Agglomeration effects seem to be important in the north-west region while the coefficients of regional dummies are significant in the cases of capital city and the north-west region suggesting that these two regions have a significantly different composition of factors explaining the number of new private firms. For the other variables the estimated coefficients are not significant. It is worth noting that the sign for wage is positive for the south-west and north-west suggesting that it is rather a high level of wages associated with a high number of new private firms. Also, the coefficients for gross regional product are positive as expected for the centre and capital city indicating the presence of private activities with high value added. The unemployment appears with the expected sign for all regions excepting south-west suggesting that the high unemployment in this region may discourage the development of the private sector. This is a region with restructuring mining and heavy industries benefiting of active labour market policies includ-

ing programmes for self-employment and the development of the private sector. It seems that these efforts have not yet proved successful in the case of this region.

Finally, we have estimated the number of self-employed at regional level. Table 4 shows the estimates obtained for one model (best fitted). In this case, unemployment appear to be a push factor for individuals to starting a private business. Home ownership is no longer significant suggesting the lower scale of businesses which do not require access to credits. Also, the urbanisation rate has a significant negative coefficient suggesting that this type of entrepreneurship is more likely to be found in rural areas. However, potential scientific knowledge spill-overs remain significant and positive, while the education level is positive but not significant. The regional distribution of self-employed is not concentrate in counties with a big percentage of minorities like it is the case with the number of new private firms.

**Figure 1. Regional distribution of new firms
with private capital/100000 inhabitants registered in Romania
between December 1990-31 December 1997**

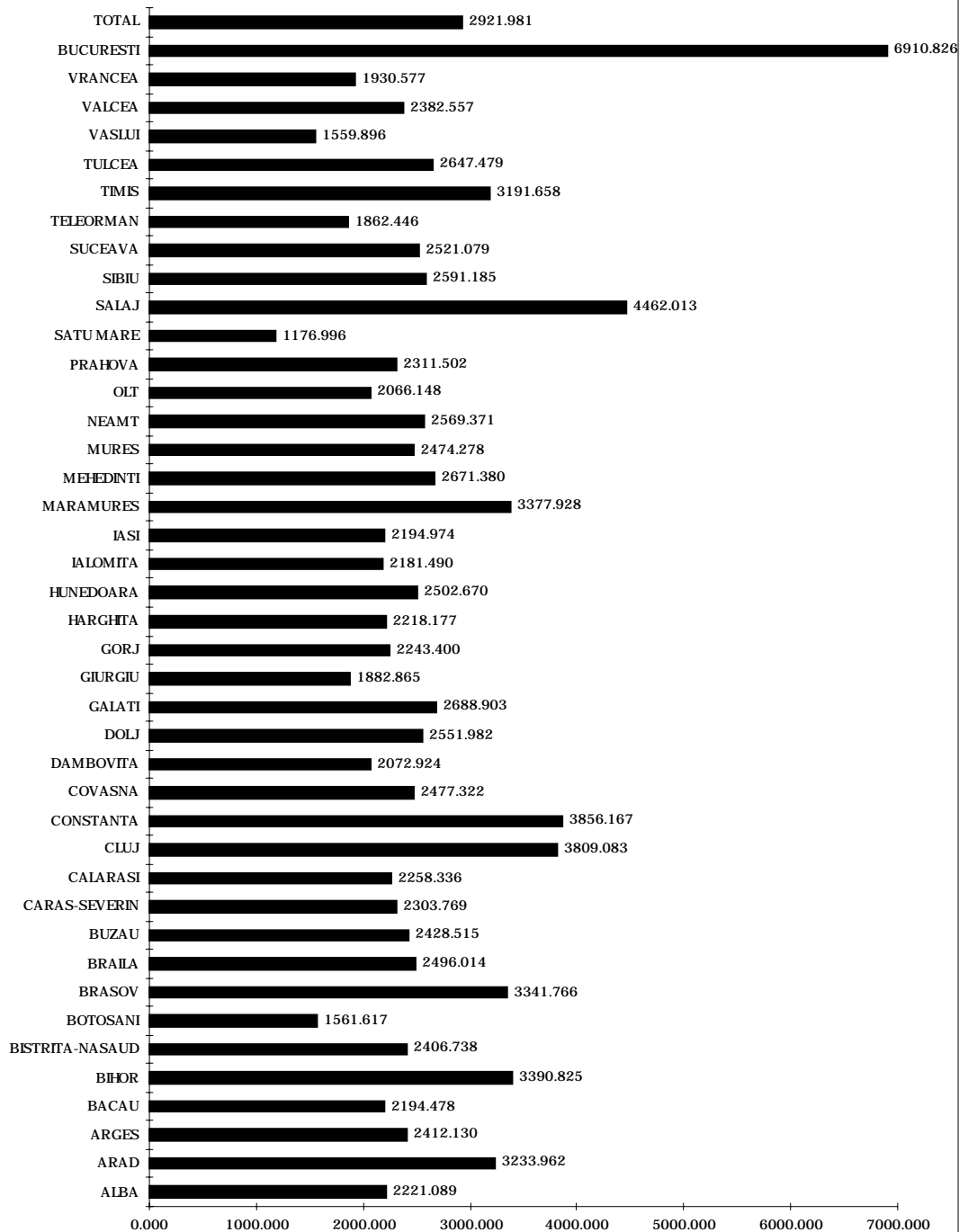


Figure 2. Regional distribution of new firms with private capital/100000 inhabitants registered in Romania in 1997

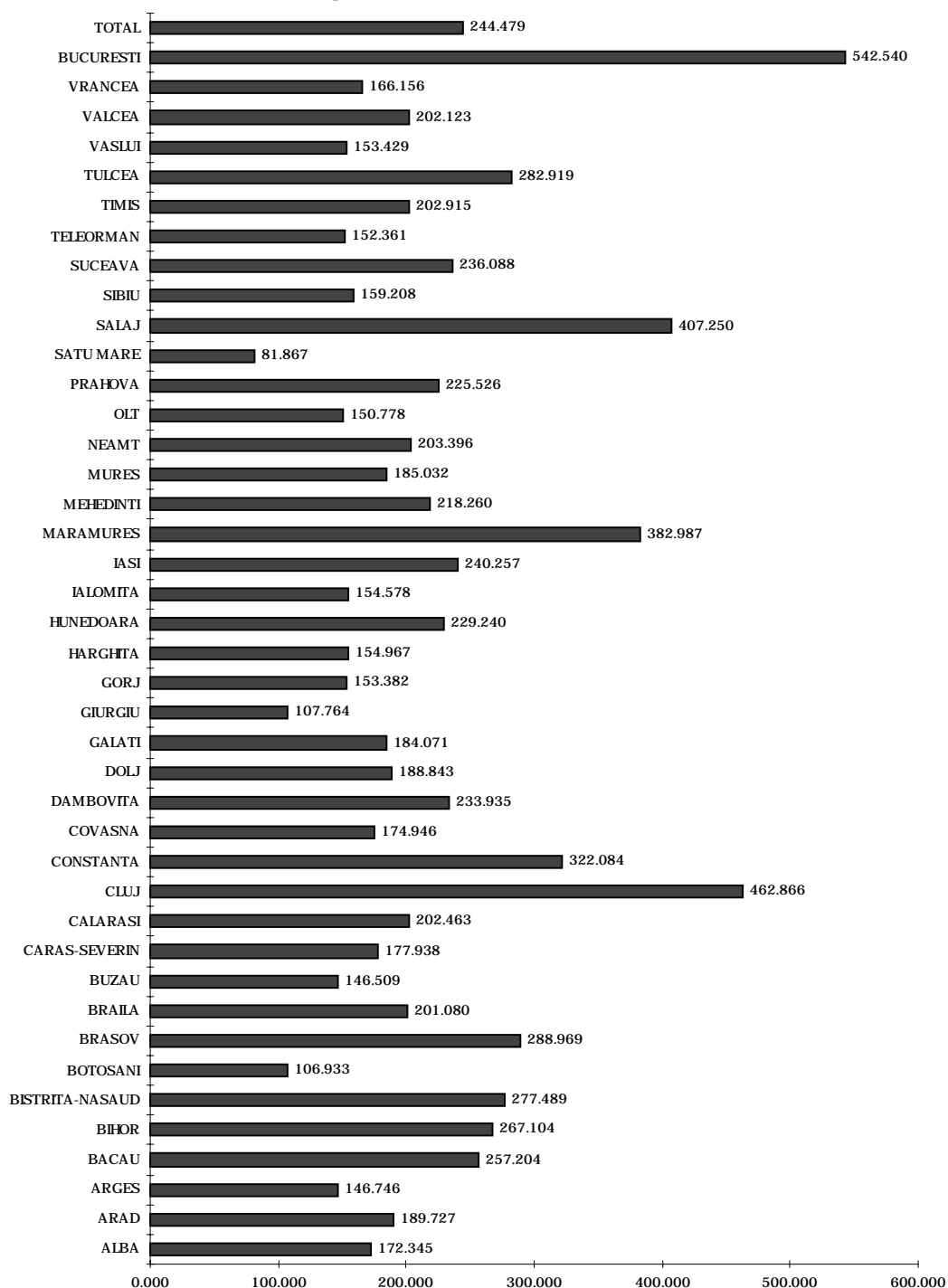


Figure 3. Regional distribution of self-employed/100000 inhabitants registered in Romania between December 1990-31 December 1997

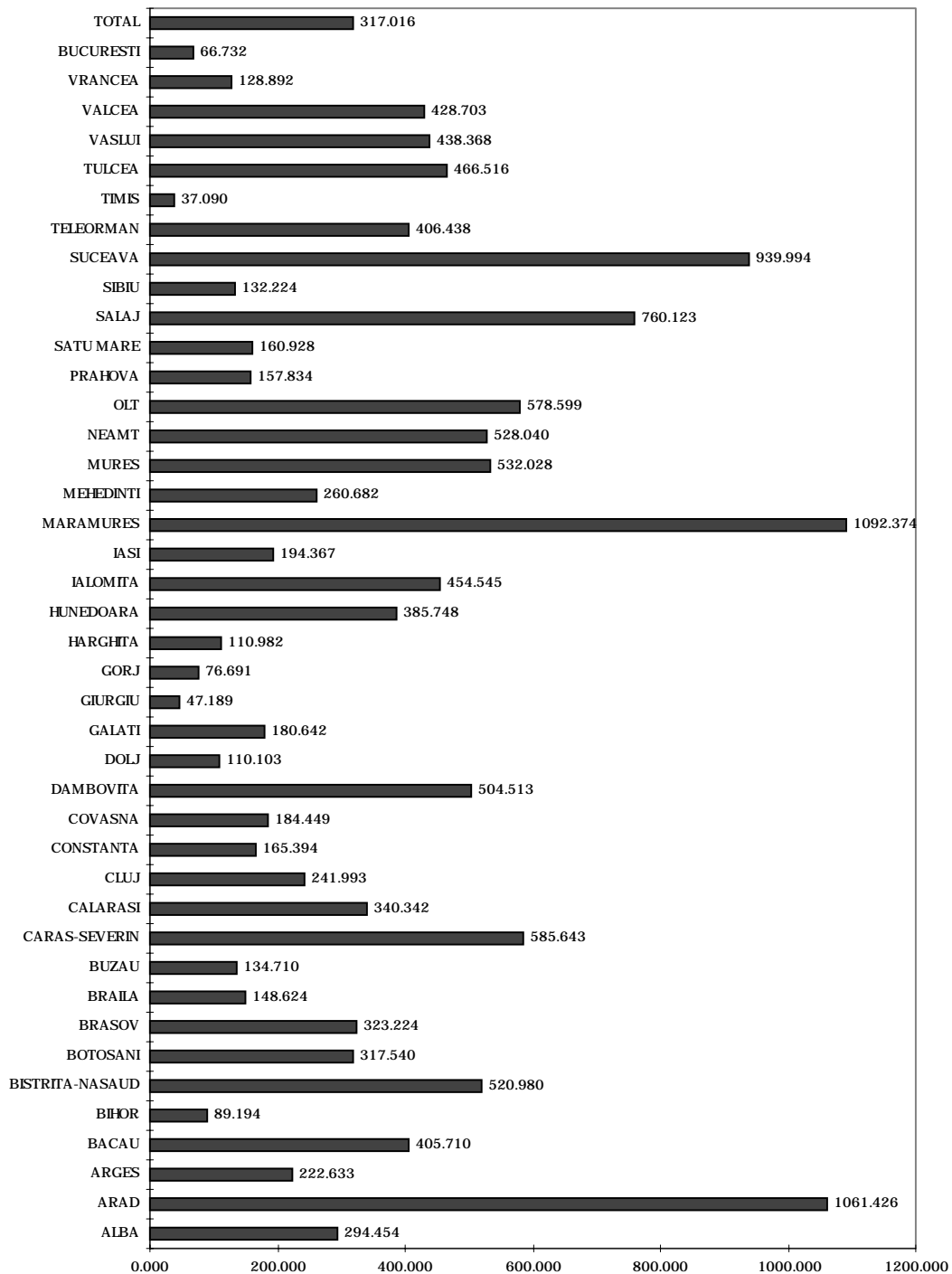


Figure 4. Regional distribution of self-employed/100000 inhabitants registered in Romania in 1997

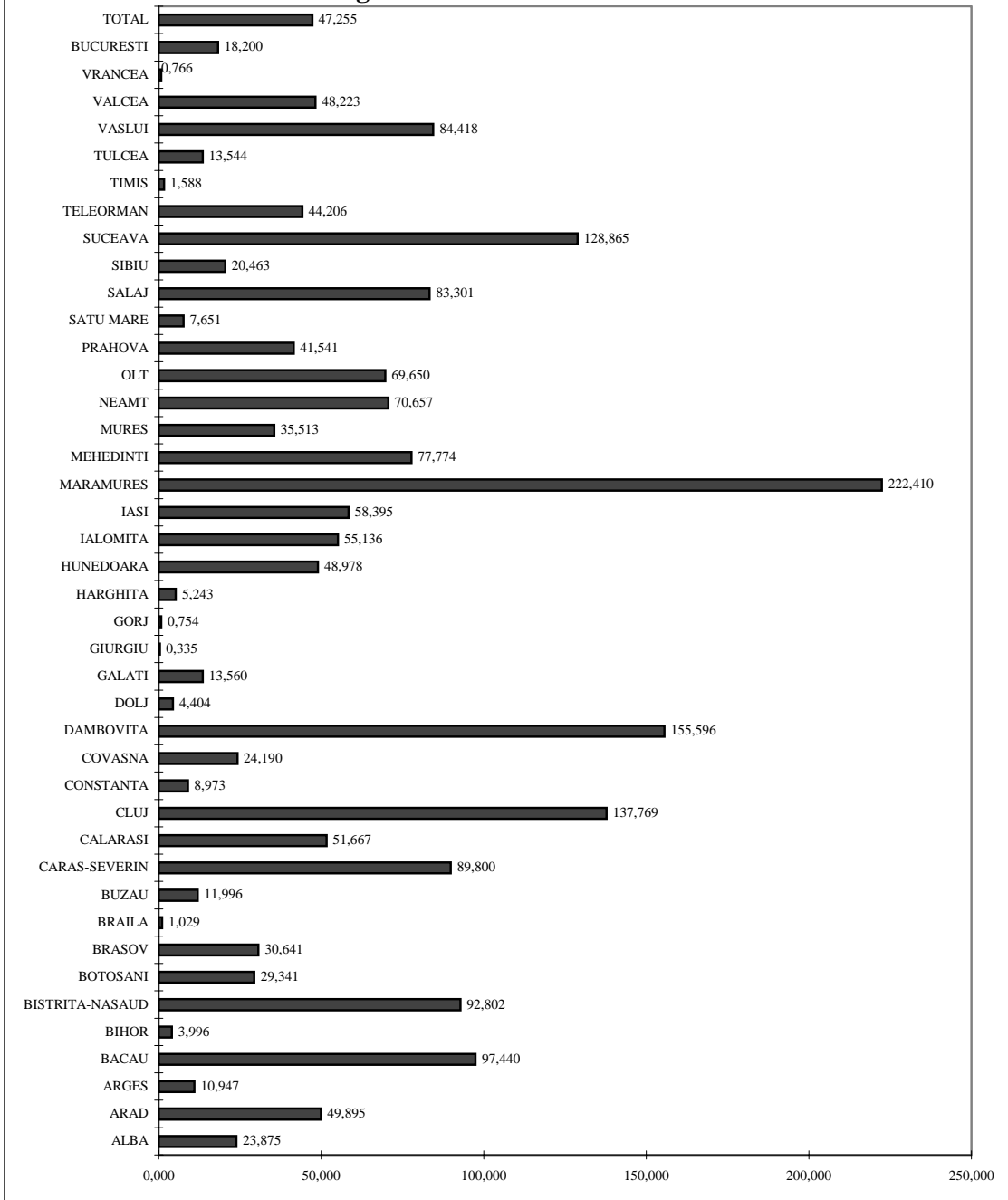


Figure 5. Regional distribution of new firms with foreign capital/100000 inhabitants registered in Romania between December 1990-31 December 1997

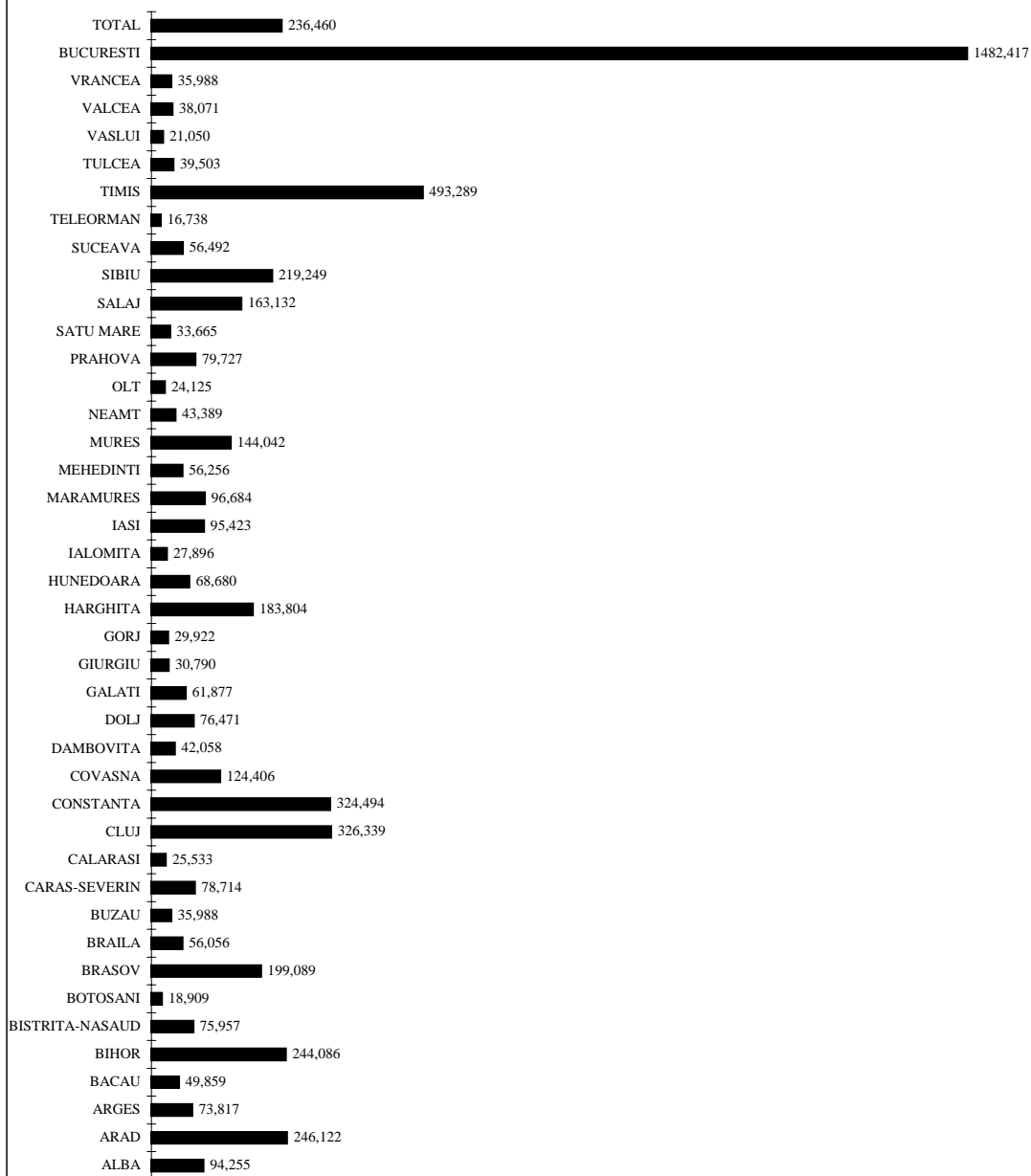


Figure 6. Regional distribution of new firms with foreign capital/100000 inhabitants registered in Romania in 1997

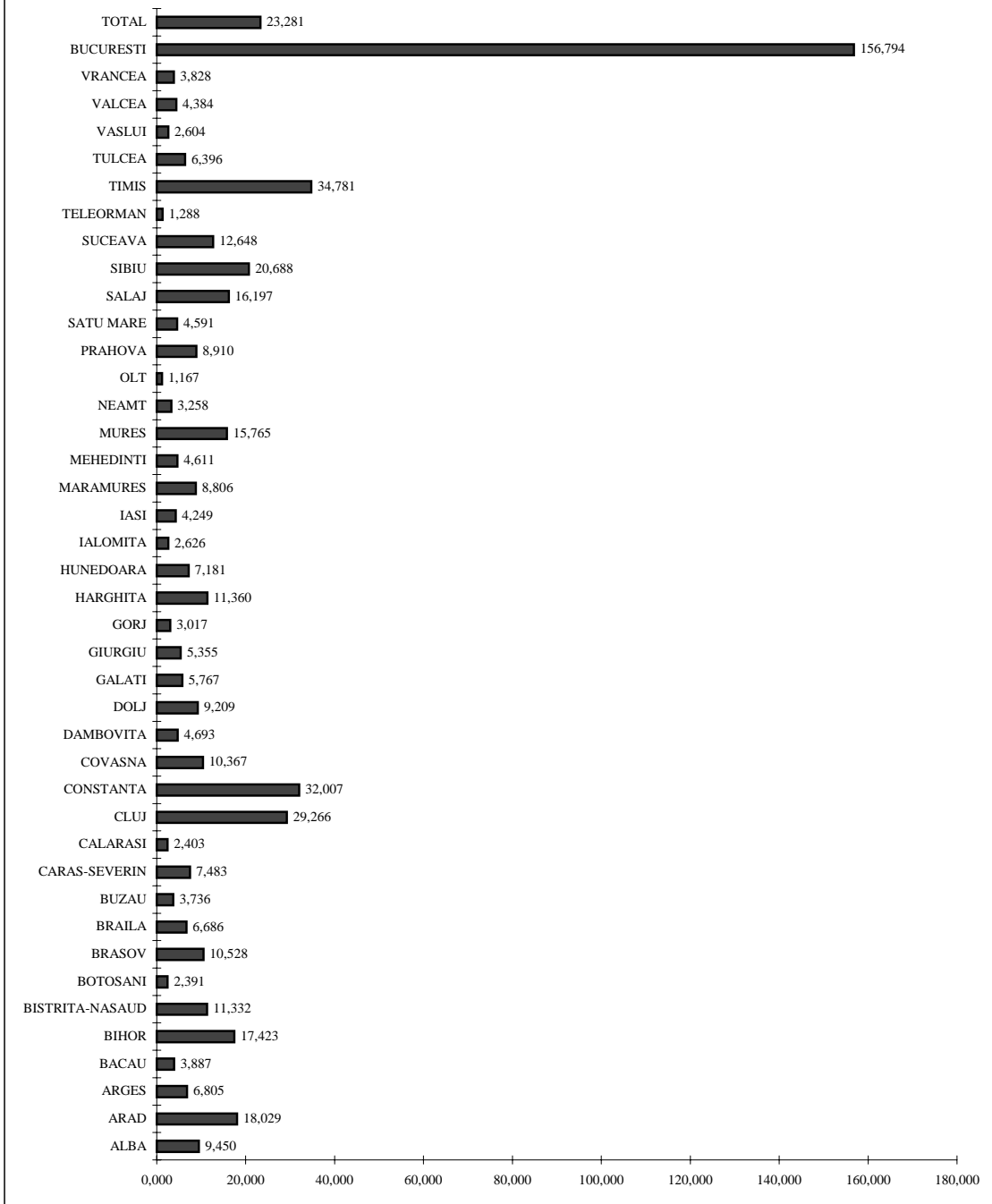


Table 1. Variables and their description used in model estimations

Variable	Description
PRIV	number of new start-up firms with private capital /100000 inhabitants (dependent variable)
SELF	number of self-employed/100000 inhabitants (dependent variable)
WAGE	average monthly nominal net wage
U	unemployment rate
GRP	gross regional product per capita
URB	the share of urban population
HOWN	the percentage of home-owners
EDU	UNDP education index (weighted index of adult literacy and gross rate of school attendance)
SCIE	R & D personnel/ 100000 inhabitants
INFR1	density of public roads/100km ²
INFR2	density of railways/1000 km ²
NAT	dummy variable taking value 1 for counties having the share of minorities above 10% and 0 otherwise (proxy for potential cross-border relationships)
IND	dummy variable for economic specialisation : 1 for industrial counties, 0 otherwise
DIV	dummy variable for economic specialisation: 1 for diversified counties, 0 otherwise
REG	dummy variable for geographical regions

Table 2. Ordinary Least Squares Estimates of the number of new private firms at regional level

PRIV	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
WAGE	-0.059 (0.465)							
U	0.302 (4.386)					0.549 (4.372)		
GRP	-0.005 (0.046)	-0.005 (0.036)						
URB	2.132 (1.627)	1.603 (1.594)	1.558 (1.542)	1.254 (1.460)	0.747 (1.433)	1.946 (1.492)	1.036 (1.512)	0.693 (1.483)
HOWN	7.518* (3.933)	8.213* (3.879)	8.350* (3.713)	5.728 (3.688)	8.151* (3.777)	7.735* (3.822)	5.802* (3.769)	8.595* (4.014)*
EDU	1655.52* (831.55)	1912.61* (790.87)	1864.31* (709.10)	1258.80* (643.68)	1255.05* (620.67)	1550.50* (674.01)	1090.79 (692.50)	1247.85* (679.56)
SCIE	0.089* (0.048)	0.083* (0.047)	0.083* (0.046)	0.106* (0.045)	0.094* (0.044)	0.087* (0.049)	0.103* (0.047)	0.096* (0.046)
INFR1		-1.428 (1.953)	-1.469 (1.906)					
INFR2				0.271 (0.163)	0.361* (0.164)		0.308 (0.171)	0.365* (0.170)
NAT					48.599* (25.461)			55.003* (32.245)
IND						10.792 (37.122)	23.107 (35.799)	5.129 (36.367)
DIV						12.643 (30.407)	25.534 (29.904)	-8.959 (35.415)
Constant	-1972.2* (721.57)	-2198.4* (718.20)	-2187.9* (704.57)	-1479.2* (697.29)	-1704.4* (682.63)	-1942.9* (680.55)	-1351.9* (727.97)	-1738.8* (743.23)
Adj. R²	0.404	0.430	0.446	0.478	0.514	0.405	0.458	0.488

standard errors in parentheses; * statistically significant at 5% critical level

Table 3.

OLS estimates of the number of new firms with private capital for the eight geographic regions of Romania

PRIV	NE	SE	S	SW	W	NW	CEN	CAP
WAGE	-0.053 (0.471)	-0.051 (0.468)	-0.093 (0.473)	0.188 (0.518)	-0.098 (0.471)	0.209 (0.435)	-0.233 (0.490)	-0.109 (0.451)
URB	1.989 (1.703)	2.637 (1.774)	2.205 (1.648)	1.457 (1.741)	2.237 (1.644)	2.645* (1.495)	2.419 (1.642)	1.113 (1.676)
GRP	-0.010 (0.049)	-0.009 (0.046)	-0.006 (0.046)	-0.009 (0.046)	-0.001 (0.046)	-0.027 (0.042)	0.009 (0.047)	0.017 (0.046)
HOWN	7.288* (4.046)	8.472* (4.164)	7.395* (3.980)	8.267* (3.986)	6.485 (4.207)	6.317* (3.615)	5.894 (4.189)	4.500 (4.170)
EDU	1763.84* (903.16)	1577.56* (843.85)	1764.85* (861.76)	1870.88* (853.72)	1554.46* (848.87)	1497.82* (60.68)	1391.33* (862.90)	997.97 (886.06)
SCIE	0.090* (0.049)	0.085* (0.049)	0.091* (0.049)	0.084* (0.048)	0.087* (0.049)	0.034 (0.048)	0.084* (0.048)	0.115* (0.049)
U	1.180 (5.164)	0.520 (4.426)	1.036 (4.614)	-0.254 (4.407)	0.360 (4.418)	1.295 (4.017)	0.320 (4.372)	2.682 (4.453)
REG	-14.360 (42.975)	-27.218 (36.712)	20.560 (36.041)	-44.573 (41.619)	-31.808 (43.590)	94.628* (34.219)	-42.655 (38.737)	187.31* (105.18)
Constant	-2019.3* (744.92)	-2005.9* (727.97)	-2052.0* (742.35)	-2240.5* (762.30)	-1796.9* (765.43)	-1761.8* (662.69)	-1604.9* (792.83)	-1177.0* (829.39)
Adj. R²	0.387	0.395	0.391	0.406	0.395	0.504	0.407	0.440

standard errors in parentheses; * statistically significant at 5% critical level

Table 4. OLS estimates of self-employment at regional level in Romania

SELF	
U	5.611 * (2.527)
HOWN	-1.496 (2.352)
EDU	200.419 (381.307)
URB	-1.836 * (0.879)
SCIE	0.130 * (0.028)
INFR2	0.134 (0.106)
NAT	12.151 (15.794)
Constant	45.465 (421.745)
Adjusted R²	0.337

Standard errors in parentheses; * statistically significant at 5% critical level

5. Conclusion

This paper uncovers and analyses regional patterns of private enterprise development and sources of enterprise learning during the transition to a market economy in Romania. Our research suggests the following policy relevant conclusions:

1. Using available data at regional level, we find different regional patterns of entrepreneurship intensity for new private firms, self-employment and new firms with private foreign capital. The new firms with private capital are concentrated in the capital city, west and north-west regions as well as south-east counties bordering the Black Sea. This distribution suggests that the proximity to the west and north-west borders and, respectively, the Black Sea harbour areas may play a role in the development of the private sector in Romania. In the case of the capital city, external economies of scale from agglomeration economies may explain the high concentration of new private firms.
2. The number of self-employed is more evenly distributed across regions. There is little overlapping with the distribution of new firms suggesting that in the case of individual entrepreneurs other factors explain their distribution.
3. The regional distribution of new firms with private foreign capital shows a high concentration in the capital city, the west region and the main Black Sea harbour area. Agglomeration economies and proximity to international connections seem important in this case.
4. After controlling for several factors, we find empirical evidence indicating that home ownership, education, R & D knowledge spill-overs, railway density and potential cross-border traffic have a significant influence on the regional pattern of private enterprise development. Wage and unemployment may play a role as push-factors. We find that unemployment is indeed a significant determinant of self-employment but not for the case of the new private firms. Our empirical analysis suggests that the entrepreneurship intensity is influenced by regional geographical characteristics. Thus, we find that geographical location has a significant influence on the number of new private firms in the case of the north-west region and the capital city.

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Endnotes

¹ See, for example Pohl et al. (1997), Belka et al. (1995), Earle (1998), Earle and Estrin (1998) Roberts et. al (1998)

² See, for example Commander et al. (1996), Konings et al. (1996), Bilsen and Konings (1996), Konings (1997)

³ See, for example, Borish and Nöel (1996), Brezinski and Fritsch (1996), Johnson and Loveman (1995), Webster (1993a, 1993b), Webster and Swanson (1993)

⁴ For instance, as mentioned in EBRD (1997), the small number of owners are able to monitor the management themselves and also new combinations of plant and equipment and skills put together by entrepreneurs

⁵ See, for example, Tas (1996), Grabher and Stark (1997), Johnson (1993)

⁶ See Grabher and Stark (1997), Johnson (1993)

⁷ This data has been made available by the National Commission of Statistics and the National Trade Registry of Romania

⁸ We use the taxonomy of regions in Romania determined in Kallai and Traistaru (1997). The criteria are described in Huber and Scarpetta (1995). According to this taxonomy, for instance, the industrial specialised counties have the share of employment in industrial activities half a standard deviation above the country mean

⁹ The eight geographical regions are North-East, South-East, South, South-West, West, North-West, Center, Capital city.

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