



# **EEPO Review: Start-up incentives, September 2014**

Romania

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European Employment Policy Observatory (EEPO)

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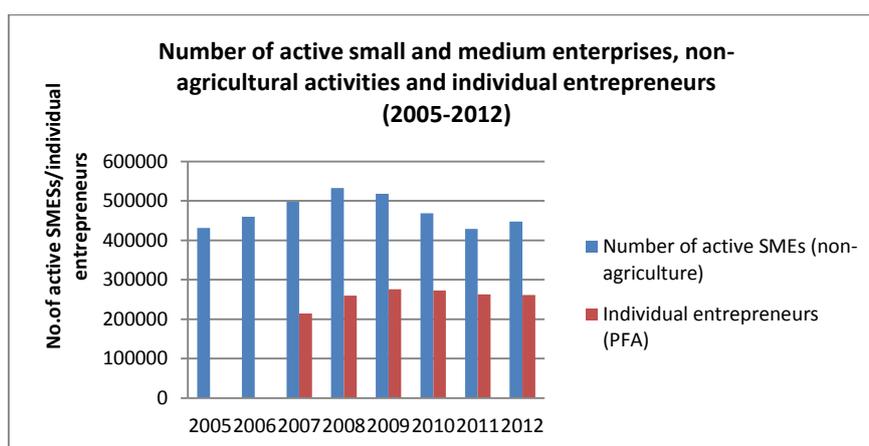
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## 1 Introduction: start-up incentives as an active labour market measure

Start-up incentives have not been slow in coming to Romania's labour market. As early as the mid-1990s, and using the existing framework of the first Unemployment Insurance Act (Law no.1/1991), the Romanian government initiated measures to support business start-up by jobseekers and by the unemployed as an alternative to dwindling salaried employment opportunities as former state owned enterprises were restructured or liquidated. This particular support measure, which with some changes is enforced even today and is the oldest form of start-up incentive in place in Romania, aimed at providing a credit line, at a subsidised rate (50 % of the rate of the National Bank of Romania), to small entrepreneurs/jobseekers willing to set-up in business or small enterprises willing to develop and create jobs. The measure took into account the scarce availability of credit in Romania at the time as well as high interest rates designed to cope with high and volatile inflation. It has been taken up, starting in 1999 by the newly established National Agency for Employment (NAE, the RO PES), and kept in place as one of the active employment measures in the newly designed Unemployment Insurance Act of 2002 (Law no.76/2002), currently applied with changes and amendments as Law 250/2013. The measure as such has been more or less kept in its original form, although some more facilities have been added so as to provide would-be entrepreneurs in the rural areas or in areas with high unemployment, as well as for students with start-up loans with interest rates as low as 25 % of the key interest rate applied by the National Bank of Romania. However, it has to be said that not much application of the measures has been seen. The scheme looked for some time redundant due to the bureaucracy involved in the completion and submission of the dossiers to the local employment agencies, the necessity to select each and every year a commercial bank to manage the loan scheme, and the fact that credit conditions and availability markedly improved once Romania entered a period of strong growth around 2003-04. There was even talk of dismantling the measure and removing it from the body of the law. While this did not happen, allocations for it have always been scarce and sometimes did not cover the whole of a fiscal year, with this occurring even when the unemployment insurance budget recorded a surplus between 2005 and 2009. Following the advent of the crisis, the measure has regained some importance as tightening of the credit conditions increased its attractiveness. However, scarce funding for the unemployment fund, which following the sharp downturn of the economy in 2009-10 fell back into deficit, meant that yet again there was little funding available.

**Chart no.1**



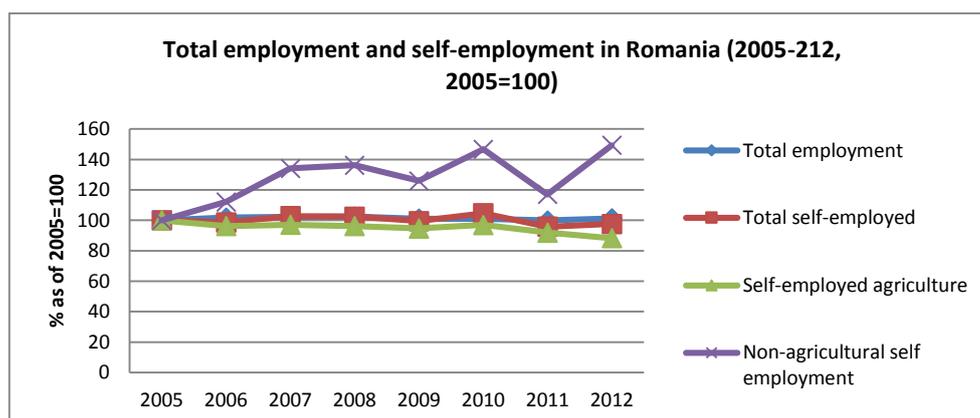
Source: National Institute of Statistics data, processed by Dr C. Ghinararu

Apart from this measure, governments through the first part of the 2000s were slow in incentivising start-ups as they thought generally that good market conditions would cater for it. Moreover, unemployment was falling sharply so apparently at least jobseekers were able to either find a job quickly or set-up in business without need of government help. Nevertheless, in 2008, the liberal government in its last year in office initiated a specific

act of law (Ordinance no.44/2008) that allowed for the creation of a simple form of self-employment, dedicated mostly to individual professionals but also to small craftsmen and traders known in Romanian as *Persoana Fizica Autorizata* - PFA ('Licensed Individual Professionals'). This simple form, which allows an individual to perform professional activities on an own-account basis, keeping simple records while allowing also for the simultaneous engagement in salaried employment, enjoyed significant success. The simplicity of the registration, the fact that only simple records can be kept, and the possibility of also maintaining some form salaried employment in the meantime were all valuable aspects for when the economic crisis hit the Romanian economy hard. According to statistics of the Register of Commerce (the body responsible for the registration of all commercial entities), during the latest economic downturn the number of the PFAs increased sharply with more than 40 000 such entities being registered in 2009 and 2010 alone and the trend rising at the same time as the number of firms fell drastically. While at the beginning the main domains have been consultancy, IT development, research, technology development, starting from 2011, agriculture has taken the lead with almost 20 000 such entities newly registering (2011). Although no financial incentives are available for this form of self-employment, which clearly appeals to professionals willing to move from dependent employment, the simplicity in registration and operation acts as an implicit incentive.

As an anti-crisis measure at the beginning of 2011, the Romanian Government launched a new scheme via Ordinance no 4/2011 called 'Debut limited liability company' (*Societate cu raspundere limitata - debutant* - SRL-D), which clearly aims at encouraging young people to set-up in business. The scheme which targets potential entrepreneurs below the age of 35 provides for a start-up grant equivalent to a maximum of EUR 10 000. Facilities also include an exemption from the payment of the employer's share of the mandatory contribution to the public pension scheme (without this affecting in any way the pension rights of the employees, although there is a cap on the number of 'pension points' to be accumulated for the period of exemption). There is an obligation of hiring at least four employees for the duration for which these facilities are granted, which is for a period of no more than three years. Conditions are also that the potential entrepreneur be a novice in business, with no previous record of having had a company or of being an associated owner or shareholder previous to the application for the scheme. The programme has run with budget funds ever since and, apparently, it has been quite successful.

**Chart no.2**



Source: National Institute of Statistics data, processed by Dr C. Ghinararu

To date this scheme has found its place in the Youth Guarantee action plan for 2014-15, being supplemented with additional provisions in the country's 2014-2020 Human Capital Sector Operational Programme (POS Capital Uman). It therefore makes for the country's most recent and most successful self-employment scheme, being particularly appreciated by young professionals for whom the provision of an initial grant as well as the facilities offered in terms of social security contribution is very valuable. It has to be mentioned that applicants also benefit from consultancy and support via the specialised agency for small

and medium enterprises of the Ministry of the Economy (which has run the scheme since 2011). They may also access credits up to the equivalent of EUR 80 000 and benefit from the guarantee offered by the Romanian Small and Medium Enterprise Guarantee Fund.

While all of these measures attempt to make life easier for small entrepreneurs and incentivise especially young people to start-up in business, they still lack both the scale and the scope to significantly impact on the labour market. Limited availability of funds made it difficult for both the National Agency for Employment as well as for the Ministry for the Economy to provide support to all those willing to apply. Moreover, in the latter case, the small amount of the initial grant means that activity developed remains small unless the young entrepreneur is bold enough to use credit facilities and thus continue development. Incentives business start-up therefore remain limited to date by the economic condition of the country, which has barely emerged from both the economic downturn of 2009-12 as well as from an Excessive Deficit Procedure which kept its options for stimulus limited between 2009 and 2013.

## 2 Start-up incentives today: detailed description

We will begin our journey into the detail of the Romanian system of start-up incentives by looking first at the oldest of the measures that we briefly announced in the introduction, the subsidised loans from the Unemployment Insurance Fund. While we have also described this measure in our contribution to the last year's EEPO review on hiring subsidies we will nevertheless endeavour again to highlight those elements that make it also function as an incentive for start-ups while nonetheless maintaining also its previous character. Its dual role may also explain its longevity and resilience in spite of the changing economic and social circumstances through which it has passed and to which it had to adapt sometimes for better and sometimes for worse, ever since its first introduction into the body of Romanian specific legislation in the mid of the 1990s.

The measure, Subsidised credits for entrepreneurs to stimulate employment generation for small and medium enterprises and start-up entrepreneurs, provides credits for a maximum duration of three years, only to be used for investment purposes and only for enterprises undertaking activities or willing to start operating in production or services (retail and wholesale commerce are thus excluded- a feature retained since its first introduction in the 1990s). Credits are granted from the unemployment insurance fund to the applicants and bear an interest rate set at 50 % of the key interest rate (*rata dobanzii de referinta*) of the National Bank of Romania (NBR) (*Banca Nationala a Romaniei* - BNR) for the respective period. In special cases and only where the rate of unemployment for the previous year has been higher than the national average, the rate of interest maybe set at 25 % of the key interest rate of the NBR. The law also provides in special cases for the possibility of accessing non-reimbursable funds (i.e. the source of the funding being the unemployment insurance fund; not to be confused with the EUs structural funds)

**Target groups:** The measure targets both existing enterprises as well potential entrepreneurs. Students up to the age of 30, provided that they are for the first time enrolled in higher education as well as that they are undertaking their studies within accredited higher education institutions, may also benefit (in this particular case and by exception the rate of interest applied is of 25 % of the key interest rate of the NBR). Beneficiaries may also be the unemployed, licensed professionals, cooperatives and family associations

**Permanent or temporary nature of the incentive:** The measure is permanent in its nature. Subsidised credits are only offered for a period of three years. Beneficiaries of a subsidised credit may receive a new line of subsidised credit only once they have fully repaid the first one, including the interest and eventual penalties.

**Amount and duration of incentives:** Amounts provided to one entity are not limited but an implicit limitation exists as the budget allocations via the unemployment insurance fund are fixed through the social insurance budget law, annually voted by the Romanian Parliament and which includes the provision for the unemployment insurance funds. It is

therefore often the case that funds are only enough for a few applications/applicants. The duration of the incentive is limited to a period of three years; a six month grace period may be granted.

**Conditionality imposed on recipients and possible target sectors:** targeted sectors are production and services with the inclusion of tourism. There is no particular targeting on social enterprises but it is worth mentioning that licensed individual professionals may also receive it even to finance their own job or in proportion to the number of jobs additionally generated to their own. The same conditions apply to family associations. However, the main conditionality relates to employment. Enterprises applying or start-up entrepreneurs (including students) are granted credits in direct relation to the number of jobs newly created (for single entrepreneurs even their own job if newly created, thus qualifying the measure as a start-up incentive also). At least 60 % of the newly appeared vacancies must be filled by registered unemployed. All newly created jobs must be maintained for a period of at least three years (including their own job if this is created with the support of the subsidised credit facility) while jobs for the unemployed must be maintained for a period of at least five years. Eventual replacements must be made also from unemployed people registered with the local offices of the NAE.

**Complementary services offered to the beneficiaries and institutional cooperation partnerships:** There is no mandatory provision for any counselling services but as the credits are granted only based on a feasibility studies first examined by the local employment agency in cooperation with the bank chosen to operate the scheme, the local PES must offer, upon demand, free of charge counselling and advice for the elaboration of the feasibility study and the business plan. No other forms of cooperation and support are foreseen except if local arrangements are in place between the local PES and the local business communities or other associations.

**Amount of public resources mobilised, financing methods and sources:** The scheme is entirely funded from national funds with the allocations being made yearly via the social insurance budget voted for by the Romanian Parliament. Financing is given via loans at subsidised interest rates (see above). The whole operation is undertaken via a commercial bank selected through competitive procedures, annually, by the National Agency for Employment. There are no other facilities granted to the beneficiaries but it is worth mentioning that once the loan is repaid, a new loan may be accessed by the same entrepreneur. Annual allocations for the last decade have been small. In some years, as the reports of the NAE show, there has been no allocation for this specific measure.

**Monitoring and evaluation system:** Monitoring is done via both the bank as well as the National Agency for Employment for employment targets. If these are not complied with, sums received have to be returned at a penalty rate. Apart from the administrative evaluations of the measure undertaken regularly by National Agency for Employment no impact assessment per se has been performed. The last independent evaluation took place sometime in the mid-2000s. Currently, the Ministry of Labour has just contracted with the National Labour Research Institute for an assessment of all active measures. The work is to start in September of this year and it is planned to last until the end of 2015.

**Interaction with policy measures to provide income security to new entrepreneurs:** Entrepreneurs accessing the measure benefit from full coverage of the mandatory state run social insurance schemes, such as pensions, unemployment and health. Employees hired under the scheme also benefit from mandatory insurance. There are no exemptions so far from the payment of contributions. The same principles apply to all of the beneficiaries without distinction with respect to their form of business organisation. If cases of business failure, standard procedures are followed. No facilities in this respect are granted as such. However, if unemployment insurance is paid (in the case of licensed individual professionals this is voluntary) then unemployment benefit is received in accordance with the legal requirements.

**Interaction with policy measures to prevent bogus self-employment:** No such measures are in place but it is generally considered that given the current structure of the

law and regulations in place for the measure, it would be hard to resort to that. The mere fact that credits are linked directly to the number of jobs created makes it difficult to develop such practices. However, there are no such cases documented (there is not enough evidence to establish that the measure in itself would lead to such side-effects). Its rather limited application may be a reason for that. It is therefore probable that a more extensive and extended application would make such measures a necessity.

As outlined in the introduction, a second measure is 'Debut limited liability company' (*Societate cu raspundere limitata - debutant* - SRL-D), enacted by the Romanian Government in early 2011 in direct response to the economic crisis, which has had a significant impact upon the Romanian economy with its limited capacity to generate jobs bearing the brunt of the negative effects. Accordingly, Ordinance no.4/2011 was issued with clear targeting upon young people. The text of the ordinance which later became a full body of law, states clearly that young people below the age of 35 (it thus extends the group from the 15-24 age range by 10 years) and with no previous entrepreneurial experience are entitled to a start-up grant amounting to 50 % of the working capital necessary for the establishment of their company, according to a business plan they submit to the Ministry of the Economy, but no more than EUR 10 000 (equivalent in RON). Once their plan is approved they have to register their company with the Register of Commerce and add, for the first three years in operation or up until they reach a total turnover equivalent to EUR 500 000 the letter 'D' from 'debut' to the conventional acronym of SRL. They are also obliged to hire at least four more staff, which they must keep for a minimum of three years (the limit is coherent with the one set in the unemployment insurance act for the subsidised loans for which also debut entrepreneurs qualify) and for which they also receive an exemption from the social security contribution (employer's share; employee share is paid which means that in practice the state subsidises the employer's share of contribution to the public pension scheme). If some of the employees are not kept for the minimum duration, and provided that they are not replaced, then the small company is liable to pay back the subsidy received. Debut enterprises are also entitled to a credit line of up to the equivalent in RON of EUR 80 000 for which the state makes available a guarantee via the Small and Medium Enterprises Guarantee Fund. The whole scheme has run by the Ministry of Economy since 2011 with a relatively good measure of success. The whole of the financing is provided via the state budget. Although the scheme has been included in the Youth Guarantee Action Plan for 2014-2015 given its target group, it still remains a fully nationally funded device. Currently, there is no evaluation of the scheme except for an administrative one as well as some appraisal in the National Competitiveness Strategy elaborated by the Ministry of the Economy. Given its provisions it is clear that the scheme is consistent with the other existing devices (clear consistency with the unemployment insurance act; debut enterprises may also be eligible for subsidised loans from the unemployment insurance fund although there are no statistics to date about if any of them attempted such a 'start-up mix'). Bogus self-employment may hardly be the case here given the fact that the organisation of the start-up is that of an enterprise, as well as that the conditionality of employing staff beyond the entrepreneur, which means that in all cases more than one job is created.

Yet another scheme on which we have made some discussion in the introduction is the one that allows since 2008 for the establishment of the simplest form of self-employment dedicated to professionals, *Persoana Fizica Autorizata* - PFA ('Licensed Individual Professionals'). While not having any financial incentive attached and therefore no other administrative obligations (the licensed professional may act alone but may also hire staff; from here on the eligibility is the same as for subsidised loans from the unemployment insurance fund), it provides those willing to set up an independent (i.e. entrepreneurial) activity with a way of doing so rapidly and very simply. The simplicity of the accounting rules is complemented by the fact that unemployment insurance is voluntary and pension insurance is not mandatory if the licensed professional also continues in some form of dependent employment with another employer. If not however, the pension contribution has to be paid in full combined rate of employer and employee, as the licensed professional is considered in this case to be both (in this case nonetheless at a combined rate of 30 %

for normal conditions it becomes burdensome). In all cases health insurance has to be paid separately. The flat 16 % income rate applies, to be paid however only on incomes effectively cashed. This form has been the most successful throughout the crisis as dependent employment necessarily lost out. Although no evaluations or assessments have been carried out, it may be that a certain form of bogus self-employment could have developed, although it is our opinion that in most cases it has been a reaction of professionals to falling salary incomes which they have tried to compensate for by engaging in independent activities as much as it has been possible. The measure, with its simplicity, low tax burden, simple accounting rules and above all no financial incentives, bears the mark of the philosophy of the liberal government of 2005-08 that initiated it. It provided a useful vehicle to counter some of the effects of the crisis.

We will proceed in the box below with some structured information in the second measure we have presented, i.e. the SRL-D/SRL-Debutant (Start-up limited liability company) for young entrepreneurs.

#### **CASE STUDY BOX**

**Country: ROMANIA**

**Measure title: SRL-Debutant (Start-up or Debut Limited Liability Company)**

**Main aims:** to encourage entrepreneurship amongst the young as an alternative to dependent employment in times of crisis; to develop initiative in medium and high value-added sectors therefore harnessing the potential of a better educated young generation.

**Short description of the initiative:** the initiative provides young people below the age of 35 with no previous business experience a grant amounting to the maximum equivalent of EUR 10 000. The newly established companies also receive an exemption from social security contribution payment (employer's share) for a period of three years. They must hire four employees for the same period of time. The scheme is permanent with annual financing from the state budget.

**Target group (who are the recipients of the start-up subsidy):** young below the age of 35 with no previous business experience.

**Target enterprises:** newly established companies, in the form of limited liability companies (*societate cu raspundere limitata*). No financial incentive is provided if the potential young entrepreneurs wish to establish in financial intermediation, gambling and casinos, arms and others as such. Productive, high value added activities are encouraged as applicants have to submit a business plan to the Ministry of the Economy.

**Eligibility conditions:** Only young people below the age of 35 with no previous business experience qualify for support. Activities mentioned in the paragraph above are excluded from the scheme.

**Budget for the measure / share of EU funding:** Set on an annual basis, part of the State budget. There is no EU funding to date. The scheme is listed as part of the Youth Guarantee Action Plan for 2014-2015 with an allocation of around EUR 4.7 million for 2014.

**Accompanying measures:** support is given by the Ministry of Economy through its specialised agency for the support of small and medium enterprises, in the form of consultancy and even training.

**Summary of evaluation findings:** No evaluation to date except a brief appraisal in the National Competitiveness Strategy. So far it seems that it works with a relative measure of success.

**Policy lessons:** simple and targeted measures work best, even if financing remains modest.

**References:** Internet: [www.minind.ro](http://www.minind.ro) [www.imm.gov.ro](http://www.imm.gov.ro)

### 3 Conclusion

Start-up incentives are not a novelty in Romania, but they have been used reluctantly. No government has apparently been so willing to put a significant effort into it, for reasons differing from period to period. The beginnings of the 2000s saw an excessive preoccupation for a rebalancing of the economy after the harsh years of radical reforms that characterised the end of the 1990s. The mid-2000s with its fast growth rates and a liberal government at the helm sought to entice people not via subsidies, in themselves abhorrent from a doctrine point of view but via deregulation and simplicity. It managed to do quite well as the 'Licensed individual professional' (*persoana fizica autorizata*) provided a good way of compensating for loss of salary income for many of the active and enterprising throughout the depths of the crisis that adversely affected Romania between 2009 and 2012. The only targeted measure, which may be genuinely called a start-up incentive and which was conceived in the recession marked days of early 2011, showed some degree of imagination, albeit limited, as it managed to combine a certain simplicity with a modest degree of financial support (i.e. a grant plus exemption from social security payments).

Concluding therefore on the five major sub-headings that should provide for a set of anchors for further thought and eventual development in the field, one may state the following.

- 1) The use of start-up incentives in **Romania** has been so far rather limited. Although some measures are old enough (e.g. the subsidised credits for employment generation that may also be accessed by start-ups) the use made of them has been very limited. Amounts allocated have always been scarce enough to preclude any significant impact. The most successful apparently have been the ones where no financial support has been provided, with the only actual support being in the form of regulatory simplicity (see the case of '*persoana fizica autorizata*'), which once again proves to be the best support any business and especially a young, start-up business can get. In other words, the cheapest and the best money can buy. Target groups have varied and there is still quite a range within at least the unemployment insurance act, where such support may be available for the unemployed as well as for individuals from disadvantaged areas (i.e. areas with high unemployment rates, above the national average). The last of the measures enacted specifically targets youth, a fact which encouraged a change of tack with respect to the unemployment insurance act measure (i.e. the subsidised loans) where a provision has been introduced for the eligibility of students.
- 2) The level of evaluation evidence available on the results remains more than scarce. Although the Ministry of Labour has now commissioned work covering the whole array of active measures, there is no assessment on the effects of the acts of law concerning the licensed individual professional, nor is there one evaluating the relative success, as much as it may be, of the SRL-D scheme run by the Ministry of the Economy. It may be also that the low amounts allocated made attempts to embark on evaluation exercises look unnecessary.
- 3) A number of relevant positive or negative policy examples provide lessons. The first is the importance of simplicity. The example of the '*persoana fizica autorizata*', where actually no incentive is in place and no facilities apart from the regulatory ones are provided, shows that for such an activity what is important is not necessarily the hand-out of money, but the lack of requirements that allows the activity to establish and then grow at least for the first few years until it is ready to build some degree of scale and maybe of scope. Second, it is important to keep measures targeted. The SRL-D scheme serves as a good example in this. Its focus made it attractive, although rules are a little but more encumbering than for the licensed professionals. However, it attracted the young as it provided them with a suitable vehicle for them. It showed also that for some categories, a little bit of money at the beginning might not be so bad at all; the fact that a clear maximum ceiling is set also helped a lot as it built

responsibility. A kind of less positive lesson is to be drawn from the experience of the oldest of schemes, the one run by the NAE. Its complexity as well as the many conditions, coupled with an intricate mechanism of delivery, made for less effectiveness.

- 4) The success factors have been clearly outlined: simplicity of rules, targeting and a clear ceiling on the amount of start-up financing made available. Where these have been observed success was evident, although it is still difficult to gauge how significant this might have been. The mitigation of social risks is rather more difficult to assess. It is clear that some form of bogus self-employment might exist but again is difficult in the absence of any proper assessment; it would be treacherous to make a blunt statement on the matter. Deadweight effects may exist, although given the crisis as well as the harsh reduction (at times even nominal) in salary incomes, it is clear that such effects are limited as many of those that set-up in independent activities might not have done it in better times.
- 5) Romania's first round of start-up incentives (the subsidised interest rate loans for small enterprises) has been misguidedly built under the assumption of a relative abundance of resources for its implementation. Hence the intricacy of rules, the rather dispersed targeting and lack of a cap on the amounts to be disbursed per individual recipient. The other two measures that followed subsequently (the SRL-D initiative and the licensed individual professional scheme) have been both built under the guise of frugality. Hence, their emphasis on the simplicity of rules, on the clearing of the regulatory ground, on better targeting as well as on strict limits with regard to the amounts to be disbursed per individual recipient. Accordingly, the relative lack of success of the former and the relative measure of success of the latter.

Elements of transferability would be: clear targeting, strict ceilings for the grants disbursed to individual recipients, a decisive and thorough removal and/or simplification of the regulatory burden for the start-ups, coupled at times with targeted and limited exemptions from social security payments.

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Internet: [www.imm.gov.ro](http://www.imm.gov.ro) (the official website of the department for small and medium sized enterprises)

## Annex 1: Measure Description Table

Measure Title	Type of measure:	Target Group	Number of beneficiaries	Amount of subsidy/duration of subsidy	Permanent or Temporary measure and dates of implementation	Conditionality imposed on beneficiary individuals or firms	Funding source and total budget	Measures complementing the initiative	Monitoring arrangements	Evaluation results available	If no evaluation is available, what is the expert's assessment of the impact of the measure?
Subsidized interest loans for small and medium enterprises to encourage job generation	Start-up incentive	Would-be entrepreneurs, unemployed, rural area inhabitants, students	1 381 (2007-12)	No limit on the loans granted (subsidy for the interest rate at 50 % or 25 % of the NBR key interest rate	Permanent measure	To hire from the ranks of the registered unemployed and keep them in employment for three to five years;	Unemployment insurance fund (EUR 3.14 million, 2007-12)	Consultancy and training may be provided	The National Agency for Employment	Not the case (the last one performed almost one decade ago; methods used-control group and interviews with key players).	Impact remains low due to limited budget allocations.
Start-up incentive for young entrepreneurs (SRL-Debutant)	Start-up incentive	Young below the age of 35 with no previous business experience	1 400 for 2014-15 (around 2 000 for the period 2011-13)	Equiv. of EUR 10 000	Permanent measure	To maintain activity for three years and hire four persons to be kept in employment for at least three years.	State budget approx. EUR 4.7 million (2014)	Consultancy and training may be provided. Credit guarantee available up to a maximum of EUR 80 000 in equivalent	The Ministry of Economy and Department for Small and Medium Enterprises	None so far, except administrative	Impact remains low in spite of being a successful measure; budget allocations make it a small scheme.
<i>Persoana fizica autorizata</i> (PFA) (licensed individual professional)	Start-up incentive	No specific target group, however mostly professionals are targeted	More than 260 000 PFA are registered to date	Not the case, no subsidy	Permanent measure	No conditionality applies	Not the case	Not the case	Not the case	None so far	In spite of having no budget allocations, impact is significant. It worked in times of crisis providing an alternative to salaried employment

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