



# BULLETIN

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## The Forgotten Fifth Element: Support of Entrepreneurship in the Eastern Partnership Region

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*The private sector is an important driving force of the transformation process in the Eastern Partnership region. Still, the sector's development is not a top priority for the EU. In order to speed up the economic integration of the eastern partners with the Union, the Commission should work out a new policy to boost entrepreneurship, including increased pressure on EaP governments to pursue business environment reforms and comprehensive funding mechanisms. In order to facilitate this process, Poland might help by offering its pre-accession experience.*

The EU institutions are pursuing a revision of neighbourhood policy, and for this reason they are searching for solutions as to how to boost the private sector in the Eastern Partnership (EaP) region. Until now, the Union has not devoted much attention to this issue, although small and medium-sized enterprises (SMEs) in the EaP countries face a number of barriers that limit their development. The efficiency of companies to adapt to EU standards will determine the pace of EU integration, bearing in mind the implementation of Deep and Comprehensive Free Trade Agreements (DCFTAs) by Ukraine, Georgia and Moldova. In relation to other countries, advancement in private enterprise might be a force for change and tighten relations with the EU.

**Small Aid, Large Needs.** EU support for SME development in the region is limited mainly to projects of multilateral cooperation through the EaP. Several initiatives were established under the umbrella of the SME Flagship Initiative as part of the platform for economic integration in 2009. They consist of advisory services for companies, credit for business development, and networking support. Since 2011, a Business Forum of EU and Eastern European companies has been held in tandem with the EaP summits. The initial years of these initiatives revealed the strong interest of businesses. Thanks to €10 million in EU financial guarantees, local banks have provided loans of €100 million, some 600 companies have benefited from advisory services, and the East Invest programme was extended for another three years.

However, the amount of funds allocated to these initiatives is small, since the total planned budget for the period 2009–2013 for the six EaP countries in total amounted to only €57 million. In comparison, in the years 2002–2013, a special fund for the private sector—the Facility for Euro-Mediterranean Investment and Partnership (FEMIP)—enabled €14.8 billion worth of projects involving companies from countries covered by the EU's southern neighbourhood policy. While the amount of EU aid dedicated to SMEs in the EaP region is relatively insignificant, the needs of the sector remain acute. SMEs struggle with such issues as competition with monopolists, a lack of available credit and little professional management. In addition, export and innovation support policies are not sufficiently developed in the EaP countries, and as such the private sector remains underdeveloped. SMEs in EaP states currently generate an average of about 50% of the jobs (compared to 60–70% in the economies of the Organisation for Economic Cooperation and Development, or OECD), and contribute more than 30% of GDP (compared to 55% in OECD economies). Most of the EaP countries, however, have made efforts to improve company registration, which is reflected in the results of the Doing Business 2015 rankings of 189 countries—three were

relatively highly ranked (Georgia 15<sup>th</sup>; Armenia, 45<sup>th</sup>; Belarus, 57<sup>th</sup>), while two others improved (Moldova, from 83<sup>rd</sup> to 63<sup>rd</sup>; Ukraine, 137<sup>th</sup> to 96<sup>th</sup>).

**Improving the Business Environment Is Not a Top Priority.** Between 2007 and 2013, the European Commission did not insist that EaP countries develop measures in order to boost their private sectors. Of the reforms financed by the EU, a special component designed for SMEs was included only in agricultural aid to Moldova. In addition, removing barriers to business was a priority in Ukraine in relation to its prospective adoption of a DCFTA. Low EU pressure on private business-related reforms resulted from the need to select a few priorities for assistance whilst bearing in mind the relatively small amount of EU aid to the region. It also seems that the Union avoided the subject as its institutions have little knowledge of the needs of the EaP region in this respect—the private sector data collected by the EaP countries and submitted to the EU are incomplete, and only since 2009 has the EU begun to finance extensive analysis on this issue.

Nevertheless, many of the reforms supported by the EU were indirectly related to business (e.g., regional development, environment), but EU delegations rarely consulted business representatives. A positive example is agricultural reform in Georgia where the signing of an agreement was preceded by a nearly two-year consultation process with various interest groups, including organisations representing businesses. This approach enabled the parties to formulate realistic reform conditions. An obstacle for the EU is the lack of a comprehensive model of support for reform that engages actors other than government administrators. In this respect, the EC lacks adequate guidelines and procedures for delegations and does not facilitate matching up the various support mechanisms of the EU.

**The Focus on Investment Projects.** The EC is involving the private sector in the EaP countries via infrastructure projects and outsourcing services. Such support, however, is only partially serving the goal of SME development because it is limited to just a few subsectors and thus does not aim to strengthen the institutional capacity of enterprises and Eastern European companies to compete in tenders against EU firms. Under the Neighbourhood Investment Facility, the EU allocates investment grants for projects in transport, energy and environment, within which the SMEs have a chance to get loans from the European Investment Bank (EIB). In 2013, the EC committed €90.5 million, which made it possible to generate projects worth €1.1 billion. In relation to public procurement and grant competitions, they are open to businesses in cross-border cooperation, technical assistance and thematic programmes. In 2013, private companies from EaP and EU countries won projects through tenders in the amount of €20 million, which represents about 6% of the EC's total expenditures in those countries.

Infrastructure projects and support for SMEs are also among actions undertaken by the European Investment Bank, which is actively developing projects in the EaP countries. However, the bank has autonomy with regards to EU institutions—the board of directors takes decisions on the bank's activities and financing of specific projects with a lower standard for political criteria than other EU institutions. Therefore, the aid may be, but not necessarily need be coordinated closely with the priorities of the EC. In the period 2007–2013, the mandate of the bank in the region (including Russia, Ukraine, Moldova, Armenia, Azerbaijan, and Georgia) amounted to €3.7 billion. Most of loans were earmarked to SMEs through local banks (40%) and the rest for investment projects in transport (30%), energy (21%), and environment (6%).

**A New SME Support Policy Is Needed.** In the EaP region, the Union allocates limited resources from its budget to support SMEs and private sector development, and these also are not top priority in terms of financing reforms in the EaP countries. By contrast, the focus is put on infrastructure projects in sectors strategically important for an EaP country's development and with the involvement of private companies. In order to increase the effectiveness of its activities in this area, the EU should develop a comprehensive approach with two aspects: one, it must put pressure on EaP governments to pursue business environment reforms, and two, create a support mechanism.

The implementation of legislation and measures related to SME development should be part of the reforms supported by the EU, even if they indirectly relate to the business community. The EC should put specific conditions in financing agreements for budget support signed with the central administrations of EaP countries (i.e., such as creating financial advantages for SME). At the same time, the EU should push the EaP governments to strengthen the consultation mechanisms for businesses or organise consultations in relation to EU-financed reforms. For this purpose, special procedures and guidelines for officials of EU delegations should be developed. Poland, as well as other new Member States, may advise the EU on the development of policies for improving entrepreneurship. In the years 1995 to 2001, in Poland's pre-accession period, the country's SMEs increased their contribution to GDP by 18 percentage points (to 48.3%) and the sector generated more than a million new jobs. Poland has good experience in the use of pre-accession funds for the development of SMEs (the PHARE programme).

Next, the EU should launch a comprehensive programme to support SMEs in the EaP region based on the latest best practices in providing this type of assistance in countries covered by enlargement policy, for instance, Serbia. Another source of inspiration may be the SME programmes of the Instrument for Pre-Accession, related to networks of exporters and firms seeking to go international; relationships between business and government; and creation of funds for innovation and R&D institutions. Existing multilateral cooperation initiatives should be included in the new programme, and the main priority should be to finance loans to businesses. This mechanism should also include an information programme explaining how to obtain these foreign funds. The new instrument should be set up in collaboration with the EIB, though the impact of the EC's decision on financing should be kept.