

## **STRATEGIC OPTIONS TO MINIMIZE THE EFFECTS OF THE ECONOMIC CRISIS ON THE CONSTRUCTION SECTOR IN ROMANIA**

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### **ABSTRACT**

*Within the European Union, the construction sector is one of the most affected by the financial and economic crisis. One of the most relevant indicators of the economic crisis on the construction sector in Europe and in Romania is the number of building permits. The number of building permits in Romania has experienced a downward trend over the years 2011-2012, reaching only 85% of the year 2005. To minimize the effects of the economic crisis on the construction sector it is necessary to adopt policy options such as integrated development of residential areas, business support specifically through greater involvement of employers' organizations specialized in mediation organizations, simplifying the technical and economic documentation and planning for the authorization of construction execution, simplification of law expropriation for public utility, changing public procurement legislation, the creation of entities to successfully participate in major public auction, improving the legislative framework for the mandatory certification capabilities of construction companies.*

**KEYWORDS:** *economic, crisis, construction, options*

**JEL CLASSIFICATION:** *L74, R30*

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### **1. INTRODUCTION**

The crisis affected since the third quarter of 2008 the world economy overall effects immediately felt in the construction sector. In the literature there are numerous publications that confirm this hypothesis. Moreover some authors consider that "the construction industry in countries experiencing severe economic crisis has vital importance to get out of stagnation because of its direct relations with 200 different sectors" (Ozkan F, Ozkan O. and Gunduz M.,2012). This idea is reiterated by other previous studies that concluded that there "the significant relationship between the construction industry and economic growth in developing countries" ( Giang and Pheng, 2011).

### **2. THE EFFECTS OF THE GLOBAL ECONOMIC CRISIS ON THE CONSTRUCTION SECTOR**

At European level effects of the economic crisis are strong and experienced in all member countries. This has caused a significant decline in economic activity, a substantial increase in unemployment, a sharp drop in productivity and a substantial deterioration in public finances. "The euphoria of the consumption created serious distortions in the economic system. Finally, in the absence of real savings, the initial boom turned into a financial crisis and, then, into a large-scale economic crisis" (Mursa, 2012)

According to reports made by the European Commission macroeconomic there were many causes of the current situation:

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- in the years preceding the crisis, several Member States have strayed from the basic principles of prudent fiscal policy development;
- in the decade before the crisis, the EU increased considerably macroeconomic imbalances;
- strong GDP contraction annulled, on average, four years of growth; the crisis has particularly affected the public finances in the euro area and the EU;
- current sharp deterioration in public finances caused by falling incomes and increasing pressure on costs, and discretionary fiscal stimulus.

In the European Commission believes that three conditions are necessary to reinstate the preliminary macroeconomic growth: implementing a rigorous fiscal consolidation, correcting macroeconomic imbalances, financial sector stability. "Dominant regime responses to the economic crisis so far seem to focus primarily on restoring the old equilibrium". (Loorbach & Lijnis Huffenreuter, 2013)

Economic situation presented above was felt in the construction industry, which is constantly increasing in the first half of 2008, before the negative impact of the financial crisis.

Within the European Union, although there are important differences between countries, there are some trends that occur persistently in the construction sector at the beginning of the economic crisis:

- construction sector is one of the most affected by the financial and economic crisis (construction and infrastructure work fell by 16% between January 2008 and November 2011 EU-27);
- tighter credit terms;
- construction companies facing financial difficulties, in some extreme cases even leading to bankruptcy;
- construction sector is mainly composed of SMEs, they rely mainly on bank loans and thus more susceptible to late payment by customers (private and public);
- contraction of new housing construction sector is continuing and emphasizes;
- the non-residential market is influenced by the business climate, faced with low investment;
- in general civil engineering works decreased compared to previous years, although they have helped sustain construction activity in many EU countries due to European and national plans for economic recovery, which give priority to infrastructure works;
- rehabilitation and maintenance remain the main engine of growth in the housing sector;
- investors tend to favor investment in housing renovation and modernization than in new housing, this being due to the current trend towards consideration of environmental protection in the construction sector, particularly tax incentives in many countries of the EU investment energy efficient.

One of the most relevant indicators of the economic crisis on the construction sector in Europe and in Romania is the number of building permits. The number of building permits in Romania has experienced a downward trend over the years 2011-2012, reaching only 85% of the year 2005 and was 12% lower fourth quarter 2012 compared to first quarter of 2011. From this point of view, Romania is within the downtrend in the euro area.

**Table no. 1 Number of building permits (year 2005 = 100)**

Country(zone)	Year 2011				Year 2012			
	Q 1	Q 2	Q 3	Q 4	Q 1	Q 2	Q 3	Q 4
Euro area	56,71	53,37	52,78	54,97	50,15	49,03	49,64	:
EU 27	58,46	54,59	53,48	55,71	50,57	50,1	52,24	:
EU 15	57,83	53,94	52,83	55,23	49,9	49,51	51,82	:
Belgium	70,59	70,73	76,18	89,52	91,9	79,42	72,04	:
Bulgaria	36,38	32,82	30,59	33,22	29,57	31,86	32,93	33,92
Czech Republic	76,63	72,38	67,06	61,32	72,54	56,88	49,82	:
Denmark	45,65	42,62	38,48	35,41	37,14	32,41	24,03	22,27

Country(zone)	Year 2011				Year 2012			
	Q 1	Q2	Q 3	Q 4	Q 1	Q 2	Q 3	Q 4
Germany	94,02	92,7	90,93	94,48	89,75	100,38	99,32	:
Estonia	34,6	32,46	28,83	28,03	28,51	30	29,14	:
Ireland	14,01	12,31	10,06	9,53	5,48	5,61	6,2	:
Greece	10,94	13,55	15,75	12,61	10,74	8,26	5,53	:
Spain	17,36	12,27	10,76	12,43	10,67	9,72	8,99	:
France	92,67	93,09	96,44	109,11	93,43	89,73	97,1	82,76
Italy	44,37	40,62	38,16	38,74	:	:	:	:
Cyprus	58,69	42,87	48,71	36,34	32,3	29,53	34,68	:
Latvia	23,14	22,8	27,69	18,87	17,35	23,72	25,35	:
Lithuania	61,72	59,69	66,24	65,4	85,86	84,5	77,78	:
Luxembourg	90,13	96,45	101,66	94,43	95,62	89,93	87,02	:
Hungary	21,93	26,19	22,47	23,79	18,59	20,36	22,04	:
Malta	46,12	50,22	42,96	38,6	37,21	28,12	31,28	41,12
Netherlands	83,53	68,79	66,66	49,19	53,47	51,45	53,14	:
Austria	118,51	114,94	120,4	124,11	112,55	109,38	106,75	:
Poland	150,4	151,19	156,63	154,08	145,71	150,85	142,96	:
Portugal	27,17	24,78	22,93	20,71	19,06	16,11	15,36	12,89
Romania	97,59	94,92	92,97	88,31	90,68	92,02	87,83	85,72
Slovenia	65,75	59,15	41,6	46,51	39,29	43,35	42,55	:
Slovakia	70,8	62,46	73,91	63,22	61,22	67,04	75,72	:
Finland	89,48	96	88,07	79,88	82,57	83,26	82,58	:
Sweden	95,19	92,25	76,24	79,65	59,73	71,51	67,51	:
Great Britain	58,17	52,45	51,56	54,66	49,07	49,8	58,72	:
Norway	83,41	66,21	83,71	86,33	73,87	81,67	76,63	85,39
Switzerland	110,98	126,38	100,72	108,79	99,09	113,24	123,96	:
Croatia	58,67	56,34	65,44	53,24	52,03	46,42	43,76	:

(Source: EUROSTAT)

The most important effects of the global economic crisis on the construction sector in Romania were:

- significantly reduce the amount of new construction works and repairs with public sector beneficiaries, especially in 2010;
- disappearance of a large number of enterprises, especially large enterprises in the construction sector;
- in the construction sector has one of the highest rates of accidents nationally;
- increasing share of undeclared work, especially for unskilled workers (by some estimates, up to 10% of employees);
- preference, where private civil construction for own purposes, which determine both the nature of the normative issues (non constructive parameters) and a lower quality of work;
- poor quality of construction and materials used especially in finishing under pressure to reduce the price competition and trading real estate market values;
- average 30% reduction in the number of building permits issued, compared with 2008.

The economic crisis was felt strongly in the construction sector in Romania and it affected all stakeholders: customers, design and construction companies, public authorities, investors. The most important effect of the economic crisis on the construction sector in Romania is to reduce demand from both the private sector and the public sector.

### 3. STRATEGIC OPTIONS TO MINIMIZE THE EFFECTS OF THE ECONOMIC CRISIS ON THE CONSTRUCTION SECTOR IN ROMANIA

Strategic options "reflects the general directions of action for achieving strategic objectives" (Popescu, 2006). That is why there are specialists who believe that "integrated analysis and rational decision-making at the micro-, meso- and macro-levels are needed to mitigate the effects of recession on the construction and real estate sector. Crisis management involves numerous aspects that should be considered in addition to making economic, political and legal/regulatory decisions. These must include social, culture, ethical, psychological, educational, environmental, provisional, technological, technical, organizational and managerial aspects" (Kaklauskas et al., 2011).

Policy options to reduce the effects of the global economic crisis across sectors fall into two broad categories: policy options at sectoral and strategic options for firms in the construction industry. At sectoral level strategic choices have to stimulate demand and correcting problems that predate the onset of the economic downturn. The most important policy options to limit the economic crisis across sectors are:

- a) *Integrated development of residential areas, based on the development by the mayors of common programming documents* - this policy option requires the involvement of local authorities and chief architects to base urban plans. Joint programming documents will facilitate the development of large local investment, reducing the possibility of correlation between development plans / planning for diverse communities;
- b) *Support specific business through greater involvement of employers' organizations specialized in mediation bodies (Economic and Social Council and others)* - increasing the number of companies included in employers' structures. The two structures ARACO employers and Building Ownership should step up efforts to attract new members so that they have greater representation. The two employers' organizations should also be involved in the Economic and Social Council;
- c) *Simplify the technical and economic documentation and planning for the authorization of construction works and their financing* - now during approval of these documents, so the training investment is greater than the duration of execution of works. It is necessary to revise and simplify the Law no. 50/1991 on the authorization of construction works and the Law. 10/1995 Quality in Construction and OM HG and enforcement of this law and in particular those that relate to the content of the technical, economic and planning for public investment;
- d) *Review the background and simplify the law expropriation for public utility, no. 33/1994*- revision and simplification of the law expropriation for public utility is required to avoid situations in which investment works on important goals sluggish due to inability to obtain land on which it should run. For large infrastructure works expropriation for public utility should become an effective mechanism for the State to take possession of the land necessary to carry out the work, with fair compensation to private owners;
- e) *Review, amend and simplify the O.G. 34/2006 regarding the award of public procurement contracts, public works concession contracts and services concession and the Common Order of MEF, MT and MDLPL no. 915/2008 on the closure of the works contracts* - this legislation is complicated, confusing, non-harmonized with European legislation inconsistent with unnecessary procedures still discriminatory, irrelevant to quickly clarify disputes to tender conditions irrelevant and creating may pass to the works of some companies are unable to prove the technical capability of execution. Strictly necessary and determinant for proving technical capability, economic and quality of constructions, organization of professional qualification certification categories of works of construction companies.

Access to auctions to be admitted only companies presenting work qualification certificate corresponding structure investment objective.

Another common problem is the scoring for the warranty period of the work. You do not have to be dotted offering warranty periods that are not related to standards and technical regulations.

In the area of public works also an issue to be resolved is the large number of complaints submitted annually to the National Council for Solving Complaints by charging a fee as a percentage of public works contract if it is found that the complaint did not object.

f) *Application for a limited period of reduced VAT levels as housing construction, thermal rehabilitation of buildings, alternative energy production installations* - is given by a double positive effect: lower costs for beneficiaries (housing associations, public or private, etc.), promoting their rehabilitation (e.g., Romania is among the last countries in the EU in terms of energy efficiency in buildings housing in the municipality of Bucharest is very old, if an earthquake risk of losing many lives) and on the other hand it stimulates and companies in the industry, faced with a lack of contracts.

g) *Investment in sectors that can quickly create jobs (e.g. renovate buildings etc.)* - part of the renovation / rehabilitation of buildings and civil engineering showed a lower rate of decline, given the significant amount of work funded public. Increasing employment of labor will stop construction labor migration to other countries / areas. Therefore be funded primarily investment objectives and categories of works that are characterized by a high consumption of workmanship.

Therefore we believe it would be useful to continue major investment programs run by M.D.R.A.P far provided a process optimization project selection:

- housing program;
- thermal rehabilitation programs;
- social investment programs - cultural and sporting activities;
- Infrastructure programs;
- National Infrastructure Development Programme.

It is necessary to reduce the number of these programs by uniting those who have the same main destination (such as for example social housing programs) and change their structure so that they have the same entity responsible for construction of housing.

In the future structure housing programs run by M.D.R.A.P should be composed of:

- a program of rental housing;
- a program of private housing construction completed including mortgage;
- a program of social and emergency housing;
- a program of savings and loan banks.

Such a structure would facilitate measuring program effects obtained in relation to investment efforts and ensure a role in regulating the market to prevent long-term effects of speculation in real estate. In the future, other programs should be launched in thermal insulation., So that more effective public intervention in this field.

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h) *Accessing EU funds for infrastructure (road, railway, environment, etc.)* - enhancing collaboration between M.D.R.A.P, Ministry of Transport, and construction companies to emphasize accessing funds. This concerns in particular the following operational programs: Regional, Sectoral Operational Programme, - Transport, Sectoral Operational Programme Environment.

i) *Agreement on a temporary moratorium on insolvency law under which companies that have received public debt and risk into insolvency to receive treatment adapted to the crisis* - the implementation of such policy options would have the effect of reducing unemployment and ensuring temporary survival of companies in trouble. Since the onset of the economic crisis in Romania construction firms were most affected by the insolvency. Therefore, it is necessary that insolvency proceedings have a customization for companies that are in this state due to the inability to recover claims representing the work done for public institutions.

A second set of policy options to mitigate the impact of the problems that persist for a long time in the construction sector. They aim in particular:

a) *Improving the legal framework for the mandatory certification capabilities construction companies* - professional and technical qualification certification of operators of construction will be done in order to recognize their capability to achieve proper construction of the essential requirements in accordance with Law no. 10/1995 on construction quality, as amended, and monitoring of certification procedures.

Construction operators seeking professional technical certification to ensure the technologies must have:

- an integrated management system according to the category of constructions to be performed;
- experience in the subject certification supported by presenting important works completed, and data on proper implementation and contractual obligations provided by the beneficiaries or the contracting authority;
- provision of equipment, plant and machinery or their insurance through collaboration agreements with firms, allowing for the technologies used and the quality assurance requirements;
- equipped with measuring devices, specialized monitoring areas where certification is requested and there where appropriate, methods of study and research, and quality control measures applied, enabling continuous improvement of production capacity and technical construction operators

b) *Create entities to participate successfully in major public auction* - the need to have strong Romanian entrepreneurs is revealed by the continuing crisis at the beginning of large construction companies. The emergence of such entities can be achieved in several ways:

- implementation of association agreements between SMEs to participate in the award of public procurement contracts so that the consortium can meet the qualification and selection criteria;
- a natural process of mergers and acquisitions between companies in the construction sector to the formation of those entities able to meet the criteria needed to participate in the implementation and design of major infrastructure.

The low concentration of firms in the sector may encourage association policies auction.

c) *Combating undeclared work* - to implement this strategic option can be followed three priorities for action: prevention of undeclared work, identifying cases of undeclared work; combating undeclared labor cases.

d) *The prioritization of public investment according to their utility* - public investments must multiannual and ranked according to their usefulness. Decision on financing must be typical of situations where multicriterial decision criteria to be used as:

- total investment;
- current state of infrastructure in the area;
- efficiency indicators;
- synergy with other projects in the area;
- employment of labor;
- other important criteria depending on the type of investment.

For this unit you will have developed a methodology, applicable at national level so that they can achieve a hierarchy of need investment. The need for public investment projects selection is not new for Romania or in any other country. There are experts who believe that "effective and efficient selection of projects in strategy-focused environments is extremely vital for maintaining organizational sustainability. The process of decision making presents itself as a complex scenario involving multi stages, more especially in the public sector. Such scenarios facade as bottlenecks to the success of projects because breaking down complexities is inconceivable without a proper understanding of its content."(Puthamont & Charoenngam, 2007)

For construction firms need to implement at least some of the following policy options:

- introduction of new technology by buying patents, patents of inventions, partnerships with foreign companies;
- increasing mechanization activities through the acquisition of machinery and equipment, either new or second hand;
- introduction of mechanisms for monitoring costs because, with the financial crisis will intensify competition;
- establishment of consortia, common to use the available resources;
- restructuring by focusing on the value chain, giving the essential activities;
- developing marketing activities by attending trade fairs and exhibitions, advertising in local media and / or national etc.
- offering rebates / discounts to customers;
- establishing partnerships with companies with complementary activities;
- achieving collaboration with universities and research centers to identify, global trends and providing products / services industries.

#### 4. CONCLUSIONS

The global economic crisis had a significant effect on the construction sector in Romania since the third quarter of 2008, especially with the onset of 2009. The most important effect of the global economic crisis on the construction sector was the reduction in demand both in the private and public sector work due to lack of financing .

To minimize the effects of the need to apply a mix of policy options to stimulate demand but to solve some other perennial problems across sectors: public procurement law review, refocus and recalibrate public investment, tax reduction for certain types of work, labor fight black, changes in insolvency law, public investment prioritization. If construction companies appear increasingly stronger need to create holding companies allowing the sharing of resources.

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