

November 8, 2002

Case No.: A-485-805

Total Pages:

Review for the Period 2/4/00 - 7/31/01

PUBLIC DOCUMENT

BY HAND DELIVERY

The Honorable Donald L. Evans
Secretary of Commerce
U.S. Department of Commerce
Import Administration
Central Records Unit, Room 1870
14th Street and Constitution Avenue, N.W.
Washington, D.C. 20230

Attn: George Smolik Room 3708
Lawrence Norton Room

Re: Certain Small Diameter Carbon and Alloy Seamless Standard,
Line and Pressure Pipe from Romania

Dear Secretary Evans:

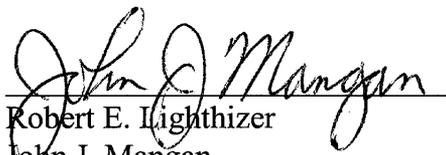
The Department has requested comments on whether Romania's status as a nonmarket economy under the antidumping and countervailing duty laws should be revoked.¹ We submit the attached memorandum on that issue on behalf of

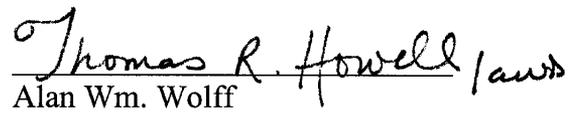
¹ Certain Small Diameter Carbon and Alloy Seamless Standard, Line and Pressure Pipe From Romania, 67 Fed. Reg. 57388, 57390 (Dep't Commerce Sept. 10, 2002) (prelim. results).

The Honorable Donald L. Evans
November 8, 2002
Page 2

United States Steel Corporation, Bethlehem Steel Corporation, and National Steel
Corporation.²

Respectfully submitted,


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² United States Steel Corporation is a Petitioner in the above-captioned review
in which the Department has requested such comments.

**CARBON AND ALLOY SEAMLESS STANDARD, LINE AND PRESSURE PIPE
(UNDER 4 ½ INCHES) FROM ROMANIA**

A-485-805

ADMINISTRATIVE REVIEW FOR THE PERIOD 2/4/00-7/31/01

PUBLIC CERTIFICATE OF SERVICE

I hereby certify that the foregoing submission was served on this 8th day of November, 2002, by hand delivery on the following:

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Vol. I of II

PUBLIC DOCUMENT

Case No.: A-485-805

Total Pages:

Administrative Review for the Period
2/4/00 - 7/31/01

**BEFORE THE UNITED STATES DEPARTMENT OF COMMERCE
INTERNATIONAL TRADE ADMINISTRATION**

IN THE MATTER OF:)
)
CARBON AND ALLOY SEAMLESS)
STANDARD, LINE, AND PRESSURE PIPE)
(UNDER 4 1/2 INCHES) FROM ROMANIA)

**COMMENTS REGARDING THE NON-MARKET ECONOMY
STATUS OF ROMANIA FILED ON BEHALF OF BETHLEHEM STEEL
CORPORATION, NATIONAL STEEL CORPORATION, AND
UNITED STATES STEEL CORPORATION**

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November 8, 2002

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A	“2001 Regular Report on Romania’s Progress Towards Accession,” <u>Commission of the European Communities</u> (Nov. 13, 2001)
B	“2002 Regular Report on Romania’s Progress Towards Accession,” <u>Commission of the European Communities</u> (Oct. 9, 2002)
C	“Romania Country Commercial Guide FY 2002,” <u>U.S. & Foreign Commercial Service and U.S. Department of State</u> (2002)
D	"Nations in Transit," <u>Freedom House</u> (2002)
E	<u>Bucharest Rompres</u> (Oct. 9, 2002) FBIS Doc. EUP20021009000488
F	"Romania: Country Reports on Human Rights Practices, 2001," <u>Bureau of Democracy, Human Rights and Labor, U.S. Department of State</u> (Mar. 4, 2002)
G	“Romania: Annual Survey of Violations of Trade Union Rights,” <u>International Confederation of Free Trade Unions</u> (2002)
H	"Romania - Economic Overview," <u>Deloitte & Touche</u>
I	“Memorandum of the President of the International Bank for Reconstruction and Development and the International Finance Corporation to the Executive Directors on a Country Assistance Strategy for the World Bank Group for Romania,” <u>The World Bank</u> (May 22, 2001)
J	“Corporate Governance in Romania,” <u>OECD</u> (2001)
K	“Romania Country Commercial Guide FY 2002,” <u>U.S. & Foreign Commercial Service, U.S. Department of State</u> (2002)
L	"Romania Excels in Corruption – Says the British Ambassador to Bucharest," <u>Bucharest Adventul</u> (Oct. 14, 2002) FBIS Doc. EUP20021014000060
M	“EU/Romania: Reluctant Reformers Chase Accession Carrot,” <u>European Report</u> (May 22, 2002)
N	"It is Difficult to Attract Financing to a Country Affected by Corruption," <u>Romania Libera</u> (May 20, 2002) FBIS Doc. EUP2002052100215

- O A. Sadeanu, "Without Giving Names or Providing Evidence, Nastase Accuses Multinational Companies in Romania of Tax Evasion," Bucharest Adventul (June 7, 2002), FBIS Doc. EUP2000206070000155
- P Excerpt from "Time to Demolish, Time to Build," Bucharest Ziva (Oct. 4, 2002) FBIS Doc. EUP20021004000216
- Q "Romania Country Commercial Guide FY 2002," U.S. & Foreign Commercial Service, U.S. Department of State (2002)
- R Bucharest Adventul (Sept. 25, 2002)
- S "Romania: Selected Issues and Statistical Appendix," IMF Country Report No. 01/16, International Monetary Fund (January 2001)
- T A. Dochia, "New Private Firm Contributions to Structural Change in the Romania Economy," Romania 2000 - Ten Years of Transition (Oct. 2000)
- U "Main Provisions of the Currency Regulation," National Bank of Romania, available at http://www/bnro.ro/En/Legi/Regval_se.asp, (last visited Nov. 4, 2002)
- V From Romanian Business Journal, available at http://www.reoembus.org/english/business/buletine_economice/ec_bul_07_2002.htm (last visited Nov. 4, 2002)
- W "Corruption Perceptions Index 2002," Transparency International (Aug. 28. 2002)
- X "I Am Corrupt, Therefore I Am?" Buchares Evenimentul Zilei (Aug. 31, 2002) FBIS Doc. EUP20020902000141
- Y I. Stefan, "The Baron's Disease," Romania Libera (Oct. 21, 2002), FBIS Doc. EUP20021023000164
- Z I. Ionita, "Corruption Masking," Bucharest Adventul (Oct. 18, 2002) FBIS Doc. EUP20021019000038 (Oct. 18, 2002)

EXECUTIVE SUMMARY

The overwhelming weight of evidence bearing on the statutory criteria that the Department of Commerce (the “Department”) must consider in its nonmarket economy (“NME”) analysis shows that Romania unequivocally remains an NME. The relevant evidence bearing on each of these criteria is encapsulated below, and is discussed in detail in the succeeding sections of this submission. When these criteria are considered, whether individually or collectively, it is clear that Romania does not have the basic elements of a market economy.

19 U.S.C. § 1677(18)(B) provides that, in determining whether a country is an NME, the Department shall take into account:

- the extent to which wage rates in the foreign country are determined by free bargaining between labor and management;
- the extent to which joint ventures or other investments by firms of other countries are permitted in the foreign country;
- the extent of government ownership or control of the means of production;
- the extent of government control over the allocation of resources and over the price and output decisions of such enterprises;
- the extent to which the currency of the foreign country is convertible into the currency of other countries; and
- such other factors as . . . {the Department} considers appropriate.

Romania is seriously deficient by all of these measures.

The extent to which wage rates in the foreign country are determined by free bargaining between labor and management. Wage rates in Romania are not determined on the basis of free bargaining between labor and management, as labor unions and worker rights are heavily restricted in practice.

The extent to which joint ventures or other investments by firms of other foreign countries are permitted in the foreign country. In practice, Romania is not open to significant foreign direct investment. Foreign investment in Romania is incredibly low, as in practice, the legal and business environment in the country – including, inter alia, an unpredictable legal system, a cumbersome bureaucracy, and rampant corruption at all levels of business and government – effectively deter significant foreign investment, and a transition to a market economy.

The extent of government ownership or control of the means of production. The Government of Romania still accounts for a large majority of Romania's industrial production and half of all banking assets. Most of the land suitable for new investment and the best arable land remain in the hands of the Government.

The extent of government control over the allocation of resources and over the price and output decisions of enterprises. The Government of Romania continues to exert significant control over the allocation of resources and price and output decisions of enterprises. The Government does so through a variety

of direct and indirect means, including price controls unrelated to any anti-inflationary objectives, and the provision of inputs, tax breaks, and credit on preferential terms to certain industries or enterprises.

The extent to which the currency of the foreign country is convertible into the currencies of other countries. There are a host of limitations on the convertibility of Romania's currency – in the form of licensing requirements for currency conversions in connection with many significant business transactions – and these limitations are likely to exist for some time to come.

Such other factors as the administering authority considers appropriate. There is widespread corruption on every level of business and government that impedes investment and economic development. Corruption in Romania is on such a massive scale as to be an important reason why that country has not developed a market economy.

I. INTRODUCTION

Several independent, authoritative observers have recently concluded, explicitly or implicitly, that Romania does not operate as a true market economy. These observers include the European Commission ("EC"), certain agencies of the U.S. Government itself, including the Department, the "watchdog" organization Freedom House, and even leading Romanian politicians.

The EC, in its regular reports on Romania's progress toward European Union ("EU") accession, repeatedly has found that Romania has not yet developed a functioning market economy. In its 2001 report, for example, the EC concluded that "Romania cannot be considered as a functioning market economy."¹ And in an updated report issued just last month, the EC, while recognizing that some progress has been made, stressed the "incompleteness of the transition process."²

Significantly, the Department and the U.S. Department of State, in their current country commercial guide for Romania, essentially concurred with the EC assessment. Specifically, they stated that:

When restructuring and privatization are completed and the basic elements of a market economy are in place, the {Romanian} govern-

¹ "2001 Regular Report on Romania's Progress Towards Accession," Commission of the European Communities (Nov. 13, 2001) at 31, 38, attached as Exhibit A.

² "2002 Regular Report on Romania's Progress Towards Accession," Commission of the European Communities (Oct. 9, 2002) at 49, attached as Exhibit B.

ment's role in the economy will diminish. In the meantime, the government plays an extremely important part in the economy.³

Freedom House, in its 2002 report on "Nations in Transit," concluded that "Romania remains a laggard in terms of liberalization, privatization, and economic restructuring."⁴

Even leading Romanian politicians have indicated that the country does not have a market economy. Just last month, a former Prime Minister and current President of the National Liberal Party, Theodore Stologan, said that Romania was the only one of the 12 countries seeking EU accession "which continued to have a non-functional market economy."⁵

These findings by objective observers should weigh heavily in the Department's mind as it considers whether Romania has, in fact, developed a market economy.

³ "Romania Country Commercial Guide FY 2002," U.S. & Foreign Commercial Service and U.S. Department of State (2002) at Chapter 2 at 5 attached as Exhibit C.

⁴ "Nations in Transit," Freedom House (2002) at 313, attached as Exhibit D.

⁵ Bucharest Rompres (Oct. 9, 2002) FBIS Doc. EUP20021009000488, attached as Exhibit E.

II. THERE ARE MAJOR LIMITATIONS ON FREE BARGAINING BETWEEN LABOR AND MANAGEMENT

Summary of Comment:

Wage rates in Romania have yet to be determined on the basis of free bargaining, as labor union and worker rights are heavily restricted in practice.

Discussion:

In its NME analysis, under 19 U.S.C. §1677(18)(B)(ii), the Department must consider “the extent to which wage rates in the foreign country are determined by free bargaining between labor and management.” “The reference to ‘free bargaining between labor and management’ reflects concerns about the extent to which wages are market based, *i.e.*, about the existence of a market for labor in which mobile labor service providers and employers are free to bargain over the terms and conditions of employment.”⁶ Because wages are an important component of producer costs and prices, the manner in which they are set is “an important indicator of a country’s overall approach to setting costs and prices in an economy.”⁷

⁶ Memorandum from George Smolik, Economist, Office of Policy, Import Administration to Faryar Shirzad, Assistant Secretary for Import Administration, re: Antidumping Duty Investigation of Silicomanganese from Kazakhstan - Request for Market Economy Status (Mar. 25, 2002) (“Kazakhstan Market Economy Memo”).

⁷ Id. at analysis of section 771 (18)(B) Factors Section

To be sure, Romania may have laws "on the books" that ostensibly protect labor union and worker legal rights. But they are enforced poorly, if at all.

In March of this year, the U.S. Department of State, in its "Country Report on Human Rights Practices" for Romania, made a number of specific, negative findings concerning the protection of union and worker rights in that country.⁸ The report found that "it continues to be difficult to hold a legal strike because of lengthy and cumbersome procedures."⁹ The Department of State also observed that Romanian unions believe that the courts have a propensity to declare illegal the majority of strikes on which they are asked to rule.¹⁰ Moreover, the report pointed out, an amendment to Romania's labor law in September 2000 permits companies to claim damages from strike initiators if the strike is deemed illegal by a court.¹¹ Finally, the report noted that unions have reported that, as a general matter, the Government of Romania ("GOR") interferes in trade union activities, collective bargaining, and strikes.¹²

⁸ See Exhibit F.

⁹ Id. at 13.

¹⁰ Id.

¹¹ Id.

¹² Id. at 12.

Finally, as others have noted, many companies make employment conditional upon agreeing not to join or create a union, or form "yellow unions" to counteract the activities of independent trade unions.¹³

III. IN PRACTICE, ROMANIA IS NOT OPEN TO SIGNIFICANT FOREIGN DIRECT INVESTMENT

Summary of Comment:

Foreign investment in Romania is incredibly low. This is because the legal and business environment in that country is quite hostile to such investments in practice.

Discussion:

Under 19 U.S.C. § 1677(18)(B)(iii), the Department must examine the “extent to which joint ventures and other investments by firms of other foreign countries are permitted in the foreign country” to determine the presence of a market economy. As the Department noted in its determination that Kazakhstan had completed its transition to a market economy:

Opening an economy to foreign investment tends to expose domestic industry to competition from market-based suppliers and the management, production and sales practices that they bring. It also tends to limit the scope and extent of government control over the market,

¹³ “Romania: Annual Survey of Violations of Trade Union Rights,” International Confederation of Free Trade Unions (2002) at 2, attached as Exhibit G.

since foreign investors, as a general rule, demand a certain degree of autonomous control over their investments.¹⁴

In evaluating this question, the Department does not simply analyze whether the formal legal framework for foreign direct investment appears to be hospitable. As its decision in the recent Kazakhstan case shows, the "legal framework" is but the starting point for its analysis.¹⁵ The Department then proceeds to evaluate "developments in the economy" to determine whether the country in question is truly open to foreign direct investment.¹⁶

In the case of Kazakhstan, the Department found the country to be "an investor-friendly country" with clear investment and tax laws, a stable business environment, and a high level of foreign direct investment ("FDI").¹⁷ The Department noted that Kazakhstan's relatively high level of FDI itself was "a strong indicator" that the Government of Kazakhstan effectively enforced its laws at the national level and actively encouraged foreign investment.¹⁸

In stark contrast, the environment in Romania is hostile to foreign investment and, as a consequence, FDI in Romania remains incredibly low. Roma-

¹⁴ See Kazakhstan Market Economy Memo.

¹⁵ Id. at analysis of section 771 (18)(B) Factors Section.

¹⁶ Id.

¹⁷ Id.

¹⁸ Id.

nia's business environment was ranked 52nd out of 60 countries included in Economist Intelligence Unit's global ranking for the period 1997-2001 and 9th out of 10 countries in its regional ranking.¹⁹

As a result, despite being Europe's second largest transition economy (after Poland),²⁰ Romania received only \$6.4 billion in FDI over the 10-year period 1991-2000, while Poland received more than \$30 billion in FDI during the same period, and much smaller countries like Hungary and the Czech Republic each attracted some \$20 billion in FDI over the same period.²¹

A significant impediment to investment in Romania is the unpredictable and confusing legal environment in which businesses must operate. Regulations can change overnight without notice.²² The executive branch of the government frequently "legislates" through emergency ordinances, a practice that the EC, among

¹⁹ See "Romania - Economic Overview," Deloitte & Touche, attached as Exhibit H at 15. The ten countries included in EIU's regional ranking were Azerbaijan, Bulgaria, Czech Republic, Hungary, Kazakhstan, Poland, Romania, Russia, Slovakia and Ukraine. Id.

²⁰ "Memorandum of the President of the International Bank for Reconstruction and Development and the International Finance Corporation to the Executive Directors on a Country Assistance Strategy for the World Bank Group for Romania," The World Bank (May 22, 2001) at 32, attached as Exhibit I.

²¹ "Corporate Governance in Romania," OECD (2001) at 52, attached as Exhibit J.

²² "Romania Country Commercial Guide FY 2002," U.S. & Foreign Commercial Service, U.S. Department of State (2002) at Chapter 7 at 8, attached as Exhibit K.

others, has "strongly criticized."²³ In its most recent report on the possible accession of Romania to the EU, issued just last month, the EC condemned this practice because it is non-transparent, and makes the law highly unpredictable.²⁴ In that report, the EC also noted that, despite its prior criticism of this practice, the use of such ordinances has not been substantially decreased by the GOR.²⁵ And, just last month, Britain's ambassador to Romania, Sir Richard Ralph, complained about the "legislative nightmare" in Romania, "which gives many headaches to those who wish to start a business in this country."²⁶

Not only are Romanian laws unclear; the courts that enforce them have numerous, serious shortcomings. The World Bank has found that the Romanian court system is "weak," that proceedings take a long time to resolve, that judgments are "highly unpredictable," and that these factors significantly complicate Romania's business environment.²⁷ Such a "burdensome and unpredictable . . .

²³ Exhibit B at 22.

²⁴ Id.

²⁵ Id.

²⁶ "Romania Excels in Corruption – Says the British Ambassador to Bucharest," Bucharest Adventur (Oct. 14, 2002) FBIS Doc. EUP20021014000060, attached as Exhibit L.

²⁷ Exhibit I at Annex H at 2.

enforcement system” was one factor that the Department cited in its 1997 determination not to revoke the NME status of Ukraine.²⁸

According to the World Bank, the courts for commercial matters are understaffed, insufficiently skilled, and lacking in expertise in specialized commercial fields such as intellectual property.²⁹ But the unpredictability of judicial decisions is not solely due to inexperience and inadequate resources; corruption is also a serious problem.³⁰ According to a World Bank survey, nearly two-thirds of businesses believe that the judiciary is corrupt.³¹ For example, Stephen Groningen, Chief Executive Officer of Romania’s Banca Agricola, has reported that his company has lost “court cases where the evidence was overwhelmingly in his favor ‘for all sorts of mysterious reasons,’ and remains unconvinced that the courts will give ‘an impartial decision in due time.’”³²

²⁸ Certain Cut-to-Length Carbon Steel Plate From Ukraine, 62 Fed. Reg. 61754, 61756 (Dep’t Commerce Nov. 19, 1997) (final determ.) (“areas of concern remain for foreign investors, in particular the reportedly burdensome and unpredictable . . . enforcement system”).

²⁹ Exhibit I at Annex H, p. 2.

³⁰ Id.

³¹ Id. at 10.

³² “EU/Romania: Reluctant Reformers Chase Accession Carrot,” European Report (May 22, 2002) at 3, attached as Exhibit M.

In its most recent report on Romania's possible accession to the EU, the EC similarly expressed serious reservations about the judicial system, stating that reform of the judiciary has been limited, and the main concerns previously raised by the EC have not been addressed.³³ The report stated:

In particular, the involvement of the executive in judicial affairs has not been substantially reduced, the courts remain over-burdened, the General Prosecutor has retained an extensive right to introduce extraordinary appeals, and the combination of a lack of resources and an inadequate human resources policy means that the judicial system is severely strained.³⁴

Other Romanian government officials likewise act in an arbitrary and/or corrupt fashion. As Freedom House reports,

Romania is plagued by an extremely heavy and cumbersome bureaucracy, and this in part explains the high incidence of corruption. In addition to increasing opportunities for bribe taking, bureaucratic complexity is responsible for a high level of arbitrariness in administrative decision making, which sometimes gets mistaken for petty corruption. Also, excessive regulations, administrative controls, and inspections are stifling the activities of the private sector.³⁵

The U.S. Government's current "Country Commercial Guide" has confirmed the existence of this corruption and arbitrariness in government decision-making. According to this report, customs, municipal zoning offices, local financial

³³ Exhibit B at 24.

³⁴ Id. 24-25.

³⁵ Exhibit D at 324.

authorities, and other bodies are affected by corruption.³⁶ Demands for bribes and payoffs from mid- to lower- level officials “can reach the point of harassment.”³⁷ Moreover, “foreign investors feel they are unfairly targeted by Romanian tax authorities for audits and reviews and that Romanian authorities view them as ‘cash cows’ that can be milked to fill government coffers.”³⁸

Jean-Pierre Vigroux, a partner in Pricewaterhouse Coopers, summarized the numerous problems confronting foreign investors as a result of the government's posture in a May 2002 interview:

It is difficult to attract financing to a country like Romania, which is affected by very many corruption-related scandals . . . In relation to the fiscal policy, Romania was perceived as a country that breaks its commitments. There used to be some facilities granted to investors, which have vanished over time.³⁹

For its part, the GOR has responded to foreign investors' complaints about corruption, smuggling, and government favoritism to state-owned enterprises by harshly criticizing the foreign investment community itself. Romania's Prime

³⁶ Exhibit K at 10.

³⁷ Id.

³⁸ Id. at 8.

³⁹ "It is Difficult to Attract Financing to a Country Affected by Corruption," Romania Libera (May 20, 2002) FBIS Doc. EUP2002052100215, attached as Exhibit N at 2.

Minister, Adrian Nastase, has alleged that foreign investors "use various means to avoid paying the profit tax."⁴⁰ According to a press report:

The prime minister's message was not well received, as most foreign businessmen criticized the offensive manner of its presentation and the fact that, as no names were given, all companies were lumped together.⁴¹

In part, Romania's failings reflect the fact that its government remains dominated by officials who held positions of authority under the Communist regime of Nicolae Ceausescu. A recent book by former Romanian President Emil Constantinescu made this point, noting that Romanian Prime Minister Nastase was a Ceausescu-era official, as was Dan Popescu, the Minister of Industry and Resources.⁴² Gheorghe Cazan, the current Minister of Development and Planning, served for 15 years under Ceausescu in the State Council in Charge of Economic Planning, "the institution that coordinated the Communist centralized economy."⁴³

In sum, the business environment in Romania is one of the most toxic in Europe toward FDI. "A complex, confusing, and constantly changing regulatory

⁴⁰ A. Sadeanu, "Without Giving Names or Providing Evidence, Nastase Accuses Multinational Companies in Romania of Tax Evasion," Bucharest Adventur (June 7, 2002), FBIS Doc. EUP2000206070000155, attached as Exhibit O at 1.

⁴¹ Id. at 2.

⁴² Excerpt from "Time to Demolish, Time to Build," Bucharest Ziva (Oct. 4, 2002) FBIS Doc. EUP20021004000216, attached as Exhibit P at 2.

⁴³ Id. at 2.

environment, erratic taxation, lack of transparency in major deals, pervasive bureaucracy, and widespread corruption have often discouraged and chased foreign investors away.”⁴⁴ The very limited influx of FDI demonstrates that Romania is not open to foreign investment.

IV. THE MEANS OF PRODUCTION REMAIN SUBSTANTIALLY IN THE CONTROL OF THE GOVERNMENT OF ROMANIA

Summary of Comment:

The GOR still accounts for a large majority of Romania’s industrial production and half of all banking assets. Most of the land suitable for new investment and the best arable land remain in the hands of the GOR.

Discussion:

In its NME analysis, the Department must examine "the extent of government ownership or control of the means of production."⁴⁵ The GOR continues to control much of the means of production in Romania, in particular through its ownership of large industrial companies.

The pace of privatization has been slow by design. The GOR has been loathe to confront the social consequences of privatizing state-owned compa-

⁴⁴ “Romania Country Commercial Guide FY 2002,” U.S. & Foreign Commercial Service, U.S. Department of State (2002) at Chapter 1 at 1, attached as Exhibit Q.

⁴⁵ 19 U.S.C. § 1766(B)(iv) (1995).

nies, or liquidating its large loss-makers. As the U.S. Government's current "Country Commercial Guide" notes:

Romania's current government has used a rhetoric that strongly supports the idea of fast privatization. Yet, in actual fact, institutional reorganization (the creation of a new Privatization Authority to replace the State Ownership Fund and the division of responsibility for privatization among the Privatization Authority, pertinent ministries, and local organizations) has slowed privatization down. When restructuring and privatization are completed and the basic elements of a market economy are in place, the government's role in the economy will diminish. In the meantime, the government plays an extremely important part in the economy.⁴⁶

The state sector still accounts for over 68 percent of Romania's industrial production⁴⁷ and 55 percent of the value added in such production.⁴⁸ Indeed, according to the U.S. Government's current "Country Commercial Guide," 80 percent of Romania's industrial core has not been privatized.⁴⁹ In terms of percentage of gross domestic product, Romania's state-owned sector is much larger

⁴⁶ Exhibit C at 5.

⁴⁷ Id. at 1. Similarly, the World Bank reports that "the state still holds shares in around 6,000 enterprises and accounts for about three-quarters of industrial output." Exhibit I at 9.

⁴⁸ Exhibit J at 47.

⁴⁹ Exhibit C at 1.

(approximately 40 percent⁵⁰) than that of Russia (approximately 30 percent⁵¹), and of the Czech Republic (approximately 20 percent⁵²) when those countries were deemed market economies by the Department.

A report issued by the Organization for Economic Cooperation and Development on Romania's economy concluded that limited progress has been made in privatizing large state enterprises, and that very few large, lossmaking enterprises have been liquidated.⁵³ "For the most part, the {Romanian} government accepts the "OECD" criticism."⁵⁴

In its most recent report on the possible accession of Romania to the EU, the EC also took note of the limited extent of privatization in Romania, and its negative implications for the restructuring of Romania as a market economy:

⁵⁰ Exhibit I at 9.

⁵¹ Memorandum from Albert Hsu, Senior Economist, to Faryar Shirzad, Assistant Secretary, Import Administration, re: Inquiry into the Status of the Russian Federation as a Non-Market Economy Country Under the U.S. Antidumping Law (June 6, 2002) ("Russia Market Economy Memo") at 21.

⁵² Memorandum from John Brinkman, Program Manager, to Robert LaRussa, Assistant Secretary for Import Administration, re: Antidumping Investigation of Certain Small Diameter Carbon and Alloy Seamless Standard Line and Pressure Pipe from the Czech Republic: Non-Market Economy ("NME") Country Status (Nov. 29, 1999) at 10.

⁵³ Bucharest Adventul (Sept. 25, 2002), attached as Exhibit R.

⁵⁴ Id. citing Eugen Dijmarescum Chief of the Economic Policies Department.

{P}rivatization and restructuring are not yet completed in most sectors and are at a relatively early stage in some. In particular, several large loss-making enterprises that actually subtract rather than add value have survived with little or no restructuring thanks to direct and indirect government support. This has weakened market incentives and deprived the budgetary and private sectors of scarce resources.⁵⁵

In the banking sector, state-owned banks account for half of all banking assets.⁵⁶ This provides an indirect, but powerful means for the GOR to control the means of production, given the state practice of propping up loss-making enterprises through the banking sector.⁵⁷

The GOR also remains a key actor in the land market.⁵⁸ Most of the land suitable for new investment is under the control of government ministries, local authorities, and state-owned enterprises, making it difficult for private investors to acquire such land.⁵⁹ Similarly, the best arable land in the country is still owned by state farms.⁶⁰

⁵⁵ Exhibit B at 49.

⁵⁶ Exhibit I at 9.

⁵⁷ Id.

⁵⁸ “Romania: Selected Issues and Statistical Appendix,” IMF Country Report No. 01/16, International Monetary Fund (January 2001) at 158, attached as Exhibit S.

⁵⁹ Exhibit I at Annex H, at 2.

⁶⁰ Id. at 10 (“the privatization of state farms, which are chronic loss-makers, remains a critical unfinished task”).

Finally, it should be noted that a number of "private enterprises" in Romania are nothing more than a device created to siphon off funds from state-owned companies. These companies, known as "tick firms," are organized by the managers of state-owned companies to sell raw materials to the state-owned company at high prices and/or buy its production cheaply.⁶¹ Such entities do not represent private enterprises in any meaningful sense of the term; they are merely shell companies designed to facilitate theft.

Thus, all of the evidence indicates that the means of production remains substantially in the control of the GOR.

V. THE GOVERNMENT OF ROMANIA EXERTS SIGNIFICANT CONTROL OVER THE ALLOCATION OF RESOURCES AND PRICE AND OUTPUT DECISIONS OF ENTERPRISES

Summary of Comment:

The GOR continues to exert significant control over the allocation of resources and the price and output decisions of enterprises.

Discussion:

Under 19 U.S.C. §1677(18)(B)(v), in making NME determinations, the Department must also consider "the extent of government control over the allocation of resources and over the price and output decisions of enterprises." The GOR

⁶¹ A. Dochia, "New Private Firm Contributions to Structural Change in the Romania Economy," Romania 2000 - Ten Years of Transition (Oct. 2000) at 14-15, attached as Exhibit T.

continues to exert significant control over the allocation of resources and price and output decisions of enterprises through a variety of direct and indirect means.

To begin with, Romania continues to control prices to a significant extent. As the EC observed in its 2001 accession report, while "most prices in Romania are liberalized, . . . sporadic price controls tend to create large distortions"62

The GOR also directly controls the allocation of resources by a variety of means. According to the EC's report last month on Romania's possible EU succession:

{G}overnment intervention has continued to affect enterprises' competitiveness, thereby holding back the process of restructuring. . . . {S}uccessive governments have continued to shelter a slowly diminishing number of sectors and enterprises from market discipline. This was achieved through the provision of explicit budgetary subsidies as well as through other less transparent and more pervasive forms of support. At different points in time, these have included controlling the price of key inputs for certain production sectors, writing off tax arrears to the budget on a regular basis, tolerating mounting inter-enterprise arrears, granting borrowing guarantees and implementing discriminatory trade and fiscal measures.⁶³

The GOR has a very lenient attitude toward the accumulation of arrears on payments owed by enterprises and this, in turn, has greatly distorted

⁶² Exhibit A at 36.

⁶³ Exhibit B at 50.

prices and the allocation of resources. In its 2002 report on "Nations in Transit," Freedom House reported that "the unpaid debts of public companies now amount to a staggering 50 percent of GDP."⁶⁴ And, in the report on Romania's possible accession that the EU issued just last month, the EC observed that the GOR's toleration of these poor payment disciplines "continues to affect the workings of the price mechanism."⁶⁵

In its previous accession report, the EC also noted that this practice has resulted in a significant misallocation of resources. Specifically, the EC stated that "unviable state-owned enterprises have been allowed to continue their operations because of the absence of hard budget constraints and, in many cases, large implicit state aid, typically granted by forgiving tax arrears and other debts to the state."⁶⁶ While such practices have allowed many loss-making state-owned companies to survive, they have also hindered the reallocation of resources to more efficient industries.⁶⁷

⁶⁴ Exhibit D at 326.

⁶⁵ Exhibit B at 45.

⁶⁶ Exhibit A at 39; see also Exhibit B at 67 ("{t}here are continuous problems with the treatment of debt cancellation – a form of state aid which is widely practised by public bodies").

⁶⁷ Exhibit B at 41.

Finally, in addition to such indirect transfers as debt forgiveness, many enterprises receive direct transfers and preferential access to credit from state-owned banks.⁶⁸

Clearly, the scope of the GOR's control over the allocation of resources and price and output decisions by enterprises is enormous. As the EC has concluded, "{g}overnment policy towards the enterprise sector has often directed scarce resources to the support of the state owned sector at the expense of developing a strong private sector."⁶⁹

VI. THE CONVERTIBILITY OF ROMANIA'S CURRENCY IS SIGNIFICANTLY LIMITED

Summary of Comment:

There are a host of limitations on the convertibility of Romania's currency – in the form of licensing requirements for currency conversions in connection with many significant business transactions – and these limitations are likely to exist for some time to come.

Discussion:

Under 19 U.S.C. §1677(18)(B)(i), in determining whether a country is an NME, the Department is directed to consider the extent to which the currency of the foreign country is convertible into the currency of other countries. "The greater

⁶⁸ Exhibit I at 9.

⁶⁹ Id. at 39.

the extent of currency convertibility, for both trade and investment purposes, the greater are the supply and demand forces linking domestic market prices in the country to world market prices.”⁷⁰

There are major limitations on the convertibility of Romania’s currency. Currency conversions in connection with numerous important business transactions require licensing by the National Bank of Romania. According to the website of the National Bank of Romania, these include:

- "(a) admission of securities and units of foreign collective investment undertakings on the Romanian market;
- (b) residents' transactions in securities and units of foreign collective investment undertakings;
- (c) transactions in securities and other instruments currently traded on the money market;
- (d) financial loans and credits granted by residents to non-residents less short-term financial leasing operations;
- (e) short-term financial loans and credits granted by non-residents to residents;
- (f) sureties granted by residents to non-residents;
- (g) operations in deposit and current account operations opened by residents abroad;
- (h) operations in . . . {Romanian currency} deposit accounts opened by non-residents in Romania;

⁷⁰ See Russia Market Economy Memo.

- (i) personal capital transfers in the form of loans granted by residents to non-residents;
- (j) import and export of financial instruments – payment instrument in the form of cash."⁷¹

Not surprisingly, in July of this year, the Vice-Governor of the National Bank of Romania acknowledged that the Romanian currency "has a limited convertibility."⁷² Moreover, he stated that he anticipated that it would not become fully convertible until 2004 at the earliest, and that this might not occur until 2007.⁷³

⁷¹ "Main Provisions of the Currency Regulation," National Bank of Romania, available at http://www.bnro.ro/En/Legi/Regval_se.asp, (last visited Nov. 4, 2002), attached as Exhibit U.

⁷² From Romanian Business Journal, available at http://www.reoembus.org/english/business/buletine_economice/ec_bul_07_2002.htm (last visited Nov. 4, 2002), attached as Exhibit V.

⁷³ Id.

VII. RAMPANT CORRUPTION HAS BEEN AN IMPORTANT REASON WHY ROMANIA HAS BEEN UNABLE TO DEVELOP A MARKET ECONOMY

Summary of Comment:

There is widespread corruption on every level of business and government that impedes investment and economic development. Corruption in Romania is so great as to be an important factor in preventing the country from developing a true market economy.

Discussion:

Under 19 U.S.C. § 1677(18)(B)(vi), in making NME determinations, the Department is authorized to take into account “such other factors as . . . {it} considers appropriate.” In the case of Romania, the Department should consider rampant corruption as one other factor weighing against a finding that Romania is a market economy. As discussed above, there is widespread corruption on every level of business and government that impedes investment and economic development. While it may be true that other countries the Department considers to be market economies are corrupt, corruption in Romania is so great as to be an important reason why Romania has failed to develop a true market economy.

In its recent determination of market economy status for Russia, the Department also found substantial corruption.⁷⁴ In Russia, however, the level of corruption was no higher than levels in some market economies and taxes were a greater concern to investors than corruption.⁷⁵ Corruption in Romania, on the other hand, pervades all levels of business and government and represents a significant impediment to the development of a market economy. The EC, in its 2001 report on Romania's progress toward accession, found that corruption in Romania is a rampant and systemic problem that hinders the development of a private sector. Specifically, the EC stated that:

{C}orruption . . . was a widespread and systemic problem that undermined the legal system, the economy and public confidence in government. Despite a general recognition of the seriousness of this problem by the government there has been no noticeable reduction in levels of corruption and measures taken to tackle corruption have been limited.⁷⁶

Corruption is a serious problem which has hampered the development of the private sector.⁷⁷

In a subsequent report issued in October of this year, the EC found that little progress has been made to reduce such corruption:

⁷⁴ See Kazakhstan Market Economy Memo at 28.

⁷⁵ Id.

⁷⁶ Exhibit A at 21.

⁷⁷ Id. at 37.

Surveys indicate that corruption is a widespread and systemic problem in Romania that is largely unresolved. . . . Corruption remains a common aspect of commercial operations but is also widely reported in dealings with public bodies as well as at the political level. Such high levels of corruption undermine economic development and erode popular trust in state institutions. Independent observers have concluded that there has been no noticeable reduction of corruption during the reporting period.⁷⁸

Pervasive corruption is widely recognized in Romania itself. One Bucharest journal observed in August of this year that corruption has become a generalized phenomenon, all over society, a legacy of the Communist era in which the organs of state power (the Party and the secret police or "Securitate") "became the most corrupt elements in society."⁷⁹ Corruption

is stimulated and rewarded . . . in a country where half the population lives below the poverty threshold, in a country lacking a functional market economy, where the state is inefficient and macro-managing things, and where privatization is politically-inspired – which makes foreign investors stay away⁸⁰

⁷⁸ Exhibit B at 26.

In fact, Romania is one of the most corrupt countries in the world . Transparency International ranked Romania 77th out of 102 countries in its 2002 Corruption Perception Index. "Corruption Perceptions Index 2002," Transparency International (Aug. 28, 2002) at 5, attached as Exhibit W. The countries with the lowest numbers are the least corrupt, and those with the highest numbers are the most corrupt. And Romania's numbers have been rising in recent years, not falling. Id. at 4.

⁷⁹ "I Am Corrupt, Therefore I Am?" Buchares Evenimentul Zilei (Aug. 31, 2002) FBIS Doc. EUP20020902000141, attached as Exhibit X.

⁸⁰ Id.

The centrist daily newspaper Romania Libera notes that government officials have transformed themselves into so-called "harmless barons," who "have turned their public positions into personal deals, meant to bring them huge profits."⁸¹ The ruling party's "barons"

acquire governmental funds in their own money-boxes . They acquire PHARE {EU reconstruction aid} funds. They traffic in oil. They purchase the newspapers that criticize them. They acquire factories by means of rigged bids. They receive money from "dubious" loans . . . They are Romania's owners.⁸²

An editorial in Bucharest Adventul, a large, centrist daily newspaper, accepted these critical judgments as basically accurate, and commented that:

As long as corruption remains at such high levels, Romania will never have a market economy. And if the country does not have a real market economy, we can say goodbye to EU accession, even in 2007, no matter how many successes the Adrian Nastase government will report.⁸³

Clearly, then, corruption in Romania is on such a massive scale that it is an important reason why that country has failed to develop a market economy.

VIII. CONCLUSION

As demonstrated by the evidence in this review, Romania lacks a market economy. The overwhelming weight of evidence bearing on the statutory

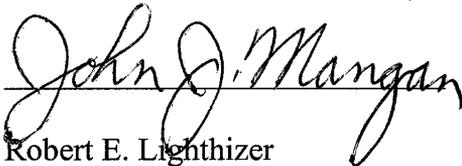
⁸¹ I. Stefan, "The Baron's Disease," Romania Libera (Oct. 21, 2002), FBIS Doc. EUP20021023000164, attached as Exhibit Y.

⁸² Id.

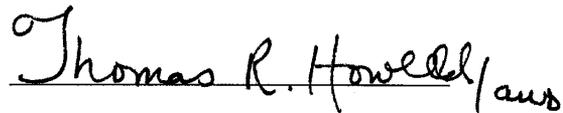
⁸³ I. Ionita, "Corruption Masking," Bucharest Adventul (Oct. 18, 2002) FBIS Doc. EUP20021019000038 (Oct. 18, 2002), attached as Exhibit Z at 2-3.

criteria that the Department must consider in its NME analysis shows that the country continues to be an NME. To determine that such an economy operates on prices and costs that adequately reflect market considerations free of government control would be to ignore the studied conclusions of the EC, World Bank, the U.S. Government itself, Romanians who are in a position to speak knowledgeably about the subject, and the other evidence on the record. Accordingly, the Department should continue to classify Romania as an NME.

Respectfully submitted,



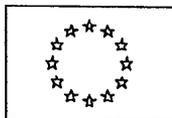
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EXHIBIT A



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 13.11.2001
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2001
REGULAR REPORT
ON
ROMANIA'S
PROGRESS TOWARDS ACCESSION

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REGULAR REPORT

ON

ROMANIA'S

PROGRESS TOWARDS ACCESSION

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A. Introduction

a) Preface

In Agenda 2000, the Commission said it would report regularly to the European Council on progress made by each of the candidate countries of Central and Eastern Europe in preparations for membership, and that it would submit its first Report at the end of 1998.

The European Council in Luxembourg decided that:

“From the end of 1998, the Commission will make Regular Reports to the Council, together with any necessary recommendations for opening bilateral intergovernmental conferences, reviewing the progress of each Central and Eastern European applicant State towards accession in the light of the Copenhagen criteria, in particular the rate at which it is adopting the Union *acquis*” ... “The Commission’s reports will serve as the basis for taking, in the Council context, the necessary decisions on the conduct of the accession negotiations or their extension to other applicants. In that context, the Commission will continue to follow the method adopted by Agenda 2000 in evaluating applicant States’ ability to meet the economic criteria and fulfil the obligations deriving from accession.”

On this basis, the Commission presented a first series of Regular Reports in October 1998, a second series in October 1999, and a third in November 2000. The Commission has prepared this fourth series of Regular Reports with a view to the Laeken European Council in December 2001.

The structure followed for this Regular Report is the same as that used for the 2000 Regular Report. In line with previous Regular Reports, the present Report:

- describes the relations between Romania and the Union, in particular in the framework of the Association Agreement;
- analyses the situation in respect of the political criteria set by the 1993 Copenhagen European Council (democracy, rule of law, human rights, protection of minorities);
- assesses Romania’s situation and prospects in respect of the economic criteria defined by the Copenhagen European Council (a functioning market economy and the capacity to cope with competitive pressures and market forces within the Union);
- addresses the question of Romania’s capacity to assume the obligations of membership, that is, the *acquis* as expressed in the Treaties, the secondary legislation, and the policies of the Union. This part gives special attention to nuclear safety standards, as underlined by the Cologne and Helsinki European Councils. It encompasses not only the alignment of legislation, but also the development of the judicial and administrative capacity necessary to implement and enforce the *acquis*, as emphasised by the Madrid European Council in December 1995, and confirmed by the Gothenburg European Council in June 2001. At Madrid, the European Council underlined the necessity for the candidate countries to adjust their administrative structures, so as to create the conditions for the harmonious integration of those States. The Gothenburg European Council emphasised the vital importance of the

candidate countries' capacity to effectively implement and enforce the *acquis*, and added that this required important efforts by the candidates in strengthening and reforming their administrative and judicial structures.

This Report takes into consideration progress since the 2000 Regular Report. It covers the period until 30 September 2001. In some particular cases, however, measures taken after that date are mentioned. It looks at whether intended reforms referred to in the 2000 Regular Report have been carried out, and examines new initiatives. In addition, this Report provides also an overall assessment of the global situation for each of the aspects under consideration, setting out for each of them the main steps which remain to be taken by Romania in preparing for accession.

In accordance with this approach, the assessment of progress in meeting the political and *acquis* criteria (including Romania's administrative capacity to implement the *acquis*) focuses on what has been accomplished since the last Regular Report, complemented with a view of the global situation for each of the aspects discussed. The economic assessment, for its part, provides, besides an assessment of progress made over the reference period, also a dynamic, forward-looking evaluation of Romania's economic performance.

The Report contains a separate section examining the extent to which Romania has addressed the Accession Partnership priorities.

As has been the case in previous Reports, "progress" has been measured on the basis of decisions actually taken, legislation actually adopted, international conventions actually ratified (with due attention being given to implementation), and measures actually implemented. As a matter of principle, legislation or measures which are in various stages of either preparation or parliamentary approval have not been taken into account. This approach ensures equal treatment for all the candidate countries and permits an objective assessment of each country in terms of its concrete progress in preparing for accession.

The Report draws on numerous sources of information. The candidate countries have been invited to provide information on progress made in preparations for membership since the publication of the last Regular Report. The National Programmes for the Adoption of the *Acquis* of each of the candidate countries, as well as the information they have provided in the framework of the Association Agreement and in the context of the analytical examination of the *acquis* (screening) and the negotiations¹, have served as additional sources. Council deliberations and European Parliament reports and resolutions² have been taken into account in the preparations. The Commission has also drawn on assessments made by various international organisations and in particular the contributions of the Council of Europe, the OSCE and the International Financial Institutions, as well as that of non-governmental organisations.

¹ As in previous years, the Report does not mention any commitments undertaken or requests made in the context of the accession negotiations.

² The European Parliament *rapporteur* is Baroness Nicholson of Winterbourne.

b) Relations between the European Union and Romania

Recent developments under the Association Agreement (including bilateral trade)

Romania has contributed to the smooth functioning of the various joint institutions. The Association Council met in March 2001. The most recent meeting of the Association Committee was held in October 2001. The Joint Parliamentary Committee, comprising representatives of the Romanian and European Parliaments, met in Brussels in January 2001 and in Bucharest in September 2001.

Although in most cases Romania continued to implement the Europe Agreement correctly, a number of specific problems arose during the course of the year. Particular causes for concern have been obstacles to EU law firms establishing themselves in Romania and the introduction of export restrictions on sensitive raw materials. Such measures represent a move away from the both *acquis* and the Europe Agreement.

Recent indicators point to a remarkable improvement in Romania's trade situation. During the course of 2000, Romanian exports to the EC were €7.6 billion (a growth of 32% compared to 1999). Over the same period, imports from the EC rose to €8.7 billion (an increase of 38% over the previous year). This increase in trade both reflected and contributed to the revival of the Romanian economy that took place in 2000. However, the rapid growth in imports meant Romania's trade deficit with the EC increased substantially to €1.1 billion, which remains a cause for concern.

Over the course of 2000, Romania's main exports to the EC were: textiles and clothing (34%), machinery and equipment (16%), steel products (12%), footwear (12%), and furniture (7%). While the structure of exports was broadly similar to previous years, the increased share of machinery and equipment is a positive development and represents a pick-up in Romania's industrial production. The EC's main exports to Romania were machinery and equipment (28%), textiles and clothing (24%), chemical products (9%) and steel products (6%).

Romania's main commercial partners amongst the EU Member States were Italy (34%), followed by Germany (25%), France (10%) and Great Britain (8%).

Regarding agricultural products, a new agreement on reciprocal concessions with Romania entered into force in July 2000 on an autonomous basis, pending the conclusion of an Additional Protocol to the Europe Agreement. As a consequence of the new agreement, approximately 85% of EC imports and 17% of EC exports of agricultural products are exempt from duties. A second round of bilateral negotiations for trade liberalisation in agriculture is presently being prepared and would cover more sensitive sectors where current trade is low, in particular due to a high degree of tariff protection. Negotiations with Romania concerning new reciprocal concessions in the field of fish and fishery products were concluded on a technical level in May 2001. Preparations for a decision of the Association Council are ongoing.

The previous bilateral wine agreement between the Community and Romania expired on 31 December 2000. The parties concluded negotiations relating to new agreements on the reciprocal recognition, protection and control of wine names and spirits designations, including trade arrangements, in October/November 2000. The results of the trade agreement were

applied as from 1 January 2001 as autonomous trade measures pending the adoption of the new agreements as an Additional Protocol to the Europe Agreement.

Accession Partnership / National Programme for the Adoption of the Acquis

A revised Accession Partnership was adopted in December 1999. Its implementation is reviewed in Part D. This Regular Report is accompanied by a proposal from the Commission to update the Accession Partnership.

In June 2001 Romania presented a revised National Programme for the Adoption of the *Acquis* (NPAA), in which it outlines its strategy for accession, including how to achieve the priorities of the Accession Partnerships (see Part D).

Community aid

There are three **pre-accession instruments** financed by the European Community to assist the applicant countries of Central and Eastern Europe in their pre-accession preparations: the **Phare** programme; **SAPARD**, which provides aid for agricultural and rural development; and **ISPA**, which finances infrastructure projects in the fields of environment and transport. These programmes concentrate their support on the Accession Partnership priorities that help the candidate countries to fulfil the criteria for membership.

In the years 2000 – 2002 the total financial assistance available to Romania will, on average, amount €260 million from Phare, €150 million from SAPARD, and between €208 and €270 million from ISPA.

The level of financial support available under the pre-accession instruments creates a substantial challenge for the Romanian administration. The capacities of the bodies responsible for programming, operational management and financial control are limited. For Phare there has been a relatively low rate of tendering and contracting in 2001 compared with the previous two years, and consequently the backlog of funds not yet committed has increased. The same limits of institutional capacity may also affect the implementation of ISPA. Considerable efforts are therefore needed to strengthen institutional structures and recruit and train staff for all key functions. In particular, the capacities of the Central Financing and Contracting Unit in the Ministry of Public Finance and the Financial Unit within the Ministry of Development and Prognosis need to be reviewed and strengthened. The development of the administrative capacity needed to manage SAPARD has begun, but substantial further efforts are needed.

The **Phare** programme has been providing support to the countries of Central and Eastern Europe since 1989, helping them through a period of fundamental economic and social transition and political change. Its current “pre-accession” focus was put in place in 1997, in response to the Luxembourg European Council’s launching of the present enlargement process.

Phare provides the applicant countries of Central and Eastern Europe with support for institution building (around one third of the Phare allocation), investment to strengthen the regulatory infrastructure needed to ensure compliance with the *acquis* (equally around one third of the allocation), and investment in economic and social cohesion (the remaining one-third of the Phare allocation). This support comprises co-financing for technical assistance, “twinning” and investment-support projects, to help these countries in their efforts to adopt the *acquis* and

strengthen the institutions necessary for implementing and enforcing the *acquis*. This also helps the candidate countries develop the mechanisms and institutions that will be needed to implement Structural Funds after accession and is supported by a limited number of measures (investment or grant schemes) with a regional or thematic focus.

During the period 1992 – 1999, the Phare programme allocated commitments of approximately €1,200 billion to Romania. In 2000 the Phare allocation was €260.3 million³, and in 2001 the Phare National Programme for Romania allocated a further €273.7 million to the following priority areas:

1. Strengthening democracy and the rule of law (€ 27 million). *Support is being provided for further action in the field of child welfare, improving the access of Roma to education, and development of civil society.*
2. Economic criteria (€6 million). *Support for improved management of municipal services.*
3. Strengthening administrative capacity (€18 million). *Projects promoting the reform of public administration policies, civil service recruitment and training, and the programming and management of EC financial instruments are being supported.*
4. Meeting the obligations of the *acquis* (€68 million). *Twinning, technical assistance and investment are being provided in the following areas: internal market, agriculture and fisheries, energy, transport, health, environment and justice and home affairs.*
5. Economic and social cohesion. (€109 million). *Investment support is being provided for regional development programmes concentrated in areas facing particular problems. Measures can also support economic restructuring. Associated institution building is being provided.*
6. Participation in Community programmes (€21 million).

An additional €13 million has been allocated for cross border co-operation (CBC) programmes with Bulgaria (€8 million) and Hungary (€5 million).

Romania also participates in and benefits from Phare funded multi-country and horizontal programmes, such as TAIEX and the Small and Medium-sized Enterprises Facility.

Funding provided under Phare 2001 pre-finances participation in Community programmes for 2002. Romania has continued to participate actively in a number of programmes: Leonardo da Vinci, Socrates, Youth, Life III and Framework Programme 5 for Research and Technological Development, and Euratom. Preparations for participation in a number of new programmes have been initiated: Gender Equality, Enterprise and Entrepreneurship, Altener, ETAP, SURE, IDA II, DAPHNE, Culture 2000, Fiscalis, European e-content, Customs 2002, and health programmes covering health monitoring, pollution-related diseases, and injury prevention. Preparations have also been initiated for Romania's continued participation in programmes

³ This includes an allocation of €13 million to Cross-Border Co-operation (CBC) Programmes.

which have had their period of application extended: SAVE II, as well as public health programmes dealing with cancer, AIDS, drugs dependence, and health promotion. Following the ratification and entry into force of the agreement, the formal participation of Romania in the European Environment Agency will start in January 2002

In order to streamline Community legal procedures and thereby facilitate future participation of Romania in **Community programmes**, a Decision is in the process of being adopted by the EU-Romania Association Council establishing the general principles for such participation.

Overall, the impact of Phare has been positive. Effective transfer of know-how, equipment and financial resources has taken place in a number of important fields such as industrial restructuring and privatisation, institutional structures and planning capacity for regional development, the phytosanitary and veterinary *acquis*, environment, transport and energy. Phare support for institution building in a wide range of *acquis*-related areas has succeeded in developing accession strategies and in focusing efforts on the legislative and institutional requirements for adoption and implementation of the *acquis*. In Romania, Phare is for example playing a particularly important role in:

- Developing the framework for designing and implementing programmes of regional development. Assistance provided under the 1998 Phare programme (€33 million) has developed the arrangements under which substantial pre-accession programmes of economic and social cohesion are being financed under the Phare 2000 and 2001 programmes.
- Initiating measures to improve border management in line with Romania's accession obligations through institution building and investment. The Phare 1998 and 2000 programmes have supported the Ministry of Interior, providing a total of €20 million.
- Developing a framework for the implementation by local authorities of projects introducing modern child welfare services and reducing institutionalisation of children in line with government policies for the reform of child protection. This is being financed under the Phare 1999 programme through a €19 million grant scheme known as "Children First". Phare is also supporting associated measures that include technical assistance and a public information campaign.

The Phare Review for 2000 confirmed the accession-driven approach and emphasised the importance of helping countries to prepare for the Structural Funds. The Review foresees the possibility that management of the Phare funds can be fully decentralised from 2002 if the strict pre-conditions set down in the Co-ordination Regulation 1266/99 are met. Second, Phare programming can be moved onto a multi-annual basis if supporting strategies are in place. Third, the reforms introduced in 1997 continue with an increased role for Delegations, further streamlining of procedures and, lastly, increasing emphasis on raising the verifiable and quantifiable impact of Phare projects in institution building, investment in compliance with the *acquis* and economic and social cohesion.

Romania's National Plan for Agricultural and Rural Development, which forms the basis for implementation of the **SAPARD programme** in Romania, was approved in December 2000. It provides for total public expenditure of around €1,423 million, of which €1,073 million will be

financed by EC SAPARD funds, over the period 2000 –2006. The annual allocation for SAPARD in Romania for 2000 was 153.2 million at 2000 prices.

The multi-annual and the annual financing agreements between the Commission and Romania setting out respectively the rules for implementing SAPARD and the Community financial commitments for the year 2000 were both signed in February 2001.

In order to accelerate the start of SAPARD implementation the government decided to concentrate efforts initially on only three of the measures of the programme: rural infrastructure, processing and marketing of agricultural and fishery products and technical assistance.

Progress has been made in preparing the accreditation of the SAPARD Agency. 150 personnel have been recruited to work in the central and regional offices of the Agency, and an updated organisational structure has been approved. New premises have been provided for the Agency in Bucharest, and eight regional offices have been set up for the territorial management of the programme.

Financial manuals and procedures are not yet completed, and further efforts are needed to complete the organisation of the financial department of the Agency. Arrangements must also be finalised for opening the SAPARD Euro Account. Efforts are continuing on the development of computerised management and accounting systems tailored to Romania's specific requirements. An audit of the system will be required, as well as extensive staff training at central and regional level.

Further efforts are needed to strengthen the National Fund and the Court of Accounts for their respective functions in relation to SAPARD. The National Fund has been preparing for the implementation of a pre-accreditation review of the SAPARD Agency, particularly as regards its draft procedural manuals. The Court of Accounts requires further strengthening in the area of clearance-of-accounts procedures for SAPARD.

The internal public expenditure audit function , which has not yet been fully implemented in Romania, needs to be substantially strengthened within the SAPARD implementation structures. An internal audit unit in the Ministry of Finance will perform this function for the National Fund, but the procedures for effectively carrying out this task have not been formalised. The Internal Audit Unit of the SAPARD Agency requires additional expertise.

The annual allocation to Romania under ISPA is between €208-270 million for the period 2000-2006. The sectors benefiting from ISPA are transport and the environment, with both sectors receiving around half of the annual allocation. The ISPA programme is designed principally to support municipalities in the field of the environment and the central authorities in the field of transport (the National Administration of Roads and the CFR railway company).

An overall ISPA strategy in the field of the environment was adopted in 2000 by Romania and the Commission and is currently being revised. It will concentrate on the 'heavy investment' directives (mainly drinking water, treatment of wastewater, and solid-waste management) that are intended to bring Romania up to EC standards. Since the beginning of 2000, eleven projects have been approved, accounting for a total ISPA allocation of more than €300 million (multi-annual commitments) in the areas of sewerage networks, drinking water treatment and waste management.

In the transport sector ISPA will concentrate on projects located on the Trans-European Networks (TENs) in the field of railways, roads, ports and airports. An overall ISPA strategy in the field of transport was adopted by Romania and the Commission in early 2000, focusing on the upgrading of Corridors IV and IX for both road and rail. Since the beginning of 2000, six projects have been approved, accounting for a total ISPA allocation of more than €500 million (multi-annual commitments).

Implementation of the ISPA project will follow the same general institutional framework as the Phare programme, with the National Fund at the Ministry of Finance being in charge of the overall financial management and with a number of Implementing Agencies being responsible for the technical implementation.

Twinning

One of the main challenges the candidate countries continue to face is the need to strengthen their administrative capacity to implement and enforce the *acquis*. As of 1998, the European Commission proposed to mobilise significant human and financial resources to help them in this respect, through the process of twinning of administrations and agencies. The vast body of Member States' expertise is now being made available to the candidate countries through the long-term secondment of civil servants and accompanying short-term expert missions and training.

To start with, twinning focused primarily on the priority sectors of agriculture, environment, public finance, justice and home affairs and preparatory measures for the Structural Funds. It now covers all sectors pursuant to the *acquis*.

A total of 372 twinning projects, primarily in the fields of agriculture, environment, public finance, justice and home affairs and preparation for the management of Structural Funds, have been funded by the Community between 1998-2000. These represent the principal priority sectors that have been identified in the Accession Partnerships. But also other important sectors of the *acquis* have been addressed through twinning, for example, social policy, fight against drugs, transport, and telecommunications regulation.

Thanks to the strong support and response from EU Member States 103 twinning partnerships, funded by Phare 1998 and involving all candidate countries and almost all Member States are coming to an end or have been concluded. Under Phare 1999 a further 124 projects are being implemented and the programming exercise for Phare 2000 includes a further 145 twinning projects. The 2001 programming exercise foresees 131 twinning projects in all Phare beneficiary countries as well as Cyprus and Malta. Furthermore, the candidate countries are being offered the possibility of drawing on Member States' expertise through "Twinning Light" (twinning projects of less than six months), to address well-defined objectives of limited scope, which emerge during the negotiation process as requiring adaptation. It is estimated that around 250 twinning projects are operational throughout the candidate countries at any one time.

Under Phare 2000, Romania benefited from 23 twinning projects - nine of which are for supporting regional development. Considerable twinning support is also being provided for the agricultural sector covering agricultural and rural policy, veterinary standards and the *acquis* on wine. The penal system and the Refugee Office each benefit from one twinning project. In the area of finance, the National Commission of Securities, the Court of Accounts and the Ministry

of Finance receive twinning assistance. A twinning project on the fight against drugs has been established with the Ministry of Interior as the main co-ordinator, and the Ministry of Education is preparing a project dealing with the mutual recognition of qualifications.

Under Phare 2001 twelve twinning projects have been designed in a variety of fields: public administration reform, phytosanitary matters, fisheries, road safety, waste management, SME and co-operatives policy, support for the ombudsman's office, migration and border management, as well as customs. The National Bank of Romania and the Border Police have requested support through the new medium-term twinning mechanism.

There have been considerable delays in drafting the 1999 covenants and this has led to less time being available for the actual implementation of some projects. The preparation for the twinning projects under Phare 2000 is well on track but the Romanian authorities should make every effort to ensure that the problems encountered with the 1999 covenants are not repeated.

Negotiations / screening

The analytical examination of the *acquis* (screening) has taken place in the context of meetings of the Association Committee and the sub-committees.

Since the opening of the accession negotiations in February 2000, substantial discussions on the individual chapters of the *acquis* started and by September 2001 negotiations on 15 chapters had been opened.

By the end of September 2001, the following 8 chapters had been provisionally closed: fisheries, statistics, small and medium-sized enterprises, science and research, education, external relations, common foreign and security policy and consumers and health protection.

B. Criteria for membership

1. Political criteria

Introduction

The political criteria for accession to be met by the candidate countries, as laid down by the Copenhagen European Council in June 1993, stipulate that these countries must have achieved “stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities.”⁴

In its 2000 Regular Report on Romania’s progress towards accession, the Commission concluded that:

“Romania continues to fulfil the Copenhagen political criteria.

"The government has shown a political commitment to addressing the problems of institutionalised children and progress has been made. Responsibility for the institutions has been transferred to local authorities, a national strategy aimed at structural reform has been adopted, and the necessary budgetary transfers have been made. Romania can therefore be judged as having met the 1999 Accession Partnership’s short-term priorities. However, the Commission will continue to monitor the situation closely to ensure that these positive policy developments result in a comprehensive reform as well as an improvement in the actual living conditions in the institutions concerned.

"In the case of the treatment of the Roma, the continued high levels of discrimination are a serious concern. The Accession Partnership’s short-term priorities still need to be met (elaborating a national Roma strategy and providing adequate financial support to minority programmes) and progress has been limited to programmes aimed at improving access to education.

"Continued improvements can be noted with regard to the functioning of the judiciary – although the reform process needs to be continued and consolidated in line with the short-term priorities of the Accession Partnership. Further progress still needs to be made with regard to demilitarisation of the police and other bodies subordinated to the Ministry of Interior (a medium-term Accession Partnership priority).

"Romania’s democratic institutions are well established, but the process of decision making remains weak. Despite the initiatives taken over the last year the government has continued to rely on legislating by ordinances and consultation on draft legislation should be substantially improved.

"In terms of administrative capacity, Romania has met short-term Accession Partnership priorities by adopting a law on the civil service and has set up a civil service agency. These developments should be built upon through the development of a comprehensive, public

⁴ These principles have been emphasised in the Charter of Fundamental Rights of the European Union that was proclaimed at the Nice European Council in December 2000.

administration reform programme. Particular care needs to be taken to ensure that decentralised responsibilities are matched by sufficient financial and human resources at the local level. Little progress has been made in reducing the levels of corruption and improved co-ordination is needed between the various anti-corruption initiatives that have been launched.”

The section below aims to provide an assessment of developments in Romania since the 2000 Regular Report, as well as of the overall situation in the country, seen from the perspective of the political Copenhagen criteria, including the overall functioning of the country’s executive and its judicial system. Developments in this context are in many ways closely linked to developments regarding Romania’s ability to implement the *acquis*, in particular in the domain of justice and home affairs. Specific information on the development of Romania’s ability to implement the *acquis* in the field of justice and home affairs can be found in the relevant section (*Chapter 24 – Co-operation in the field of justice and home affairs*) of part B.3.1. of this Report.

Recent developments

Parliamentary elections were held in November 2000. The main winner was the Romanian Party of Social Democracy (PDSR) which won 45% of the seats in the Chamber of Deputies and 46% of the seats in the Senate. The PDSR was able to govern without forming a coalition and has secured parliamentary majorities on a case-by-case basis working together with other parties – in particular the Democratic Union of Hungarians in Romania and representatives from national minorities. The new government was sworn-in in December 2000. In June 2001, the PDSR merged with the small Romanian Social-Democratic Party to form a single new party (the Social Democrat Party).

Presidential elections were also held at the same time and the PDSR candidate, Ion Iliescu, was elected as President of the Republic. Both parliamentary and presidential elections were free and fair.

1.1. Democracy and the rule of law

As mentioned in the previous Regular Reports, Romania has achieved stability of institutions guaranteeing democracy and the rule of law. This section focuses on the most significant developments of the past year.

The parliament

The efficiency of the legislature, which had been recognised as a particular problem in previous Regular Reports, improved considerably over the reporting period.

Prior to the elections the legislature had been effectively paralysed by the weakness of the ruling coalition. One of the first acts of the new Parliament was to reform the functioning of both houses in order to accelerate the legislative process. In the Senate changes included streamlined procedures for amending legislation, and reducing opportunities for “filibustering.” In the Chamber of Deputies the changes included an accelerated procedure for the adoption of priority legal acts – including legislation related to EU accession.

A series of measures have also been introduced in order to improve the relationship between the legislature and the executive. Meetings between the President, the Prime Minister and the speakers of the two chambers take place on a weekly basis. A Minister for Relations with Parliament has been appointed. State Secretaries responsible for parliamentary relations have been appointed in all line-ministries. Taken together, these measures illustrate the importance given by the government to effective co-operation with Parliament.

The combination of a government with a strong position in both houses and reformed parliamentary procedures has seen the number of laws adopted by Parliament increase significantly since the beginning of the year. This has allowed the legislature to effectively process the backlog of some 700 draft legislative acts left over from the previous government.

The improved functioning of Parliament has been matched by the government's reduced reliance on ordinances and emergency ordinances as legislative instruments. This said, legislation by ordinance remains too common and has frequently been used without a clear justification for bypassing parliamentary procedures. This is a concern because Parliament's power to subsequently amend or reject legislation introduced by ordinance can result in legislative instability. A further concern is that parliament's ability to carry out the essential function of scrutinising legislation remains limited.

The executive

Reforms made since the elections have significantly improved the functioning of government. Inter-ministerial co-operation has increased, as has the policy-making capacity of the administration. Progress has also been made with the decentralisation of powers to local government – although certain problems remain related to the implementation of reforms. A remaining concern is the lack of progress in carrying out a strategic reform of the public administration.

Since taking office at the beginning of the year, the new government has conducted an extensive overhaul of the executive. The number of ministers and ministries has been increased and all government agencies have been subordinated to ministries – previously many of them were considered as independent bodies. Bringing the agencies more closely into the structures of government has improved the cohesion of the administration.

A positive development has been the particular emphasis placed upon re-enforcing the structures that are responsible for managing the accession process. The new Ministry of European Integration is responsible for co-ordinating the EU accession effort including implementation of the pre-accession strategy, management of EC financial assistance and conducting the accession negotiations. The position of Chief Negotiator has been upgraded to a ministerial-level post, and a Secretary of State responsible for European Integration has been appointed in each line-ministry. These Secretaries of State meet regularly in an inter-ministerial committee. At the civil servant level, inter-ministerial working groups have been established to deal with the preparation of each negotiating chapter. These measures have significantly improved the quality of Romanian preparations for accession.

Following the elections, a number of specific initiatives were taken to strengthen *policy formulation* (identified as a particular problem in last year's Report). These changes, combined

with a situation where all ministers now belong to the same political party, have significantly improved the policy-making capacity of the government.

A Law on the Organisation and Functioning of the Government of Romania was adopted in February 2001. One of the important elements of the law was the provision of a legal basis for inter-ministerial bodies "in order to elaborate, integrate, correlate and monitor certain policies". The General Secretariat of the Government has been made responsible for co-ordinating the activities of line ministries and ensuring that the correct legal procedures are observed in the elaboration and endorsement of draft legislation. In general terms this initiative has improved policy co-ordination – although there are still cases of government decisions being taken hurriedly and without key ministries being consulted.

Consultation with stakeholders when drafting legislation –social partners, NGOs, the business community – has improved over the reporting period but remains limited. The Council for Economic and Financial Co-ordination, which was created by the previous government and which proved to be ineffective, has been dissolved.

Last year's Regular Report welcomed the adoption of a Civil Servants' Statute and the establishment of the Civil Servants' Agency to implement the Statute and to take a leading role in public administration reform. Unfortunately, little substantial progress on *civil service reform* can be noted since last year.

All ministries have been re-structured - but this has been the result of a change in government rather than of a programme of strategic reform. Certain positions have disappeared while others have had their responsibilities changed. This has led to the removal of many civil servants, either through resignations or through redundancies. This process has seriously undermined the stability of the civil service at all levels of public administration. The number of secretaries of state (political appointees) has been significantly increased. Most of them have taken over the responsibilities that were held by director generals (career civil servants).

The reorganisation of ministries was accompanied by the announcement of a 30% reduction in the numbers of civil servants (as of September 2001, staff numbers had been reduced by 22%). This measure has reduced the already low levels of administrative capacity and has left several important ministries understaffed. There was no evidence of systematic overstaffing in the central administration and making substantial cuts in each ministry missed the opportunity of reallocating excess resources to those areas that needed additional staff.

In terms of process, these dismissals were made following written tests and therefore followed the provisions of the Civil Service Statute. However, the National Agency for Civil Servants was not involved at any stage. This not only raises concerns as to the standard of these testing arrangements (which were the responsibility of each ministry) but also indicates that the Agency is not yet carrying out its role as guardian of the Civil Service Statute.

In spite of this retrenchment a fresh wave of recruitment has also taken place – particularly for the newly established ministries. Many of the staff hired by the new ministries are officials previously employed by other ministries which makes it difficult to assess the overall reduction in numbers of civil servants. Just as with the dismissal of officials, the National Agency of Civil Servants has not been involved in either supervising or implementing the recruitment process.

A National Institute of Public Administration has been established with the remit of improving the training provisions for civil servants. As the Institute will only become fully functional in the 2002-2003 academic year, it is not possible to assess the effectiveness of this institution.

The Commission has made the case that a fundamental structural *reform of the public administration* should be one of the new government's most urgent priorities. In order to make the 1999 Civil Servants Statute fully operational, secondary legislation is still needed to cover recruitment, career structures, and remuneration. In addition, a comprehensive reform strategy should be developed (this is one of the priorities in the 1999 Accession Partnership that has not yet been implemented). Such a strategy should cover the development of mechanisms to ensure the political independence and accountability of civil servants, improved provisions for both initial and in-service training, and the introduction of a career structure based on transparent promotion and assessment.

In September 2001, the Romanian Government responded by adopting a "General Strategy Regarding the Acceleration of Public Administration Reform", and a strategy on e-government. An inter-ministerial council, directly subordinated to the Prime Minister, has been established to monitor the implementation of the reform strategy. Considerable work will be necessary to further develop the strategy. Nevertheless, these developments are significant steps forward and should represent the foundations for future progress.

The bodies responsible for administrative reform are the Ministry of Public Administration and the National Agency of Civil Servants - but their own operational capacity is limited as is their political influence on other ministries. If a reform programme is to succeed then it is essential that these institutional arrangements should be considerably reinforced.

The new executive has given considerable attention to issues related to *local administration and decentralisation*. In March 2001, a new Law on Local Public Administration was adopted in order to extend and clarify the decentralisation process. This legislation enshrines the principle of local autonomy, clearly sets out the competencies of local authorities, and defines the relationship between central and local government. Crucially central government is prohibited from devolving additional responsibilities to the local level without also providing the necessary financial means. At the same time a greater fiscal autonomy is envisaged and the law sets out the right of local authorities to levy local taxes and to elaborate and approve their own budgets. This is a positive development, although difficulties have continued to arise from the transfer of new responsibilities to local authorities (e.g. education, health, institutionalised children) without a corresponding transfer of resources. The capacity of local government to raise local taxes remains limited and is an issue that should also be addressed.

Significantly, the Law on Local Public Administration also promotes the rights of ethnic minorities by providing for the use of minorities' languages in the local administration where more than 20% of the population belongs to a minority.

Local authorities have been increasingly involved in international assistance programmes and some have started contracting foreign loans to develop local infrastructure without a sovereign guarantee. These developments are indications of increasing *administrative capacity* although the performance of the local administrations still varies greatly from one place to another. In general terms, the local level has not yet developed sufficient financial or administrative capacity to deal with the decentralisation of competencies. This has contributed, in many local

communities, to cumbersome administration and, on occasion, a mismanagement of funds – and these shortcomings will have to be urgently addressed if further decentralisation is to be successful.

With regard to the *demilitarisation of the police*, no substantial developments can be reported although the Government did approve draft laws on the statute of policemen and on the modification of the law on the organisation and functioning of the Romanian police, and has submitted them to Parliament using urgency procedures. These laws should establish the legal basis for the demilitarisation of the police and redefine policemen as civil servants albeit with a special status.

The judicial system

Romania has made considerable advances in reforming its judiciary over recent years. This process has continued over the reporting period and there has been progress with speeding up court procedures and the enforcement of judicial decisions. At the same time, additional reforms are still necessary and should include measures to further guarantee the independence of the judiciary and to develop a human resource policy for judges and supporting court staff.

A revised version of the Civil Procedure Code entered into force in April 2001. New procedures were introduced in order to speed up the operation of the courts and improve the enforcement of judicial decisions. In a separate measure, the government made it necessary for judges to publish a reasoning for all their decisions (previously this was only necessary in cases involving appeals to higher courts). Most of the changes to the Civil Procedure Code represent welcome and much needed efforts to improve the efficiency of the judicial system. However, some of these changes raise concerns: the Supreme Court, which is already overburdened, has been given additional tasks (hearing appeals in commercially significant cases), and the process of simplifying procedures has considerably restricted the right to appeal in certain cases.

A further set of concerns relate to the extension of the General Prosecutor's right to introduce extraordinary appeals against judicial decisions. This provision already existed in Romanian law but an Emergency Ordinance extended the period during which extraordinary appeals could be brought (from 6 months to 1 year), allowed extraordinary appeals to be made before all other legal avenues had been exhausted (previously only "final" judgements were covered) and made the right to introduce such appeals more discretionary (they can now be exercised against "obviously ungrounded judicial decisions" - an ill-defined criterion). This is a potential worry since the extension of such extraordinary procedures risks undermining the principle of legal certainty.

A number of developments have occurred during the reporting period that draw attention to the independence of the judiciary from the executive. During the first half of 2001, a number of presidents and vice-presidents of courts have been transferred from their posts (i.e. demoted) without clear reasons being given. Decisions over transfers and removals of judges are taken by the Superior Council of the Magistracy, but the Ministry of Justice has a significant influence over this body (one third of its members are appointed by the Ministry and the Minister chairs its meetings). In a separate development, the Ministry of Justice issued a circular letter to courts in March 2001 asking them to pay attention to the social consequences in cases concerning restitution of nationalised houses. As the Romanian authorities have subsequently recognised, such recommendations would appear to contradict the principle of an independent judiciary.

While the involvement of the executive in judicial affairs is not a new phenomenon in Romania, these incidents indicate that further efforts are needed in order to guarantee the independence of the Romanian judiciary.

Magistrates continue to rank amongst the best paid public officials, but a change in the wage policy means that this preference is being eroded - unlike other public employees, magistrates will not receive a wage adjustment in 2001 to compensate for inflation. Working conditions of judges need to be improved and existing plans to develop and introduce adequate IT systems to facilitate case handling and to give access to case law and legislation should be implemented.

Since the last report there have been no major developments with regard to the total number of judges or the number of judicial vacancies. The average number of cases dealt with by each judge has decreased slightly from 514 in 1999 to 511 in 2000, but the workload remains heavy, which limits the ability of judges to carry out their functions effectively. Compared to 1999, the number of pending cases in Courts of the First Instance and in Courts of Appeal dropped in 2000. However, over the same period, there was a slight increase in pending cases before Tribunals.

The National Institute of Magistracy is currently the sole entry point for a career as a judge although it remains unclear if the Institute will keep this position since the law organising the judicial system provides for other routes into the judiciary. The initial training period has been extended to two years with effect from the academic year 2001/2002. The training programmes include Community law, constitutional and human rights subjects, as well as citizens' liability claims and judicial co-operation in civil and penal matters. Continued support for the National Institute for the Magistracy, granting it self-governing status and confirming it as the sole entry point to the judiciary are important elements in developing a professional and independent judiciary. In a separate development a training centre for legal clerks was opened in December 2000 – although it is not yet operational.

Anti-corruption measures

Last year's Regular Report noted that corruption was a widespread and systemic problem that undermined the legal system, the economy and public confidence in government. Despite a general recognition of the seriousness of this problem by the government there has been no noticeable reduction in levels of corruption and measures taken to tackle corruption have been limited.

A section for anti-corruption and related organised crime at the General Prosecutor's Office was established in October 2000. According to the anti-corruption law passed last year, this body was to take the lead in combating corruption. However, it has never been functional due to a lack of staff and equipment. Out of 38 posts for prosecutors only 17 are filled. Secondary legislation detailing institutional arrangements for the anti-corruption section has not yet been adopted and as a result there has been no substantial progress in implementing the anti-corruption law. Co-ordination between the various other bodies charged with tackling organised crime and corruption remains a problem and recent administrative changes have not led to any improvements.

Reports on the funding of political parties have indicated that expenditures (and in particular election expenditures) are considerably higher than declared revenues. This applies to all

political parties and is a potential source of corruption. In order to address this issue, Romania should adopt a fully transparent system of party funding.

A positive development regarding the fight against corruption was the adoption, in April 2001, of an ordinance introducing public procurement procedures and establishing the right to appeal against the award of public contracts.

Romania has still not ratified the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime. It has signed, but has still to ratify, the Council of Europe's Criminal and Civil Law Conventions on Corruption. Romania is involved in the Stability Pact Anti-corruption Initiative supported by the OECD Secretariat. Romania is a party to the Council of Europe's partial agreement "Group of States against Corruption" (GRECO).

Access to information is an important issue that is closely related to both the accountability of government and the fight against corruption. Although the principle of access to information is enshrined in the 1991 Constitution there is no effective implementing legislation.

In conclusion, and with the important exception of public procurement legislation, there has been no substantial progress in the fight against corruption since last year's report. In order to begin making progress, secondary legislation needed for the implementation of the anti-corruption law should be adopted and the anti-corruption section at the General Prosecutor's Office given the resources it needs to operate effectively. The National Strategy to Combat Corruption should be finalised and adopted. The division of tasks among the bodies involved in the fight against corruption needs to be clarified and overlapping competencies should be removed. The concept of criminal liability of legal persons should be introduced into Romanian criminal law and the rules governing the funding of political parties revised.

1.2. Human rights and the protection of minorities

As mentioned in the previous Regular Reports, Romania continues to respect human rights and freedoms. The following section concentrates on major developments since the last Regular Report.

Romania has ratified the major human rights conventions (see annex). In November 2000 Romania signed Protocol no. 12 to the European Convention on Human Rights containing the general prohibition of discrimination on any grounds such as sex, race, colour, and language.

A major development, and one which was noted in the last Regular Report, was the issuing of an Emergency Ordinance, in September 2000, on the prevention and *combating of all forms of discrimination*. The ordinance covers rights defined in relevant international agreements and is broadly in line with the Council Directive on Implementing the Principle of Equal Treatment between Persons Irrespective of their Racial and Ethnic Origin (*see chapter 13-Employment and Social Policy*) as well as recent recommendations of the European Commission against Racism and Intolerance. However the ordinance is not yet operational since the necessary secondary legislation has not been adopted and the implementing body, the National Council for Preventing and Combating Discrimination, has not yet been established. Despite these delays, this legislation should, when implemented, represent a positive development by providing legal protection against discrimination on various grounds, including ethnic origin, language, religion and sexual orientation.

The Office of the Ombudsman deals with complaints lodged by persons whose civil rights and freedoms have been infringed by the public administration. In 2000 the institution dealt with 4 556 complaints, a slight increase over the previous year. Almost half of these cases were declared admissible (compared to 40% in 1999) which demonstrates the growing public awareness of the role and function of the Ombudsman. Most of the complaints referred to alleged infringements of individual rights in the process of restitution of land or residential property. Other frequent cases concern women's and family rights, and cases related to the provision of social security.

Over the reporting period, significant developments included the setting up of regional offices, increased co-operation with NGOs and a large increase in the number of direct audiences held with complainants. In terms of administrative capacity, the personnel reductions imposed on the entire central administration at the beginning of 2001 reduced the number of posts at the Ombudsman's office from 108 to 80. However, this did not lead to redundancies, as only 77 posts had been filled at the end of 2000.

Despite the fact that the performance of the Ombudsman's office has improved significantly over recent years, its co-operation with other state institutions remains problematic. Many institutions have failed to respond to requests from the Ombudsman within the legally set delay. The Senate, which is itself responsible for appointment of the Ombudsman, has repeatedly delayed debating the Ombudsman's Annual Report. This attitude undermines both the credibility and the effectiveness of the institution.

Civil and political rights

Romania has made significant progress in improving the civil and political rights of its citizens. Reform of the childcare system is well under way and the decriminalisation of homosexuality has brought Romania in line with European standards. Important new legislation has been passed regarding the restitution of property. New legislation has clarified the rights of asylum seekers and refugees and the introduction of probation represents an important reform of the penal system. Positive initiatives have been taken to address trafficking of human beings – although this remains a serious problem. Despite this progress, implementation of reforms has been disappointing in several of these areas. This is a challenge that the government will have to address. Other areas where further reform is needed include modernising the Penal Code (in particular the articles relating to freedom of expression) and increasing the public accountability of police officers.

In last year's Strategy Paper, the Commission noted that Romania had adopted legislative, administrative and financial measures to address the problems in *child-care* institutions. However, it stressed that further sustained efforts were needed to improve living conditions, implement structural reforms and address the problem of street children in full respect of human rights.

There has been further progress made over the reporting period. The budget allocated to child-care has been substantially increased (€79 million in 2001 compared to €42 million in 2000). The number of child-care services offered as alternatives to institutions has been increased. Presidents of county councils have direct responsibility for all institutions related to child protection - a measure intended to ensure that local administrations give sufficient political priority to child-care issues. Important translation errors in the United Nations Convention on

the Rights of the Child were corrected. The process of moving children out of special schools and into mainstream education has been initiated.

The reforms made mean that Romania has met the 1999 Accession Partnership priority related to child protection. However, and despite these developments, the demand for state-supported care remained constant in 2001 with poverty being the main reason. A better-targeted social allowance scheme for families with children is therefore necessary in order to prevent child abandonment and institutionalisation.

According to official figures, at the end of 2000 there were 129 296 children in need of special protection out of which 77 844 were children in residential care and 51 452 were children supported in natural or substitute families.

In May 2001 the Government adopted a revised Strategy on the Protection of Children in Need (2001-2004). The revision was made following consultation with NGOs and international organisations and is a broadly positive development – although the emphasis is placed on rehabilitating institutions rather than closing them. There are also important areas that are not fully addressed by the strategy: the provision of support to families and mothers, the care of young adults leaving the residential care system, and policies to prevent abandonment.

In terms of institutional structures, the National Authority for Child Protection and Adoption was placed under the Secretary General of the Government. This was an important development that provided the Authority with representation at ministerial level. At the same time, insufficient budgetary resources and training reduce the Authority's ability to effectively carry out its regulatory and monitoring functions. The role of the National Authority in co-ordinating government policies related to children's rights is still not fully established. This is a matter of some urgency since the integration of childcare policy with other sectoral policies, such as social and family policies, health and education, has not been adequately addressed.

A High Level Group to support and monitor the reform efforts was set up during the reporting period. This body is made up of the European Parliament's rapporteur on Romania⁵ (who took the initiative to establish it) and representatives of the Romanian Government, the European Commission, the World Bank, UNICEF and the WHO.

In the 2000 Regular Report, the Commission expressed concern with regard to legislation and practices on inter-country adoption that allowed considerations other than the best interest of the child to influence adoption decisions. This risked having a negative effect on efforts to reform the child protection system in Romania. Following this and similar expressions of concern, the Romanian government decided to suspend international adoptions. In December 2000 the Romanian Adoption Committee stopped referring children to international adoption foundations. As of June 2001, the Committee suspended the registration of new foreign families requesting international adoption for at least one year.

The Commission welcomes this moratorium as a mechanism to end practices that were incompatible with Romania's international obligations under the United Nations Convention on the Rights of the Child and which risked opening opportunities for trafficking in children and other forms of abuse. The Romanian authorities need to reform legislation on international

⁵ The European Parliament *rapporteur* is Baroness Nicholson of Winterbourne.

adoptions and to develop the appropriate administrative structures and capacity in order to ensure that adoption decisions are made exclusively in the best interest of the child. This should be done prior to international adoptions being resumed.

Cases of inhuman and *degrading treatment by the police* continue to be reported by human rights organisations. There is no evidence to suggest that these cases are the result of a systematic disregard of human rights by the police. At the same time, it is clear that the use of physical violence to extract confessions is not exceptional and that the safeguards in place to prevent such incidents are inadequate. Allegations of police abuse are investigated through the system of military courts, and investigations are typically lengthy and often inconclusive. Increasing the public accountability of police officers should reduce instances of degrading treatment. It is therefore important that progress is made with the demilitarisation of the police force.

Romania is both an origin and a transit country for the *trafficking of human beings*. Economic and social uncertainty, widespread poverty and domestic prostitution rings are the main reasons for this problem. Recent research has revealed a very low level of public awareness on this issue and, alarmingly, a continuing decrease in the age of the victims. In the first eight months of the year the police dealt with 435 trafficking cases.

Against this background, the Romanian government has made considerable efforts to detect and fight trafficking in persons. Within the framework of the Regional Centre for Combating Organised Cross-border Crime, a task force for combating trafficking in human beings was set up. In October 2000, the Ministry of the Interior launched a programme for the protection of women and children against trafficking and, in April 2001, the Government appointed a national co-ordinator to combat trafficking. In May 2001 the Government established an inter-ministerial commission to draft an anti-trafficking law. Despite these actions, there are still insufficient legislative tools for prosecuting and punishing traffickers and for protecting victims.

Overall *prison conditions* are often extremely poor and prisons remain severely overcrowded. A particular problem with pre-trial detention is that the periods of detention can be excessive – up to half of the possible sentence. In order to address these issues, important reforms of the Romanian penal system have been initiated. An ordinance establishing a probation system entered into force in October 2000 and 11 experimental probation centres have been set up in seven counties. The Penal Code was amended through an Emergency Ordinance in November 2000 to further improve the provisions on conditional release from prison. These are positive developments. However, a major constraint on the effective implementation of these laws is the severe shortage of probation officers.

Other initiatives have been taken in order to improve prison conditions, such as finding jobs for inmates and limited improvement to educational and recreational facilities. A further positive development has been the granting to prisoners of the right to appeal against disciplinary measures.

The Civil Procedure Code contains provisions for granting *legal aid* to persons who cannot afford the legal costs of a case. The Penal Procedure Code guarantees the right to defence throughout criminal proceedings. The legal aid provisions are applied in Romania - although the relatively low levels of payment and the delays in processing payment claims limit the attractiveness of these cases for the legal profession. In criminal cases, both the Romanian

Constitution and the Penal Procedure Code provide for free access to an interpreter for citizens belonging to a national minority, as well as persons who cannot understand Romanian.

Concerning *asylum-seekers and refugees*, a new Law on Aliens was adopted in April 2001. This legislation represents a much needed improvement upon the previous legislation (which dated from 1968) although certain problems remain – notably concerning the possibility of expelling foreigners without their having the right to challenge this decision in the courts. Amendments to the Refugee Law, in line with the *acquis*, were approved by Parliament in June 2001. The principle of ‘non-refoulement’ is guaranteed and the amended legislation represents considerable progress. This said, there are still shortcomings in the legislation and the provisions on detention of asylum seekers should be based on stronger legal guarantees. In parallel with revised legislation, the assistance provided to refugees and asylum seekers has been improved. Measures have been developed to ensure minimum standards of reception for all asylum seekers throughout the whole asylum procedure and refugees enjoy the same basic rights as Romanian citizens, including the right to work.

The Romanian constitution provides for *freedom of expression* and prohibits censorship. There is a great diversity of media in Romania with 15 national daily papers, many more local daily papers, over 70 private television channels and over 150 private radio stations. Most of the print media is privately owned and both the written press and electronic media are able to report freely. At the same time there are limitations on the free operation of the media.

Of particular concern are provisions in the Penal Code that restrict the activities of journalists. The articles dealing with slander and libel are restrictive and the extensive use of legal proceedings against journalists, in particular where they have made allegations of corruption, undermines the freedom of the press. A related concern is that the burden of proof in such cases is weighted against journalists since the accused is obliged to prove the absolute truth of public statements – as opposed to the responsibility lying with the plaintiff to demonstrate that a mis-representation of the truth had taken place. An amendment to the Penal Code, that would have reversed this situation and brought Romania in line with the case law of the European Court of Human Rights, was drafted by the previous government but has not been taken forward.

Other articles in the Penal Code dealing with “offences against authorities” and “verbal outrage” provide for specific punishments, including prison, for insulting or defaming elected officials or civil servants. As a general principle, supported by the case law of the European Court of Human Rights, politicians and civil servants should expect closer public scrutiny of their actions than private individuals. There is also a risk that these provisions could be used to stifle public criticism of the authorities. Although these concerns about the Penal Code have been raised by international observers, no progress can be reported since the last Regular Report.

Freedom of religion is guaranteed by the Constitution and the government does not restrict the observance of religious belief. However, as last year’s Regular Report noted, the 1948 decree on religious denominations, which is still in force, is outdated and in need of reform. There are 15 recognised religions in Romania and other congregations are obliged to register as either religious foundations or as cultural associations and are not permitted to build churches or houses of worship. A further issue is that legislation on conscientious objection to military service differentiates between members of “recognised religions” and other religious groupings.

In June 2000, the government adopted an emergency ordinance that amended the Penal Code in order to *decriminalise homosexuality*. Homosexual relations are no longer a criminal offence, and sexual offences are now governed by the same legislation irrespective of sex. This represents a major and positive development in human rights legislation that brings Romania into line with European standards.

The Romanian Constitution provides for the *freedom of association* and the *freedom of assembly*. Both of these rights are respected in practice.

The Real Estate Restitution Law entered into force in February 2001, setting out the basic principles and procedures that are to be applied for the *restitution of property* – as well as establishing a mechanism for providing compensation in cases where restitution is not possible. The law applies to all real estate “abusively taken” by the former Communist regime between 1945 and 1989. The law also covers the 1940–45 period, thus satisfying many of the restitution demands of Jews who suffered from anti-Semitic laws adopted during the war.

The law has several positive aspects. Most importantly it provides a legislative framework for addressing an issue that has remained unresolved since 1989. It goes considerably further than the requirements of the European Convention on Human Rights by covering almost all confiscations made under the Communist regime. It also extends the right for restitution to all persons who have been dispossessed (earlier restitution legislation only covered Romanian citizens).

Despite these developments, implementation of the new legislation has proved to be disappointing and crucially, the administrative procedures for calculating and awarding compensation have not yet been adequately defined. A further issue arises because the restitution law does not cover property confiscated from churches. Although the law indicates that this issue will be covered by future legislation there has been no progress in preparing such legislation.

The law on the restitution of land and forests has also been amended in order to address some of the shortcomings of the initial version of the law that had proved to be inoperable.

Economic, social and cultural rights

The government’s agenda has prioritised social issues such as the fight against social exclusion and promoting equal opportunities between men and women. Various initiatives have been launched - but a lack of resources and limited administrative capacity has slowed down implementation. More substantial progress has been made with the conclusion of a Social Pact with the social partners – although the position of trade unions in private enterprises remains weak.

In December 2000 the government approved the National Action Plan Regarding *Equal Opportunities* for Men and Women. The plan identifies a number of areas of intervention and a number of operational objectives in the fields of legislation, social rights, economy, participation in decision-making, and public awareness. While the action plan is a welcome development, there have been no concrete actions taken in order to implement it and the resources allocated for implementation are insufficient.

The government has identified equal opportunities between men and women as one of its main objectives and has made important changes to administrative structures in order to address this issue. A new structure for liaison with NGOs and trade unions has been set up in the Ministry of Labour and Social Solidarity. Specific departments have also been set up within both governmental and non-governmental bodies (the Equal Opportunities Commission within the Economic and Social Council, the Department for Family, Children and Women within the Ombudsman's office, and departments for equal opportunities within the trade union confederations).

Following last year's election, 10% of deputies in the Chamber of Deputies are female (33 women out of a total of 345 deputies) as are 9% of senators (12 women out of a total of 140). In the government, four out of 28 cabinet ministers are female (European Integration, Justice, Education and Research, and Health and Family).

Disabled persons, the elderly and isolated women are particularly at risk of both poverty and *social marginalisation*. The government's programme has prioritised the fight against social exclusion as a political priority and has adopted legislation establishing a Minimum Guaranteed Income, under which the state will cover the basic living expenses of the unemployed as well as persons earning less than the legal minimum income. In April 2001, the Law on the Public Pension entered into force. During the reporting period, the government also took a number of decisions concerning evaluation of needs of the elderly, criteria for identifying dependency degrees, and definition of the type of services to be supplied to dependant persons.

Despite these developments, the fragmentation of the administrative structures dealing with socially vulnerable sections of society is a considerable obstacle to making decisive reforms. No less than five government bodies are involved in the provision of social assistance and the fight against exclusion. The decentralisation of social services and social assistance has also led to difficulties related to finding the appropriate level of decentralisation (municipalities or counties), low levels of administrative capacity at the local level, and problems related to financial decentralisation.

The new government has demonstrated a firm commitment to strengthen the *role of trade unions* in social and political life. Recognising that social peace and partnership are indispensable for implementing economic and social reforms, the government signed a Social Pact with the social partners shortly after taking office. The main objective of this initiative was to establish an agreed economic and social agenda (macro-economic stability, social policy, employment, social protection and fiscal measures). The Social Pact also provides a framework for negotiations – although important disagreements still arise and there have been serious labour conflicts during the reporting period.

The Economic and Social Council has been created as an institution to allow social partners to comment on legislation with a significant economic and social impact. However, to date, the Council has not been systematically consulted. At the working level, commissions for social dialogue have been created within all ministries and prefectures. The commissions are consulted on draft sectoral legislation, as well as economic restructuring and privatisation issues.

Despite these initiatives, the role and the recognition of trade union activities in private enterprises remains weak. Bipartite social dialogue at enterprise level is not sufficiently developed – a problem that is magnified because the employers' movement remains divided.

Minority rights and the protection of minorities

During the reporting period, a number of positive developments took place in this area. New legislation extended the use of minority languages, and a National Strategy for Improving the Condition of Roma was adopted.

There are over 1.6 million ethnic Hungarians in Romania and they represent the most politically active minority group. Romanian provisions for respecting the rights of minorities are well developed and existing policies provide extensive rights for education in minority languages. Further developments were made during the reporting period with the Law on Local Public Administration giving linguistic minorities, in localities where they represent more than 20% of the population, the right to receive services from local authorities in their mother tongue. In these localities, the law also stipulates that the agenda and decisions of the local council will be made public in the relevant minority languages.

During the school year 2000-2001, the number of educational units providing teaching in minority languages remained constant. A slight increase was noted in the number of students from linguistic minorities studying their mother tongue in schools teaching in Romanian. There were no developments with establishing a public university teaching in Hungarian, German and Romanian (the proposed Petöfi-Schiller University) despite the fact that legal obstacles had already been removed in 2000. However, a decision was taken to establish a private Hungarian university, financed with the support of the Hungarian State. Courses started in October 2001 for 450 students.

Since the last Regular Report, the government has taken several major initiatives to address the problems faced by the *Roma minority*. The most important of these was the adoption, in April 2001, of a National Strategy for Improving the Condition of Roma – which means that Romania has met one of the key political priorities contained in the 1999 Accession Partnership. The strategy is a comprehensive and high quality document that was elaborated together with Roma organisations and has been welcomed by them. The strategy covers a 10-year period and sets out a plan of measures to be taken for the first four years. The starting point of the document is a clear admission that discrimination against Roma is a serious problem in Romania. It goes on to set objectives that include changing negative public perceptions, improving living conditions for the Roma, and encouraging Roma participation in all aspects of civil society. It is anticipated that Roma NGOs will play an active role in the implementation of the strategy. At the same time, the lack of unity between Roma organisations could pose an obstacle to the implementation of the strategy. Important next steps will be drafting an operational plan, and securing the necessary budget allocations.

One of the key features of the strategy is its decentralised nature. This is an important consideration since most of the public institutions covered by the strategy (e.g. education, police, hospitals) are managed at the local level. In order to implement the strategy local Roma offices are being set up in each county. Staff, who are themselves Roma, have been hired for these offices. This represents a positive development, although there are concerns that their actual responsibilities remain unclear and that recruitment has been based on reasons other than technical merits.

Despite these positive developments, discrimination against the Roma minority remains widespread – although it occurs as individual incidents and is not institutionalised. Human rights

organisations have documented instances of police harassment of individual Roma as well as of whole Roma communities. Roma face difficulties in gaining access to schools, medical care and social assistance. Social discrimination is often manifested in Roma being banned from public places and, despite the fact that it is illegal, a number of job advertisements explicitly exclude Roma applicants.

1.3. General Evaluation⁶

In its 1997 Opinion, the Commission concluded that Romania fulfilled the political criteria. Since then, the country has made considerable progress in further consolidating and deepening the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. Over the past year, further positive developments have been noted. Romania continues to fulfil the Copenhagen political criteria.

The efficiency of the legislature has improved considerably as has the overall functioning of government. The reform of judicial procedures has continued and effective implementation of new legislation on public procurement should play an important role in the fight against corruption – although corruption remains a serious problem that is largely unresolved. Other particular concerns are the lack of progress in carrying out a strategic reform of the public administration and the need to further guarantee the independence of the judiciary.

Significant progress has been made in the field of human rights. Reform of the childcare system is well under way; homosexuality has been decriminalised; and important new legislation has been passed regarding the restitution of property and the treatment of asylum seekers and refugees. The introduction of probation represents an important reform of the penal system and several initiatives have been taken to address trafficking of human beings. Future reforms should seek to modernise the Penal Code and increase the public accountability of police officers as well as ensure the proportionality of their actions. Efforts to improve the actual living conditions in childcare institutions should continue.

New legislation extending the use of minority languages was approved, and a National Strategy for Improving the Condition of Roma adopted. Efforts now need to focus on the implementation of the strategy, with the aim of effectively combating widespread discrimination, and improving living conditions.

Romania has addressed the short-term Accession Partnership priorities related to the political criteria by improving the conditions of institutionalised children, making progress with the reform of childcare policy, developing a national strategy for Roma, and taking measures to provide support to minority programmes. As regards medium-term priorities, progress has been made towards meeting the medium-term priority related to childcare, and initiatives have been taken to increase the Roma's access to education. However, important actions are still needed in other areas: the Roma strategy has not yet been implemented; anti-discrimination legislation has been adopted but it is not yet operational; and the demilitarisation of the police has not yet started.

2. Economic criteria

2.1. Introduction

In its 1997 Opinion on Romania's application for EU membership, the Commission concluded:

"Romania has made considerable progress in the creation of a market economy"; it would face serious difficulties coping with the competitive pressure and market forces within the Union in the medium term".

This finding was confirmed in the 1998 and 1999 Regular Reports. In its 2000 Regular Report the Commission found that:

"Romania cannot be considered as a functioning market economy and it is not able to cope with the competitive pressures and market forces within the Union in the medium term."

In examining the economic developments in Romania since the Opinion, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires:

- the existence of a functioning market economy; and
- the capacity to cope with the competitive pressures and market forces within the Union.

In the analysis below, the Commission has followed the methodology applied in the Opinion and the previous annual Regular Reports.

2.2. Economic Developments

The macroeconomic environment has improved. After three years of declining economic activity, GDP growth was positive in 2000, and accelerated in the first half of 2001. Export performance has been remarkable, but the current account deficit has been widening in 2001 on the back of surging imports. Other indicators of external vulnerability, however, have improved as gross international reserves increased, and Romania regained access to international capital markets. After several years of fiscal consolidation, the deficit is targeted to decrease slightly to 3.5% of GDP. Though declining, inflation remained high throughout 2000 and the first half of 2001.

⁶ See "Making a success of enlargement: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2001) 700.

Main economic trends							
Romania		1996	1997	1998	1999	2000	2001 latest
Real GDP growth rate	per cent	3.9	-6.1	-4.8	-2.3	1.6	4.9 H1
Inflation rate ⁷							
- annual average	per cent	38.8	154.8	59.1	45.8	45.7	37.2 ⁸ Sep
- December-on-December	per cent	56.9	151.5	40.6	54.8	40.7	31.2 Sep
Unemployment rate, end-year							
- ILO definition	per cent	6.7	6.0	6.3	6.8	7.1 P	7.7 P Q1
General government budget balance ⁹	per cent of GDP	-3.5	-4.5	-4.4	-2.1	-3.8	:
Current account balance	per cent of GDP	-8.8	-6.1	-7.1	-4.2	-3.7	:
	million ECU/euro	-2,446	-1,895	-2,637	-1,382	-1,477	-1549 ⁹ Jan-July
Foreign debt							
- debt export ratio	per cent	76.4	82.6	84.2	86.8	65.8	:
- gross foreign debt	million ECU/euro	5,974	7,513	7,346	8,315	8,960	:
Foreign direct investment in flow							
- balance of payments data	per cent of GDP	0.9	3.5	4.9	3.0	2.8	:
	million ECU/euro	250	1,077	1,804	980	1,114	391 ¹⁰ Jan-July

The political uncertainty in the months prior to the end-of-2000 elections delayed progress on Romania's key reform priorities. In the closing months of 2000, privatisation

⁷ PROXY HICP since 1996 (see methodological notes)

⁸ Moving 12 month average rate of change

⁹ Source: Website of National Bank

¹⁰ Source: Website of National Bank

sales ground to a halt and the decision to cap energy prices at their August 2000 level undermined previous efforts to strengthen enterprise sector financial discipline. As a consequence, enterprise arrears increased dramatically during the first half of 2001. After the election, there were increasing signs of a renewed commitment to privatisation, and two important sales – Banca Agricola, and SIDEX – were finalised. In the summer months of 2001, energy prices were raised, to more closely reflect production costs, and tied to the exchange rate, to protect their real value.

Main Indicators of Economic Structure in 2000		
Population (average)	thousand	22,435 ¹¹
GDP per head ¹²	PPS	6,000
	per cent of EU average	27
Share of agriculture ¹³ in:		
- gross value added	per cent	12.6
- employment	per cent	42.8 P
Investment-to-GDP ratio ¹⁴	per cent	18.5
Gross foreign debt/GDP ¹⁵	per cent	22.4
Exports of goods & services/GDP	per cent	34.1
Stock of foreign direct investment	million euro	7,121
	euro per head ¹⁶	317

P: provisional data

Romania has been losing ground in the catching-up process with the EU. GDP per capita in Purchasing Parity Standards (PPS) as a percentage of the EU average has fallen over the last five years, from 32% in 1995, to just under 27% in 2000. Regional disparities are moderate: per capita income is some 40% above the national average in the capital region, some 20% below in the poorest region. Pension levels are very low. In June

¹¹ At 1st of July

¹² Figures have been calculated using the population figures from National Accounts, which may differ from those used in demographic statistics.

¹³ Agriculture, hunting, forestry and fishing.

¹⁴ Data refer to gross fixed capital formation as % of GDP.

¹⁵ At 1st of July

¹⁶ Figures have been calculated using the population figures from National Accounts, which may differ from those used in demographic statistics.

2001, the social insurance pension was approximately € 40 a month, and represented 30% of the net average wage. The economic activity rate and employment rate have declined somewhat to 63.2% and 64.2% in 2000, while the unemployment rate increased slightly to 7.1% from 6.8%. Unemployment is higher in urban areas and higher for men than for women, at respectively 7.7% and 6.4%. Long-term unemployed workers account for nearly half of all unemployed. The declining level of income has imposed serious hardship in the population, and the social, education and healthcare infrastructures have deteriorated, creating serious obstacles for human capital development.

2.3. Assessment of the Copenhagen Criteria

The existence of a functioning market economy

The existence of a functioning market economy requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus about economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

There is a growing consensus about the ultimate objectives of economic policy. The commitment to structural reform and macroeconomic stabilisation was reaffirmed by concluding a new IMF programme at the end of October 2001. In September 2001, the government approved Romania's first Pre-Accession Economic Programme and submitted it to the Commission in early October.

In 2000, Romania experienced a 1.6% increase in economic activity. This ended the recession which had caused a 13% cumulative decline in GDP since 1997. The primary source of growth in 2000 was investment, which grew by 5.5%, along with inventory accumulation and exports, which expanded by nearly 24% in real terms. In contrast, household consumption expenditure fell by 1.2%.

Driven by rising domestic demand, growth accelerated during the first half of 2001. Gross domestic product grew by 4.9% in the six months to June. Higher social transfers and real wages led to a recovery in household consumption, which rose by 7.6%. Investment growth accelerated to 6.7%. However, stocks also continued to accumulate. The strong pick-up in activity was also reflected in industrial production, which rose 10.8% year-on-year in the seven months to July.

In recent months, labour market conditions have improved. Over the last five years, labour force participation has fallen from around 65% to 63%. In 2000, unemployment was 7.1%, compared to 6.8% in the previous year. In the first quarter of 2001, it increased further to 7.7% (ILO definition). However, as economic activity picked up in 2001, the registered unemployment rate has fallen and private sector employment started to increase.

Monetary policy has focused on objectives other than price stability. In order to honour its external obligations and maintain external competitiveness, the central bank has pursued the twin objectives of building up foreign exchange reserves and keeping the real exchange rate competitive. However, this came at the expense of price stability, which was already hard to achieve given the difficulty to control costs, and most notably public enterprises wages, in the

absence of hard budget constraints. As a consequence, inflation has remained very high, although declining. The December 2000 end of period inflation rate was 40.7%, compared to 54.8% the previous year. The twelve-month average inflation rate had fallen to 37.2% in September 2001 from 45.7% in 2000.

After several years of significant fiscal consolidation, the deficit has stabilised. In 2000, the GFS-based general government consolidated deficit was 4.0% of GDP, compared to 3.8% in 1999. The previous government successfully resisted expenditure pressures in the run-up to the elections. The budget was also helped by a lower foreign debt-servicing requirement. Government expenditure accounted for 35.6% of GDP, while total revenues accounted for 31.6% of GDP. For 2000, the authorities' estimate for the ESA 95-based general government deficit was also 3.8% of GDP¹⁷.

The underlying fiscal dynamics have improved in recent months. The 2001 budget, adopted in April, prioritised social expenditure, particularly in the areas of child allowances and pensions, and targeted a general government deficit of 3.7% of GDP. Due to the upturn in economic activity during 2001, tax revenues have performed well. Interest expenditure, as a percentage of total expenditure, has fallen giving the authorities some room to increase social outlays. In line with the improved budgetary performance, the deficit target was revised downwards to 3.5% of projected GDP last June. Since the budget outturn for the first half of the year was a deficit of 2% of projected GDP, the revised target implies a welcomed tightening of fiscal policy. In line with this new stance, the deficit target for 2002 was set at 3% of GDP.

Much remains to be done to improve the transparency of fiscal policy, increase the quality of public expenditure management, and enhance medium term fiscal sustainability. These problems are particularly severe at the local government level. These issues need to be addressed to allow Romania to increase EU accession-related expenditures. Furthermore, the government has not yet addressed the medium term fiscal challenges, especially pensions and healthcare reform. So far government policies have been directed at attaining short-term stability.

After improving to 3.7% of GDP in 2000, the current account deficit widened sharply over the first seven months of 2001, when it totalled 3.6% of projected GDP. Over the last 18 months, export performance has been impressive. In 2000, exports increased by 22% in (dollar) value terms. Growth remained buoyant but slowed down to 14.6% in the eight months to August. The foundation for this strong export performance was laid in 1999 when the real exchange rate depreciation restored external competitiveness. Export demand was also strongly affected by developments within the EU economy. The value of imports increased by around 25% in 2000 and grew at roughly the same pace year-on-year over the first eight months of 2001. The import surge is partly the result of temporary factors in 2000, such as higher world oil prices and a drought, which depressed agricultural production and increased food import needs. Lately, however, import growth has been supported by rising capital expenditure and by the looser policy mix leading to stronger household consumption.

¹⁷ Two figures are given for the government balance. One is based on the most commonly used national concept, and the other is calculated according to the European System of Accounts (ESA 95), which was reported by the candidate countries for the first time this year.

In general, indicators of external vulnerability have improved recently. Romania's liquidity position has improved considerably in recent months. In September 2001, gross reserves held by the central bank were €4.1 billion, compared to €2.4 billion a year earlier. Romania will easily meet this year's external debt servicing obligations. The liquidity position has also been helped by a more benign debt servicing profile, especially compared to the difficult year of 1999. However, in the early months of 2001 a significant proportion of the current account deficit was financed by debt-creating inflows to the public sector, which regained access to the international capital markets in late-2000. While external indebtedness is still low by international standards, it has increased rapidly in recent months. In December 2000, medium and long-term external debt was €10.8 billion, but by June 2001 the stock had risen to €12.7 billion with short term external debt slightly increasing to €454 million. This growth of external borrowing will have to be curtailed if current account sustainability is to be maintained.

In general, the policy mix has not paid sufficient regard to reducing inflation and maintaining the external balance. As evidenced by the rise in non-interest expenditures, fiscal policy has become more expansionary in 2001 against the background of a largely accommodating monetary policy. From this point of view, the plan to tighten the fiscal stance in the second half of 2001 and the new IMF programme are welcome developments. An improved co-ordination of macro-economic policies, based on an effective public sector income policy and on a tighter enterprise financial discipline, is urgently needed in Romania. Only under this new policy framework can the central bank develop a more aggressive anti-inflationary strategy.

Most prices in Romania are liberalised, but sporadic price controls tend to create large distortions, which can be very costly to the economy. The share of regulated prices in the consumer price index is 18%, of which 9% are energy prices. However, as already mentioned, the decision to cap energy prices at their August 2000 levels had a severe impact on enterprise sector financial discipline. Lower domestic energy prices relative to international prices did nothing to reduce domestic consumption, while the utilities had to pay for energy imports by borrowing abroad with the support of state guarantees. Enterprise arrears, primarily within the utilities sector, increased by nearly 50% during the first three months of 2001. At the end of March, total arrears within the largest state-owned enterprises were € 3.2 billion, or 7% of GDP. A further deterioration took place in the second quarter. The government has recently introduced an emergency ordinance, which links management salaries to the financial performance of the public utilities. Following a small rise in end-users electricity prices in April, electricity, heating and gas prices were increased more substantially and linked to the exchange rate in the summer. Nonetheless, any progress on enterprise sector financial discipline will require that the authorities continue to increase prices further as envisaged under the new IMF arrangement.

The private sector is still quite under-developed, with the state owned enterprises accounting for a significant share of economic activity. In 2000, the private sector produced 65% of GDP. The state owned enterprises still play a major role in many sectors of the economy, including the utilities sector, finance, and manufacturing.

The authorities have renewed their commitment to privatisation. In the closing months of 2000, the privatisation process effectively ground to a halt. However, during the first six months of 2001, privatisation activity started again. The government reaffirmed its commitment to sell 64 of the largest state-owned enterprises, and it has developed a broad timetable to fulfil it. The

sale of Banca Agricola and the large loss-making steel producer SIDEX were two important successes with a high symbolic value. In recent months, the authorities have also sold about 40 medium sized companies and more than 180 small enterprises.

The authorities have modified the administration of the privatisation process. The new government abolished the State Ownership Fund, the institution that had previously been responsible for managing and privatising state-owned enterprises. It was replaced by the Authority for Privatisation and Management of State Assets (APAPS). This new institution was given additional legal authority to accelerate the privatisation process. The authorities decided against modifying the existing privatisation law but are prepared to adopt a more flexible case-by-case approach with those enterprises where there is strong investor interest. However, the flexibility of a case-by-case approach will have to be coupled with greater transparency to avoid opportunities for corruption.

Most of the legal framework of a market economy is already in place; however, the institutions to implement and enforce it are either weak or have not yet established. Regulations are frequently changed, and public officials often interpret them in a discretionary manner. Corruption is a serious problem which has hampered the development of the private sector. Bankruptcy legislation has only limited effectiveness, as procedures are often long and difficult. The number of liquidation procedures during 2001 is unchanged relative to 2000.

While some progress has been made towards clarifying property rights for land, much still needs to be done. Many large state farms have not yet been privatised. It is still difficult to use land as collateral, and this has limited the development of modern market-orientated financial structures for the rural economy.

The financial system is very underdeveloped, and it cannot yet provide effective intermediation between savers and investors. In June 2001, total banking sector assets amounted to only 24.7% of projected GDP, while total lending activity was only 10.4% of GDP. The majority of commercial loans have very short maturities. Over half of all loans have a maturity of less than one year, while only 13% have a maturity greater than five years. Mortgage lending accounts for just over 1% of all lending activity. Around 69% of all loans are denominated in foreign currency. In June 2001, the commercial bank interest rate spread for non-bank clients was a massive 19%.

Although the dominance of the state-owned sector has fallen in recent years, the state still plays a major role within the banking system. The three remaining state-owned banks account for 46% of total assets, while in 1998 the state-owned sector accounted for three-quarters of total assets. By June 2001, foreign banks accounted just over 50% of total assets.

The financial sector is turning away from the damaging practices of the past. The state-owned banks have now been cleaned up by removing bad and dubious loans. Large directed credits are no longer channelled through the banking system. Commercial bank loans to state-owned enterprises account for just 10% of all lending activity. Based upon the available information, the largest state-owned bank – BCR – seems to be profitable. The Savings Bank (CEC) is now the most problematic state-owned bank. Its cost structure is extremely heavy. Due to the highly inflationary environment and the considerable macroeconomic uncertainty, the Savings Bank enjoys a high spread between government bonds (its primary investment vehicle) and its deposits. The bank could quickly run into difficulties if interest rate spreads narrowed.

The central bank has stopped issuing liquidity support to the banking sector. Between September and December 2000, the central bank extended significant credit lines to Banca Agricola. However, these were withdrawn after the privatisation of the bank. To set a sound basis for the future development of the banking sector, the recent government restraint from interfering in banks' credit decisions, the limitation of new state guarantees, and the elimination of liquidity support by the central bank for those banks which do not pose a systemic risk need to become permanent features of Romanian economic policy. In addition, the mandate of the debt recovery agency should be kept limited to minimise the costs of the banking sector clean up and reduce moral hazard problems.

The equity markets are at a rudimentary stage of development. Romania has two main stock exchanges - the Bucharest Stock Market and the over-the-counter RASDAQ. Their capitalisation is very small. In August 2001, the capitalisation in the Bucharest market was €0.7 billion or just 1.7% of GDP, while RASDAQ was €1.2 billion, representing 2.7% of GDP. Trading is generally very light, and in recent months trading volumes have declined compared to 2000. Since 1997, foreign participation in both markets has fallen.

In the area of financial-sector supervision, the picture is mixed. Supervision within the commercial bank sector has improved. An early warning system is now in place, and banks are inspected more frequently. The central bank has taken a more proactive role with those banks that break prudential regulations, issuing warning letters and sanctioning offenders. The central bank has also recently assumed responsibility for supervising the potentially problematic co-operative institutions and what are known as the "popular banks". In contrast, capital market regulation is extremely weak. The Romanian National Securities Commission is only starting to effectively carry out all its legal responsibilities, because it is still building up its capacity.

The capacity to cope with competitive pressures and market forces within the union

The ability to fulfil this criterion depends on the existence of market economy and a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also requires a sufficient amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union before accession. Both the volume and the range of products traded with EU Member States provide evidence of this.

The absence of a functioning market economy has hampered the development of economic activity – particularly the growth of the private sector. This often led to economic disequilibria with high social costs. Misplaced attempts to solve the problems through further direct government intervention eventually failed, producing cycles of stop and go policies. The high inflationary environment has been especially damaging to private sector confidence.

Romania's education system suffers from a lack of resources. In 2000, government expenditure on education was just 3.6% of GDP. Romania has a low participation rate of students in higher education and only 11% of the workforce has received tertiary level

education. The amount spent on research and development has fallen from 0.8% of GDP in 1994 to 0.5% of GDP in 1998. Skill levels in the rural areas are low.

Romania does not have sufficient physical capital. The transport infrastructure is weak and suffers from a lack of investment. The motorway network has not increased in nine years. A long-term programme for the rehabilitation of the main road and railways networks has now been established, but it will have to be financed by international donors. In 2000, gross fixed capital formation amounted to 18.5% of GDP, although this ratio was inflated by often wasteful investments made by the state-owned enterprises. The large agricultural sector suffers from particularly difficult problems, including an obsolete capital stock, low productivity and feeble market institutions. Energy sector infrastructure is also in a poor state as artificially low prices have starved firms of the funds needed to maintain and upgrade their capital.

Cumulative foreign direct investment (FDI) remains low on a per capita basis. Nonetheless, FDI has provided a fairly constant inflow of funds, averaging 3.5% of GDP over the last four years. In 2000, net foreign direct investment amounted to € 1.1 billion, which represents 2.8% of GDP. In the first half of 2001, FDI flows remained constant in nominal terms relative to the same period in 2000. The authorities have tried to improve the administrative procedures for foreign investors. They have created a new government department for relations with foreign investors, which will act as a “one-stop shop” for investments above \$10 million. Although the government has adopted a new investment law which offers tax incentives to investors, the stability of the tax codes, rather than the continuous fine-tuning of targeted incentives, holds the key to increase investors’ interest.

The new government has emphasised the importance of developing small and medium-sized enterprises. SMEs represent the vast majority of firms and employ around 50% of the labour force. Most are very small and operate in trade and services. An unstable legal environment has hindered their development. SMEs have also found it difficult to gain access to the financial system, forcing them to rely largely on retained profits to finance their growth.

Government policy towards the enterprise sector has often directed scarce resources to the support of the state owned sector at the expense of developing a strong private sector. Several large and inefficient firms have been allowed to survive with state support. Despite poor corporate governance, unviable state-owned enterprises have been allowed to continue their operations because of the absence of hard budget constraints, and, in many cases, large implicit state aid, typically granted by forgiving tax arrears and other debts to the state. Moreover, the state has not been able to stop these companies from building up very considerable arrears to creditors, including workers, utilities and the budget. By allowing these enterprises to continue their operations, successive governments have failed to create an appropriate structure of incentives for a thorough restructuring of the supply side of the economy.

However, the authorities have set up the institutional framework for monitoring and approving state aids. The Competition Council, which was created in 1999, now considers each case of state aid, and assesses its impact upon the competitive environment.

As a result of strong recent export performance, the Romanian economy has become much more open. In 2000, exports and imports accounted for 74% of GDP, compared to 62.4% in 1999. The European Union is Romania’s largest trading partner. In 2000, the EU

accounted for around 64% of exports and 57% of imports. Reflecting Romania's comparative advantage and increased wage competitiveness, the product composition of exports is changing. Textiles now account for about a third of exports, while metallurgical products account for about 15%. Over the last two years, the real exchange rate has remained broadly constant.

2.4. General evaluation¹⁸

Romania has made progress towards establishing a functioning market economy and although it would not, in the medium term, be able to cope with competitive pressure and market forces within the Union, it has taken measures that would allow to develop its future capacity, provided that it keeps to the engaged economic reform path.

Romania has made progress towards macroeconomic stabilisation: growth has resumed and exports have increased. The government is acutely aware of the need to implement the programme agreed with the IMF and the Pre-accession Economic Programme. Structural reforms have been re-launched, most notably in the area of privatisation and energy price adjustments. The recent privatisations demonstrate a new commitment towards the establishment of a functioning market economy.

However, there are still serious economic imbalances with high inflation and a widening current account deficit, in a difficult social environment. The still fragile macroeconomic environment, the uncertain legal framework and the poor administrative capacity hinder the development of the private sector. Large parts of the enterprise sector have yet to start restructuring or are still in the early stages of the process. Romania's reform agenda remains considerable. The authorities should give priority to securing macroeconomic stability by fighting inflation and halting the deterioration of the external account. The full implementation of the programme agreed with the IMF, focusing on reversing the causes of inflation, would permit a gradual shifting of monetary and exchange rate policy towards inflation reduction. Enterprises' financial discipline should be established by halting the accumulation of inter-enterprise arrears and the provision of state support to inefficient ventures. The removal of the burden that these practices put on fiscal policy would allow for a better co-ordination between fiscal and monetary policy. A further priority is to accompany enterprise restructuring and privatisation with the establishment of sound legal and institutional foundations of the functioning market economy.

¹⁸ See "Making a success of enlargement: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2001) 700.

3. Ability to assume the obligations of membership

Introduction

This section aims to update the Commission's 2000 Regular Report on Romania's ability to assume the obligations of membership - that is, the legal and institutional framework, known as the *acquis*, by means of which the Union implements its objectives. Alongside an evaluation of relevant developments since the 2000 Regular Report, this section seeks to provide an overall assessment of Romania's ability to assume the obligations of membership, and of what remains to be done. This section is structured to follow the list of twenty-nine negotiating chapters, and incorporates an assessment of Romania's administrative capacity to implement the *acquis* in its various aspects. Romania's progress in translating the *acquis* into its official language is assessed in a separate section.

The European Council in Madrid in December 1995 referred to the need to create the conditions for the gradual, harmonious integration of the candidates, particularly through the adjustment of their administrative structures. Taking up this theme, in Agenda 2000 the Commission underlined the importance of effectively incorporating Community legislation into national legislation, and the even greater importance of implementing it properly in the field, via the appropriate administrative and judicial structures. This is an essential pre-condition for creating the mutual trust indispensable for future membership.

The European Council in Santa Maria da Feira and in Gothenburg in June 2000 and June 2001 respectively recalled the vital importance of the applicant countries' capacity to implement and enforce the *acquis*, and added that this required important efforts by the applicants in strengthening and reforming their administrative and judicial structures. Building on the assessment of Romania's administrative capacity provided in the 2000 Regular Report, the present Report seeks to add further depth and detail, focusing on the main administrative structures which are required for implementing the *acquis* in its various aspects.

In the 2000 Regular Report, the Commission concluded that :

"Romania has continued to advance with the adoption of the *acquis* - although the achievements over the last year have been mixed. In certain sectors both legal transposition and the setting up of the necessary administrative structures are advanced. At the same time there is a worrying lack of progress in certain key areas.

Those areas where positive developments can be noted include *company law* and *competition* where Romania has achieved a high degree of compatibility with the *acquis*. Romania has also made significant progress with the transposition and implementation of *transport acquis* during the last year (although the questions of fiscal harmonisation in road transport and maritime safety still need to be addressed). Advances have been made with the transposition of the *statistics* *acquis* although statistical coverage for a number of areas still needs substantial improvement.

Concerning *internal market legislation*, progress has been made in the field of public procurement and positive developments have also taken place with regard to the simplification of the issuance of work permits for EU citizens and the adoption of a new law on social security. Romania has also eased authorisation requirements on capital imports and has made

progress in combating the problem of money laundering. Romanian *VAT and excise duties* are broadly in line with the EU principles.

Despite the positive achievements noted above, there are many areas where further progress is needed. For the *internal market*, Romania still needs to develop framework legislation on the principles of the New and Global Approach. A number of crises in the banking industry demonstrate that the effective supervision of financial services still has to be considerably strengthened. Further work is required to ease the authorisations for capital exports and to transpose the *acquis* on cross border credit transfers. Romanian legislation on the protection of personal data remains inadequate and substantial harmonisation is still required in the area of direct taxation.

In the case of *agriculture*, a major structural reform of the sector is needed. The conditions that would allow the implementation of much of the EU agricultural *acquis* do not yet exist. The lack of administrative capacity is acute and the Ministry of Agriculture is not able to either develop the necessary reforms, or to effectively implement those items of legislation that have been adopted. In the case of *social policy*, little legislative progress was made over the period and further measures are needed with regard to the adoption of a new Labour Code, improving the protection of employee rights, and extending legislation on health and safety at work. The structures for social dialogue do exist but need to be accorded greater importance. In the *environmental sector*, in contrast to previous years, Romania has made progress with preparing strategies for transposing the *acquis* but the status of approximation is still very low. Specific cost assessments and the corresponding financial plans for implementing the environmental *acquis* need to be developed. Romania's approach to *industry policy* is not yet either market-based or predictable and Romania still has to develop an official industrial policy at both national and sectoral level. With *telecommunications*, there has been no substantial progress with the transposition of the *acquis* and further efforts are required to develop the regulatory framework. In the field of *justice and home affairs* positive measures have been taken on visa policy, border management and asylum. This said, Romania still needs to adopt or amend legislation in several important areas (the status of foreigners, the state frontiers, the organisation of the police and the statute of police officers).

The Romanian authorities have not yet elaborated a comprehensive policy framework for internal *financial control*. Policy guidelines still need to be developed for preventive financial control and internal audit functions (this is particularly important at the local level where the capacity to manage and control public funds remains weak). Substantial efforts are still required to develop control mechanisms for pre-accession funds. National *budgetary procedures* are weak and the medium-term programming of expenditure needs to be substantially improved.

A related concern is the ability of Romanian institutions to effectively manage the increased levels of EU funding. A programme-oriented budgeting system needs to be developed and the overall budget execution process strengthened. Romania should also take measures to strengthen public financial control functions through the provision of adequate staff, training and equipment.

The quality of the Romanian administration is very diverse. A number of ministries are well managed and are staffed by qualified professionals. However, in general terms, the *capacity of the public administration* to implement and manage the *acquis* is very limited and represents a major constraint in the accession preparations. Despite the widespread recognition in Romania

that this is a fundamental problem there has been little progress in developing administrative capacity since the last regular report. The main conclusions of the 1999 report - that certain key institutions still need to be set up, that in many key sectors (particularly agriculture and environment) the administration lacks the required level of competence, and that there is a need to ensure independence of regulatory and supervisory bodies - remain valid.

With regard to meeting short-term Accession Partnership priorities, Romania has made some progress in the areas of *taxation, customs, transport and justice and home affairs* although none of the priorities identified for these sectors have yet been fully met. Some, limited progress has been made in addressing the priorities related to the *internal market*, and the *reinforcement of administrative and judicial capacity*. In the case of *agriculture, employment and social affairs and environment* no substantial progress has been made.

Romania has already started to address some of the medium-term Accession Partnership priorities.”

3.1. The chapters of the *acquis*

As indicated, the review of Romania's ability to assume the obligations of membership that is below has been structured in accordance with the list of twenty-nine negotiating chapters. Accordingly, this section opens with an assessment of progress related to the so-called “four freedoms”, the cornerstones of the internal market, and continues with a systematic review of progress on each of the chapters, to cover the *acquis* in all its various aspects, including sectoral policies, economic and fiscal affairs, regional policy, environment, justice and home affairs, external policies, and financial questions.

Chapter 1: Free movement of goods

Since the last Regular Report, Romania has made only limited progress in this domain, except for new legislation on the New and Global Approach and public procurement.

In the area of **horizontal and procedural measures**, Romania has only recently adopted framework legislation introducing *New and Global Approach principles* into domestic legislation but no further progress has been made over the last year in the implementation of these principles. Nor can any significant progress be reported on the transposition of the *acquis* related to the notification procedure, interchange of data between administrations, market surveillance, product safety and safety checks at external borders.

Very little progress can be reported on the adoption of **sector specific legislation**. In the areas covered by *New Approach Directives*, this lack of progress is linked to the lack of framework legislation. This has delayed the implementation of the *acquis* concerning lifts, gas appliances, electromagnetic compatibility, medical devices, recreational crafts, legal metrology (non-automatic weighing equipment) and, pressure equipment, as well as radio- and telecommunications terminal equipment. New legislation on low voltage equipment and simple pressure vessels has been adopted, which will be difficult to fully implement in the absence of framework legislation.

As regards sectors covered by *Old Approach Directives*, the directive on wood has been fully implemented. Some limited progress has been made in the implementation of the *acquis* on

chemicals and pre-packaging. No further progress can be reported on motor vehicles, pharmaceuticals and the Old Approach Directive on legal metrology. Romania has transposed only part of the textiles, motor vehicles and cosmetics *acquis*. No progress can be reported on the *acquis* on glass. As regards the issue of food safety - foodstuffs legislation (*see also chapter 7 - Agriculture*) no new developments took place in the period under consideration.

There have been no developments on the transposition of the *acquis* on firearms and cultural goods.

As concerns the development of Romania's administrative capacity for the implementation of horizontal and procedural measures and sector specific legislation the gradual improvement has continued during the period under consideration. The Romanian Accreditation Body has signed some multilateral recognition agreements and the Romanian standardisation institution has continued its programme of transposing European standards, having so far transposed about 15% of European harmonised standards. However, there are still institutional weaknesses concerning conformity assessment bodies and laboratories, which also affect the implementation of the *acquis* on food safety. The overall administrative capacity to implement the *acquis* on industrial products has improved only gradually over the course of the last year.

Since the last Regular Report, no progress has been made as regards **non-harmonised area**.

New **public procurement** legislation eventually entered into force on 1 April 2001 after an Act of Parliament on the subject, adopted in 2000, had seen its entry into force postponed repeatedly and, once entered into force, had been suspended. While this legislation still leaves room for improvement and its protracted postponement is regrettable, it nonetheless brings Romanian legislation much closer to the *acquis* in this area.

Overall assessment

On the whole, the alignment with the *acquis* on free movement of goods has been considerably limited throughout the reporting period by the persistent lack of framework legislation on the principles of the New and Global Approach, which has also prevented further progress on sector specific legislation in areas covered by the New Approach Directives.

In the non-harmonised area, Romanian authorities should ensure that all legislation in conflict with articles 28-30 of the EC Treaty is amended by the date of accession. To ensure the principle of mutual recognition, a clause of mutual recognition should be integrated into each piece of relevant Romanian legislation on goods by the date of accession.

As regards sector specific legislation for areas covered by Old Approach Directives, apart the implementation of the wood directive, some limited progress can be noted in the transposition of the *acquis* on textiles, chemicals, motor vehicles, cosmetics and pre-packaging. However, further substantial steps are required in all these sectors, particularly in transposing the *acquis* on pharmaceuticals, foodstuffs, legal metrology and glass.

As for administrative capacity in this domain, the Romanian standardisation and accreditation bodies) have been in place for some years and continue to function appropriately. Efforts need to be strengthened to adopt European standards to meet the requirements for membership of CEN, CENELEC and the European Telecommunications Standards Institute. Major efforts are

required to improve the overall administrative capacity to implement the *acquis* on industrial products, which remains very weak. Particular efforts will need to be devoted to re-structuring the food control system, while abolishing the pre-market approval system for foodstuffs and preparing both the administration and the food operators to the principles underlying the EC food safety system. Urgent progress is required to establish conformity assessment bodies and laboratories, and improve the capacity of those which already exist to cope with their tasks. Furthermore, the capacity of the administration to design legislation on free movement of goods is still limited and should be reinforced.

As regards safety checks on products at external borders, Romania still needs to establish appropriate customs and market surveillance infrastructure as well as effective administrative cooperation between competent authorities.

After numerous delays in the entry into force of the legislation on public procurement adopted in August 1999, it eventually entered into force during the reporting period, but was suspended shortly after. Meanwhile, the Romanian authorities have in May 2001 published a new Emergency Ordinance. Although the protracted postponement of the legislation in public procurement is regrettable and despite the fact that the legislation still requires work on substantive issues, it will constitute a significant progress in the alignment to the *acquis* on public procurement. However, the new public procurement procedures need to be implemented by over 10000 contracting public authorities in all areas of public activity throughout the country, such as ministries, regional governments, public utilities and schools. It is a significant challenge to make the staff of all these institutions familiar with the new system and to ensure that the legislation is properly and competently applied throughout the country.

Chapter 2: Free movement of persons

In the area of free movement of persons no significant developments can be recorded during the reference period.

No progress was made on **mutual recognition of professional qualifications** or on **citizens' rights**. As regards non-discrimination towards EU citizens in the field of education, tuition fees for foreigners in higher education are set by a Government Ordinance at a fixed level. Fees for Romanian students are set by the University Senates on the basis of cost calculations provided by the National Council for the Funding of Higher Education. As a result, the fees for foreign students are considerably higher.

In December 2000, the Romanian Parliament amended the law on the legal profession, which increased existing discrimination against EC legal firms. This represents a move away from the *acquis* and the provisions of the Europe Agreement.

As regards free **movement of workers** no significant developments took place. While the 1999 law on work permits was amended in October 2000, the changes have little consequence for the free movement of workers and concern the preliminary visa requirements for work permits, and the taxes and fees applied. A bilateral agreement on free movement of workers was concluded with Portugal in July 2001. Romania also signed a bilateral agreement on the exchange of trainees with Luxembourg in July 2001.

No significant developments related to the **co-ordination of social security systems** occurred during the period.

Overall assessment

Alignment with the *acquis* has been limited in Romania. Steps have been taken to establish the required administrative structures and these efforts will need to be maintained and institutional capacity strengthened in all areas.

Measures to ensure mutual recognition of professional qualifications and diplomas should be intensified, and the necessary administrative structures and education and training programmes introduced.

It should be ensured that by accession there are no provisions in Romanian legislation which contradict Community rules, in particular with respect to nationality, residence or language requirements. Legislation on mutual recognition will need to include simpler procedures to allow the provision of services.

With respect to professional qualifications obtained before harmonisation, Romania should introduce measures to ensure that all its professionals can, as from accession, meet the requirements laid down by the directives.

Although some progress has been made in the area of free movement of persons, in particular with respect to equal treatment and work permits, further alignment with the *acquis* is needed. This is particularly important with regard to the employment and residence of migrant workers and their families.

As regards future co-ordination of social security systems, Romania needs to develop the required administrative structures and to train the necessary staff. Romania is encouraged to conclude further bilateral social security agreements, in particular with Member States, as these normally rely on the same principles as the Community rules in this field.

Steps will have to be taken to strengthen public employment services with view to future participation in the European Employment Services (EURES) network. A particular emphasis should be placed on language training for staff.

Chapter 3: Freedom to provide services

Since last year's Regular Report, Romania has made no substantial progress in this area - with the exception of the field of financial services.

In the area of **the right of establishment and the freedom to provide services** (other than financial services), legislative developments over the last year have further entrenched previously existing discriminatory provisions concerning legal practice by EU law firms. Legislative developments concerning other liberal professions have also introduced rules incompatible with the Europe Agreement and the *acquis*. Romanian law continues to contain provisions concerning residence requirements and, in the case of lawyers, prescribes particular legal forms of incorporation and requirements to associate Romanian lawyers in registered law firms. In addition, EU legal firms can no longer use their habitual name for practice in Romania, but must conform to the form prescribed by Romanian law.

No progress concerning alignment with the *acquis* on *self-employed commercial agents* can be reported, since the law in force still requires residence in Romania.

In the field of **financial services**, with regard to the *banking sector*, the National Bank of Romania has issued a number of rules bringing banking regulation more closely into line with the *acquis*. These rules concern notably accounting norms, minimum required share capital, own funds, and liquidity levels. Progress has also been made in the implementation of legislation approved in 2000 to extend normal prudential surveillance requirements to credit co-operatives.

In the *insurance sector* the appointment of members to the Insurance Supervision Commission Council, even if it occurred much later than had been provided for in the relevant legislation, has allowed initial steps to be taken to allow the independent regulator to start operations.

With regard to *investment services and securities markets*, no major legislative developments have occurred.

Concerning the **protection of personal data and the free movement of such data and information society directives** no progress can be reported. In July 2001 the Government published a law on electronic signature.

Overall assessment

Recent developments have reinforced Romanian laws that discriminate against EU citizens with regard to the right of establishment and freedom to provide services. This represents a move away from the *acquis* since the last Regular Report.

Concerning financial services as a whole, Romania will still have to make substantial efforts to bring its legal framework in line with the *acquis*.

However, in the *banking sector* Romanian legislation has made some progress towards compatibility with the *acquis* and further steps forward continue to be made. Its rules, policies, and practices follow broadly the Recommendations of the Basle Committee on Banking Supervision and to the relevant EC directives. Despite progress in this area, the sector is still fragile and only the consistent application of the regulatory and supervisory framework over a period of time will re-establish confidence.

As regards the *insurance sector*, the late establishment of the Insurance Supervision Commission (ISC), which is in charge of drafting relevant secondary legislation, has delayed the implementation of the *acquis*. Furthermore, the situation concerning administrative capacity of the new Insurance Supervisory Commission is unclear, and indications are that the ISC will require considerable strengthening in terms of staff, training, and equipment. At present, a large number of currently registered insurance companies are not expected to meet the requirements of the legislation. While waiting for the new law to come into force, some of these companies have continued to operate, while others do not report any activity at all. In the meantime, no new companies have been able to commence operations in the sector. The ISC will have to meet a considerable challenge during its start-up period to oversee all operators in the sector, while laying the groundwork for its own operations.

In the field of *investment services and securities markets*, current legislation remains incompatible with the *acquis*. The new law on securities supervision is still before Parliament. In the absence of a suitable legal framework, the National Securities Commission can only make marginal improvements in the situation, which has given rise to major crises in recent years. Moreover, the administrative capacity of the National Securities Commission continues to be a cause for concern. As noted in previous years, the National Securities Commission's

effectiveness is restricted by the limited number and experience of its staff. This reduces its capacity to gather and process information about operators in its sector. Considerable progress is necessary in this area - starting with the creation of an adequate legal framework.

In the field of the protection of personal data and the free movement of such data, the current legislation remains inadequate.

Chapter 4: Free movement of capital

Progress on liberalisation measures has been limited since the last report.

As regards **capital movement and payments**, the Government approved, at the start of 2001, a three-stage approach to abolish all existing restrictions by 2004. Some initial measures have been taken in the course of 2001 to implement this plan. Nevertheless, tight capital controls, requiring prior authorisation for capital account transfers, remain in force. Over the course of the year the only change introduced to the foreign exchange regime was allowing residents to acquire foreign exchange, for the purposes of payments to other residents, and only in the case of transactions carried out within free zones.

In the reporting period the Government adopted a law on the promotion of foreign direct investments with significant impact on the economy. This law aims to guarantee the stability and coherence of the legal framework for foreign direct investment and the application of international conventions in this area.

No significant progress can be reported on the implementation of the *acquis* on **payment systems**. Nevertheless, the establishment in May 2001 of the National Society for Settlement by Transfer (TransFonD S.A.) creates the framework for the externalisation, by the National Bank of Romania, of the inter-bank transfer of funds.

As for the related *acquis* on **money laundering**, although no major legislative developments can be reported over the last year, the National Office for the Prevention and Control of Money Laundering is operational. The Office has recruited staff and investigation and enforcement operations have commenced.

Overall assessment

While Romania has aligned with some of the *acquis*, a comprehensive system of exchange controls and other restrictions on capital movements still exists.

While there are no specific restrictions on inward direct investment, current laws are ambiguous and open-ended as concerns undefined "sensitive" sectors where prior authorisation can be imposed through "special laws."

The Romanian Constitution forbids the purchase of real estate by non-nationals. Nevertheless, for companies established in the country, even if wholly foreign-owned, land purchases for the conduct of business are allowed.

Preparations for the creation of a new inter-bank payment and settlement system are, as yet, at an early stage. Considerable work remains to be done in order to transpose the *acquis* in payment systems (including the introduction of adequate and effective redress procedures for settlement of disputes between bank and customers) and to improve the payment infrastructure.

The National Bank of Romania regulates and supervises banking and credit institutions, operates exchange control and oversees the payment system. The National Bank has sufficient staff and administrative capacity to ensure the effective application of legislation in these areas.

In the area of money laundering the National Office for the Prevention and Control of Money Laundering needs to complete the recruitment process and the acquisition of certain specialised equipment related to enforcement. The National Office for the Prevention and Control of Money Laundering has introduced important measures concerning the reporting obligations of financial institutions, but revision to the current legal framework is required concerning the civil liability of the Office in the course of investigations.

The Office is a member of the Egmont Group and connected to the Egmont Secure Web permitting the secure exchange of information on financial transactions. The Office has signed Memoranda of Understanding with Slovenia and Belgium on the exchange of financial information.

Compliance with the Recommendations of the Financial Action Task Force should be ensured.

Chapter 5: Company law

In the year under review further progress was made as regards company law, accounting regulation, and the protection of intellectual and industrial property rights.

Regarding **company law** as such, legislative developments included the introduction in May 2001 of a simplified, single procedure for the registration and authorisation of traders. In June 2001, a law providing for accelerated winding-up procedures for companies failing to meet minimum levels of social capital was adopted.

Romania has transposed much of the content of the 4th, 7th and 8th Accounting Directives. This process has continued throughout the year with further transposition of the 4th Accounting Directive. Romanian legislation now provides the framework for consistent application of the Harmonised Accounting Regulations in relation to Romanian Accounting Standards.

In the field of **industrial and intellectual property rights**, Romania ratified the Geneva Treaty on Copyright and the Geneva Treaty on Performances and Phonograms. The ratification instruments were deposited with the World Intellectual Property Organisation in February 2001.

Romania has also adopted legislation to ensure the protection of intellectual property rights during customs clearing operations. Secondary legislation on the law's application was also adopted. As regards enforcement, staffing at the Romanian Copyright Office was recently reduced, although this reduction was limited to posts then unfilled. Romania has a long tradition of legislation on industrial property rights and has become a member of the International Convention for New Variety of Plants Protection. Since the last Regular Report, Romania also ratified the Geneva Act in the Hague Agreement on International Patenting of Industrial Designs. In June 2001 the Romanian Parliament approved a law transposing provisions regarding the protection of undisclosed data.

Overall assessment

As mentioned in previous years' Regular Reports, Romania has already aligned with most of the *acquis* on **company law**. Further transposition is, however, necessary as concerns company registration, Economic Interest Groupings, and provisions on the jurisdiction and enforcement of foreign judgements in civil and commercial matters.

In the area of *accounting law*, Romanian legislation is largely in line with the *acquis*.

The body responsible for Accounting Standards is the Ministry of Finance through the Department of Accounting Regulations. Romania does not plan to create an independent accounting standards body before 2005, by which time it expects to have completed the implementation of the International Accounting Standards.

In the field of **industrial and intellectual property rights**, Romanian legislation is generally consistent with the *acquis*. The process of further alignment and transposition of the *acquis* has continued during the reporting period and it should be pursued in order to align with the directive on copyright in the information society and the directive on the resale right.

As regards *administrative capacity* in the field of intellectual and industrial property rights, the Romanian Copyright Office and the Office for Inventions and Trademarks are the competent authorities to which right-holders can present applications for intellectual and industrial property protection. Despite considerable efforts in this area, further improvements in staffing and budgets should be made. Financial allocations were increased recently, but taking into account inflation, further financial allocations are deemed necessary to secure the Office a sufficient level of resources. Overall, administrative capacity in this area is considered adequate, although statistical reporting could be improved. Nevertheless, the Commission has repeatedly expressed concern about weaknesses in the enforcement of legislation on intellectual and industrial property rights.

Of particular concern is the import into Romania of pirated and counterfeit goods. Controls at Romania's borders continue to give rise to concerns, as demonstrated by the high percentage of counterfeit goods in circulation. However, the statistics currently produced are insufficient to allow a detailed assessment of trends in copyright piracy. Further progress is necessary with implementing border controls and enhancing co-operation between organisations involved with industrial and intellectual property rights, (the border police, the judiciary and customs authorities). Additional training is also required for the judiciary on intellectual property rights issues. Further efforts are needed to avoid overlapping between the institutions involved in industrial and intellectual property rights, particularly as regards to "name" rights, where cross checking to avoid granting overlapping registrations is necessary. The creation of an efficient inter-institutional network is vital in making progress in the fight against piracy. Communication and co-operation between customs, police, border police, the Ministry of Justice, and the judiciary need to be improved and joint training programmes established.

Chapter 6: Competition policy

Romania has made some progress in this area since last year's Regular Report.

In the field of **anti-trust** legislation, the turnover thresholds for merger notifications were updated in February 2001. The enforcement record of the *Competition Council*, as the national competition authority in Romania, has further developed in the past year. In 2000, the Council Board handled 437 cases, including 2 prohibition decisions concerning vertical restraints and horizontal co-operation. Of these decisions 18 were challenged in court.

In the field of **state aid**, the law of 1999 became operational, but no new legislative measures were taken. The national state aid monitoring authority is the *Competition Office*, which operates under the authority of the Ministry of Public Finance. The investigative and decision-making body is the *Competition Council*. The *Competition Council* dealt with 72 state aid cases in 2000. However, the state aid authorities were not consulted systematically on all state aid measures and in some cases their opinion was not observed by the Government.

Following concerns expressed in last year's Regular Report concerning the law on "industrial parks", measures have been taken to replace the law governing the creation of these industrial parks with legislation more compatible with existing state aid legislation and the *acquis*. In September 2001, a Government Order regarding the constitution and functioning of industrial parks repealed the previous law of 2000.

The Competition Office finalised its work on state aid reports for the years up until 1999. Romania also presented a proposal for a regional aid map.

Overall assessment

Romania has made considerable progress in creating a legal framework in this area that is broadly aligned with the Community *acquis*. However, additional efforts are necessary to complete the legal framework and ensure its adequate enforcement.

As regards **anti-trust**, Romania's legislation is largely in line with, and covers most of, the *acquis* provisions. However, further secondary legislation still needs to be adopted, to take account of the Commission's new vertical restraints policy and its policy on horizontal co-operation agreements. The Competition Council has broad powers to enforce competition rules but will need further reinforcements- especially in the form of training and IT equipment, in order to fulfil the tasks assigned to it. It is essential that the Competition Council could focus its resources more effectively on cases with most serious distortions to competition. A more deterrent sanctioning policy will also be required. Finally, general transparency, including an improved access of the public to relevant documents should be increased.

As regards **state aids**, the existing legislation covers the basic principles of state aid control. However, the field of application of this law is not comprehensive and numerous state aid measures are not notified to the competition authorities. Romania should rapidly adopt the required secondary legislation on state aids, which is currently being prepared. This is a precondition to any effective enforcement activities. A significant number of unaligned aid schemes remains such as the profit tax rate 5% on export earnings and the law on direct investment promotion. Moreover, implementation of state aid policy in sensitive sectors is still at an early stage. There are continuous problems with the monitoring of frequent waivers by public bodies of the accumulated debt.

Romania has now formally adopted state aid reports for the period 1996 – 1999 but has yet to finalise the state aid inventory. In addition, Romania's recent proposal for the regional aid map would allow aid intensities for regional investment aid of up to 50% net grant equivalent. In the area of state aids, both the Competition Office and the Competition Council require further strengthening in terms of human resources and training.

In addition to strengthening administrative capacity within the competition authorities, particular attention should also be given to intensifying the training of the judiciary in the specific fields of anti-trust and state aid. There is also a need to raise awareness amongst all market participants, and especially amongst administrations granting state aids, of the policy and legislative provisions in this area.

Chapter 7: Agriculture

While Romania has made progress in alignment with several aspects of the agricultural *acquis*, restructuring of the agricultural sector has barely begun.

In 2000, agriculture accounted for 12.6% of Romania gross value added as opposed to 14.8% in 1999¹⁹. Agricultural employment represents 42.8% of the national labour force and around 70% of the rural labour force²⁰.

The situation in 2000 and at the start of 2001 was particularly difficult for the agricultural sector due to the severe drought, which affected the entire country. The decline in vegetable production was particularly serious and of the order of 20%, despite an increase in cultivated area. The fall in grain production negatively affected livestock. Numbers of cattle, sheep and goats fell by 6% while pig numbers declined by 18%. Agri-food exports dropped by 30% in 2000 as against 1999. Exports were €337 million and imports were €1010 million. The trade deficit in agricultural food products represented 22% of Romania's total trade deficit.

In 2000, EC imports²¹ of agricultural products originating in Romania decreased by 2% to €224 million. EC exports to Romania increased by 24% to €332 million. The trade balance in favour of the Community amounted to €107 million compared to €39 million in 1999. The most important product groups in terms of EC imports from Romania are live animals (27%) with an increase of 40%, oilseeds (15%) with a decrease of 56% and vegetables (7%) with a decrease of 18%. As far as EC exports to Romania are concerned, the most important sectors are meat (12 %) with an increase of 265%, due to a strong progression of exports of pig meat and poultry meat, miscellaneous preparations (10%) with an increase of 40%, tobacco (9%) with a decrease of 17% and fruit (8%) with an increase of 72%.

A first round of trade negotiations with Romania was concluded in May 2000 and the results were applied as from 1 July 2000 as autonomous trade measures pending their adoption as an additional Protocol to the Europe Agreement (Council Regulation (EC) N°2435/2000). As a consequence of the new agreement approximately 85% of the EC imports and 17% of EC exports of agricultural products are exempted from duties (*see section A.b. - Relations between the European Union and Romania*).

In 2001, the allocation from the state budget for agriculture and forestry was €403 million. In real terms, the level of domestic budget support for agriculture remained steady (about €332 million in 2001 as compared with €330 million in 2000). Some changes in the type of measures for domestic support were decided on, and the voucher-for-inputs scheme was replaced with a fixed cash payment of about €41 per hectare. This new scheme accounts for 61% of total assistance but does not radically change the philosophy of last year's voucher-for-input scheme. It continues to subsidise the purchase of farm inputs but it targets bigger individual farms and associations rather than small subsistence households. The severe drought that affected Romania last year led the Government to make a large budgetary contribution for irrigation (14% of the total budgetary support to agriculture in 2001).

Over the reporting period there has been some progress in the privatisation of agri-food companies. By the end of May 2001, out of 637 former state-owned farms, 113 had been privatised and 210 were in the process of being liquidated. The privatisation of the food

¹⁹ The source for all agricultural statistics is EUROSTAT unless otherwise specified.

²⁰ Eurostat Labour Force Survey (LFS). Agricultural employment is defined in LFS terms as economically active persons who gain a significant part of their income from agriculture.

²¹ Source: Uruguay Round Agreement definition of agricultural products, figures taken from EUROSTAT COMEXT (see U.E 12/15: Commerce des produits agricoles 1988-2000, 1 Partie DG AGRI/ A.2 Analyses quantitatives, prévisions, statistiques, études, 2001, p. 10-57 et 86-89)

processing industry is more advanced, and out of a total of 440 commercial companies 345 had been privatised by the same date. Despite the adoption of a legal framework for restitution of agricultural and forested land the actual pace of restitution was very slow. By May 2001, only 6% of claims for restitution of agricultural land and 0.03% of claims for forested land had been processed. At the same time, the land market has started to grow and is likely to be larger than reflected by central statistics, but Romania still has to establish an agricultural cadastre register and ensure a fully operational land market.

Horizontal issues

Following the change of government in January 2001 there has been an increased political commitment to the SAPARD programme and considerable efforts have been made to make up the delay in setting up and accrediting the SAPARD Agency (*see also Section A.b. - Relations between the European Union and Romania*). The main priorities for Romania's rural development policy were set in the Rural Development Plan approved by the Commission in November 2000. The Multi-annual Financing Agreement signed in February 2001 and the 2000 Annual Financing Agreement signed in March 2001 were ratified by the Parliament. The legal basis for the implementation of SAPARD and rural development support schemes was approved and the SAPARD Agency was set up under the responsibility of Ministry of Agriculture, Food and Forestry.

A decision was taken as regards the central and regional structure of the Agency including the number and positions of staff. The Managing Authority, Competent Authority, and Certifying Bodies were officially designated.

By May 2001 the recruitment of the SAPARD Agency staff was well under way – and the senior positions had been filled. Training courses are being organised, the staff are competent and motivated, and the administrative capacity of the SAPARD Agency is developing. Nevertheless, continued efforts are needed in order to consolidate the newly created structures and to fulfil criteria for accreditation.

In contrast to the positive developments on SAPARD, there has been very little progress with preparations to establish the Integrated Administration and Control System (IACS). No progress has been registered in developing the animal identification and farm registration system. The Ministerial Order adopted last year was never published and consequently could not be enforced.

No major progress has been made as regards the development of a land registration system, which is a vital pre-condition for the identification of agricultural parcels.

As regards the implementation of *trade mechanisms* only limited progress has been made with setting up the administrative structures required by the Common Market Organisations for each specific sector. New legislation introduced a grain grading system and warehouse receipts. However, there has been no improvement as regards regular market and price monitoring.

Progress has been made as regards protection of denomination of origin for wines, wine by-products and alcoholic beverages obtained through natural fermentation. Secondary legislation was approved by ordinance in February 2001 allowing full enforcement of the framework law on wine and new administrative structures responsible for the enforcement of the law have been

established. A list of laboratories for wine quality control has been authorised and inspectors have been appointed in all regional inspection offices.

The basic elements of the *Farm Accountancy Data Network* (National Committee, Liaison Agency) have not been set up.

Common Market Organisations

Since last year's Regular Report there has been no progress in Romania as regards the development of the horizontal structures necessary to operate the Common Market Organisations for arable crops, sugar, specialised crops (including fruit and vegetables, plants and flowers) or animal products. There has been little progress (with the exception of the wine sector) as regards the introduction of a legal framework and overall administrative structures for the establishment of the Common Market Organisations.

Rural development and forestry

Concerning *agri-environmental measures*, some progress has been made. A Government Decision of October 2000 approved the Action Plan for Protection of Waters Against Pollution with Nitrates from Agricultural Sources, and set up a Commission for the enforcement of the Action Plan. The Plan proposes the identification of vulnerable zones and establishes a framework for introducing the Code of Good Agriculture Practices.

Progress was made with the legal designation of the competent authority for monitoring and classifying forest resources (the National Regie of Forests).

Veterinary and phytosanitary issues, including food safety

Since last year's Regular Report some progress has been made in the **veterinary** sector.

The lack of a coherent overall strategy for adoption and enforcement of the veterinary *acquis* remains a major problem. The absence of agreement amongst different ministries is an obstacle to reaching the necessary consent on new draft legislation.

Substantial efforts have been made to improve laboratory infrastructure for animal health and diseases control. New laboratories have been set up and scientists have been trained in new laboratory techniques. Preparation has started for the accreditation of laboratories for quality control of foodstuff of animal origin. Insufficient resources have been allocated to allow implementation of EC directives on veterinary controls for animal health and meat products at the place of origin. In the context of the Geographical BSE Risk Assessment, Romania has been classified in group III.

No significant progress can be reported in the field of animal nutrition.

Although the National Sanitary Veterinary Agency was restructured during the reporting period there is no evidence of any real improvement in its functioning. Administrative capacity is low.

In the **phytosanitary** sector, considerable progress has been achieved with the adoption of legislation in the area of *plant health, pesticide residue control, and harmful organisms*. Legislation approved in 2001 sets up measures for protection against the introduction and

spread on Romanian territory of organisms injurious to plant and plant products. A framework law for determining maximum pesticide residue levels of was approved in December 2000. This was followed by the adoption of secondary legislation that is aimed at completing the harmonisation with the *acquis*. Progress has also been made in developing the infrastructure necessary to enforce the newly adopted laws on pesticide residues and a new Central Analytical Laboratory for the control of pesticide residues in plants and plant products has been established in Bucharest. Plant protection and phytosanitary quarantine activities were re-organised in 2001 and the competent authority is now the Directorate for Plant Protection and Phytosanitary Quarantine inside the Ministry of Agriculture. Training programmes have been carried out for central and local staff and internships for border inspectors have been organised. Recent investments have been made to set up a nation-wide computerised system linking the counties' phytosanitary inspectorates with the central administration.

As regards **food safety** (*see also chapter 1 - Free movement of goods*), Romania produced a Food Safety Strategy in early 2001. The document outlines the systems for co-ordination between the various official bodies involved, their roles, organisation, and staffing. Little progress has been made with regard to upgrading food-processing establishments and considerable efforts are still necessary.

Overall assessment

The pace of agricultural reform and alignment with the CAP *acquis* has been disappointing.

Despite some progress in *privatisation of state-owned farms*, the majority of these continue to be state-owned and to accumulate losses. Little attention is paid to economic efficiency and new investments in the privatisation process have not improved the economic situation of the sector.

As far as the restructuring of the *agri-food industry* is concerned, some progress has been made in privatisation of the food processing industry and agricultural services companies.

Regrettably, progress in *land reform* has continued to be slow and there has been no significant restitution of agricultural and forested lands. The overall economic environment continues to be unfavourable to the development of Romanian agriculture and the diversification of the rural economy. Fragmentation of land remains a major problem and the lack of a land consolidation policy perpetuates inefficient farm structures. However, a more positive development is that markets for both sale and leasing of agricultural land are now emerging in many areas of Romania. Legislative reforms over the past two years have stimulated the agricultural land market, and it is significant that sale transactions, and not just lease transactions, are now taking place in Romania.

The lack of reliable *statistics and regular market and price monitoring instruments* combined with the lack of competitive marketing channels weaken the government decision-making process. It often merely reacts to interest groups' pressures for measures that will create a window of opportunity for increased profit margins. As a matter of priority, Romania should carry out an agricultural census.

Progress has been made in several sectors with the *adoption of EC-compliant legislation*. However, the enforcement of legislation has proved to be difficult due to delays in adopting

secondary legislation and a lack of financial and human resources. While some investments have been made in the control infrastructure for animal health and phytosanitary control, further developments are still required to ensure appropriate enforcement of the *acquis*. Romania still needs to establish a vineyard register and control systems in the wine sector.

As regards **horizontal issues**, The SAPARD Agency accreditation process is now at an advanced stage. However, progress in areas such as land registration, trade mechanisms, inter-professional organisations, quality policies and the Farm Accountancy Data Network is limited.

Romania still needs to carry out conceptual work to prepare the administrative structures and systems required for handling the Common Agricultural Policy expenditure under the Guarantee and Guidance section of the EAGGF.

Preparation of the administrative and horizontal structures necessary for the operation of **Common Market Organisations** is at a very early stage. The internal support policies are still based on measures that are not compatible with the CAP and a change in agriculture policy to achieve sustainable agriculture needs to be undertaken.

Although some legislative progress has been made, overall progress in the area of **rural development and forestry** remains limited.

As concerns **veterinary and phytosanitary issues, including food safety**, the lack of a coherent overall strategy for the adoption and enforcement of the veterinary *acquis* remains a major problem. The shortage of resources allocated to the Sanitary Veterinary Agency continues to be a major obstacle to strengthening its administrative capacity. Although an assessment has been carried out as regards the real capacity and possibilities for implementation of EC Directives on veterinary controls for animal health and meat products at the place of origin, no decision on the allocation of the necessary resources has been taken.

In the phytosanitary field there has been some progress towards the approximation of Romanian legislation with the *acquis*. However, greater efforts as regards both transposition and implementation are still needed. Administrative capacity has been improved but remains weak.

The overall *administrative capacity* of the Ministry of Agriculture is weak. Although the technical staff of the ministry are well qualified, the current situation is typified by an inappropriate allocation of human resources between central and local services, understaffing, a high turn-over of personnel, job insecurity, and limited career prospects. Further support is required to strengthen the overall capacity of the agricultural administration to elaborate and enforce agricultural policies compatible with the *acquis*. Particular priority should be given to the ability to conduct economic assessments of various policy options and to prepare administrative structures for the management of EC-funded rural development programmes. The capacity of middle and senior management also needs to be improved and would greatly benefit from increased job stability. Staff cuts made at the beginning of the year have weakened the capacity of some services and agencies to carry out their mandate (e.g. the veterinary agency, and the phytosanitary directorate). A clear policy decision needs to be taken on the outsourcing of agricultural services whose functioning has been impaired by a lack of certainty about their future.

The Ministry of Agriculture and its subordinate institutions need to take urgent measures to develop administrative capacity in order to be able to implement and enforce the management

mechanisms of the Common Agricultural Policy - in particular the Integrated Administration and Control System, including an animal identification and registration system.

Chapter 8: Fisheries

Since the last Regular Report, significant progress in the fisheries sector has been recorded.

Concerning **resource management, inspection and control** a new law on fisheries resources, fishery and aquaculture was adopted in April 2001 and represents a significant step forward. The law establishes the legal framework regulating resource conservation, resource control and management, fisheries inspection, aquaculture and state intervention for the management and development of the fisheries sector.

The law initially provided for the setting up of the National Company for the Management of the Fisheries Fund and the creation of a Fisheries Inspection. The main tasks of the National Company would be to implement the national strategy for protection of fish stocks and total annual catches. Romania finally decided not to proceed with the establishment of the said company and to establish instead 8 regional offices. Therefore the enforcement of the newly adopted law risks being delayed. The Fisheries Inspection is in charge of monitoring the enforcement of the law. Inspectors have been given considerable additional powers, although pending the full enforcement of the new law, all inspections and controls continue to be carried out according to the procedures set out in the Ministerial Order on the matter issued last year.

As regards inspection operations, good progress has been made: in 2000, 102 infringements were detected, and the Coast Guard and the Fishery Inspection opened 57 criminal investigations.

The newly-adopted law also introduces measures for conservation of fish stocks. These include the introduction of total allowable catches, limits on the capture of small fish, forbidding certain devices and practices, and setting up minimum fish landing sizes.

As for **structural actions**, the new fisheries law introduces a Fishing Vessel Register that is separate from the General Fishing Register. Pending the approval of the necessary secondary legislation, previous provisions establishing a register office remain valid although no new records have been entered into the database. Progress has been made over the reporting period with providing the register office with basic IT equipment and with training staff. All vessels will have to be measured in accordance with the 1969 London Convention by the end of 2001.

There were no specific structural actions in the fishing industry. Significant progress has been made in the privatisation of fishing farms. Concerning **market policy**, no significant development can be recorded. The supply of fish in Romania is channelled through several distribution channels. Some of the companies are vertically integrated, covering all stages from fishing to retailing. There was a slight increase in 2001 in the number of fish and fish products' storage facilities (121) as compared with 1999 (103). Three professional associations have been set up representing respectively the interests of caviar producers, the Danube Delta fishermen and the Black Sea fishermen.

As concerns **State aid to the fisheries sector**, support has been given to preserve animal genetic heritage and covering, *inter alia*, freshwater fish. In total, the new measure concerns

ten farms and research institutes. No other State aids for the fisheries sector exists. In July 2001, legislation was adopted to support Romanian Black Sea fisheries via VAT exemptions for diesel oil. As regards **international fisheries agreements**, Romania is party to several international fisheries conventions and is a member of the General Fisheries Commission for the Mediterranean. Over the reporting period, Romania withdrew from the North-western Atlantic Fishing Convention (NAFO). Negotiations have continued on a new convention for fishing in the Black Sea.

Overall assessment

Despite good progress achieved with regard to legislation, considerable further work and investment is still needed, especially in terms of administrative structures, for Romania to achieve compliance with the *acquis*.

Considerable efforts are needed to strengthen administrative structures that, at present, are only partially able to implement the common fisheries policy. The institutional set-up needs to be streamlined and some administrative responsibilities still need to be clarified between the Ministry of Agriculture and the Ministry of Waters and Environmental Protection. The Fisheries Department within the Ministry of Agriculture, although recently reinforced, remains understaffed.

In the field of resource management, inspection, and controls, Romania already has a licensing scheme for marine fishing vessels. Licences specify the type of fishing, allowed gears and area of operation. The newly adopted fisheries law brings the Romanian legislative framework largely in line with the *acquis*. However, the enforcement of the law and the effective creation of the Fisheries Inspection, and the National Company will depend upon the adoption of secondary legislation. This should therefore be treated as a priority.

Control actions have intensified but fisheries control in Romania is still weak. No full-time enforcement service exists and the inspectors carry out many other tasks. More emphasis should be put on training fisheries inspectors and providing appropriate equipment, as well as on increasing the number of inspectors for controlling sea fisheries.

Development of a research strategy remains among Romania's short-term priorities in fisheries.

As for structural actions, primary legislation regarding the Fishing Vessels Register is now in line conformity with EC requirements, although secondary legislation is still needed and sufficient resources should be allocated for implementation of this legislation. The process of reforming the fisheries administration should be accelerated.

As regards market policy, no market intervention mechanism for fish products has been established so far. While there has been some progress as regards the establishment of producer organisations (there are now five), there is no indication as to their compliance with the EC conditions for recognising such organisations. Romania still needs to set up a market monitoring instrument and improve the collection of statistics.

Chapter 9: Transport policy

Romania has continued to make good progress in harmonising its legislation.

As regards **Trans-European Transport Networks**, Romania has continued to develop and rehabilitate its infrastructure. However, considering the costs involved, the full rehabilitation of the road network to make it suitable for lorries with 11.5 tonnes axle-weight will be a long-term objective. Romanian plans are restricted to the rehabilitation of part of its national road network.

As regards **land transport**, in the area of *road transport*, progress has been achieved in the field of technology and safety, with a Government Decision approving the gradual application of the provisions of the European Agreement for the road transport of dangerous goods and in the field of weights and dimensions, including a Government Ordinance on the legal arrangements relating to roads. No progress has been made with transposition of the *acquis* on recording equipment and speed-limiting devices.

Only limited progress can be reported in the field of fiscal harmonisation: Romania has submitted a plan to gradually phase out the existing discriminatory practices and has adjusted tariffs at Giurgiu-Ruse bridge to make them less discriminatory. That being said, the new user charge system announced by Romania for 1 January 2002 will continue to discriminate in favour of Romanian national operators performing domestic transport operations.

The road transit agreement for the carriage of goods was signed with Romania in June 2001, and should enter into force by the beginning of 2002. Its implementation will result in an increased number of transit authorisations for both Romania and the EU. In October 2000 Romania signed the European Agreement on International Occasional Carriage of Passengers by Bus (INTERBUS). Its implementation will result in partial harmonisation with the road passenger transport *acquis*.

As far as the *railways* sector is concerned, several activities such as maintenance and ticket selling have recently been contracted out from the former freight and passenger transport companies. The freight transport sector is fully liberalised, five different operators have been licensed, and subsidies are no longer provided. With regard to passenger traffic, the 8 (newly created) regional companies were re-merged with the national passenger company. The main reasons for this decision were that the public service obligation compensations from local budgets and the division of costs and revenues between various operators were not functioning properly.

In the *inland waterways* sector, no progress has been registered as regards alignment of Romanian vessels with EC technical requirements. Since this sector suffers severely from the present blockage of the Danube, the Romanian authorities have decided to wait until the economic situation improves before taking any decision.

No major developments have been registered in the field of *combined transport*, mainly due to the financial implications of promoting this mode of transport .

As concerns **air transport**, Romania has adopted legislation which partly transposes the Joint Aviation Requirements and covers certification procedures for aircraft, additional navigability requirements, noise produced by aircraft, minimum equipment of civil aircraft and rules for international air transport. Romania also became a full member of the Joint Aviation Authority in December 2000. The Civil Aviation Inspectorate, which carries out technical investigation of civil aviation accidents and incidents, has been separated from the Directorate for Air Transport

within the Ministry of Public Works, Transport and Housing. It is now directly subordinated to the Minister.

The privatisation of TAROM, the national air carrier, was launched at the end of 2000 but failed: no offers were received. Romania has therefore given up the idea of privatisation in the short-term and decided to restructure the company. The success of this operation will ultimately depend on the willingness of the Romanian authorities to implement drastic measures. Romania has recently demonstrated a reticence to adopt the *acquis* on the licensing of air carriers, fearing that this would result in non-Romanian control of TAROM.

As regards **maritime transport**, Romania has made considerable progress on the legislative aspects, and has adopted Governmental ordinances on: safety of life at sea, the tonnage measurement of ballast spaces in segregated ballast oil tankers, standards of training, certification and watch-keeping for seafarers, methodological norms for international maritime traffic, oil pollution preparedness, response and co-operation in case of hydrocarbon pollution, civil liability for oil pollution damage, the international convention on rescue, and minimum standards for merchant shipping.

The main problem in this sector concerns safety issues due to sub-standard vessels operating under the Romanian flag. The authorities have therefore undertaken a policy of "cleaning" their national shipping registry and the total number of vessels flying the Romanian flag has decreased to 48, out of which only 14 belong to state-owned companies. The institutions involved in the implementation of the port and flag State controls are currently being reorganised in order to ensure improved co-ordination. Unfortunately, these positive developments have not yet resulted in acceptable detention rates: according to 2000 statistics under the Paris Memorandum of Understanding, the percentage of Romanian flag vessels detained following port State control was still very high: 19.1%, even though a significant decrease compared to 1999 (29.6%) and 1998 (20.9%). This compares to an average for EU-flagged vessels of 3.9% in 2000.

Overall assessment

Considering the overall level of transposition, the main issue over the coming years will be the strict implementation of the recently adopted legislation, particularly considering the financial resources that will be necessary for the heavy investment needed to meet the standards required by the *acquis*. In the short-term, Romania should concentrate on three key issues where concrete results have not yet materialised: fiscal harmonisation in road transport, maritime safety and restructuring of TAROM.

As regards Trans-European Transport Networks, Romania is implementing its long-term rehabilitation plan and will only be able to speed up this process when the global economic situation improves, allowing the country to invest additional financial resources in infrastructure.

On road transport, the operators have made considerable efforts to adapt their fleet to EC norms. The main difficulty in Romania is the intentional maintaining of certain discriminatory tariffs and charges in favour of Romanian hauliers. Although plans to gradually phase out these practices are becoming clearer, no concrete improvement has been registered on the ground with the exception of tariff adjustments at the Giurgiu-Ruse bridge. In addition, Romania needs to develop the administrative capacity for enforcing the road transport *acquis*.

As regards railways, Romania is in line with most of the EC requirements.

Concerning inland waterways, Romania has decided to postpone all reforms until navigation along the Danube restarts. This is particularly worrying as Romanian vessels are already far from complying with EC technical requirements and this policy will result in additional delays in adapting the Romanian fleet.

Concerning air transport, Romania has made significant efforts to transpose the *acquis*. The main remaining problem is the restructuring of TAROM. According to a recently carried-out assessment, TAROM could become profitable by 2005 if properly restructured. A restructuring plan has been drawn up and a set of measures intended to cut losses have been identified. However, stronger political commitment to implement the recommended restructuring measures is still required.

As regards maritime safety, Romania is currently taking measures to solve the outstanding problems. However detention rates remain very high and Romania should intensify its efforts. Priority should be given to the reorganisation of the institutions involved in port and flag State controls in order to clearly define their responsibilities and avoid the present lack of co-ordination.

Chapter 10: Taxation

Since the last Regular Report Romania has made some progress, particularly with regard to excise duties.

In the area of **indirect taxation**, Romania has continued to align its legislation on excise duties with the *acquis*. The specific duty on cigarettes was increased in March 2001, bringing the total duty on the most popular price category to 45% (although this is still below the present EC minimum of 57%). The Emergency Ordinance from 2000, providing a 50% reduction on excises on alcoholic products for producers without outstanding liabilities, was abolished. This removed an important area of conflict with the *acquis*. An Emergency Ordinance from September 2001 established a single excise duty rate for all kinds of alcohol and alcoholic beverages. No progress was made on the alignment of VAT legislation.

No progress was reported as regards **direct taxation**. The reduced tax rate of 5% on profits made from exports (instead of the normal profit tax of 25%) remains in force, even though this measure appears to contravene Romania's WTO and Europe Agreement obligations.

As regards **administrative co-operation and mutual assistance**, Romania has continued to modernise its tax administration. The National School of Public Finance has developed training programmes covering most aspects of tax administration. IT-systems have been introduced to improve revenue collection and to support control and audit activities.

Overall assessment

Romania has continued, albeit at a slow pace, to align its legislation with the *acquis*. Limited results have been achieved in modernising the tax administration.

Significant alignments are still needed in the area of VAT as regards the taxable scope, VAT refunds, exempt transactions and zero rates.

While some progress has been made concerning excise duty levels, Romanian legislation on excise duties still requires extensive adjustment with regard to the structure of the duties, exemptions, and the applied rates (which remain much lower than EC minimum levels). The taxable scope of mineral oils should also be aligned with the *acquis*.

As regards direct taxation and the directives on administrative co-operation and mutual assistance, full transposition is still required. The setting up of national IT systems compatible with EC systems should be given priority.

It will be important to ensure that existing and future legislation complies with the principles of the Code of Conduct for Business Taxation.

Despite the efforts made during the reporting period the administrative capacity of Romania's tax authorities remains weak.

The Romanian administration has given a commitment to develop a Code of Ethics by mid-2003. In order to address issues related to corruption, and to improve administrative practices, the application of this code should be brought forward.

Chapter 11: Economic and Monetary Union

A detailed assessment of Romania's economic policy in its various aspects has been given above, in the Chapter discussing the economic criteria (B-2). Therefore, the present section is limited to a discussion of those aspects of the Economic and Monetary Union *Acquis* - as defined by title VII of the EC treaty and the other relevant texts - which candidate countries should implement before accession, i.e. the prohibition of direct public sector financing by the central bank, the prohibition of privileged access of the public sector to financial institutions, and independence of the national central bank. As to the process of liberalisation of capital movements, upon the completion of which compliance with the EMU *Acquis* is conditional, this aspect has been covered above, in the section on *Chapter 4 – Free movement of capital*.

Since the last Regular Report, there have been no significant developments with regard to alignment with the EMU *acquis* in Romania.

Romanian legislation still allows for the possibility of **direct public sector financing by the Central Bank** though an overdraft facility. Public authorities made only very limited use of financing by the National Bank of Romania during the course of 2000 and no such cases have been reported during 2001.

No specific developments can be reported regarding **privileged access of the public sector to financial institutions**.

Romania's legislation already guarantees a very high degree of **independence for the Central Bank**. This legislation has remained unchanged over the last year.

Overall assessment

Romania will participate in EMU upon accession with the status of a country with a derogation under article 122 of the EC treaty. It will need to implement the necessary changes to its institutional and legal framework by the date of accession.

Romania has transposed a significant part the *acquis* on Economic and Monetary Union, but has not yet fully aligned its legislation with the *acquis*. Further changes to Romanian legislation, concerning for example the elimination of direct public sector financing and the full independence of the National Bank, will be necessary in order to achieve this goal.

Chapter 12: Statistics

Romania has continued over the past year with the gradual implementation of the statistics *acquis*.

The new statistical law has helped strengthen the mission and organisation of the statistical system in Romania. Meanwhile, Romania's **statistical infrastructure** has also undergone significant changes during the reporting period. In the context of a general restructuring of the public administration, decision-making processes in the National Institute for Statistics were simplified and the number of staff was cut by 20%. The National Institute for Statistics now has 436 posts at headquarters and 1381 posts in its territorial units. There are now 34 directorate generals at country level and 8 regional statistical directorates, one for each of Romania's main regions. It is too early to assess the full impact of this reorganisation, although it appears not to have had a negative impact on the National Institute for Statistics' ability to carry out its core tasks.

The Ministry of Development and Prognosis is in charge of the National Institute for Statistics. The National Institute for Statistics co-operates closely with line ministries, the National Bank of Romania and other administrative bodies, which supply the National Institute for Statistics with data on a regular basis. A Co-ordination Council for Statistics Activities, chaired by the National Institute for Statistics' president, advises on the development of the Romanian statistical system. The National Institute for Statistics is financed on the state budget.

Demographic and social statistics have been brought further in line with EU practice regarding the quarterly labour survey and the multi-functional sample of territorial units. However, Romania has postponed to 2002 the population census, which was originally scheduled for March 2001.

Romania has continued to align **regional** statistics with the *acquis*. The creation of 8 regional statistical offices should facilitate the collection of data at NUTS II level. Some regional data, for example business statistics, have been made available starting in 1998. Regional data in a number of other areas, such as population, GDP and social conditions are being collected and fed into the system on a regular basis. More efforts are required to create a coherent regional collection and storage system for statistical data.

Romania has also made progress over the last year in the field of **macro-economic statistics**. ESA 95 methodology was used for the first time for the 1998 National Accounts. The Consumer Price Index has been brought closer to EU practice by the introduction of annual

updating of expenditure weightings. Last year Romania completed its first fiscal notification and submitted it to the Commission, although the notification is not yet in line with EC requirements. The National Institute for Statistics should try to maintain an adequate number of staff with the specific skills required for the elaboration of macro-economic statistics.

Concerning **business statistics** Romania has set up a sampling base of industrial companies in line with the *acquis*. A pilot survey on PODROM 2000 was carried out during the first half of 2001. Sectoral statistics for industry, construction, trade and services have also been brought closer in line with the *acquis* during the past year. A structural business survey is being carried out at regional level. There are no new developments to report concerning tourism statistics.

In the area of **transport statistics** Romania started to collect data on railways and inland waterway traffic in 2001. However, there is still a need to improve the statistical coverage of motor vehicle use and maritime transport.

As concerns statistics on **external trade** Romania was connected to the foreign trade database of EUROSTAT (COMEXT) at the beginning of 2001.

In the area of **agricultural statistics** a micro-census on agricultural holdings was carried out in October 2000 with the goal of establishing a sampling frame for the first structural survey in agriculture (planned for December 2002). However, significant efforts are still necessary to bring agricultural statistics in line with the *acquis*. No significant progress can be reported on forestry and fishery statistics.

Overall assessment

Romania is quite advanced in the field of statistics. However, there are still shortcomings, in particular concerning agricultural statistics (a general agricultural census is not planned until end 2002) and tourism statistics. These are the same areas which the 2000 Regular Report identified as weaknesses. The one-year delay in carrying out the population census is also disappointing.

There is room to improve the administrative capacity of Romania's statistical system, in particular as concerns the relatively low qualifications and relatively high turnover of staff. Adequate resources need to be made available to further strengthen statistical capacities, including at regional level

Chapter 13: Social policy and employment

Mixed progress was made in this area since the last Regular Report.

Pending the adoption of a new Labour Code no major legislative development can be reported in the field of **Labour Law**, although Romania did ratify the ILO Convention on Child Labour.

In the field of **equal treatment for men and women**, slow progress in transposition and enforcement of the *acquis* is a cause for concern.

A National Action Plan on equal opportunities was adopted in December 2000. It identifies priority areas of intervention according to the European strategy model: legislative framework, social rights, economy, decision-making, and civic awareness. While the National Action Plan is

a welcome development it does not appear to have been followed by any implementing action and it is essential that the Plan is adequately financed if it is to have any impact. Other than the National Plan, there has been little progress in improving the position of women on the labour market.

In the field of **health and safety at work** initiatives include a clearer definition of different categories of employers and the requirement for specific health and safety norms for certain economic sectors. The Government has also established the methodology and the criteria for defining "special conditions" in work places.

The administrative capacity of the Labour Inspectorate remains weak. There is a scarcity of funds, and a serious shortage of qualified staff. The Labour Inspectorate has been allocated 239 staff at the central level and 2,570 regional staff, but 40% of the central posts and 20% of the regional posts remain vacant. The creation of a centre for training and re-training labour inspectors is a welcome development.

On **public health**, legislation on the labelling of tobacco products has been adopted which partly transposes the *acquis*. No measures have been taken on the maximum tar yield of cigarettes. No new measures have been taken related to epidemiological surveillance although the establishment of a functioning surveillance system has been initiated.

With a view to stabilising the **social dialogue**, the Government signed a social pact with trade unions and employers' confederations, which sets common social, economic, and legislative priorities. Secretaries of State responsible for, amongst other things, the relationship with the social partners have been appointed in all ministries. In a separate initiative, tripartite social dialogue commissions, with consultative power, were established at the sectoral and territorial levels. Despite these developments, no progress can be reported concerning bipartite social dialogue and workers' participation at enterprise level.

The level of unemployment increased to 7.0% in 2000. Employment in agriculture is particularly high in Romania (45% in 2000) and is increasing. At the same time, illegal working is widespread.

Romania and the Commission have launched the Employment Policy Review in order to examine progress in adapting the Romanian employment system so as to be able to implement the European Employment Strategy in line with the Employment Title. Work on a Joint Assessment Paper started in May 2001. The preparation of a National Plan for Employment is also under way.

The National Agency for Employment has been designated as the body responsible for the implementation of **European Social Fund (ESF)**-type projects. However, since the Ministry of Development and Prognosis is formally responsible for the programming and implementation of ESF-type programmes, in the framework of pre-accession support, the overall coherence of the system remains unclear. Other than this, no progress can be reported concerning preparations for administering the ESF.

Social protection and social assistance were presented as major political priorities in the new government's programme and some progress has since been made in addressing them. A Commission for the Fight against Poverty and Social Inclusion has been set up. This Commission will report directly to the Prime Minister. In July 2001, the law creating a minimum

guaranteed income was adopted. The law includes provisions covering additional allowances such as heating allowances, and allowances for childbirth. In a separate development, the National Solidarity Fund was consolidated into the national budget.

Following an agreement with the major trade union confederations, the Government amended the law on public pensions. The main changes include lower retirement ages and revaluation of pension points. The government has also defined priorities for provision for the elderly as well as norms for home-care services. Local authorities are responsible for the provision of these services but ensuring adequate budgetary transfers to the local level remains a problem.

The issue of the financial sustainability of the pension system has begun to be addressed through better collection measures and the overall situation has improved slightly, mainly due to transfers from the unemployment budget to the social insurance budget. However, the question of social contributions remains unresolved and undeclared working combined with the non-payment of social insurance contributions by many employers has led to a serious deficit in the social and unemployment budgets.

As regards **anti-discrimination**, no further progress can be reported.

Overall assessment

While Romania has advanced in some areas, considerable efforts are still needed to align with the social policy *acquis*.

The approval of a new Labour Code is a particular priority. Further work is also required to align Romania's legislation with the *acquis* on health and safety at work and improving the capacity of the Labour Inspectorate should be dealt with as a matter of urgency.

On equal treatment for women and men, substantial work is required to align and enforce the *acquis*.

On public health, some progress can be recorded as regards tobacco directives but further steps need to be taken to comply with the new *acquis* on tobacco. Efforts to establish the national surveillance system for communicable diseases in line with the Community Network should be stepped up.

Basic indicators, such as high infant mortality and low life expectancy, demonstrate the low level of public health in Romania. While reform of the health care system is one of the Government's priorities, the budget allocation to the health sector, measured as a share of GDP, is far lower than EU levels. This lack of resources limits the delivery and quality of health services. Romania should therefore continue with its health sector reforms and a greater emphasis should be placed on strategic planning of human and financial resources in order to make efficient use of scarce public funds. Ensuring equal access to basic health care should be one of the Government's objectives.

Despite some recent progress, social dialogue is still not given sufficient importance and the Economic and Social Council is repeatedly by-passed in the decision making process. Efforts are required to promote and strengthen bipartite social dialogue structures especially at sectoral level. Social dialogue in the public sector remains inadequate. At enterprise level, social dialogue mechanisms and worker participation in works councils should be improved. The Government

will need to help the social partners to develop their capacity before they can play an active role in the EU context.

As regards employment, necessary re-structuring of the economy will pose further challenges on the labour market. Therefore, finalising a Joint Assessment Paper and approving a national employment strategy should be considered as priorities. Romania should further develop an active labour market policy, develop the capacity of the National Agency for Employment, and strengthen the administrative capacity of the local employment offices in order to improve their provision of services.

As regards preparation for participation in the European Social Fund, Romania should use the expertise gained with ESF-type projects in order to fully benefit from the European Social Fund after accession and to establish links with the European Employment Strategy and the Social Inclusion Process.

Increasing poverty and the risk of social exclusion of different categories of the population (including abandoned children, young unemployed, families of unemployed, single parent families, homeless families, and the Roma population) is a major challenge facing Romania. Sustained efforts are required to reform social assistance which is currently hampered by fragmented administrative structures and the confused decentralisation of resources and responsibilities to the local level.

The fight against exclusion, as laid down in Article 136 of the Treaty establishing the European Community, is part of the objectives of EU social policy. As decided at the Lisbon and Nice European Councils, policies to combat social exclusion combine commonly agreed objectives at the EU level and national action plans. The Göteborg European Council in June 2001 invited candidate countries to translate the Union's objectives of promoting social inclusion into their national policies.

Legislation on preventing and sanctioning all forms of discrimination does exist and contains the basic principles of the *acquis* - equal pay, equal access to employment, training, promotion and working conditions. However, this law is not yet applied due to the lack of implementing legislation. Efforts should continue to ensure alignment with the *acquis* on anti-discrimination based on Article 13 of the EC Treaty.

Chapter 14: Energy

During the reporting period the energy sector has been subject to contradictory decisions which led to an inconsistent evolution. The first half of 2001 was typified by the blockage of reforms and even steps backward. This contrasts with positive developments, in particular as regards pricing, that occurred during the second part of 2001. Overall progress has therefore been limited.

Concerning **security of supply**, no progress has been registered. The *acquis* has still not been transposed and there is no reliable oil stock monitoring system. On this point, following clarification with the competent Romanian authorities, it appears that the present level of stocks of oil and oil products corresponds to over a third of the required level of consumption, while the storage capacity already meets the requirements of the *acquis*.

On competitiveness and the internal energy market, there have been major developments over the reporting period - not all of them positive. A long-awaited "National Strategy for Energy Development" was adopted in June 2001. This document mainly focuses on energy production (especially electricity and heat), and proposes an extensive rehabilitation and investment programme, with little mention of how to secure the necessary funds. It does not address core issues such as demand-side management, improvement of the financial health of energy utilities, sectoral restructuring and regulation, and energy pricing. In its present form the strategy is not an adequate basis on which a competitive and market-oriented energy sector can be developed.

In the *electricity* sector, the market openness has reached 15%, with licensed suppliers and eligible customers. In practice, the contracts signed between licensed suppliers and eligible customers amount to 8%. For the first months of 2001, electricity prices were frozen and were only increased in the early summer by 20% compared with last year. However, the present prices cover only around 85% of production costs. ANRE, the national regulatory authority, has performed a reasonable amount of work despite the fact that it is understaffed with only 65 employees. In particular it has elaborated secondary legislation to strengthen the electricity market. Since December 2000, ANRE has been brought under the control of the Ministry of Industry and Resources, which now plays an active role in the setting of electricity prices.

A more positive development is the restructuring of the distribution and transport utilities. Electrica, the distribution company, was reorganised into 8 regional branches and one service subsidiary in June 2001 (reversing a reorganisation in 2000 that had set up 19 branches of limited size, which made individual branches less attractive to private investors). The maintenance activity of the electricity transport company Transelectrica has been contracted out

As regards energy production, despite its worrying financial situation, Termoelectrica has only been subject to limited reorganisation: 8 plants have been closed down for lack of efficiency and there are plans to transfer several heating power plants to local municipalities.

Concerning the interconnection to the Western European UCTE (Union Co-ordinating the Transport of Electricity) electricity networks, two 400 kV connections with Hungary and Ukraine have become operational. Tests have started with a view to a future interconnection with UCTE.

The *gas sector* has also been subject to considerable shifts in policy during the past year. Whereas the market used to be open at a rate of 15% with licensed suppliers and eligible customers, the Government suspended all bilateral contracts in October 2000. In July 2001, it re-opened the sector at a rate of 10% and the regulatory authority selected 18 new eligible customers.

The gas utility ROMGAZ was re-established in 2001 by merging the gas production and underground storage companies (in 2000 it had been unbundled into five companies responsible for transport, production, underground storage and distribution in the south and in the north of Romania). The Government initially kept the price of indigenous gas production artificially low with most of it directed to household customers. This had an effect similar to cross-subsidisation: household customers paid nearly half the price that industrial customers paid. In

mid-August 2001, a single regulated price for all gas consumers was established, reducing greatly this price distortion and ensuring cost recovery.

As for legislative harmonisation, ANRGN, the regulatory authority for the gas sector, has elaborated secondary legislation in order to facilitate the establishment of the gas market in Romania. With 51 employees, ANRGN is understaffed.

Although it is difficult to obtain precise figures on energy bill collection rates the situation seems to have improved slightly with a collection rate around 85%. However, this still significant level of non-payment, combined with an electricity price that does not cover production costs worsens the financial situation of the utilities and continues to endanger the whole sector. Because of cash flow shortages, the utilities have to borrow at high costs on the international market to pay their suppliers. These loans worsen their financial situation, and ultimately the Government has to intervene to take over these debts. As an illustration, the Government had to write off the penalties (about €450 million) and to reschedule the debt (also about €430 million) of 13 energy companies or utilities in April. Payment rates for the electricity produced by Romania's nuclear power plant have, however, improved to a level whereby Nuclearelectrica no longer needs to resort to budgetary help.

In the sectors of *oil* and *solid fuels*, no major developments have been recorded.

As far as **energy efficiency** is concerned, the efficiency of the existing network, and in particular the heating systems, is very poor. The energy intensity of the economy is very high and has been estimated at between two and four times that of EU member states. Legislation has been adopted on energy efficiency requirements for washing machines, washing-drying machines and refrigerators. More importantly, a law for "the efficient use of energy" providing for the establishment of the National Energy Efficiency Fund has been adopted. However, detailed rules for the implementation of the law have not yet been elaborated, and the budget devoted by the Government to the fund is very limited (€2.5 million for 2001). Moreover, the enforcement of the law is the responsibility of the Romanian Agency for Energy Conservation, which suffered a severe reduction in staff numbers over the reporting period and therefore has limited administrative capacity.

In the field of **nuclear energy**, Cernavoda unit 1 (a CANDU unit of Canadian design) provides 9-10% of the country's electricity. The government has declared the completion of the second unit (CANDU type 700 MW) a national priority. This second unit is expected to be operational by 2005 – 2006.

The Nuclear Safety Authority (CNCAN) has been returned to the control of the Ministry of Water and Environmental Protection. CNCAN can now concentrate on regulatory issues since the Environmental Radioactivity Surveillance Networks have been transferred to the local Environmental Protection Agencies. CNCAN has 80 employees, but salaries remain very low when compared with employees in the nuclear industry.

Overall assessment

The Romanian energy sector has been characterised by a succession of reorganisations and contradictory decisions, which have finally resulted in an overall limited level of alignment with the energy *acquis*. This was the consequence of the lack of a clear medium-term vision for the

energy sector - as illustrated by the limited scope of the energy strategy that was produced. This instability and lack of direction has slowed down the reform of the Romanian energy sector. In order to stabilise the sector and to restore the confidence of foreign investors, Romania should elaborate a clear medium-term policy for restructuring the energy sector, establish annual action plans, and strictly implement these programmes.

In the electricity sector, price setting is not subject to market rules. Prices still do not reflect the production costs and therefore the financial situation of the utilities has become very serious. This is all the more worrying as no clear programme yet exists to restructure the energy production companies in order to reduce production costs (beyond the intention to transfer non-viable plants to local municipalities). Transferring ownership without addressing core issues is unlikely to solve structural problems.

The gas market has been subject to an even more erratic evolution, with the re-merger of the production and underground storage gas companies after only one year of independence, the suspension of internal market and the return of distorted prices. However, the situation has improved and Romania has recently re-opened its gas market and adjusted gas prices (which resulted in a doubling of the gas price for household customers).

Although improvement can be registered, the problem of non-payment of energy bills continues to weaken not only the energy sector but also the economy as a whole. The debts and the arrears of the energy utilities continue to grow at a preoccupying level.

Progress has been achieved with legislation to promote energy efficiency. However, Romania still does not devote the necessary resources to effectively address the very serious issue of energy efficiency, which would offer large potential for savings and rationalisation. In order to do so, the administrative capacity of the Romanian Agency for Energy Conservation needs to be reinforced.

There is a continued lack of progress in the transposition of the oil stock *acquis* and related necessary investment.

As regards nuclear energy, the European Union has repeatedly emphasised the importance of a high level of nuclear safety in candidate countries. In June 2001, the Council of the European Union took note of a Report on Nuclear Safety in the Context of Enlargement. This report contains findings on the situation and perspective regarding nuclear safety in each candidate country, as well as recommendations for specific improvements. In July, the Commission conveyed this report to the candidate countries.

General recommendations of the Council Report call for all candidate countries with nuclear power plants to complete their plant-specific safety improvement programmes, and to ensure that their programmes include measures considered good practices within the European Union. This concerns particularly specified safety measures such as assessment practices, emergency procedures, feedback of experience, resources of the regulatory authority and other aspects.

The report recommends all candidate countries to continue their national programmes regarding the safe management of spent fuel and radioactive waste, and regarding the safety of their research reactors.

For Romania, the Council Report recommends seven specific measures to ensure the safe operation of the Cernavoda nuclear power plant and other nuclear installations. The measures concern the capability and resources of the regulatory authority, the financial situation and competence of the operator, the establishment of an on-site emergency centre, fire and seismic hazard analyses and due consideration and, if applicable, implementation of safety improvements implemented in Canada for the CANDU type reactor used in Cernavoda.

The resources of CNCAN, the nuclear safety regulatory authority, should be further strengthened and salary levels should be brought in line with those in the nuclear sector. No progress has been achieved regarding spent fuel and nuclear waste, which are two issues that need to be addressed in the very short term.

Romania will also need to ensure compliance with Euratom requirements and procedures. In this respect, due attention should be given to preparing the implementation of Euratom Safeguards, in particular regarding the reporting of nuclear material flows and inventories directly by the persons or structures operating nuclear installations or storing nuclear material. It should be noted that Romania has concluded a Full Scope Safeguards Agreement with the IAEA. An Additional Protocol to this Agreement has been in force since July 2000.

Chapter 15: Industrial policy²²

Since the 2000 Regular Report, the government has made some further progress in developing a national industrial policy. Despite some progress, efforts still need to be made with the privatisation and restructuring process.

In July 2001 the Government approved the **industrial strategy** document "Industrial Policy of Romania", together with an Action Plan covering the measures needed to implement this policy. The document was drawn up after consultation with relevant stakeholders (professional associations, trade unions, employers, ministries, private sector, academics, and other public institutions).

The stated objective of the strategy is to increase Romania's industrial competitiveness through the development of a business-friendly environment, speeding up structural adjustment measures, more effective investment promotion, respecting European environment standards, supporting the SME sector, and developing industrial and business services.

Over the last year the Romanian authorities have prioritised **investment promotion**, in particular through the simplification of legal and administrative procedures and by improving the stability and transparency of the legislative system. Several tax initiatives aiming at the promotion of investment were introduced and in July 2001 a law on the promotion of investments was adopted. The law covers large-scale investments (worth over US \$1 million) and provides a combination of special fiscal incentives and measures to improve the business environment. In contrast to previous efforts to attract investment, the fiscal incentives offered would appear to be compatible with Romania's international obligations. In September 2001 legislation on the establishment of industrial parks was adopted. Significantly, this law repealed the legislation of June 2000 and introduced measures that are compatible with the Europe Agreement and the

²² "Developments in industrial policy should be seen in relation to developments in the context of SME policy (see chapter 16 – Small and medium-sized enterprises).

relevant *acquis*. (See also chapter 16 – *Small and medium-sized enterprises for progress in implementing the business environment*).

The **privatisation and restructuring** process came to a virtual standstill in the period before the November 2000 elections. This was followed by a period of institutional re-organisation which saw the abolition of the State Ownership Fund, (responsible for managing and privatising state-owned enterprises), and its replacement by the Authority for Privatisation and Management of State Assets (APAPS). This new institution was given additional legal authority to accelerate the privatisation process.

The pre-election stagnation of privatisation and subsequent institutional changes meant that the number of privatisations recorded during the first half of the reporting period was very low. The high profile privatisation of Banca Agricola and the progress made with the privatisation of the steel company SIDEX (where a pre-privatisation agreement has been concluded) have demonstrated the government's commitment to the privatisation process. In September 2001 the Government approved a "**Steel Industry Restructuring Programme**".

Overall assessment

Romania's policy towards industry is moving towards the principles of EC industrial policy, i.e. market-based, stable and predictable. However, considerable additional efforts will be needed before policy objectives are reflected in practice.

In 2000, industrial output increased by 6.1% over the previous year. This trend has continued and over the first six months of 2001 the growth of industrial value-added was 11.2%. An increase in domestic investments has also taken place since the last Regular Report although, by regional standards, the level of Foreign Direct Investment remained low (see *Section B.1.2. - Economic criteria*).

Privatisation and restructuring remain an area where major additional efforts are needed. There is still a considerable backlog with privatisation and this should be addressed as a matter of urgency. Romania's progress, to date, has been limited (the private sector only accounted for 65% of GDP in 2000).

While the development of a Steel Industry Restructuring Programme is a welcome (and long overdue) development, the plan remains incomplete, and improved transparency in the field of State aids as well as better coordination between ministries involved in implementing the restructuring strategy are urgently needed. There has only been limited progress in the actual restructuring of the sector and individual viability plans for Romania's steel enterprises have still to be submitted to the Commission.

Romania continues to grant both direct and indirect State aids to its steel industry and, with the notable exception of SIDEX, the privatisation process has been slowed down by restructuring delays and the high level of indebtedness of the main steel enterprises.

It should also be noted that an important element of any industrial policy is the control of state aid and that the compatibility of support schemes with EC rules, including the current rules on state aid of the ECSC Treaty, will have to be examined under the Europe Agreement (see *Chapter 6 - Competition policy*).

The government has made notable efforts to collaborate with bodies representing industrial interests as well as with foreign investors. This is a welcome development. At the same time, there is still scope for the administration to further improve its dialogue with the business community so that their concerns can be taken into account when policy is being drafted.

The Ministry of Industry and Resources is responsible for the design and implementation of industrial policy – although a particular concern is that the department responsible for these tasks has limited administrative capacity.

Chapter 16: Small and medium-sized enterprises²³

The Romanian authorities have made considerable progress in developing policy and measures for SME development.

Over the reporting period, the government has developed a comprehensive **SME strategy and implementing policies**. An “Action Plan for the Abolition of Certain Barrier to SMEs” was adopted in May 2001 and responds, to a large extent, to problems identified by international studies of the SME sector. The Action Plan specifically aims at the simplification of registration and licensing procedures for new SMEs, streamlining the legal framework, reducing and simplifying the tax system, promoting access to finance and access to public contracts, and providing an information system for SMEs.

The measures identified in the Action Plan for the first semester of 2001 have already been implemented – essentially through reactivating a 1999 law that had subsequently been suspended. These include the establishment of a programme for stimulating R&D in the SME sector, training programmes for entrepreneurs, and the establishment of a national consultancy network for SMEs. In order to improve SMEs' access to finance, the government has established a National Credit Guarantee Fund, which can grant low-interest loans to SMEs. A simplified taxation system has been introduced for micro-enterprises. Important tax exemptions are given to SMEs on selected imports, as well as for the re-investment of profits. Reductions on profit tax are given for job creation and for profits generated by exports, although there are concerns that these incentives are incompatible with Romania's WTO and Europe Agreement obligations (*see also chapter 10 – taxation and chapter 26 – external relations*).

A further set of measures aim at improving the **business environment** through the **simplification of registration and licensing procedures**. An Emergency Ordinance issued in May 2001 established a “one-stop-shop”, situated in local Chambers of Commerce, where new companies can be registered and get all necessary operating permits within 20 days (an earlier initiative had only dealt with registration procedures). Progress has also been made by the unification of the two identification codes (the fiscal code and the trade code) into a single code.

The new Government's commitment to promoting the sector was demonstrated by the creation of a new ministry - the Ministry for SMEs and Co-operatives. The Ministry is responsible for elaborating policies to support SME development and for ensuring that SME interests are

²³ Developments concerning SME policy should be seen in relation to the overall enterprise policy, including the industrial policy (*see Chapter 15 - Industrial policy*).

integrated into other policy areas. The Ministry shares responsibility for the implementation of SME support measures with other ministries, public institutions and accredited NGOs.

Overall assessment

The Government has recognised the importance of the sector and, through its Action Plan, has started to address some of the most serious problems facing SMEs. This is a positive development, although the Action Plan should only be considered a first step - it is far from complete, and lacks sufficient detail in several key areas.

While recent initiatives may result in some improvements, the Romanian business environment remains hostile and considerable further efforts are needed. A comprehensive simplification of enterprise licensing remains overdue, as does a clear and binding calendar for streamlining the existing legal framework. There is also considerable scope for reducing the cost and bureaucracy involved in gaining access to the services provided by public utilities (e.g. electricity, water, telephones).

Heavy state controls also place an excessive burden on SME operators. A large number of bodies are authorised to conduct inspections and audits of businesses. Businesses can expect to be investigated several times each year and the wide degree of discretion left to inspectors creates opportunities for corruption. This issue was not raised in the recent SME Action Plan.

The preferential tax treatment of SMEs is a potential concern and the fiscal incentives contained in the SME law will prove difficult to apply – a situation which creates the risk of increased bureaucracy, as well as arbitrary treatment of enterprises. These measures also appear to contravene normal market rules and are potentially incompatible with Romania's international obligations, including the Europe Agreement. Finally, giving such preferential status to SMEs could encourage the fragmentation of larger enterprises.

Since the banking system is typified by high interest rates and heavy collateral procedures, access to investment funds remains a serious constraint on the development of SMEs. Concessional finance schemes for SMEs have been launched, but the funds allocated by government are insufficient to meet financing needs.

The Romanian SME definition is broadly in line with the EC definition.

Setting up a ministry to deal exclusively with SME policy underlines the political importance attached to the sector. However, this initiative will only prove effective if the new Ministry of SMEs and Co-operatives is given sufficient influence over other ministries that also deal with issues related to the SME sector. There is a considerable risk of overlapping responsibilities. A further concern is that funding allocated to the ministry will prove insufficient given the ambitious scope of its mandate. The new ministry may well emerge as a dynamic and effective institution. However, what is most urgently required is a period of institutional stability. There have been three different administrative structures responsible for SME policy in the last 18 months. These constant changes have undermined the possibility of making genuine progress.

Chapter 17: Science and research

In the area of science and research some progress has been made since the last Regular Report.

In January 2001, the Ministry of National Education was reorganised as the Ministry of Education and Research. It took over the responsibilities of the former National Agency for Science, Technology and Innovation, with a view to establishing closer links between higher education and research. So far the reorganisation has taken place at government level but organisation at lower levels (e.g. universities) has not seen any change.

The National Plan for Research, Technological Development and Innovation, which was launched in 1999, has been only partly implemented due to lack of funding. The plan was further updated in June 2001 to cover the period until 2005. The updated plan shifts the focus of Research and Technological Development activities away from supply-oriented and towards demand-oriented actions with the aim of better responding to the needs of economy and society. Co-operation with the enterprise sector has been reinforced.

The state budget expenditure in research and development as percentage of GDP continued to decrease in 2000 and was approximately 0.22%. The state budget for 2001 foresees an increase to 0.25% of GDP.

Romania continued to be fully associated with the Fifth Framework Programme, as well as with the Euratom Framework Programme. As for other candidate countries associated with the Fifth Framework programme, Romania has been granted observer status in CREST (*Comité pour la Recherche Scientifique et Technique*).

Overall assessment

Though the financial and institutional framework for participation in the Fifth Framework Programme is well established, the reinforcement of research-related administration capabilities, as well as the strengthening of research-related infrastructure is necessary to ensure Romania's successful participation.

Romania's contribution to the EC budget for participation in the Fifth Framework Programme is financially significant for a country with limited resources. The results Romania achieved in the participation have improved over the reporting period but they remain less than satisfactory. As a consequence, Romania is currently unable to reap the full benefits from its contribution to the Fifth Framework Programme. Although active information dissemination and assistance activities for the project promoters through the National Contact Point network and regional and institutional networks continued, they need to be further intensified if this situation is to be remedied.

Funding for RTD activities is low compared to many European countries and remains far below the EU average. This lack of funding has prevented the full implementation of the National Plan for Research, Technological Development and Innovation. Efforts are needed to ensure adequate levels of funding for this sector.

The recent reorganisation of research activities at the government level is a welcome development. However, the reinforced co-operation between research centres, universities and enterprises is necessary to ensure successful participation in the framework programme.

Chapter 18: Education and training

Some progress has been made since the last Regular Report.

As regards participation in **Community programmes** in the fields of education, training and youth, the new Association Council decision establishing the financial contribution of Romania to Socrates and Youth for the years 2001 to 2006 was adopted in May 2001, and information activities through the agencies and the network of county school inspectorates were intensified and improved results can be noted (*see section A.b Relations between the European Union and Romania*).

A legal framework for voluntary activities was created in April 2001.

The Government decision adopted in June 2001 represents a significant step towards the transposition of the **Directive concerning education of children of migrant workers**. However, some details still require further clarification.

As regards the reform of the education system, support measures for poor families and for children from rural areas were introduced in order to facilitate school attendance. These include providing free notebooks and schoolbooks in primary and secondary education for children from families with limited income and organising school transport in rural areas. Scholarships for higher education students from rural areas will also be provided. One negative development is that some legislative measures that were noted in the last Regular Report have not been implemented: the overall legislative framework for vocational training of adults has not come into effect and is being modified; legislation on social partnership in vocational education and training was rejected by the Parliament; and legislation on quality management in higher education has been suspended.

Following the governmental reorganisation, education and research activities were merged into a single ministry, the Ministry of Education and Research (*see chapter 17 – Science and Research*).

Romania has a low GDP per capita expenditure on education and there are insufficient resources available to make necessary investments. In 2001 funding of pre-university education was decentralised to local authorities. The transfer of responsibility will be accompanied by budgetary transfers from the state to the county councils. However, it is important that appropriate measures are taken to ensure that the new system does not increase regional disparities in educational standards.

Overall assessment

Participation in relevant Community programmes is satisfactory and national structures are functioning. A regulatory framework for voluntary activities has been established and Romania has advanced towards the full transposition of the Directive concerning education of children of migrant workers. However, some details remain to be clarified.

Absence of a structured vocational training system for adults is a problem in the context of large scale economic restructuring. A coherent system should urgently be established and this will require intensified co-operation between all concerned authorities: education, labour and the social partners.

Adequate level of funding for the education system as a whole should be ensured.

Chapter 19: Telecommunications and information technologies

Progress since the last Regular Report has been limited. The main development in this sector was the abolition in January 2001 of the National Agency for Communications and Informatics and its replacement by the Ministry of Information Technology and Communications. The Ministry of Information Technology and Communications has taken over all the responsibilities of the former Agency, including policy and strategy formulation and regulatory functions.

Concerning the **liberalisation of the telecommunications market**, steps announced last year to introduce competition in the 1800Mhz band for mobile telephony became the subject of a court dispute between two private operators and the incumbent, Romtelecom, which currently has the monopoly on fixed line telephony. In the end, the parties reached an agreement stipulating that the private mobile telephony companies would not use frequencies allocated in the 1800Mhz band before the end of 2002. The date foreseen for the liberalisation of the fixed line telephony market remains the end of 2002. Until that date, the incumbent maintains a monopoly on these services. However, liberalisation has already taken place in other markets, such as cellular mobile telephony, data transmission, and the provision of Internet services, cable television, and satellite networks.

As regards the **regulatory framework**, a law on the processing of personal data and the protection of privacy in the telecommunications sector, transposing the Directive concerning the processing of personal data and the protection of privacy in the telecommunications sector, has been passed. As stated above, the new ministry has taken over the regulatory functions of the former National Agency for Communications and Informatics. It will continue to exercise these functions until the creation of the independent national regulatory authority in the course of 2002.

As regards the **postal services**, no major developments can be reported in the period under review. There is, however, a considerable degree of liberalisation already in the sector, with the following services being open to competition: express mail, insured mail, parcel services and advertising and marketing mail services. Restrictions remain for the moment on regular mail, parcels below 2kg and money order and wire transfers.

Overall assessment

While the overall development in the telecommunications sector has been limited, there has been extensive preparatory work through the identification of key personnel and arranging assistance with the transposition of the *acquis*.

In terms of administrative capacity, only a short time after its creation the Ministry of Information Technology and Communications has given considerable indications of a new impetus in preparing for the liberalisation of the communications and postal markets. In order to achieve the objectives of liberalisation of fixed line telephony by the start of 2003 and postal services by the same date, considerable legislative work remains to be done. Furthermore, administrative weaknesses in the exercise of regulatory functions as regards telecommunications remain. Although these functions are scheduled to be transferred in 2002 to the new National

Regulatory Authority, considerable training will be necessary to ensure adequate administrative capacity in this area for the new body.

As for postal services, a political decision was taken regarding the establishment and type of regulatory authority in the sector, contrasting with the lack of any such decision by former governments. On the other hand, some key departments of the Ministry of Information Technology and Communications still require further strengthening.

Chapter 20: Culture and audio-visual

Romania has made limited progress since the last Regular Report.

In January 2001 the Ministry of Culture and Religious Affairs was given new responsibilities in the field of **audio-visual** policy, including the right of legislative initiative, and the mandate to negotiate international agreements in the film and audio-visual field. This is a positive development. A Directorate for Harmonisation, Media, Audio-visual and Evaluation was set up to assume these responsibilities but its staff remains limited.

No progress can be recorded as regards the audio-visual framework law, which means that no progress in aligning with the Television Without Frontiers directive has been achieved.

Although staffing at the National Audiovisual Council remains the same as last year (138 posts out of an allocation of 144 are occupied), the monitoring and control activities of the Council have increased over the reporting period. However, the capacity of the National Audiovisual Council still needs strengthening in terms of equipment and training. In order to encourage self-regulation in the audio-visual field, the NAC also issued recommendations relating to the respect of human dignity, protection of minors and restricting excessive violence in broadcasts. A decision concerning the right to reply was adopted in April 2001.

A strategy for culture was established in 2000, but results have been limited despite the fact that a number of cultural managers were trained to implement the strategy.

Overall assessment

Adoption of the main legislation related to the audio-visual sector remains pending.

The debate on the new audio-visual framework law, which has been on-going since 1998, proved inconclusive. Following the breakdown in discussions, the Ministry of Culture and Religious Affairs, the Ministry of Communications and Information Technology, and the National Audiovisual Council have been charged with elaborating a completely new law that fully covers all aspects of the *acquis*. The deadline for the adoption of this law has been set for March 2002. In order for this deadline to be respected, it will be important to ensure due co-operation between the various bodies involved in the sector.

Romania has signed but not yet ratified the Council of Europe Convention on Transfrontier Television. Upon ratification Romania will be bound, as well, by the Protocol amending the Convention.

Romania's obligations under the GATS agreement – which are not in line with the obligations that Romania will have to take on under the *acquis* and the obligations that it already has through the implementation of the Europe Agreement - still need to be clarified.

Chapter 21: Regional policy and co-ordination of structural instruments

Some progress has been achieved in preparing for the implementation of structural policies since the last Regular Report.

No further developments can be reported as regards the **territorial organisation**.

Concerning Romania's **institutional structures**, the National Agency for Regional Development was disbanded following the change of government, and the main responsibilities for regional development were moved to the newly created Ministry of Development and Prognosis. Two of the Ministry's five state secretaries are in charge of regional policy: the State Secretary for Investment and Regional Development (responsible for programming and management), and the General Secretary (responsible for payments).

In the field of **financial management and control**, Romania has made some progress. The Ministry of Development and Prognosis has developed its own payment and accounting procedures for financial management and a Payment Directorate Office has been established as a separate function from the General Directorate for Regional development. No developments can be reported concerning preparation for a multi-annual budgeting system.

The **legislative framework** has been amended to reflect these changes. Government decisions of January and April 2001 have defined the Ministry of Development and Prognosis's role as the central body responsible for co-ordinating the national development policy, drawing-up the National Development Plan, managing the National Fund for Regional Development, and managing EC pre-accession funds for social and economic cohesion. The Minister of Development and Prognosis chairs the National Board for Regional Development.

Two Government decisions have been taken concerning the definition of territories with special development problems: one modifies and adapts the criteria for "less favoured areas", and the other establishes eleven industrial restructuring zones as priority areas for EC economic and social cohesion assistance. Three related laws were passed in April and July 2001. The law on local public administration defines new responsibilities for local authorities and gives a co-ordination power to the local representative of the central government (the prefect). The law on the State Budget provides for state co-financing of pre-accession funds.

The National Agency for Employment was designated as the body responsible for the implementation of the European Social Fund. In order to ensure the smooth implementation of future ESF-type programmes, the administrative capacity of this agency needs to be strengthened and co-ordination with the Ministry of Development and Prognosis improved.

Regarding **programming**, the National Development Plan is in the process of being revised.

Administrative capacity improved over the reporting period, mainly through improved training, although significant weaknesses remain. As a new institution, the Ministry of Development and Prognosis experienced delays in filling several key positions, defining responsibilities and organising internal work. Substantial efforts have been made to strengthen the Regional

Development Agencies' administrative capacity - both in terms of staff training and office facilities. This said, insufficient financial resources and inadequate premises remain a problem.

No major developments can be reported with regard to the application of the **partnership principle, monitoring and evaluation and regional statistics**.

Overall assessment

While Romania has developed some structures for the implementation of the Structural Funds many issues still need to be tackled.

Romania has already agreed with EUROSTAT on a national territorial organisation for statistical purposes. The territorial classification consists of 42 *judets* (similar to NUTS 3) and of 8 groupings of *judets*, termed "development regions" (similar to NUTS 2).

There is still a need to clearly define the responsibilities of ministries and all other bodies involved in the preparation of future Structural Funds assistance - both at national level and regional level. Romania needs to ensure that the structures for inter-ministerial co-ordination are efficient and based on a political consensus. In this context, the newly created Ministry of Development and Prognosis needs to be given greater authority.

While new legislation foresees that administrative structures will be put in place at the regional level, these structures' role in programme development and implementation needs to be further clarified. Regional development institutions also need to be strengthened in terms of the recruitment of sufficient numbers of qualified staff and the allocation of sufficient financial resources by local authorities. At the central level, the Payment Directorate is currently understaffed, and better-qualified and better-trained staff are needed in the bodies involved in the programming, management and implementation of Structural and Cohesion Fund assistance.

Concerning the European Social Fund, Romania is slowly developing the necessary structures and operational arrangements to implement the European Social Fund. Substantial efforts are still required to improve both administrative capacity and the mechanism for co-ordinating European Social Fund interventions in the context of the European Employment Strategy and the Social Inclusion Process.

As regards programming, in order to match sectoral and regional approaches inter-ministerial co-ordination needs to be made more effective and comprehensive. Genuine partnership structures at the regional level, including regional/local authorities, the economic and social partners and other relevant organisations need to be established.

With a view to preparing for Structural and Cohesion Funds, substantial progress is needed with the technical preparation of projects (project pipeline).

In the field of financial management and control the newly established internal audit departments need to be strengthened. The training of internal auditors should be a priority. Appropriate systems and procedures for financial management and control should be established in relation to the structure of the managing and paying authorities, in order to fulfil the specific requirements of the Structural Funds regulations.

Significant work is still necessary to ensure compliance with the *acquis* requirements for monitoring and evaluation. Particular priorities are ex-ante evaluation of the National Development Plan and the collection of the relevant statistical information and indicators. The timely availability and effective functioning of a monitoring and evaluation system will be of central importance for the efficient implementation of the Structural Funds.

As regards regional statistics, further efforts are necessary to bring them up to the level required for regional policy planning and programming.

Chapter 22: Environment

Since the last Regular Report, Romania has made progress with ratification of international conventions, elaboration of action plans for alignment, and adoption of some elements of the *acquis*.

With regard to the **integration of the environment with other policies**, no significant progress has been achieved. The Ministry of Water and Environment Protection has experienced difficulties assuming its co-ordination role and the inter-ministerial committee, established two years ago, has not met since the end of 1999.

In the field of **horizontal legislation**, Romania ratified the Convention on environmental impact assessment in trans-boundary contexts (the Espoo Convention). Ratification of the Agreement on the participation in the European Network for Information and Observation is in the final stage. Romania has also ratified the Kyoto Protocol on climate change. While these are positive developments, Romania is still some way from complying with EC requirements in other key areas - in particular with the legislation on environmental impact assessments.

Substantial legislation aiming at transposing the *acquis* on **air quality** has been adopted: an emergency ordinance on air protection was promulgated, guidelines for air polluting emissions inventories were established and a governmental decision on the reduction of the sulphur content of diesel fuel was taken.

On **waste management**, limited progress has been achieved in the legislative field, with three emergency ordinances adopted on waste arrangements, on the management of recycled industrial waste, and on the procurement of metal and non-ferrous waste.

In the field of **water quality**, a National Plan for the prevention of water pollution by nitrates from agriculture has been drawn up and adopted. Romania is also in the process of identifying and selecting areas to be classified as sensitive areas as regards urban wastewater. This process is of great importance given the costs that will be involved in proper implementation. Romania has also adopted a regulation for the organisation and functioning of water basin committees in line with the requirements of the recent water framework directive.

On **nature protection**, in order to transpose the directives on the conservation of natural habitats, of wild fauna and flora, and on the conservation of wild birds, an emergency ordinance has been adopted and published. In addition, an Order of the Ministry now establishes the permitting procedures for the harvest, capture, purchase and commercialisation of wild flora and fauna. Efforts are needed to prepare for the NATURA 2000 network.

As regards **industrial pollution control and risk management**, no progress has been made, only an inventory of the enterprises that will be concerned by this legislation is under

preparation. The importance of legislation in this area is demonstrated by the numerous industrial pollution accidents that occurred during the reference period.

With regard to **chemicals and genetically modified organisms**, an emergency ordinance on classification, labelling, packing, and packaging of hazardous chemical substances has been adopted. Romania also adopted the provisions of several Amendments to the Montreal Protocol on substances that deplete the ozone layer.

As far as **noise** is concerned, only a Government Decision intended to transpose the Directive on airborne noise emitted by households appliances has been adopted.

No progress has been recorded in the field of **radiation protection**, (*see also chapter 14 – Energy*), where the level of alignment is quite limited.

As regards *administrative capacity*, the Ministry of Water and Environmental Protection is responsible for drawing up of environmental policy. The Ministry has been reorganised once again but there has been no improvement at the level of staffing, who still number 170. Implementation of environmental policy lies with the 42 local authorities (counties). Since the last report, the Environmental Protection Inspectorates in the counties have had their staff cut by over 20% (there are now 1680 employees working for the Environmental Protection Inspectorates plus around 200 additional staff in the environmental radioactivity surveillance network).

The budget allocated for environment has been slightly increased, but remains extremely low: it reached around €73 million in 2001, which represents less than 0.4% of GDP (the average figure for EU Member States is approximately 1.5%).

Overall assessment

Romania still has a long way to go before being in line with the *acquis* in the field of environment policy: the overall level of transposition and implementation of the environmental *acquis* still remains low. Whereas transposition has advanced, the development of the administrative capacity in 2001 has led to increased uncertainty about Romania's enforcement capacities in this sector.

On the one hand, the determination exists in the Ministry of Water and Environment to harmonise Romanian practices with the environmental *acquis*. In this respect, progress has been achieved and several pieces of legislation transposing the *acquis* were adopted in 2001, or are now before Parliament for final approval. The top priorities for the next year should be the transposition of legislation on environmental impact assessment and industrial pollution control and risk management. Particular emphasis needs to be put on the development of implementation plans, including financing strategies and institutional strengthening.

On the other hand, there have been no improvements in creating the administrative capacity to enforce the newly adopted legislation. Furthermore, the resources allocated to environment in Romania are insufficient to address the environmental problems the country faces. The situation is made worse by the fact that domestic institutions have a relatively short experience in the field of environmental protection, especially as regards transposition of legislation and application of economic instruments.

At the local level, the staff allocations for policy implementation have been reduced and the self-financing mechanism set up last year has only generated one quarter of the expected revenues. Co-ordination at regional level is non-existent. At the national level, the budget devoted to

environmental protection is insufficient, and the Environmental Fund is unlikely to be operational in the short term.

Romania should make the environment one of its priorities for accession and considerable investments need to be secured, also in the medium-term, to ensure implementation of the environmental *acquis*.

Chapter 23: Consumers and health protection

In the field of consumer protection, the intensive legislative work noted in the last Regular Report has continued.

On **safety related measures**, no new measures can be recorded. As regards **non-safety related measures**, modalities regarding price indication were established and a law on unfair contract terms was adopted. In terms of **administrative structures**, the National Authority for Consumer Protection (NACP) replaced the Office for Consumer Protection. This reorganisation has resulted in the number of posts being cut from 770 (of which 668 were filled at that time) to 600. Currently still 612 posts are filled. A five-year strategy for the NACP was adopted in June 2001.

The National Authority for Consumer Protection has the right of initiative in consumer protection and co-ordinates Government policy in the field. As regards **market surveillance** it has the right to impose sanctions, which can take the form of fines, definite or temporary prohibition of marketing of the product or service or imposing withdrawal from the market and it actively exercises this right. However, the authority cannot order refunds or compensation, since it only acts as an administrative body.

The National Authority for Consumer Protection functions as the contact point for TRAPEX (Transitional Rapid Exchange of Information System). Under TRAPEX, 22 notifications of dangerous products on the Romanian market were received between January and August 2001.

During the period between September 2000 and August 2001, 9 371 out of the 17 205 consumer complaints received by the authority were judged admissible. Consumer associations submitted 398 complaints.

The National Authority for Consumer Protection actively provides consumer and legal advice. A web-site has been established and complaints can now be submitted online.

Consultative Councils of consumers at county and local level are functioning, but the Inter-Ministerial Committee for Markets, Products and Services Surveillance, which was established in 2000, has only met once and its functioning has recently been reviewed. As a result of the review, the consumer organisations are no longer represented as formal members of the Committee. This can be considered a negative development, especially as one of main objectives of the Committee is co-operation with the civil society. Co-operation with other bodies involved in consumer protection issues could be further strengthened, as well.

There are 127 consumer associations in Romania, organised into 16 federations and one confederation. These have the right to be consulted on legal acts and receive some funding from the state budget. However, the extent to which active consultations are carried out remains

unclear. The degree to which some of these organisations are genuinely representatives of consumer interests should also be examined.

Overall assessment

Romania has successfully managed an ambitious legislative agenda in the field of consumer protection over a relatively short time period. However, adjustments are still necessary in order to align fully with the *acquis* and in some areas the *acquis* have not yet been transposed (consumer credits, time-share, injunctions, sales of consumer goods and associated guarantees) or is only partly transposed (product liability). As regards legislation that was recorded in last year's Regular Report, the law on advertising is partially in line with the *acquis*. While addressing these gaps, Romania should also place particular emphasis on the implementation of existing legislation.

The adoption of the five-year strategy for the National Authority for Consumer Protection represents progress, although concrete measures to implement it have still to be established. Recent staff cuts may have an impact on the well-established control and monitoring activities, which are crucial for the implementation of activities in the field of consumer protection.

Romania should pay further attention to clarifying the roles of different bodies involved in consumer protection and enhancing co-operation between them. This will be necessary in order to establish a clear market surveillance mechanism and to avoid overlapping activities. The support for and concrete involvement of consumer organisations in decision-making, as well as full enforcement of consumers' rights, should be ensured.

Chapter 24 - Co-operation in the field of Justice and home affairs

Since the 2000 Regular Report, significant progress has been made in Romania in the fields of visa policy, border control and migration. However only limited progress can be reported on police co-operation and the fight against fraud and corruption.

Romania has not yet adopted legislation on **Data Protection**.

As far as **visa policy** is concerned, the conditions and criteria for obtaining visas have been specified in methodological norms implementing the new Law on Aliens and in common instructions agreed by the Ministry of Foreign Affairs, the Ministry of Interior and the Ministry of Labour. The new Law on Aliens and the provisions on visas were adopted in April 2001. Particularly strict conditions are applied to citizens of 86 countries with high migratory tendencies. Since 1 January 2001, visas can, as a rule, only be obtained from Romanian diplomatic missions and consular offices. They are only issued at border posts in exceptional cases. Since 1 July 2001, Moldovan citizens have needed to have a passport to enter Romania.

All visa applications are sent from the diplomatic or consular missions to the National Visa Centre, which takes the final decision on the issuing of a visa. The applications from nationals of countries with high migration tendencies are also sent, for a further check, to the Directorate for Aliens and Migration Issues of the Ministry of Interior. A new Schengen-compatible type of visa application form has been introduced.

Significant progress has been made in alignment with, and implementation of, the *acquis* in the field of control of **external borders**. Two emergency ordinances were adopted in June 2001, one on the Romanian State Border and another on the organisation and functioning of the Border Police. The former contains general provisions on the border regime and aligns Romanian legislation in the field of border control with similar legislation in EU Member States. The ordinance on the Border Police establishes a new organisational structure and sets up the framework for co-operation between the Border Police and other agencies. It also contains provisions on the competences of the individual border policemen.

A Government Decision was adopted in April 2001 on the exchange of existing passports for a new type of passport with additional security features.

As regards administrative capacity, a new organisational structure was introduced in June 2001. The hierarchical structure has been simplified and one regional level of command has been abolished. The number of Regional Directorates has been decreased to one for each land border and one for the Black Sea. Significant numbers of personnel have been reassigned from administrative to operational tasks. The professionalisation of the border police, i.e. the progressive replacement of conscripts with professional staff, has continued. The newly recruited sergeants get initial training for a period of three months at regional Border Police training centres.

Several measures have been taken to fight corruption amongst the Border Police. Following the entry into force of the new law on fighting corruption (May 2000), a specialised service, the General Internal Protection Directorate, was set up within the Ministry of Interior. This new structure, which became operational in January 2001, is one of the results of a recently developed anti-corruption strategy for the Ministry of Interior and its subordinate bodies. One of the tasks of this new structure is to carry out preventive and *ad hoc* inspections of Border Police structures.

In February 2001 a co-operation protocol was signed between the Border Police and the National Office for Refugees with the purpose of carrying out joint controls at airports. The controls focus on transit travellers coming from high-risk migration destinations.

To make controls of travel documents and visas more effective, a co-operation protocol was signed in May 2001 between the General Inspectorate of Border Police and the national airline (TAROM). The protocol provides for special training programmes on the detection of false or forged documents for airline staff.

Training activities have been carried out as regards preparations for the **Schengen** Agreement. Otherwise there have been no significant developments in this area.

As regards **migration**, a new Aliens Law entered into force in May 2001, establishing the conditions for entry and stay in Romania as well as the regime for expulsions. As indicated, the Government also adopted the 'methodological norms' to implement the above-mentioned law. These norms contain detailed provisions specifying the procedures for applying the law as regards checking of documents, issuing visas, granting residence rights and expelling aliens.

Recently adopted legislation has also tightened the conditions for obtaining work permits in Romania. A necessary pre-condition is the possession of a work visa (i.e. persons having a student visa are therefore no longer allowed to obtain a work permit).

The Government has signed an agreement with the International Organisation for Migration, to establish a centre offering temporary protection for women victims of trafficking as well as managing programmes supporting their reintegration into society.

In 1998, 2,830 foreigners were expelled for not complying with the conditions of entry and stay in Romania. This number increased in 1999 to 3,431 aliens, but then decreased to 2,498 in 2000.

As regards **asylum**, the Refugee law of 1996 was amended through a government ordinance in August 2000. In June 2001, Parliament definitively approved this ordinance after certain changes had been made. The amended law introduces new concepts in Romanian legislation on asylum in order to align it with the *acquis*, such as 'manifestly unfounded applications', 'safe third country', 'country of origin', and 'accelerated procedures'. 'Non-refoulement' is, in principle, guaranteed. The body responsible for dealing with asylum applications is the National Office for Refugees, whose decisions can be appealed against before a court of law. However, when Parliament adopted the government ordinance it eliminated the right to a second appeal in cases of accelerated procedures.

Following the new legislation, measures have been developed to ensure minimum standards of reception for all asylum seekers during the whole procedure. As far as recognised refugees are concerned, they have a right to nine months of public financial support. Additional support is provided for particular categories of refugees, such as unaccompanied minors, elderly people, and single women with children. Refugees basically enjoy the same rights as Romanian citizens, including the right to work. The National Office for Refugees has a modern accommodation centre for asylum seekers located in Bucharest with a capacity of 250 places. However, due to lack of resources, accommodation centres for asylum-seekers are not fully equipped and have a shortage of staff.

According to the Romanian authorities, the number of people applying for asylum in Romania decreased from 1,667 in 1999 to 1,366 in 2000. Asylum seekers in Romania come mainly from Afghanistan, Bangladesh, India, Iran, Iraq and Pakistan. Most of the applicants (95%) apply for asylum as soon as they enter the country.

In the field of **police co-operation and the fight against organised crime**, the structures dealing with organised crime within the General Inspectorate of the Police have been reorganised and the Directorate for Combating Organised Crime has become a General Directorate for Combating Organised Crime and for Anti-drugs. The process of bringing the police under civilian control has continued and the police have received training courses on the respect of human rights. Police numbers at central level have been reduced and these posts have been transferred to operational levels (*see Section B. 1.1, Democracy and the rule of law*).

As far as the **fight against fraud and corruption** is concerned, a section for anti-corruption and related organised crime at the General Prosecutor's Office was established in October 2000 (*see section B.1.1. - Democracy and the rule of law*).

In the field of **drugs**, after the adoption of the law on the fight against trafficking and illicit consumption of drugs, no further important legislation has been adopted. However, in December 2000 secondary legislation for enforcement of the aforementioned law was adopted.

An Anti-drug Squad was established in March 2001 within the General Inspectorate of the Police. After a peak in 1998, drugs seizures decreased significantly during 1999 and 2000.

The current legislation on **money laundering**, has been supplemented with new legal acts (*see also Chapter 4 - Free movement of capital*). The Penal Code and Penal Procedure Code have been amended and the responsibility for judging crimes relating to money laundering has been passed to the tribunals (the second level of jurisdiction in the Romanian court system). The National Office for Preventing and Fighting Money Laundering Operations has carried out training sessions for its own staff and the personnel of the reporting entities.

In 2000, the National Office for Preventing and Fighting Money Laundering Operations sent 130 reports to the General Prosecutor's Office. Investigations have been started in 87 cases and 3 cases have been sent to court for trial. Eight seizure orders have been issued in money laundering investigations on related properties to a value of €2.5 million. Although the National Office for Preventing and Fighting Money Laundering Operations is functioning well, the criminal investigations and court proceedings in money laundering cases have not yet led to any convictions.

As regards **customs co-operation**, no mutual assistance agreements have been signed since the last report. An Anti-fraud Service was established in January 2001 in the Directorate for Customs Surveillance and Fighting Customs fraud within the General Customs Directorate.

On **judicial co-operation**, no major conventions have been ratified since the last Regular Report. A Ministerial Order of November 2000 established the legal framework for a network of judges to function as local correspondents in the field of international judicial assistance.

Overall assessment

While important legislation has been adopted recently, in particular on border control and on the aliens regime, much remains to be done on legal approximation and strengthening administrative capacity. Particular attention should be paid to speeding up the reform of the national police and the recent anti-corruption law should be followed up by measures to strengthen the capacity to enforce the legislation.

Legislation on personal **data protection**, data protection and privacy in the telecommunications sector, and on the ratification of the European convention on Data Protection, is pending in Parliament. It is envisaged that the Romanian Ombudsman will be the implementing and supervisory body, although it is questionable whether the modest budget allocations will allow the ombudsman to successfully carry out this additional responsibility.

Romania has also made significant progress in aligning its **visa policy** with that of the European Union. There are 156 countries whose citizens need a visa to enter Romania, while nationals of 35 countries, including the EU Member States, are exempted from the visa requirement. Further alignment with the EU visa policy should continue, in particular with regard to the introduction of visa obligations for countries with high migration potential.

In order to improve identity checks and detect attempts to misuse visas, a Schengen-type visa sticker will need to be developed and Romania should also rapidly implement the upgrading of existing passports. As regards **external borders**, the reorganisation and modernisation of the

Romanian Border Police is ongoing and is yielding its first results in terms of improved efficiency and practices. However, inter-agency co-operation between border management agencies should be further improved and efforts to combat corruption increased.

The Border Police currently has 23,000 staff made up of both professionals and conscripts. The ongoing replacement of conscripts with contract staff is to be completed by the end of 2002. Plans to reform the training programmes for different categories of border police staff still need to be implemented.

Considerable investments have been made in surveillance equipment and further investments are foreseen. Border posts still need to develop an on-line connection to the central database on immigration.

Romania should start the preparations for participation in the **Schengen** area and develop a Schengen Action Plan.

Romania has concluded readmission agreements with all Member States except the United Kingdom and Portugal. These agreements are all in force, except the agreements with Finland and Ireland, which have been signed but not yet ratified. In addition, 6 readmission agreements with candidate countries (Poland, Slovakia, the Czech Republic, Slovenia, Hungary and Bulgaria) are in force. There are also agreements with Switzerland, India, Croatia and Moldova. The Romanian Government has re-negotiated the readmission agreements with Sweden, Slovenia and Hungary in order to update and align them with the relevant EU recommendations and standards. For the same purpose the agreement with Austria is in the process of negotiation.

The amended Refugee Law has considerably improved the alignment of the **asylum** legislation. However the provisions on detention of rejected asylum seekers need to be further clarified. Romania also needs to develop country-of-origin information and there is still scope for improving accommodation conditions for asylum-seekers.

In the field of **police co-operation and the fight against organised crime** new legislation on Police Organisation and Operation and on the Statute of Policemen were approved by the Government and are pending in Parliament. This legislation will form the legal basis for the demilitarisation of the police, which will be essential in order to increase the democratic control and the accountability of the police forces. Discussions with EUROPOL for concluding a co-operation agreement have not yet started. A prerequisite for the negotiations is the adoption of a data protection law.

Very limited progress has been made with the **fight against fraud and corruption**. Far greater efforts are needed to create an efficient implementing capacity and to improve inter-institutional co-operation in this area.

In order to ensure the protection of the financial interests of the European Communities Romanian should, as a matter of priority, align its legislation with the 1995 Convention on the Protection of the Financial Interests of the European Communities and its protocols.

The Romanian authorities have applied for full membership of the OECD Working Group for Combating Corruption in International Commercial Transactions. The council of Europe Civil and Criminal Law Conventions on Corruption remain to be ratified.

Romania is a party to all international conventions listed under the *acquis* in the field of **drugs**, with the exception of the 1995 Agreement on Illicit Traffic by Sea. The national drug strategy should be further developed to cover both drug demand and drug supply reduction. The Inter-ministerial Committee for Fighting Drugs should be made fully operational. The capacity of the law-enforcement agencies, especially the police and customs, should be increased. Further efforts are required to improve the collection and availability of information on drug-related issues. The creation of the National Drug Information Focal Point, in accordance with EMCDDA (European Monitoring Centre for Drugs and Drug Addiction) requirements, should be completed.

As regards **money laundering**, Romanian legislation is, to a great extent, already aligned with the *acquis*, although the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of Proceeds of Crime still has to be ratified. Sufficient financial means and training should be given to the National Office for Preventing and Fighting Money Laundering Operations. The capacity of the Office to co-operate with other law-enforcement agencies should be strengthened, in particular with the police and prosecutors. Specialised training should be organised for police officers and prosecutors dealing with money laundering issues.

Romania has made progress on **customs co-operation** by setting up the Anti-Fraud Service within the General Customs Directorate. Inter-agency co-operation needs to be improved and mutual assistance agreements signed. Areas where good progress has been made are the development of risk analysis and the development of a national computerised database in line with CIS standards. However, other methods for fighting fraud and corruption should still be developed, including the introduction of mobile surveillance units, the development of customs laboratories and the attribution of powers to customs personnel to carry out controls and enforce compliance.

As far as **judicial co-operation** is concerned, Romania has ratified most of the international conventions included in the *acquis*. The following conventions need still to be ratified: the Hague Convention of 1965 on Service of Documents; the Hague Convention of 1970 on the taking of Evidence Abroad; the Hague Convention of 1980 on International Access to Justice; the European Convention on Recognition and Enforcement of Decisions Concerning Custody of Children.. Further efforts will be required in order to ensure the appropriate level of co-operation in civil matters, notably as regards mutual recognition and enforcement of judicial decisions, and direct court-to-court dealings in cross-border situations.

All the **human rights** legal instruments covered by the Justice and Home Affairs *acquis* have been ratified by Romania, with the exception of the 1981 Council of Europe Convention on the protection of individuals with regard to automatic processing of personal data. Legislation for its ratification is pending in Parliament.

Chapter 25: Customs union

Good progress has been made by Romania in the field of customs since the last Regular report.

As regards alignment between the Romanian legislation and the **EC Customs Code and its implementing provisions**, further progress has been achieved in areas including simplified procedures, inward processing, duty relief, customs value, counterfeit and pirated goods, and transit.

Regarding the **customs *acquis* outside the Customs Code**, legislation was passed in October 2000 harmonising Romanian laws on the protection of cultural goods with those of the EC. In November 2000, legislation on protection of intellectual property rights was also harmonised. In December 2000, the printed form of the Romanian Customs Integrated Tariff (TARIR) was finalised. This document uses the same principles of codification and integration as the EC Integrated Tariff (TARIC).

Progress has also been made in improving the **administrative and operational capacity** to implement the *acquis*. The ASYCUDA system (a computerised customs system) is operational and currently processes 98% of all customs declarations. The Integrated Customs Information System (ICIS) has been designed, developed and implemented taking into account interconnectivity with EC IT systems. The opening of the National School of Public Finance in October 2000 represented an important step towards upgrading the training of customs officials.

At the beginning of 2001, the Romanian customs administration was reformed. The new structure includes an Internal Control and Audit Division in charge of ensuring the regularity of customs operations and detecting fraud. Considerable efforts have been made to introduce IT-based systems for risk analysis. A Risk Analysis Office has been set up and specialist staff have been appointed to carry out risk analysis both at central and regional levels. Co-operation protocols have been concluded with other agencies with border-related competencies such as the border police, the national police and the financial guard. The reform also introduced a new system for appeals against administrative decisions in customs matters.

Considerable efforts have been made in order to secure the Northern and Eastern borders. Substantial investments have been made in upgrading border infrastructure and in purchasing equipment for customs enforcement and control. A drug-testing laboratory has been set up within the General Customs Directorate. For the control of other kind of goods, the customs administration has concluded agreements with external laboratories.

Overall assessment

Although Romania has adapted large parts of its legislation to the customs *acquis*, efforts are still needed, in particular with regard to rules of origin and the status of free zones. Further harmonisation is also needed in the cases of simplified procedures, end use provisions, and precursors.

Romania should continue its efforts to tackle the problem of waiting times at borders, step up the fight against customs fraud, and further improve co-operation with other enforcement bodies.

Romania is a signatory to the major international customs agreements and is an observer in working groups of the Common Transit System. Free Trade Agreements with Latvia and Estonia still need to be finalised; this is important in order to allow the full integration of Romania into the pan-European system of origin cumulation.

As regards administrative and operational capacity to implement the *acquis*, Romania should increase its efforts to combat corruption within the customs administration. Border management should be improved and customs laboratories established. With regard to IT development, it

must be emphasised that flawlessly functioning EC-compatible IT systems should be in place at least one year before EU accession in order to allow a sufficient period of time for the test requirements and to guarantee interconnectivity with the EC customs computerised systems.

Chapter 26: External relations

Romania has continued to align itself with the *acquis*, in most cases, and to co-ordinate positions and policies within the World Trade Organisation with those of the EU, in particular with regard to the preparation of the New Round. However, several new trade measures have represented a move away from EC practices.

As regards the **common commercial policy**, Romania will be required to align its tariffs with those of the EC upon accession. Romania's applied tariffs currently average 19.4% on all products, 33.2% on agricultural products, 21.4% on fishery products and 15.6% on industrial products. By comparison the EC tariffs²⁴ currently stand at 6.3% on all products, 16.2% on agricultural products, 12.4% on fishery products and 3.6% on industrial products.

Over the reporting period, Romania has increasingly resorted to trade policies that are incompatible with its international obligations. In response to pressure from domestic producers, Romania introduced export restrictions on strategic raw materials (logs, sunflower seeds and scrap metal – although in the case of sunflower seeds the restrictions have not been implemented). This is not only a move away from the *acquis* in the field of commercial policy but potentially violates Romania's obligations under both the Europe Agreement and the WTO. Romania should also honour its commitments under the WTO Agreement on Subsidies and Countervailing Measures and abolish the export subsidies it currently maintains in the form of reduced taxation on profits from exports (*see chapter 10 - Taxation*).

As regards **bilateral agreements with third countries**, Romania has finalised negotiations for a FTA with Lithuania and has started negotiations with Croatia. Romania's FTA with Israel entered into force in July 2001. Within CEFTA, the member countries, including Romania, signed Additional Protocol No. 8 on the updated version of the Pan-European cumulation of origin of goods (*see chapter 25 – Customs Union*).

In January 2001 the responsibility for commercial policy was transferred from the Ministry of Industry to the Ministry of Foreign Affairs (the Department for Foreign Trade and Economic Promotion). This reorganisation resulted in a reduction of staff dealing with trade policy as well as a reduction in the number of commercial counsellors in Romania's diplomatic missions. The Department for Foreign Trade has exclusive powers in certain policy areas (e.g., trade defence instruments), a co-ordination role in other areas (e.g. international trade negotiations), and an overall responsibility for ensuring that legislation drawn up by other government departments compatible with Romania's overall trade policy.

As regards **development policy and humanitarian aid**, Romania has neither institutions nor a policy framework for managing external assistance. Romania has, however, consistently provided emergency assistance following natural disasters in other countries.

²⁴ WTO bound tariffs after full implementation of all concessions including - where possible - estimated *ad valorem* equivalents of specific and compound tariffs.

Overall assessment

Where alignment with the Community *acquis* on commercial policy is necessary - for example concerning rules of origin and dual-use goods – Romania is advanced. . However, breaches of the Europe Agreement and WTO commitments are a serious cause of concern.

The EC and Romania have established a framework for co-operation regarding WTO issues both at ministerial and at departmental level. Romania has been supportive of EC policies and positions within the WTO framework. As regards the New Round, Romania concurs with the EC on the need to launch a comprehensive trade round as soon as possible and shares the view that the results of work under the built-in-agenda would be less substantial in its absence.

Romania is a signatory to the WTO plurilateral agreements on Civil Aircraft and Information Technology. By the time of accession Romania will need to have joined the WTO plurilateral agreements on Government Procurement. Further co-operation is also needed to ensure alignment of Romania's GATS commitments with EC commitments and MFN exemptions.

As regards the WTO Agreement on Trade in Textiles and Clothing (ATC), Romania needs to use the third stage of integration under the ATC to align its integration programmes with those of the EC, while avoiding the integration of products not yet integrated by the EC.

Romania lacks enforceable legislation on trade defence instruments (anti-dumping, anti-subsidy, and safeguards) and has no provisions relating to the application of an "injury test" as part of anti-dumping and countervailing investigations. The result of this legal vacuum is that Romania has not made use of trade defence instruments as a part of its commercial policy. While not a problem in itself, there is a risk that, in the absence of conventional control mechanisms, otherwise legitimate requests for protection by Romanian producers will be met through other instruments - such as non-tariff barriers.

Romania is a member of CEFTA and has concluded FTAs with the Republic of Moldova, Israel, Turkey and EFTA. Any international agreement which is incompatible with the obligations of membership will have to be re-negotiated or renounced prior to accession. Romania should continue to keep the Union fully informed about existing trade agreements or negotiations aimed at the conclusion of any new trade agreements with a third country. This also applies to Bilateral Investment Treaties concluded with third countries.

With regard to medium and long-term export credits, further alignment with the *acquis* is necessary.

Despite significant staff cuts the Ministry of Foreign Affairs has sufficient personnel to manage Romania's commercial policy.

In principle, the transfer of responsibility for commercial policy to the Ministry of Foreign Affairs should have had the benefit of distancing trade policy from vested domestic interests. However, this has not happened and there have been several instances of trade measures that are incompatible with Romania's international commitments being adopted without properly consulting the responsible ministry. In order to prevent a repeat of these problems, the trade department of the Ministry of Foreign Affairs urgently needs to improve its control over the formulation of its trade policy. Development and humanitarian aid are also administered by the Ministry of Foreign Affairs. Romania's future contribution to the European Development Fund

will rely upon effective management of the national budget organisation and management of the flow of funds to the EC budget. These issues are addressed under *Chapter 29 – Financial and budgetary provisions*.

The administrative infrastructure concerning customs services is addressed under *Chapter 25 - Customs union*.

Chapter 27: Common foreign and security policy

Over the reporting period Romania has continued to align its foreign policy with that of the European Union and has participated constructively in the framework of the Common Foreign and Security Policy (CFSP).

The regular **political dialogue** established by the Association Agreement with Romania is proceeding smoothly and Romanian participation in the CFSP has included meetings at the level of Political Directors, European Correspondents and Working Groups.

Romania has shown a keen interest in continuing the political dialogue with the EU including European Security and Defence Policy (ESDP) developments. It has actively participated in the exchanges in this context with the EU and, for ESDP, in the EU+15 format meetings (i.e. with non-EU European NATO members and candidates for accession to the EU). Romania played an active role in the first Capabilities Commitment Conference in November 2000 and, in March 2001, held bilateral consultations with the EU on its participation in ESDP missions. It has pledged forces to EU Rapid Intervention Force missions from 2003 (including two battalions of ground troops, three specialised companies, and four ships).

Since the last Regular Report, Romania has responded positively to all invitations of association with EU **joint declarations and demarches**. Since October 2000, Romania has associated itself with 8 EU common positions, including 3 on the Federal Republic of Yugoslavia. Romania has also implemented those joint actions which it was invited to join and has aligned itself with the Union's decisions on **international sanctions and restrictive measures** and has implemented negative measures in accordance with those adopted by the EU.

Romania has been Chair-in-Office of the OSCE in 2001. This important responsibility was successfully carried out by the Ministry of Foreign Affairs and during its chairmanship Romania co-operated effectively with the EU institutions.

Romania's relations with neighbouring countries have been mixed. High level visits confirmed a spirit of co-operation between Romania and the new Bulgarian government and Romania participated in the trilateral summit with Bulgaria and Turkey in February 2001. Diplomatic relations were resumed with Yugoslavia following an official visit from the Yugoslav President. Romania established the Euro-Regio "Upper Prut" together with Ukraine and the Republic of Moldova. However, border demarcation negotiations with Ukraine have proved controversial due to the Ukrainian decision to authorise oil and gas exploration in one of the areas covered by the negotiations. Relations with Hungary have encountered difficulties concerning Hungarian legislation granting preferential status to ethnic Hungarians living in selected third counties (including Romania).

The Ministry of Foreign Affairs was restructured after the new Government took office and alignment with the CFSP is managed within its Department for Multilateral Affairs.

In the field of arms exports control, the National Agency for the Control of Strategic Exports and the Prohibition of Chemical Weapons (ANCESIAC) was established as a body within the Ministry of Foreign Affairs. This measure is aimed at improving the implementation of existing export controls. In a separate development, the Ottawa Convention on landmines was ratified in November 2000 and entered into force in May 2001.

Overall assessment

Romania has demonstrated a good track record in the Common Foreign and Security Policy and there have been no problems regarding Romania's alignment with the CFSP *acquis*.

Romania has subscribed to the EU Code of Conduct on Arms Exports and continues to respect and implement those aspects of the Code that are applicable to candidate countries.

On the regional level Romania has maintained an active role in the Stability Pact. Romania has also made considerable efforts to support international peacekeeping missions and has participated in KFOR and a series of UN, OSCE and WEU (MAPE) peacekeeping and observer operations. The Romanian contribution includes 6 military personnel in KFOR, 62 military and 49 support staff in the Dutch Unit in SFOR, and 70 police officers in UNMIK (Kosovo).

The successful management of the OSCE Presidency provides a clear demonstration of Romania's capacity to assume an international leadership role in the field of foreign affairs. Romania has a well-staffed and functioning Ministry of Foreign Affairs that has sufficient administrative capacity to implement the provisions relating to CFSP. The effectiveness of the ministry was demonstrated by its efficient chairmanship of the OSCE. The Ministry is connected to the Associated Correspondents' Network information system through which the EU communicates within the CFSP with the associated partners.

Chapter 28: Financial control

Romania has made some progress in this area during the period covered by the Regular Report.

As regards **Public Internal Financial Control**, the Ministry of Public Finance further developed the ex-ante financial control function during the reporting period, through legislative acts defining the methodology for both own and delegated ex-ante control. No particular development can be reported in the area of internal audit.

The Romanian Court of Accounts is the institution responsible for **external audit**, reporting to Parliament on the financial management and control of public funds exercised by government. The Court has begun to prioritise the development of systems-based and performance-audit methodologies. The staffing levels of the Court have been considerably reduced.

With regard to preparation for **control of structural action expenditure**, some progress has been made in the creation of structures for the control and audit of SAPARD funds but substantial efforts are needed in order to meet the requirements for the accreditation of the

SAPARD Paying Agency and the National Fund. An Order of the Minister of Finance has been issued concerning the organisation of delegated preventive financial control for ISPA funds. No specific progress can be reported concerning audit of ISPA and Phare funds and preparations for extended decentralisation in the management of these programmes.

No progress can be reported either in the field of the protection of **EC financial interests**.

Overall assessment

Further substantial efforts are required in order to complete the policy framework for public internal financial control and to adopt new legislation in line with EC requirements, focusing in particular on internal audit. Romania needs to establish functionally independent internal audit units in the budget spending centres, with a focus on systems-based and performance audit methodology.

The Policy Paper on Public Internal Financial Control (PIFC) has not yet been finalised, whereas the administrative capacity for Public Internal Financial Control remains insufficient, both in terms of numbers of staff and level of training. Difficulties have been experienced in attracting competent new personnel.

The co-ordinating functions of the Ministry of Public Finance as regards harmonisation of the methodology for financial management and control, as well as for internal audit, should be defined. A coherent programme of recruitment and staff development for financial control and internal audit functions in all spending centres should be developed. Romania should make further efforts as regards the implementation of legislation on public procurement, including ex-ante control of commitments, tender and contracting procedures, as well as disbursements and recovery of unduly paid sums.

The availability of the staff necessary for the Romanian Court of Accounts to fulfil its mandate, and to develop its capacity to implement modern audit methods, should be ensured. The Court of Accounts should continue its efforts to prioritise the development of modern audit methodologies. Parliament should put in place follow-up procedures relating to the audit findings and recommendations of the Romanian Court of Accounts.

With regard to the control of structural action expenditure, efforts need to be made in order to enhance Romania's capacity for the management of pre-accession funding and future structural funds. Clear rules and procedures for public internal financial control should be established and administrative capacity should be substantially reinforced. The development of mechanisms for the recovery of lost funds is equally important.

With a view to ensuring suitable protection of EC financial interests, Romania needs to adopt legislation allowing the competent EC bodies to carry out on-the-spot checks. It should also develop the adequate administrative capacity to implement the acquis, including the ability of the Romanian law enforcement bodies and judiciary to address cases where EC financial interests are at stake. Romania should designate, in consultation with OLAF, an institution or administrative structure capable of co-ordinating investigations into cases of fraud and irregularities affecting the Communities' financial interests and of acting as a single contact point in relations with OLAF.

Chapter 29: Financial and budgetary provisions

Romania has made some progress over the reporting period, in particular as regards strengthening **national budget** procedures and ensuring **co-financing of EC financial instruments**.

Efforts were made in the context of the preparation of the State Budget Law for 2001 to move towards a programme-based approach to budgeting based on national and sectoral priorities in a multi-annual macroeconomic framework. The number of ministries and government agencies using a programme-based budget approach has been increased. The State Budget Law for 2001 ensures the co-financing of projects and programmes supported by EC pre-accession financial instruments.

The national budget for 2002 was submitted to Parliament by early October 2001.

There has been some progress during the past year in the development of the capacities for medium-term economic forecasting and the preparation of a medium-term budget strategy. There has also been considerable progress in absorbing special funds into the state budget.

As regards **Own Resources and administrative infrastructure**, and more specifically control measures relating to own resources, Romania's customs and tax administrations are in the process of carrying out reforms in order to enhance their operational and administrative capacity. These reforms involve the completion of the computerisation process, the strengthening of human resources, and the improvement of internal organisation. This is also important in the context of control relating to own resources with a view to ensuring the protection of EC financial interests.

Overall assessment

Continued efforts are needed to ensure that budgetary principles and rules are brought into line with the standards generally applicable in the Community. Preparation of a new Law on Public Finance should contribute to this process.

Submission of the national budget for 2002 to Parliament by early October 2001 represented an improvement in performance in comparison with previous years.

Legislation to strengthen the role of the Ministry of Finance's co-ordination of line ministries when preparing budget proposals should be adopted. Procedures for multi-annual budgeting should be put in place, and the inclusion of multi-annual co-financing in the national or local budgets should be ensured.

Links between the National Plan for Adoption of the Acquis and the budgetary process should be developed. Capacity should be developed to assess the cost-effectiveness of proposed budgetary expenditure in fulfilling national and sectoral policy objectives. In parallel, on-going work on improving macro-economic forecasting and drawing up a medium-term budget strategy should be continued. The work in progress for defining and implementing the operating procedures for the management of EC pre-accession funds, through the National Fund, should be continued and improved.

In the interest of transparency and efficiency the number of extra-budgetary funds should be further reduced.

The procedures for selecting, monitoring and evaluating public investments and expenditure programmes need to be strengthened in order to improve the process of allocation of resources.

Inter-ministerial co-ordination for Community Own Resources under the Ministry of Public Finance should be developed to prepare for the tasks required after accession. The Ministry of Public Finance is the central body of state administration responsible for taxation, and for the performance of customs functions. These functions are performed through the Romanian Customs Administration and the Central Tax Directorate respectively. The calculation of own resources based on gross national product (GNP) is the responsibility of the National Institute for Statistics. Further efforts are needed to bring practice in Romania closer to the European System of Accounts (ESA 95) standards. There is currently no provision in Romanian law with regard to the levies on trading in and warehousing of sugar, which forms part of the Traditional Own Resources.

Romania still needs to improve its capacity to calculate GNP as well as VAT and customs receipts in a reliable, harmonised, controllable and transparent way. The administrative capacity to duly collect and transfer in a timely manner all Own Resources to the Community budget will need to be established prior to accession, as will the ability to provide the Commission with accurate reports on the situation with regard to each type of own resources. With regard to the control of future EC Own Resources, Romania should continue its efforts to set up effective instruments to combat fraud relating to VAT and customs duties.

In addition to the need for central co-ordination for the proper collection, monitoring and payment and control of funds to and from the EC budget, administrative capacity should be strengthened in the context of the relevant policy areas described elsewhere in this report, such as financial control, taxation, agriculture, customs, and regional policy.

3.2. Translation of the *acquis* into the national languages

Applicant countries are to translate the various legal texts constituting the *acquis* into their national languages by the time of their accession. The *acquis*, consists of primary and secondary binding legislation, and represents a considerable volume of acts, roughly estimated at 60,000-70,000 pages of the Official Journal. To help the candidate countries in this process, assistance is being provided under the Phare programme. With the help of TAIEX, a centralised Translation Co-ordination Unit has been created in each of the ten candidate countries of central Europe.

In the case of Romania, this unit has been established within the European Institute of Romania and became operational in December 2000. The unit is responsible for translation, linguistic revision, and technical revision of texts. It functions effectively, but is understaffed in relation to the volume of translation work required. As of September 2001, approximately 14 300 Official Journal pages of *acquis* had been translated by the Translation Co-ordination Unit - of which some 5 000 had also been revised. This represents a considerable improvement since the last Regular Report.

The Romanian government has also allocated substantial resources from the state budget in order to speed up translation of the *acquis*. This is a separate initiative managed by the

National Institute of Information and Documentation, under which, as of September 2001, approximately 11 600 Official Journal pages of *acquis* had been translated.

Without prejudice to the outcome of the accession negotiations, while the progress made in translation is welcomed, further efforts will be needed, in particular to ensure quality control and the technical uniformity of texts.

Due attention should also be given to the training of conference interpreters.

3.3. General evaluation²⁵

Romania has continued to make progress with the adoption of the *acquis*. However, advances in legal transposition have not always been matched by improvements in administrative capacity.

Romania's progress with *internal market legislation* has been mixed. Other than the adoption of new legislation on public procurement, little progress has been made with the *free movement of goods* and the framework legislation for the New and Global Approach has still not been adopted. The administrative infrastructure for standardisation, certification and market surveillance should be reinforced. Only limited progress has been made in aligning with the *acquis on free movement of persons*, and while progress has been made with insurance and banking supervision there has been no progress with transposing the *acquis* on financial securities markets. Legislation on the protection of personal data remains inadequate. New Romanian legislation on money laundering is a welcome development but a comprehensive system of exchange controls and other restrictions on capital movements still exists. The supervision of financial services should also be improved. Further progress was made in aligning with the *company law* and *competition policy acquis* – sectors where Romania has already achieved a high degree of transposition. This said, the supervision of intellectual property rights should be further developed as should the capacity to enforce state aid and anti-trust rules.

In the field of *taxation*, Romania has made some progress particularly with regard to excise duties. However, further alignment is still needed in the area of VAT and much remains to be done to modernise the tax administration – including the development of electronic data exchanges with the Community and Member States. Romania's adoption of an *industrial strategy* document is a welcome development and while some important progress has been made in privatisation considerable further efforts are still needed. Good progress has been made in promoting the *SME sector* and a series of measures have been taken to improve the business environment.

While Romania has made progress in aligning with several aspects of the *agricultural acquis*, restructuring of the sector has barely begun. The overall administrative capacity of the Ministry of Agriculture remains weak and Romania still needs to develop the ability to implement the management mechanisms of the Common Agricultural Policy. Inspection arrangements in the veterinary and phytosanitary fields also need to be upgraded. The newly adopted fisheries law brings the Romanian legislative framework largely in line with the *acquis*. However, efforts are still needed to strengthen administrative structures.

²⁵ See "Making a success of enlargement: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2001) 700.

Romania has continued to make good progress in harmonising its *transport* legislation. Policy related to the *energy sector* has been inconsistent and therefore only limited progress can be noted. While there has been limited progress in the *telecommunications sector* in terms of transposition, extensive preparatory work has been carried out that should enable future reforms. Romania has made advances in aligning itself with the *environmental acquis* but does not have the administrative capacity to effectively enforce the newly adopted legislation and insufficient financial resources are allocated to the sector. Romania has made progress in aligning with several aspects of the *consumer protection acquis* but attention will be required to ensure effective enforcement. Romania has only made limited progress in the *audio-visual* sector.

Social policy is a priority for the government, and while progress has been made further alignment with the *acquis* is necessary, as are improvements in administrative capacity (in particular in the area of occupational health and safety and in strengthening labour inspectorates). Some progress was made in the area of *regional policy* during the reporting period - mainly in terms of improving institutional arrangements. However, the new structures remain fragile and considerable work is still necessary as regards programming, monitoring and evaluation and developing the capacity to manage and control public funds.

In the field of *justice and home affairs*, significant progress has been made in the fields of visa policy, border control and migration. However, there is still a need to adopt legislation in some important areas such as data protection and to further upgrade the capacity and infrastructure for border management.

Romania has increasingly resorted to *trade policies* that are incompatible with its international obligations and which represent a move away from the *acquis*. At the same time, the management of the OSCE Presidency demonstrated Romania's capacity to assume its responsibilities international leadership role in the field of foreign affairs. Romania has continued to make progress on harmonisation with the *customs acquis* although the operational capacity of the customs service should be improved and efforts should be intensified to develop systems that will allow the exchange of computerised data between the EC and Romania.

Despite some positive developments, the Romanian authorities have not yet succeeded in elaborating a comprehensive policy framework for internal *financial control* over public funds, and further efforts are needed to strengthen administrative capacity in this area. Romania has made some progress in reforming national budgetary procedures but further efforts are required both in relation to the national budget and own resources.

The overall *capacity of the public administration* to implement the *acquis* remains limited and represents a major constraint on Romania's accession preparations. While certain parts of the administration are able to function effectively there are many important sectors where the weakness of the administration is a serious cause for concern. These concerns extend beyond adoption of the *acquis* and also apply to the management of EC funds. There has been no significant progress in developing administrative capacity although this issue is beginning to be addressed by the government.

With regard to meeting short-term Accession Partnership priorities, Romania has met the priorities related to *transport*. While progress has been made in the areas of *taxation*, *customs*, and *justice and home affairs* none of the priorities identified for these sectors have

yet been fully met. Some, limited progress has been made in addressing the priorities related to the *internal market, agriculture, environment, employment and social affairs* and the *reinforcement of administrative and judicial capacity*. Romania has started to address some medium-term Accession Partnership priorities. In *transport* and *fisheries* Romania is close to meeting the medium-term priorities. However, no substantial progress has been made in the cases of *agriculture, environment, and employment*.

C. Conclusion²⁶

In its 1997 Opinion, the Commission concluded that Romania fulfilled the political criteria. Since then, the country has made considerable progress in further consolidating and deepening the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. Over the past year, further positive developments have been noted. Romania continues to fulfil the Copenhagen political criteria.

The efficiency of the legislature has improved considerably as has the overall functioning of government. The reform of judicial procedures has continued and effective implementation of new legislation on public procurement should play an important role in the fight against corruption – although corruption remains a serious problem that is largely unresolved. Other particular concerns are the lack of progress in carrying out a strategic reform of the public administration and the need to further guarantee the independence of the judiciary.

Significant progress has been made in the field of human rights. Reform of the childcare system is well under way; homosexuality has been decriminalised; and important new legislation has been passed regarding the restitution of property and the treatment of asylum seekers and refugees. The introduction of probation represents an important reform of the penal system and several initiatives have been taken to address trafficking of human beings. Future reforms should seek to modernise the Penal Code and increase the public accountability of police officers as well as ensure the proportionality of their actions. Efforts to improve the actual living conditions in childcare institutions should continue.

New legislation extending the use of minority languages was approved, and a National Strategy for Improving the Condition of Roma adopted. Efforts now need to focus on the implementation of the strategy, with the aim of effectively combating widespread discrimination, and improving living conditions.

Romania has addressed the short-term Accession Partnership priorities related to the political criteria by improving the conditions of institutionalised children, making progress with the reform of childcare policy, developing a national strategy for Roma, and taking measures to provide support to minority programmes. As regards medium-term priorities, progress has been made towards meeting the medium-term priority related to childcare, and initiatives have been taken to increase the Roma's access to education. However, important actions are still needed in other areas: the Roma strategy has not yet been implemented; anti-discrimination legislation has been adopted but it is not yet operational; and the demilitarisation of the police has not yet started.

Romania has made progress towards establishing a functioning market economy and although it would not, in the medium term, be able to cope with competitive pressure and market forces within the Union, it has taken measures that would allow to develop its future capacity, provided that it keeps to the engaged economic reform path.

²⁶ See "Making a success of enlargement: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2001) 700.

Romania has made progress towards macroeconomic stabilisation: growth has resumed and exports have increased. The government is acutely aware of the need to implement the programme agreed with the IMF and the Pre-accession Economic Programme. Structural reforms have been re-launched, most notably in the area of privatisation and energy price adjustments. The recent privatisations demonstrate a new commitment towards the establishment of a functioning market economy.

However, there are still serious economic imbalances with high inflation and a widening current account deficit, in a difficult social environment. The still fragile macroeconomic environment, the uncertain legal framework and the poor administrative capacity hinder the development of the private sector. Large parts of the enterprise sector have yet to start restructuring or are still in the early stages of the process. Romania's reform agenda remains considerable. The authorities should give priority to securing macroeconomic stability by fighting inflation and halting the deterioration of the external account. The full implementation of the programme agreed with the IMF, focusing on reversing the causes of inflation, would permit a gradual shifting of monetary and exchange rate policy towards inflation reduction. Enterprises' financial discipline should be established by halting the accumulation of inter-enterprise arrears and the provision of state support to inefficient ventures. The removal of the burden that these practices put on fiscal policy would allow for a better co-ordination between fiscal and monetary policy. A further priority is to accompany enterprise restructuring and privatisation with the establishment of sound legal and institutional foundations of the functioning market economy.

Romania has continued to make progress with the adoption of the *acquis*. However, advances in legal transposition have not always been matched by improvements in administrative capacity.

Romania's progress with *internal market legislation* has been mixed. Other than the adoption of new legislation on public procurement, little progress has been made with the *free movement of goods* and the framework legislation for the New and Global Approach has still not been adopted. The administrative infrastructure for standardisation, certification and market surveillance should be reinforced. Only limited progress has been made in aligning with the *acquis on free movement of persons*, and while progress has been made with insurance and banking supervision there has been no progress with transposing the *acquis* on financial securities markets. Legislation on the protection of personal data remains inadequate. New Romanian legislation on money laundering is a welcome development but a comprehensive system of exchange controls and other restrictions on capital movements still exists. The supervision of financial services should also be improved. Further progress was made in aligning with the *company law* and *competition policy acquis* – sectors where Romania has already achieved a high degree of transposition. This said, the supervision of intellectual property rights should be further developed as should the capacity to enforce state aid and anti-trust rules.

In the field of *taxation*, Romania has made some progress particularly with regard to excise duties. However, further alignment is still needed in the area of VAT and much remains to be done to modernise the tax administration – including the development of electronic data exchanges with the Community and Member States. Romania's adoption of an *industrial strategy* document is a welcome development and while some important progress has been made in privatisation considerable further efforts are still needed. Good progress has been made in promoting the *SME sector* and a series of measures have been taken to improve the business environment.

While Romania has made progress in aligning with several aspects of the *agricultural acquis*, restructuring of the sector has barely begun. The overall administrative capacity of the Ministry of Agriculture remains weak and Romania still needs to develop the ability to implement the management mechanisms of the Common Agricultural Policy. Inspection arrangements in the veterinary and phytosanitary fields also need to be upgraded. The newly adopted fisheries law brings the Romanian legislative framework largely in line with the *acquis*. However, efforts are still needed to strengthen administrative structures.

Romania has continued to make good progress in harmonising its *transport* legislation. Policy related to the *energy sector* has been inconsistent and therefore only limited progress can be noted. While there has been limited progress in the *telecommunications sector* in terms of transposition, extensive preparatory work has been carried out that should enable future reforms. Romania has made advances in aligning itself with the *environmental acquis* but does not have the administrative capacity to effectively enforce the newly adopted legislation and insufficient financial resources are allocated to the sector. Romania has made progress in aligning with several aspects of the *consumer protection acquis* but attention will be required to ensure effective enforcement. Romania has only made limited progress in the *audio-visual* sector.

Social policy is a priority for the government, and while progress has been made further alignment with the *acquis* is necessary, as are improvements in administrative capacity (in particular in the area of occupational health and safety and in strengthening labour inspectorates). Some progress was made in the area of *regional policy* during the reporting period - mainly in terms of improving institutional arrangements. However, the new structures remain fragile and considerable work is still necessary as regards programming, monitoring and evaluation and developing the capacity to manage and control public funds.

In the field of *justice and home affairs*, significant progress has been made in the fields of visa policy, border control and migration. However, there is still a need to adopt legislation in some important areas such as data protection and to further upgrade the capacity and infrastructure for border management.

Romania has increasingly resorted to *trade policies* that are incompatible with its international obligations and which represent a move away from the *acquis*. At the same time, the management of the OSCE Presidency demonstrated Romania's capacity to assume its responsibilities international leadership role in the field of foreign affairs. Romania has continued to make progress on harmonisation with the *customs acquis* although the operational capacity of the customs service should be improved and efforts should be intensified to develop systems that will allow the exchange of computerised data between the EC and Romania.

Despite some positive developments, the Romanian authorities have not yet succeeded in elaborating a comprehensive policy framework for internal *financial control* over public funds, and further efforts are needed to strengthen administrative capacity in this area. Romania has made some progress in reforming national budgetary procedures but further efforts are required both in relation to the national budget and own resources.

The overall *capacity of the public administration* to implement the *acquis* remains limited and represents a major constraint on Romania's accession preparations. While certain parts of the administration are able to function effectively there are many important sectors where the

weakness of the administration is a serious cause for concern. These concerns extend beyond adoption of the *acquis* and also apply to the management of EC funds. There has been no significant progress in developing administrative capacity although this issue is beginning to be addressed by the government.

With regard to meeting short-term Accession Partnership priorities, Romania has met the priorities related to *transport*. While progress has been made in the areas of *taxation, customs, and justice and home affairs* none of the priorities identified for these sectors have yet been fully met. Some, limited progress has been made in addressing the priorities related to the *internal market, agriculture, environment, employment and social affairs* and the *reinforcement of administrative and judicial capacity*. Romania has started to address some medium-term Accession Partnership priorities. In *transport* and *fisheries* Romania is close to meeting the medium-term priorities. However, no substantial progress has been made in the cases of *agriculture, environment, and employment*.

D. Accession Partnership and National Programmes for the Adoption of the *Acquis*: Global assessment

The purpose of the Accession Partnership is to set out in a single framework:

- the priority areas for further work identified in the Commission's Regular Report;
- the financial means available to help candidate countries implement these priorities;
- the conditions which will apply to this assistance.

Each candidate has been invited to adopt a National Programme for the Adoption of the *Acquis*. This sets out how the country in question envisages dealing with the Accession Partnership, the timetable for implementing the Partnership's priorities, and implications in terms of human and financial resources. Both the Accession Partnerships and the National Programmes for the Adoption of the *Acquis* are revised on a regular basis, to take account of progress made, and to allow for new priorities to be set.

1. Accession Partnership

In the following assessments the main sub-headings are indicated in bold type and further key concepts taken from the Accession Partnership are highlighted in *italics*.²⁷

Short-term priorities

Political criteria:

Following on from the progress made last year, *adequate budgetary provisions* have been made for *institutionalised children* and a *strategy for a comprehensive reform of child-care policies* has been launched and is in the process of being implemented. The political criteria priority relating to children continues to be met. The reform strategy covers the situation of *children with chronic diseases and handicaps*. At the same time, the situation of *adults with chronic diseases and handicaps* remains a matter of concern. In the case of the Roma a *national strategy* has been adopted and has been widely recognised as being of a high quality – although implementation is only just beginning. There is scope for improving the *provision of adequate financial support to minority programmes* and this will be particularly important over the coming year when the Roma strategy is implemented. In overall terms, **the political criteria priorities have been met** although close attention needs to be given to implementation of commitments that have been given.

Economic criteria

Macro-economic stability is improving and a revised *medium term economic strategy* has formed the basis for progress on structural reforms. Over the reporting period Romania has made considerable progress in reaching *agreements with the International Financial Institutions*. There have been limited initiatives taken to *restructure public finances* but this is an area where considerable additional work is needed. Important legislation has been adopted

²⁷ For the detailed text of the short and medium term priorities established in the 1999 Accession Partnership please refer to Council Decision 1999/853/EC. Official Journal L 335, 28/12/1999 pp. 15-21.

with the aim of improving the *functioning of the property market* but implementation has proved to be disappointing. There has been no progress with introducing a *national land and property register*. Some progress has been made in privatisation of *small and medium-sized enterprises* although there is certainly scope for efforts to be accelerated. In the case of large companies, which still have had a very significant influence on the entire economy, two important deals have shown the government's renewed commitment to privatisation, although further progress needs to be made. A series of measures have been taken to improve the overall *business environment*. These are welcome developments but it will take time to assess the extent to which this will improve the overall *competitiveness* of Romanian industry. There is certainly scope for additional measures to be taken. An improved *bankruptcy law* was already established during the previous reporting period but market exit remains unsatisfactory – a situation highlighted by the ability of businesses to continue operating while building up huge arrears. A *steel restructuring plan* has been developed but further work will be necessary before it can be judged as the requirements of the Europe Agreement. **Romania has made progress in meeting the numerous priorities related to the economic criteria – but considerable additional efforts are necessary.**

Internal Market

- A new ordinance on *public procurement*, which is broadly in line with the *acquis*, has entered into force although it is too early to pass judgement on the effectiveness of its implementation. Romania has made major efforts in transposing the *acquis* on *industrial property rights* although further efforts are needed in the case of *intellectual property*. Work has been progressing with improving the *administrative capacity* in this field as well as with *border controls on counterfeit goods*, and while advances have been made this is inevitably a long-term process and continued efforts will be necessary. Despite considerable preparatory work, no progress has been made during the reporting period with transposing the *acquis* on *data protection* or with the establishment of an independent supervisory authority.

As concerns *free movement of goods*, progress has been made in implementing a number of Old Approach directives, and in adopting the framework legislation on the New and Global Approach. However, administrative infrastructure for market surveillance remains a problem. As concerns *financial services* the main development has been the adoption of a new *insurance law*, but this has still to be fully implemented. The administrative capacity of the financial sector supervision agencies remains weak. Romania has made good progress in approximating its *competition legislation* (particularly good in the area of anti-trust although more needs to be done as concerns state aids) and has improved the capacity of the Competition Council and the Competition Office. However, implementation of State Aids legislation remains a concern and a particular worry has been the continued non-delivery of annual State Aid reports and a State Aid inventory. Romania still needs to complete the alignment of its *audio-visual legislation* with that of the EC.

Romania has continued to make important progress in aligning its legislation on *VAT and excise duties* and the discrimination between imported and domestic tobacco products has been eliminated. Despite certain positive developments in the field of *customs* substantial additional efforts are still needed to fight *fraud and corruption*. Overall Romania has continued to make progress in several areas. While many priorities have been partially met Romania **continues to have not yet fully implemented any of the Accession Partnership Priorities concerning the internal market.**

Agriculture

- There is an urgent need to develop strategies for the adoption of the *acquis* based on a realistic assessment of the human and financial resources needed to implement specific policies. The legislative framework for the *phytosanitary acquis* is in place and the emphasis should now be placed on implementation. With regard to the veterinary *acquis*, important efforts have been made in improving the laboratory infrastructure for animal health and diseases control. However, although the National Sanitary Veterinary Agency was restructured during the reporting period there is no evidence of any real improvement of its functioning. A coherent strategy for the development of *border controls* still needs to be elaborated. Legislation aligning with the *acquis* regarding *pesticide residues* and the plant health regime has been adopted – although enforcement issues still need to be addressed. As regards the implementation of a *national animal identification system*, there has been little progress. A *vineyard register* has still not been established although there has been progress made in strengthening the management and control systems in the wine sector. In conclusion, there has been **limited progress in meeting the Accession Partnership priorities in the agricultural sector.**

Transport

- Romania has transposed the *acquis on maritime safety* and has therefore **fully met this priority.** Romania's focus should be now turned to the enforcement of legislation where capacities remain weak.

Employment and Social Affairs

- Progress has been made with developing the *social dialogue* although the *capacity of the social partners* remains low and the bipartite social dialogue is underdeveloped. Romania has initiated the work on a Joint Assessment Paper and the preparation of a National Action Plan for Employment. The finalisation of these is a priority. **Despite good progress these priorities have only been partially met.**

Environment

- Romania has drawn up *directive specific approximation and implementation programmes* for all main sectors (excluding noise). Progress can also be noted with regard to *transposition programmes* where new legislation has been adopted. Progress has also been made with preparing framework legislation for air, waste, water quality and industrial pollution. Romania has also made progress with the transposition of the *Environmental Impact Assessment directive*. However, despite these positive developments there is still no realistic *plan for financing investments* and the weakness of the *environmental administration* raises serious questions as to the capacity to enforce recently passed legislation. **While good progress has been made with transposition of legislation, the priorities related to administrative capacity have not been addressed.**

Justice and Home Affairs

- The *Border Police* has been restructured and the process of replacing conscripts with permanent staff is well under way. Romania has also passed a Law on the State Frontier and initiated a programme to *strengthen border controls and prevent illegal immigration.*

However, there has been no substantial progress with regard to preparation for participation in the Schengen Information System. A law on the prevention of, and the fight against, *corruption* has been adopted and the capacity to deal with money laundering has been strengthened. This said, the *co-ordination between agencies* involved in the fight against corruption still needs to be improved and while an anti-corruption unit has been established it is severely understaffed. New *laws on aliens and refugees* have been adopted and introduced, inter alia, accelerated *asylum procedures*. There has not been any significant progress yet *with upgrading the capacities of law enforcement agencies* and there has been no progress with the demilitarisation of the police force (although some other bodies, which were controlled by the Ministry of the Interior, have been demilitarised). Romania has not yet ratified the *international conventions* listed in the Accession Partnership and it can be concluded that despite progress since the last Regular Report the **Justice and Home Affairs priorities continue to have only been partially met.**

Reinforcement of administrative and judicial capacity (including capacity to manage and control EC funds)

- Romania has adopted a new *Civil Service Law* but it has only been partially implemented. The *Government of Romania has adopted the National Development Plan and the Rural Development Plan*. Progress has also been made in setting up an agency to be responsible for *implementation of SAPARD* in Romania – although considerable further efforts will be needed before it can be accredited. The *functioning of the judiciary* has improved through organisational changes in the court system, improved training and recruitment, and improved enforcement of civil decisions. This said, working conditions leave much to be desired and computerisation of courts should be accelerated. The proportion of persons in *pre-trial detention* of the total prison population has decreased. However, the *penal code* and *law on penal procedure* are still in need of substantial revision. The Romanian legal system provides for *access to legal advice and representation*. With regard to financial management, some progress has been made towards improving budget procedures through introduction of medium-term budgetary perspectives and *programme-based budget methodology*. Ongoing efforts to review budgetary procedures and to prepare new legislation need to be continued. Improvements have also been introduced into *public procurement* legislation, but sustained efforts are needed to implement the legislation effectively. Further efforts are needed to define legislative and organisational requirements related to ensuring adequate *financial control and audit* of Romanian public expenditure and EU funds managed by Romanian public authorities. To conclude, **Romania has made mixed progress in meeting the priorities relating to administrative and judicial capacity.**

Medium-term priorities

Political criteria

Conditions for children in care have improved and *reform efforts have been consolidated*. Initiatives have been taken to increase the *Roma's access to education*. The Roma strategy has only recently been adopted and therefore the medium-term priority of continuing to implement the strategy is not relevant. Comprehensive *anti-discrimination* legislation has adopted - but it is not yet operational. The demilitarisation of the police has not yet been started and therefore the medium-term priority of continuing to demilitarise the police is not

relevant. Progress towards meeting the medium term political criteria priorities has **been made in the case of child-care while important efforts are still needed in the other areas.**

Economic priorities

The *privatisation* process in Romania is still far from complete and since a steel restructuring programme has only recently been adopted the medium-term priority of continuing to implement the programme is not relevant. However, a *fiscal surveillance* notification has been submitted and efforts have been made in support of *private enterprise and SME's* in particular. Romania has **therefore made progress in meeting two priorities – supporting business and SME development and establishing an annual fiscal surveillance procedure. The other priorities in this area still need to be addressed.**

Internal market

- Romania has made little progress in implementing *new approach directives*. Progress has been made in the area of *consumer protection* through aligning with the *acquis* and developing the capacity of market surveillance and enforcement authorities. Romania has not yet completed alignment of *intellectual and industrial property rights*. Very limited progress has also been made with regard to the *mutual recognition* of diplomas. Further alignment is still needed concerning *VAT exemptions, zero-rates and refund procedures*, as well as concerning *excise duties structure, minimum rates and exemptions*. A full review of existing legislation needs to be carried out, in order to ensure that it complies with the Code of Conduct for Business Taxation. Considerable additional efforts are needed in order to improve the *efficiency of the tax administration* and an *independent telecoms regulatory body* still has to be set up. In the field of *competition*, price controls are largely in line with competition rules and steps have been taken to develop the capacity of competition authorities. In the *customs* area, a series of steps have been taken to improve administrative and operational capacity, simplified procedures are applied and an integrated tariff has been prepared. **Progress has been made on several internal market priorities, although in the area of free movement of persons, progress has been disappointing.**

Agriculture

- Despite having legislation in place that lays the foundations for establishing some Common Market Organisations, the basic *CAP management mechanisms* have not been set up. A lack of accurate statistics makes the *monitoring of agricultural markets* impossible. The food control administration is not able to guarantee *EU hygiene and public health standards* yet. Only limited progress has been made with setting up *quality control systems, animal waste treatment, and border inspection*. **This priority has been met to a limited degree.**

Fisheries

- Impressive legislative developments need to be matched by increasing the *capacity of the fisheries administration* to implement the Common Fisheries Policy. **This priority has been met to a limited degree.**

Energy

- No progress has been made with regard to improving *energy efficiency* and implementing the *acquis on oil stocks*. Only limited progress has been made with regard to *energy pricing* (although cross subsidies in the electricity sector have been removed) and adopting EU fuel quality standards. While a considerable amount of legislation has been passed relating to Romania's participation in the *internal energy market* important secondary legislation is still missing and there are serious concerns about the capacity to enforce this legislation. Romania continues to ensure high levels of *nuclear safety* at the Cernavoda Nuclear Power Plant and has taken measures to improve the *regulatory structures* for nuclear safety and radiation protection. **Romania has met the medium-term priority related to nuclear safety but not those related to other aspects of energy policy.**

Transport

- Romania has continued *alignment of its legislation with the acquis* with regard to all transport sectors, though further work remains to be done. Additional work is necessary with regard to *freight taxation* and *technical requirements for inland waterway vessels*. **This priority has been partially met.**

Employment and social affairs

- Pending the adoption of a new labour code, Romania has made very limited progress with meeting the Accession Partnership priorities and no *independent fund* exists to protect employees in the event of employer insolvency. Considerable work is needed to *align with EU legislation* and *administrative structures* still need to be strengthened.

Economic and social cohesion

- Work has started on a national policy for economic and social cohesion although much remains to be done. Romania has made preparations for implementing regional development programmes and Community initiative. Inter-ministerial co-ordination has also improved. But there has been no substantial progress with developing pluri-annual budgeting or with the development of appraisal and evaluation mechanisms. **This priority has been partially met.**

Environment

- While progress has been made with the adoption of the *acquis* Romania remains far from *full transposition*. Little appears to have been done to *integrate sustainable development principles* into the definition of other sectoral policies and Romania's *enforcement and monitoring* capacities remain weak. **This priority has therefore not been met.**

Justice and Home Affairs

- Romania's *visa policy* has been substantially aligned with that of the EU and measures have been taken to combat *trafficking in women and children* – although this remains a serious problem. Romania still has to adopt and apply the international instruments related to the *fight against drug trafficking* and should take steps to reinforce the *independence of the judiciary* from the executive. **Two of these priorities have been met** while further work is necessary with the other two.

Administrative and judicial capacity

- Romania has recently adopted a strategy for the *reform of the public administration* but has not yet started with its implementation. In contrast, the National Institute of the Magistracy has provided *training in EU law* for the legal profession. Some progress has also been made in improving the legislative framework for *ex-ante financial control* although administrative weakness hampers implementation. This progress is not matched by the development of the internal audit function and as a result the Romanian approach to financial control remains incomplete. With regard to external audit, the Romanian Court of Audit has made progress in defining a programme of institution building measures although these still have to be implemented. Despite some improvements, the Romanian *statistical system* is still far from compliance with EU standards. **Romania has only made limited progress in meeting the priorities relating to administrative and judicial capacity.**

2. National Programme for the Adoption of the Acquis

The revised Romanian National Programme for the Adoption of the *Acquis* was adopted by the Romanian government in June 2001 and subsequently presented to the Commission.

The NPAA covers the period 2001-2004 and is in the same overall format as previous years. Actions are divided between short-term measures (2001 and 2002) and medium-term measures (2003 and 2004). All chapters of the *acquis* are covered in line with negotiation chapters. Political and economic accession criteria are also addressed, as is the issue of public administration reform. An innovation compared to previous editions is the inclusion of a chapter on the actual process for preparing Romania's accession efforts. Issues raised in previous Regular Reports and in the Accession Partnership are systematically covered and commitments given are generally consistent with those given in other frameworks.

The format is clear and consists of two volumes. The first provides a description of the current situation as well as of short-term and medium-term priorities. The second volume consists of a matrix that lists the elements of *acquis* that need to be adopted, specifies the national measure(s) proposed to meet each part of the *acquis*, indicates the lead institutions that will be responsible for initiating the required reforms, and finally, provides an indicative deadline. In most cases the deadlines given for the transposition of the *acquis* are realistic.

An estimate of the financial resources required to implement each item of the NPAA is also provided as an annex to the NPAA. However, the methodology used to calculate these financial estimates remains unclear, as is the relation between these figures and the national budget. As was noted in last year's Regular Report, these issues will have to be resolved before the NPAA can become a fully operational policy tool. While EU funding from the Phare, ISPA and SAPARD programmes is taken into account by the NPAA the document does not represent a co-ordination instrument for the use of these funds.

In general the Romanian NPAA is a well-structured and readable document. The quality is an improvement over previous years. It provides a useful overview of Romania's pre-accession strategy and also functions as a co-ordination tool for Romania's own accession preparations. Understandably, the presentations vary from sector to sector, but general observations can be made. Firstly, there is a tendency to focus on past achievements (which is useful as background) rather than to provide additional detail on future plans. And secondly, in several sectors it would be useful to have more detail on structures for the implementation of legislation.

Annexes

**Human Rights Conventions ratified by the Candidate Countries,
30 September 2001**

<i>Adherence to following conventions and protocols</i>	BG	CY	CZ	EE	HU	LV	LT	MT	PL	RO	SK	SI	TK
ECHR (European Convention on Human Rights)	X	X	X	X	X	X	X	X	X	X	X	X	X
Protocol 1 (right of property)	X	X	X	X	X	X	X	X	X	X	X	X	X
Protocol 4 (freedom movement et al.)	X	X	X	X	X	X	X	O	X	X	X	X	O
Protocol 6 (death penalty)	X	X	X	X	X	X	X	X	X	X	X	X	O
Protocol 7 (ne bis in idem)	X	X	X	X	X	X	X	O	O	X	X	X	O
European Convention for the Prevention of Torture	X	X	X	X	X	X	X	X	X	X	X	X	X
European Social Charter	O	X	X	O	X	O	O	X	X	O	X	O	X
Revised European Social Charter	X	X	O	X	O	O	X	O	O	X	O	X	O
Framework Convention for National Minorities	X	X	X	X	X	O	X	X	X	X	X	X	O
ICCPR (International Covenant on Civil and Political Rights)	X	X	X	X	X	X	X	X	X	X	X	X	O
Optional Protocol to the ICCPR (right of individual communication)	X	X	X	X	X	X	X	X	X	X	X	X	O
Second Optional Protocol to the ICCPR (death penalty)	X	X	O	O	X	O	O	X	O	X	X	X	O
ICESCR (International Covenant on Economic, Social and Cultural Rights)	X	X	X	X	X	X	X	X	X	X	X	X	O
CAT (Convention against Torture)	X	X	X	X	X	X	X	X	X	X	X	X	X
CERD (Convention on the Elimination of All Forms of Racial Discrimination)	X	X	X	X	X	X	X	X	X	X	X	X	O
CEDAW (Convention on the Elimination of All Forms of Discrimination against Women)	X	X	X	X	X	X	X	X	X	X	X	X	X
Optional Protocol to the CEDAW	O	O	X	O	X	O	O	O	O	O	X	O	O
CRC (Convention on the Rights of the Child)	X	X	X	X	X	X	X	X	X	X	X	X	X

X = Convention ratified

O = Convention **NOT** ratified

BG=Bulgaria; CY=Cyprus; CZ=Czech Republic; EE=Estonia; HU=Hungary; LV=Latvia; LT=Lithuania; MT=Malta; PL=Poland; RO=Romania; SK= Slovak Republic; SV=Slovenia; T=Turkey

Statistical data

	1996	1997	1998	1999	2000
Basic data					
in 1000					
Population (at 1 st of July)	22.608	22.546	22.503	22.458	22.435
in km ²					
Total area	238.391	238.391	238.391	238.391	238.391
National accounts					
1000 Mio Lei					
Gross domestic product at current prices	108.920	252.926	371.194	539.357	796.534
1000 Mio ECU/euro					
Gross domestic product at current prices	27,8	31,2	37,2	33,0	40,0
ECU/euro					
Gross domestic product per capita ²⁸ at current prices	1.200	1.400	1.700	1.500	1.800
% change over the previous year					
Gross domestic product at constant prices (nat. currency)	3,9	-6,1	-4,8	-2,3	1,6
in Purchasing Power Standards					
Gross domestic product per capita ²⁹ at current prices	6.100	5.900	5.800	5.800	6.000
% of Gross Value Added ³⁰					
Structure of production					
- Agriculture	20,1	19,5	15,8	14,8	12,6
- Industry (excluding construction)	34,8	33,4	30,3	29,9	30,5
- Construction	6,8	5,7	5,5	5,4	5,3
- Services ³¹	38,3	41,5	48,4	49,9	51,5
as % of Gross Domestic Product					
Structure of expenditure					
- Final consumption expenditure	82,6	86,4	90,2	87,2	86,4
- household and NPISH	69,5	74,2	76,0	74,4	73,9
- general government	13,1	12,3	14,2	12,7	12,5
- Gross fixed capital formation	23,0	21,2	18,3	18,0	18,5
- Stock variation ³²	2,9	-0,5	-0,4	-0,8	1,0
- Exports of goods and services	28,1	29,2	23,5	29,0	34,1
- Imports of goods and services	36,6	36,2	31,5	33,4	39,9
Inflation rate					
% change over the previous year					
Consumer price index ³³	38,8	154,8	59,1	45,8	45,7
Balance of payments					
in Mio ECU/euro					
- Current account	-2.446	-1.895	-2.637	-1.382	-1.477
- Trade balance	-2.350	-1.756	-2.332	-1.183	-1.831
Exports of goods	7.693	7.475	7.376	7.986	11.268
Imports of goods	10.043	9.231	9.708	9.169	13.099
- Net services	-366	-367	-581	-402	-276
- Net income	-294	-285	-393	-387	-305
- Net current transfers	564	513	669	589	935
-of which: government transfers	45	57	46	54	76
- FDI (net) inflows	250	1.077	1.804	980	1.114
Public finance					
in % of Gross Domestic Product					

²⁸ Figures have been calculated using the population figures from National Accounts, which may differ from those used in demographic statistics.

²⁹ Figures have been calculated using the population figures from National Accounts, which may differ from those used in demographic statistics.

³⁰ Including FISIM.

³¹ These figures include changes in inventories, acquisitions less disposals of valuables and the statistical discrepancy between the GDP and its expenditure components.

³² These figures include changes in inventories, acquisitions less disposals of valuables and the statistical discrepancy between the GDP and its expenditure components.

³³ Changes in Methodology: PROXY HICP since 1996 (see methodological notes).

General government deficit/surplus	-3,5	-4,5	-4,4	-2,1	-3,8
General government debt	:	16,5	17,9	24,4	22,9

Financial indicators	in % of Gross Domestic Product				
Gross foreign debt of the whole economy	21,5	24,1	19,8	25,2	22,4
	as % of exports				
Gross foreign debt of the whole economy	76,4	82,6	84,2	86,8	65,8
Monetary aggregates	1000 Mio ECU /euro				
- M1	2,2	2,1	1,7	1,6	1,9
- M2	5,9	7,0	7,2	7,3	7,7
- M3	:	:	:	:	:
Total credit	6,3	5,7	6,8	6,0	4,9
Average short-term interest rates	% per annum				
- Day-to-day money rate	53,4	86,0	80,9	80,8	44,8
- Lending rate	55,3	72,5	55,4	65,6	53,8
- Deposit rate	38,1	55,7	37,3	45,8	32,9
ECU/EUR exchange rates	(1ECU/euro=.. Leu)				
- Average of period	3922	8112	9985	16345	19922
- End of period	5182	8859	12814	18345	24142
	1991=100				
- Effective exchange rate index	1,2	0,6	0,5	0,3	0,2
Reserve assets	Mio ECU/euro				
- Reserve assets (including gold)	1.259	2.780	1.981	2.455	3.637
- Reserve assets (excluding gold)	429	1.987	1.175	1.519	2.652
External trade	Mio ECU/euro				
Trade balance	-2.733	-2.596	-3.202	-1.979	-3.055
Exports	6.364	7.481	7.381	8.055	11.365
Imports	9.097	10.077	10.583	10.034	14.420
	previous year = 100				
Terms of trade	97,2	101,2	105,1	103,8	103,5
	as % of total				
Exports with EU-15	56,5	56,6	64,5	65,5	63,8
Imports with EU-15	52,3	52,2	57,7	60,7	56,6
Demography	per 1000 of population				
Natural growth rate	-2,5	-1,9	-1,5	-1,4	-0,9
Net migration rate (including corrections)	-0,9	-0,6	-0,3	-0,1	-0,2
	per 1000 live-births				
Infant mortality rate	22,3	22,0	20,5	18,6	18,6
Life expectancy :	at birth				
Males:	65,2	65,2	65,5	66,1	67,0
Females:	73,0	73,0	73,3	73,7	74,2
Labour market (ILO methodology)	% of labour force				
Economic activity rate	64,8	64,8	63,6	63,4	63,2 P
Unemployment rate, total	6,7	6,0	6,3	6,8	7,1 P
Unemployment rate, males	6,3	5,7	6,5	7,4	7,7 P
Unemployment rate, females	7,3	6,4	6,1	6,2	6,4 P
Unemployment rate of persons < 25 years	20,2	18,0	18,3	18,8	18,6 P
Unemployment rate of persons >= 25 years	4,2	3,8	4,2	4,9	5,3 P
	as % of all unemployed				
Long-term unemployment	51,3	47,7	41,9	44,3	51,5 P
Average employment by NACE branches	in % of total				
- Agriculture and forestry	38,0	39,0	40,0	41,7	42,8 P
- Industry (excluding construction)	27,2	26,3	25,4	23,9	22,4 P
- Construction	4,3	4,2	4,0	3,7	3,8 P
- Services	30,5	30,5	30,6	30,7	31,0 P

Infrastructure	in km per 1000 km²				
Railway network	47,8	47,7	46,2	46,1	46,2
	km				
Length of motorways	113	113	113	113	113

Industry and agriculture	previous year = 100				
Industrial production volume indices	106,3	92,8	86,2	97,8	108,2 P
Gross agricultural production volume indices	101,3	103,4	92,5	105,2	85,8 P

Standard of living	per 1000 inhabitants				
Number of cars	106	116	125	133	139
Main telephone lines	139,8	151,9	161,2	168,3	173,8
Number of subscriptions to cellular mobile services	:	9,0	24,5	50,1	90
Number of Internet subscriptions	:	:	:	:	:

P=provisional figures

Methodological Notes

Inflation rate

As part of the preparations for the common currency the EU Member States (MSs) have designed a new *consumer price index* in order to comply with the obligations of the EU Treaty. The aim was to produce CPIs comparable between Member States. The main task was to harmonise methodologies and coverage. The result was the Harmonized Index of Consumer Prices (HICP). A similar exercise has been started with Candidate Countries (CC). In respect to enlargement, it is equally important that their economic performance is assessed on the basis of comparable indices. Some progress has already been made towards adapting the new rules. Since January 1999 CCs report monthly to Eurostat so-called proxy HICPs that are based on national CPIs but adapted to the HICP coverage. They are not yet fully compliant with the HICPs of the MSs. In the table, the proxy HICPs are back-calculated to 1995 (rates from 1996).

Finance

Public finance: The government deficit and debt statistics of the Candidate Countries are provisional, in the sense that they do not yet fully comply with EU methodological requirements. Broadly speaking, the general government deficit / surplus refers to the national accounts concept of consolidated general government net borrowing / net lending of ESA95. General government debt is defined as consolidated gross debt at end-year nominal value. The series are available from 1997; the 1996 data are an approximation derived from the IMF's GFS methodology.

Gross foreign debt is of the whole economy, covering both short- and long-term, but excluding equity investment and money market instruments. The source for stock of outstanding debt is OECD, while the source of GDP is Eurostat. For the ratio of gross foreign debt to exports, the national accounts definition of exports of goods and services is used (source: Eurostat). The data for 2000 are Eurostat estimates, based on joint OECD/IMF/BIS/World Bank series.

Monetary aggregates are end-year stock data, as reported to Eurostat. Generally, M1 means notes and coin in circulation plus bank sight deposits. M2 means M1 plus savings deposits plus other short-term claims on banks. M3 means M2 plus certain placements in a less liquid or longer-term form. Not all countries produce an M3 series. Total credit means loans by resident monetary financial institutions (MFIs) to non-MFI residents.

Interest rates: Annual average rates based on monthly series reported to Eurostat. For Romania, lending rates refer to bank lending to customers other than banks (all maturities). Deposit rates refer to bank deposits of customers other than banks (all maturities). Day-to-day money rates are overnight interbank rates.

Exchange rates: ECU exchange rates are those that were officially notified to DG ECFIN until 1 January 1999, when the ECU was replaced by the euro. Euro exchange rates are reference rates of the European Central Bank. The effective exchange rate index (nominal), as reported to Eurostat, is weighted by major trading partners.

Reserve assets are end-year stock data, as reported to Eurostat. They are defined as the sum of central bank holdings of gold, foreign exchange, SDRs, reserve position in the IMF, and other claims on non-residents. Gold is valued at end-year market price.

External trade

Imports and exports (current prices). The data is based upon the special trade system, according to which; external trade comprises goods crossing the customs border of the country. Trade data excludes direct re-exports, trade in services and trade with customs free zones as well as licenses, know-how and patents. Value of external trade turnover includes the market value of the goods and the additional costs (freight, insurance etc.). The term FOB means that all costs incurred in the course of transport up to the customs frontier are charged to the seller. The term CIF means that the purchaser pays the additional costs. Exports are recorded here on FOB basis and imports on CIF. External trade includes all exchanges of goods between Romania and other countries having as its objective: import of goods directly for consumption, imported goods taken out of customs warehouses or free zones in order to be consumed, export of national products as well as export of imported goods declared for domestic consumption and imported goods under financial leasing system. The goods are classified according to the Combined Nomenclature on which the customs tariff is based. Value of export data is given in FOB external effective prices for exports and in CIF for imports. External trade statistics are customs statistics, values being registered in USD. Data for 1999 are provisional and can be rectified due to delayed arrival, modification or cancellation of customs declarations from previous periods.

Terms of trade. The indices are calculated yearly by the „unit value” method (Paasche index).

Imports and exports with EU-15. Data declared by the Republic of Romania.

Demography

Net migration rate. Crude rate of net migration (recalculated by EUROSTAT) for year X, is: $\text{population (X+1)} - \text{population (X)} - \text{Deaths (X)} + \text{Births (X)}$. This assumes that any change in population not attributable to births and deaths is attributable to migration. This indicator includes therefore also administrative corrections (and projection errors if the total population is based on estimates and the births and deaths on registers). Figures are in this case more consistent. Further, most of the difference between the Crude rate of net migration provided by a country and the one calculated by Eurostat is caused by under reporting or delay in reporting of migration.

Labour force

Economic activity rate (ILO Methodology). Percentage of labour force in the total population aged 15+. This rate is derived from LFS (Labour Force Survey) observing the following ILO definitions and recommendations:

Labour force: employed and unemployed persons according to ILO definitions stated below.

The employed: all persons aged 15+, who during the reference period worked at least one hour for wage or salary or other remuneration as employees, entrepreneurs, members of

cooperatives or contributing family workers. Members of armed forces and women on child-care leave are included.

The unemployed: all persons aged 15+, who concurrently meet all three conditions of the ILO definition for being classified as the unemployed:

have no work,

are actively seeking a job and

are ready to take up a job within a fortnight.

LFS excludes persons living in non-private households (so-called institutional population).

Unemployment rate (by ILO methodology). Percentage of the unemployed in labour force. This rate is derived from LFS (Labour Force Survey) observing the ILO definitions and recommendations (see ILO definitions above)

Average employment by NACE branches. This indicator is derived observing the ILO definitions and recommendations. The employed comprise all people aged 15 years and over, who have carried out an economic or social activity producing goods or services, with a duration of 1 hour at least (for self-employed and unpaid family workers from agriculture, the minimum duration is 15 hours) during the reference period (one week), with a view to achieve certain incomes in form of salaries, in kind remuneration or other benefits.

Infrastructure

Railway network. All railways in a given area. This does not include stretches of road or water even if rolling stock should be conveyed over such routes; e.g. by wagon-carrying trailers or ferries. Lines solely used for tourist purposes during the season are excluded as are railways constructed solely to serve mines; forests or other industrial or agricultural undertakings and which are not open to public traffic. The data considers the construction length of railways.

Length of motorway. Road, specially designed and built for motor traffic, which does not serve properties bordering on it, and which:

(a) is provided, except at special points or temporarily, with separate carriage ways for the two directions of traffic, separated from each other, either by a dividing strip not intended for traffic, or exceptionally by other means;

(b) does not cross at level with any road, railway or tramway track, or footpath;

(c) is specially sign-posted as a motorway and is reserved for specific categories of road motor vehicles.

Entry and exit lanes of motorways are included irrespectively of the location of the signposts. Urban motorways are also included.

Industry and agriculture

Industrial production volume indices. Since 1996, IPI is computed based on a sample of representative products, constituted in series-witness, for which quantitative and value data are collected, these covering 76% of total industrial activity. The successive aggregation of industrial production indices are compiled using a system of constant weights, which corresponds to the

structure by activities of the gross value added at the cost of factors from the base year. Starting with 1998, the base year is 1995. Data for 1996 and 1997 are recalculated using the 1995 weights. Data on industrial production are provided by all the enterprises with 50 employees and over, having industry as the main activity. For the food industry due to its specific, smaller economic units (20-49 employees) these are also sample surveyed, as well as those having agriculture as their main activity but with industrial subunits specialised in the manufacture of food products. Units belonging to handicraft and consumption co-operatives which are surveyed only yearly are not included. Indices are not adjusted.

Gross agricultural production volume indices. Indices based on evaluation of all individual products of gross agricultural production in constant prices of the year preceding the examined one. Data for 1999 are provisional.

Standard of living

Number of cars. Passenger car: road motor vehicle, other than a motor cycle, intended for the carriage of passengers and designed to seat no more than nine persons (including the driver).

The term "passenger car" therefore covers microcars (need no permit to be driven), taxis and hired passenger cars, provided that they have less than ten seats. This category may also include pick-ups. Passenger cars exclude minibuses.

Telephone subscribers. Phone subscriptions include subscriptions of natural and legal persons (including subscriptions for fax and mobile phones).

Sources

Total area, external trade, infrastructure, demography, industry and agriculture, labour market, standard of living (except Internet connections): National sources.

National accounts, inflation rate, balance of payment, public finance, finance: Eurostat.

EXHIBIT B



COMMISSION OF THE EUROPEAN COMMUNITIES

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2002

REGULAR REPORT

ON

ROMANIA'S

PROGRESS TOWARDS ACCESSION

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2002
REGULAR REPORT

ON

THE

ROMANIA'S

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A. Introduction

a) Preface

In Agenda 2000, the Commission said it would report regularly to the European Council on progress made by each of the candidate countries of Central and Eastern Europe with preparations for membership, and that it would submit its first Report at the end of 1998.

The Luxembourg European Council decided that:

“From the end of 1998, the Commission will make Regular Reports to the Council, together with any necessary recommendations for opening bilateral intergovernmental conferences, reviewing the progress of each Central and Eastern European applicant State towards accession in the light of the Copenhagen criteria, in particular the rate at which it is adopting the Union *acquis*” [...] “The Commission’s reports will serve as the basis for taking, in the Council context, the necessary decisions on the conduct of the accession negotiations or their extension to other applicants. In that context, the Commission will continue to follow the method adopted by Agenda 2000 in evaluating applicant States’ ability to meet the economic criteria and fulfil the obligations deriving from accession.”

On this basis, the Commission presented a first series of Regular Reports in October 1998, a second in October 1999, a third in November 2000, and a fourth in November 2001.

In its 2001 Enlargement Strategy Paper, which accompanied the 2001 Regular Reports, the Commission indicated that, given the pace of negotiations and the progress made so far, the Commission should be able to make recommendations on those candidate countries ready for accession on the basis of its 2002 Regular Reports. At its meeting in Seville in June 2002, the European Council concluded that “in order to enable the European Council to be held in the coming autumn to decide which will be the candidate countries with which negotiations can be concluded at the end of 2002, [...] the Commission will have to draft appropriate recommendations in the light of the Regular Reports.” The Commission has prepared this fifth series of Regular Reports with a view to the Brussels European Council in autumn 2002.

The structure followed for this Regular Report is largely the same as that used for the 2000 and 2001 Regular Reports. In line with previous Regular Reports, the present Report:

- describes the relations between Romania and the Union, in particular in the framework of the Association Agreement;
- analyses the situation in respect of the political criteria set by the 1993 Copenhagen European Council (democracy, rule of law, human rights, protection of minorities);
- assesses Romania’s situation and prospects in respect of the economic criteria defined by the Copenhagen European Council (a functioning market economy and the capacity to cope with competitive pressures and market forces within the Union);

- addresses the question of Romania's capacity to assume the obligations of membership, that is, the *acquis* as expressed in the Treaties, the secondary legislation, and the policies of the Union. In this part, special attention is paid to nuclear safety standards, which were emphasised by the Cologne and Helsinki European Councils. This part includes not only the alignment of legislation, but also the development of the judicial and administrative capacity necessary to implement and enforce the *acquis*. The European Council stressed the importance of this latter aspect at its meeting in Madrid in 1995 and on a number of subsequent occasions, most recently at Seville in June 2002. At Madrid, the European Council stressed that the candidate countries must adjust their administrative structures, so as to create the conditions for the harmonious integration of these States. The Seville European Council also stressed how important it was that candidate countries should continue to make progress with the implementation and effective application of the *acquis*, and added that candidate countries must take all necessary measures to bring their administrative and judicial capacity up to the required level.

This Report takes into consideration progress since the 2001 Regular Report. It covers the period until 15 September 2002. [In some particular cases, however, measures taken after that date are mentioned.] It looks at whether planned reforms referred to in the 2001 Regular Report have been carried out, and examines new initiatives. In addition, this Report provides a global assessment of the overall situation for each of the aspects under consideration, setting out for each of them the main steps still to be taken by Romania in preparing for accession.

Furthermore, in view of the fact that the 2002 Regular Reports will provide the basis on which the Commission will formulate its recommendations as to which countries are ready to conclude negotiations, this Report includes an evaluation of Romania's track record since the 1997 Opinion. As regards the economic criteria, the Report also provides a dynamic, forward-looking evaluation of Romania's economic performance.

For each of the negotiating chapters, this Report provides a summary evaluation of the extent to which commitments made in the negotiations have been implemented. The commitments made by each country reflect the result of the accession negotiations, and, in accordance with the principle of differentiation underlying the negotiation process, may differ between countries. Where negotiating countries have committed themselves to completing specific measures by the time of accession, the Commission assesses the relevant preparatory processes. For chapters on which the accession negotiations continue, and final commitments remain to be defined, an indicative assessment is given of the state of implementation of the commitments that have been made to date.

Romania has set itself 2007 as the target date for accession. The time scale for the implementation of commitments made by Romania takes account of this perspective.

The Report includes a separate section examining the extent to which Romania has addressed the Accession Partnership priorities. This section also assesses the progress Romania has made in implementing the measures set out in the Action Plan for strengthening administrative and judicial capacity that the Commission developed with each negotiating country in the spring of 2002.

As has been the case in previous Reports, "progress" has been measured on the basis of decisions actually taken, legislation actually adopted, international conventions actually

ratified (with due attention being given to implementation), and measures actually implemented. As a matter of principle, legislation or measures which are in various stages of either preparation or Parliamentary approval have not been taken into account. This approach ensures equal treatment for all the candidate countries and permits an objective assessment of each country in terms of their concrete progress in preparing for accession.

The Report draws on numerous sources of information. The candidate countries have been invited to provide information on progress made in preparations for membership since the publication of the last Regular Report. The information each of the candidate countries has provided within the framework of the Association Agreement and the negotiations, the National Programmes for the Adoption of the *Acquis* where they are available, as well as the process of developing the Action Plans, and various peer reviews that have taken place to assess candidate countries' administrative capacity in a number of areas, have served as additional sources. Council deliberations and European Parliament reports and resolutions¹ have been taken into account in the preparations. The Commission has also drawn on assessments made by various international organisations, and in particular the contributions of the Council of Europe, the OSCE and the international financial institutions, as well as those of non-governmental organisations.

b) Relations between the European Union and Romania

Recent developments under the Europe Agreement, including bilateral trade

Romania has continued to implement the Europe Agreement and the various joint institutions have continued to function smoothly. The Association Council met in March 2002 and the most recent meeting of the Association Committee was in October 2001. The Joint Parliamentary Committee, comprising of representatives from the Romanian and European Parliaments, met in Brussels in April 2002.

Relations between Romania and the Economic and Social Committee continued to be good and in June 2002 a report on Romania's road to accession² was adopted. No progress has been made with regard to establishing a Joint Consultative Committee with the Committee of the Regions.

Romania's implementation of the Europe Agreement improved considerably and a number of outstanding issues were resolved during the course of the year (for example, the removal of export restrictions on sensitive raw materials and the phasing out of a discriminatory system of profit taxation). Measures were also taken to remove discriminatory restrictions on the right of lawyers from EU Member States to establish in Romania.

Recent indicators point to a steady improvement in Romania's trade situation. During 2001, Romanian exports to the EC totalled €9.3 billion (68% of total Romanian exports, an increase of 21% compared to 2000). Over the same period, imports from the EC rose to €10.2 billion (57% of total Romanian imports, an increase of 17% over the previous

¹ The European Parliament *rappporteur* is Baroness Nicholson of Winterbourne.

² The *Rappporteur* for the Economic and Social Committee is Mr Bedossa

year). This growth in trade both reflected and contributed to the revival of the Romanian economy that took place in 2001.

In 2001, Romania's main exports to the EC were: textiles and clothing (37%), machinery and equipment (15%), footwear (12%), and steel products (9%). The EC's main exports to Romania were machinery and equipment (27%), textiles and clothing (24%), transport equipment (10%), chemical products (7%) and steel products (5%).

As a consequence of the agreement resulting from the first round of trade negotiations in the agriculture sector (adopted on an autonomous basis, pending the conclusion of an Additional Protocol to the Europe Agreement), approximately 85% of EC agricultural imports from Romania and 43% of EC agricultural exports to Romania are duty free or benefit from preferential reduced duty rates (average trade figures for 1998-2000).

Negotiations on a further round of liberalisation, covering more sensitive sectors where trade is currently rather low, began at the end of 2001 and were concluded in June 2002. The result of this further round, scheduled to take effect in January 2003, enhances the existing agricultural trade preferences between the parties and promotes the abolition or reduction of import duties either within tariff quotas or for unlimited quantities in sectors such as cereals, dairy, beef and sheep meat. This further agreement also includes a commitment by the parties to remove export refunds for certain sectors.

The anti-dumping investigation on imports of urea from Romania (among others) led to the imposition of definitive duties in January 2002.

In March 2002, in response to protectionist measures taken by the US, which greatly restricted access to their market and created the risk of considerable trade diversion, the EU initiated provisional safeguard measures, with erga omnes effect, on imports of certain steel products. The measures were partly confirmed in September 2002.

Accession Partnership

A revised Accession Partnership was adopted in January 2002. Its implementation is reviewed in Part D.

Action Plan for reinforcing administrative and judicial capacity

As announced in the Commission's 2001 Enlargement Strategy, in spring 2002 the Commission and Romania jointly developed an Action Plan to strengthen Romania's administrative and judicial capacity, on which common understanding was reached in June. The revised Accession Partnership has served as the point of departure for this exercise.

The purpose of this Action Plan is to identify jointly the next steps required for Romania to achieve an adequate level of administrative and judicial capacity by the time of accession, to ensure that all necessary measures in this regard are taken, and to provide Romania with targeted assistance in areas that are essential for the functioning of an enlarged Union. As such, the Action Plan is a key tool for meeting the common objective of the EU and Romania, i.e. to ensure that Romania's preparations for accession take place as effectively as possible within the planned timeframe.

The implementation of the Action Plan is reviewed in Part D of this Report.

National Programme for the Adoption of the Acquis

In July 2002 Romania presented a revised National Programme for the Adoption of the *Acquis* (NPAA), in which it outlines its strategy for accession, including how to achieve the priorities of the Accession Partnerships.

Community Assistance

Three **pre-accession instruments** have been financed by the European Community to assist the applicant countries of Central and Eastern Europe with their pre-accession preparations: the **Phare** programme; **SAPARD**, which provides aid for agricultural and rural development; and **ISPA**, which finances infrastructure projects in the fields of environment and transport. The support provided by these programmes is focused on the Accession Partnership priorities which are intended to help the candidate countries meet the criteria for membership.

The level of financial support available under the pre-accession instruments creates a substantial challenge for the Romanian administration. At present, the capacity of the bodies responsible for programming, operational management and financial control is insufficient. For Phare the rate of tendering and contracting in 2001 was significantly lower than the volume of new funds committed during the year. Consequently the backlog of funds not yet contracted has increased. Similar limits of institutional capacity may also affect the implementation of ISPA.

In accordance with the conditionality of the Phare 2001 programme, the Government of Romania produced an assessment of the bodies responsible for the implementation of Phare and ISPA. The assessment, which has been adopted by Government, identified the human and material resources required for management of these programmes during the period 2002 to 2004. Measures to strengthen the capacity of the Central Financing and Contracting Unit in the Ministry of Public Finance and the Financial Unit within the Ministry of Development and Prognosis are particularly urgent.

The **Phare** programme has been providing support to the countries of Central and Eastern Europe since 1989, helping them through a period of fundamental economic and social transition and political change. Its current "pre-accession" focus was established in 1997, in response to the Luxembourg European Council's launching of the present enlargement process.

Phare provides the applicant countries of Central and Eastern Europe with support for institution building, investment to strengthen the regulatory infrastructure needed to ensure compliance with the *acquis*, and investment in economic and social cohesion. This support helps these countries with their efforts to adopt the *acquis* and strengthen the institutions necessary for implementing and enforcing the *acquis* and comprises of co-financing for technical assistance, "twinning" and investment-support projects. Phare also helps the candidate countries develop the mechanisms and institutions that will be needed to implement Structural Funds after accession and is supported by a limited number of measures (investment and grant schemes) with a regional or thematic focus. In the context of the Action Plans for strengthening administrative and judicial capacity, a particular emphasis is placed on the issue of institution building and associated

investment intended to ensure compliance with the *acquis*. For 2002, the Commission has mobilised special financial assistance of up to €250 million to accompany negotiating countries' efforts, over and above the indicative annual allocations for each of the Phare countries, bringing total Community assistance for strengthening the administrative and judicial capacity of the negotiating countries in 2002 to around €1 billion.

During the period 1992-1999, the Phare programme allocated commitments of approximately €1 200 billion to Romania. In 2000 and 2001 the allocations for Romania were €260 million and €287 million³. The **2002 Phare National Programme** for Romania consists of €229 million, complemented by €36.5 million under the Phare 2002 supplementary institution building facility. The 2002 programme focuses on the following priority areas:

- Strengthening democracy and the rule of law: Phare is providing continuing support for actions in the field of child welfare and is assisting with the implementation of the national strategy to improve Roma conditions (€ 19 million).
- Economic criteria: support for restructuring the CEC savings bank (€2.5 million).
- Strengthening administrative capacity: support in this area is designed to improve the capacity to manage EC programmes, to strengthen the local public administration, to pursue the institutional development of the Romanian Court of Accounts, to support the implementation of the strategic plan of the Ministry of Public Finance, and to reinforce the implementing bodies for SAPARD (€34 million).
- Meeting the obligations of the *acquis*: twinning, technical assistance and investment are being provided in the following areas - internal market, competition, customs union, consumer protection, social affairs and employment, agriculture, energy, transport, health, environment and justice and home affairs (€84 million).
- Economic and social cohesion: investment support will be provided for regional development programmes focussing on areas facing particular problems. There are also measures to support economic restructuring and institution building (€107 million).

An additional €13 million have been allocated for cross border co-operation (CBC) programmes with Bulgaria (€8 million) and Hungary (€5 million).

Romania also participates in and benefits from Phare funded multi-country and horizontal programmes, such as TAIEX, the Small and Medium-sized Enterprises Facility, SIGMA and the nuclear safety programme.

Funding provided under Phare 2002 part-finances participation in Community programmes for 2003. Romania remains an active participant in a number of programmes: Leonardo da Vinci, Socrates, Youth, Life III, the Multi-annual Programme for Enterprises and Entrepreneurship, Culture 2000 and Framework Programme 5 for Research and Technological Development and Euratom. Romania has expressed an interest in participating in Framework Programme 6 for Research and Technological

³ These figures include an allocation of €13 million per year to Cross-Border Co-operation (CBC) Programmes.

Development and Euratom. Romania will also participate in the following programmes: Gender Equality, Combating Social Exclusion, Combating Discrimination, Enterprise and Entrepreneurship, Altener, SAVE, IDA II, Fiscalis, European e-content, Customs 2002, Community Action in the field of public health and the Action Programme promoting NGOs in the field of environmental protection. The formal participation of Romania in the European Environment Agency began in January 2002.

Overall, the impact of Phare has been positive. Effective transfer of know-how, equipment and financial resources has taken place in a number of important fields. In Romania, Phare has played a particularly important role in:

- Building capacity for **regional development** programmes. Grant schemes have supported local initiatives in tourism and rural development as well as the development of human resources.
- Preparing for implementation of **ISPA** and **SAPARD**, through project preparation activities and technical assistance to support development of the necessary administrative structures.
- Initiating activities in the area of **human resource development and vocational education and training** in line with the priorities of the European Social Fund.
- Supporting improved collaboration between national and local authorities on the implementation of the **national strategy for improvement of the situation of the Roma**, in particular by allocating funds for 40 local partnership projects through the Resource Centre for Roma Communities.
- Supporting the rehabilitation of two **national road** sections (DN1 and DN2), which has led to a marked improvement in traffic safety.
- Providing continued support to **civil society** to develop sustainable partnerships between NGOs and local authorities, and to set up a network of citizens' advice bureaux.
- Supporting the **European Initiative for Democracy and Human Rights**, aimed at strengthening non-governmental bodies and associations in areas such as: anti-discrimination, conflict resolution, refugee and migrant rights, civic education, human rights promotion, local administration, media, NGO development & training, parliamentary practice and organisation, penal reform and gender equality.
- Supporting the development of **modern child welfare services** through projects proposed and implemented by local authorities.

The 2000 Phare Review confirmed the accession-driven approach and emphasised the importance of helping countries to prepare for the Structural Funds. The trends introduced in 1997 have continued, with an increased role for Commission Delegations, further streamlining of procedures and an increased emphasis on raising the verifiable and quantifiable impact of Phare projects on institution building, investment in compliance with the *acquis* and economic and social cohesion.

The Review also provided for the possibility of further decentralisation of Phare management, by waiving the requirement for *ex ante* approval by the Commission

Delegations for tendering and contracting. For this to be possible, strict pre-conditions covering programme management, financial control and structures regarding public finance must be met. An extended decentralised implementation system (EDIS) should be put in place for each negotiating country at the latest by the time of accession. High Level Working Groups are being established for each country to oversee this process, along with other key procedural steps in the run up to accession.

The Commission approved the Romanian **SAPARD** programme in November 2000. The indicative allocation for SAPARD in Romania for 2002 is € 157.9 million at 2002 prices (allocation 2001: € 156.3 million at 2001 prices).

The operational programme includes 11 measures and is based on four priorities: improvement of the competitiveness of processed agricultural and fisheries products; improvement of infrastructure for rural development and agriculture; development of rural economy; development of human resources.

The Multi-annual Financing Agreement (MAFA), which sets out the rules for implementing SAPARD, and *the Annual Financing Agreement (AFA)*, which sets out the Community financial commitment to Romania for the year 2000, have been in force since January 2002. The AFA 2001 was signed in February 2002. It will enter into force when Romania notifies the Commission of the completion of all requisite national formalities.

The following structures are responsible for the implementation of SAPARD: the National Fund, located within the Ministry of Finance, administers the SAPARD funds under the responsibility of the National Authorising Officer (NAO) and is responsible for the national accreditation of the SAPARD Agency; the Managing Authority is located within the Ministry of European Integration; the SAPARD Agency is located within the Ministry of Agriculture.

In June 2002 the National Act of Accreditation of the SAPARD Agency, along with all relevant documents, was submitted to the Commission. In July 2002, the Commission adopted a Decision provisionally conferring management authority for SAPARD, on a fully decentralised basis, to the SAPARD Agency. This decision includes approval of 3 out of 11 measures of the SAPARD programme and covers 50% of the amount available for Romania.

A Monitoring Committee has been established by the Managing Authority and has met twice.

ISPA programming is governed by the national strategy papers for transport and environment which the Romanian authorities finalised in 2000. The strategy for the environment sector was revised in 2001, to lower the population threshold for water projects from 300 000 to 100 000 inhabitants. Due to a lack of maintenance in the past 20 years, most environmental and transport infrastructure is suffering from serious deterioration. In the case of transport, the emphasis is on upgrading and modernising road and rail links in the trans-European corridors to European standards. Development of waterways is also a priority. As regards the environment sector, Romania faces acute problems concerning air, water and soil pollution requiring large-scale investments from both the public and the private sectors.

For the years 2000 and 2001, the full (mid-range) allocation for Romania has been committed, i.e. €493.2 million (€239.2 million in 2000 and €245.6 million in 2001). The allocation for 2002 will be between €217.8 million and €283.2 million.

Nine environmental projects were approved in 2001: three projects combining investments in the drinking and waste water sectors, in Cluj, Pascani and Targu Mures, with ISPA contributions of €35.1 million, €12.2 million and €20.9 million respectively; five projects focusing on waste water collection and treatment, in Timisoara (ISPA contribution of €334.1 million), Braila (ISPA contribution of €44.9 million), Arad (€13.5 million), Focsani (€11.7 million) and Oradea (€16.7 million); and technical assistance for the preparation of a project for the rehabilitation of the Bucharest waste water treatment plant (€1.4 million). Five transport projects were approved in 2001: three investment projects in the road sector, namely, the rehabilitation of the Craiova-Drobeta road section (€87.8 million), the rehabilitation of the Drobeta-Lugoj road section (€138 million) and the construction of the Sibiu by-pass (€67.9 million); and two technical assistance measures to prepare a project for a rail link with the Hungarian border (€0.6 million) and a project for the rehabilitation of the Craiova-Lugoj road section (€1.1 million). So far in 2002, two measures have been approved in the environment sector: a solid waste project in Ramnicu Valcea (€11 million) and a combined drinking/waste water project for the city of Brasov (€41.7 million). A technical assistance measure to strengthen the capacity of ISPA implementing agencies has also been approved in 2002. Further projects are in preparation.

As regards preparation for extended decentralisation (EDIS), a gap assessment has been carried out. According to the EDIS road map, the Romanian authorities must subscribe to its recommendations in order to proceed with the process.

A number of service contracts have been signed for design, supervision and technical assistance in both the transport and the environment sectors, and three works contracts have been signed in the environment sector and one works contract in the transport sector. Most of the tenders for the remaining ISPA projects approved in 2000 have been launched or are currently in preparation.

Twinning

One of the main challenges still facing the candidate countries is the need to strengthen their administrative and judicial capacity to implement and enforce the *acquis*. As of 1998, the European Commission began to mobilise significant human and financial resources to help them with this process, using the mechanism of twinning administrations and agencies. In 2001, the Commission strengthened this emphasis on institution building further, through the launch of the Action Plans for strengthening administrative and judicial capacity.

The twinning process makes the vast body of Member States' expertise available to the candidate countries through the long-term secondment of civil servants and accompanying short-term expert missions and training.

A total of 503 twinning projects were funded by the Community between 1998 and 2001. Between 1998 and 2000, these projects primarily targeted the main priority sectors identified in the Accession Partnerships: agriculture, the environment, public finance, justice and home affairs and preparation for the management of Structural Funds. Since

2000, other important sectors of the *acquis* have also been addressed through twinning, such as social policy, the fight against drugs, transport, and telecommunications regulation. Twinning now covers all sectors of the *acquis*.

Thanks to the strong support of the EU Member States, 103 twinning partnerships were funded by Phare 1998, involving all the candidate countries and almost all the Member States. These first-generation projects have already come to an end. Under Phare 1999 a further 123 projects are currently being implemented and the programming exercise for Phare 2000 included a further 146 twinning projects. The 2001 programming exercise includes 131 twinning projects embracing all the Phare beneficiary countries, as well as Cyprus and Malta. Under the 2002 programming exercise, 119 twinning projects have already been planned and approved for implementation. A substantial number of additional twinning projects are planned, and these should be approved and implementation launched before the end of 2002. They include twinning projects identified in the Action Plans for strengthening administrative and judicial capacity in the negotiating countries. It is estimated that around 300 twinning projects are operational throughout the candidate countries at any one time. Furthermore, the candidate countries are being offered the a further way of drawing on Member States' expertise through "Twinning light", a mechanism to address carefully-circumscribed projects of limited scope which emerge during the negotiation process.

Under Phare 2001, Romania is implementing 12 twinning projects. Substantial support is being provided for public administration reform and customs. Projects are in place for the National Commission of Statistics, the phytosanitary administration and fisheries. Twinning will be used to develop the Integrated Border Management Strategy and support the institutional framework in the field of migration. Other twinning projects target road safety, waste management and SME policy. The National Bank of Romania as well as the Border Police have designed "twinning light" projects.

Special assistance for Romania through twinning is being prepared under the Phare 2002 programme and a total of 29 twinning projects are scheduled - the highest number of any Candidate Country.

Justice and home affairs will be the main area for twinning projects in 2002. A total of ten projects will address the issues of asylum, refugees, Schengen *acquis*, modernisation of the gendarmerie, and general strengthening judicial capacity. The Ministry of Finance is also a major beneficiary with six twinning projects to assist the implementation of its strategic plan. Two environmental projects (chemicals directives and VOC, LCP and SEVESO II legislation), three projects in the social and employment field (equal opportunities, social security of migrant workers and continued vocational training) and three projects for the internal market (customs, competition and insurance supervision) have been designed. Twinning will also be used to support the implementation of the *acquis* in the fields of animal nutrition and inland waterway transport. Finally, two projects were designed to prepare Romania for the management of structural funds.

Negotiations

Accession negotiations were opened with Romania in February 2000, and by September 2002 negotiations on 27 chapters had been launched while the following 13 chapters had been provisionally closed: Company Law, Fisheries, Economic and Monetary Union, Statistics, Social Policy and Employment, Industrial Policy, Small and Medium-sized

Enterprises, Science and Research, Education and Training, Consumers and Health Protection, External Relations, Common Foreign and Security Policy, Institutions.

B. Criteria for membership

1. Political criteria

Introduction

The political criteria for accession to be met by the candidate countries, as laid down by the Copenhagen European Council in June 1993, stipulate that these countries must have achieved "stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities."⁴

In its 1997 Opinion on Romania's application for EU membership, the Commission concluded:

"Romania's new institutions are democratic and their stability now seems guaranteed. They do, however, need to be anchored by greater respect for the primacy of law at all levels of the apparatus of State. Elections are free and fair; they led to a genuine change-over in November 1996.

There remain a number of shortcomings with regard to respect for fundamental rights, even if the measures adopted and the undertakings given by the Romanian authorities since November 1996 are steps in the right direction. For instance, much still remains to be done in rooting out corruption, improving the working of the courts and protecting individual liberties from the activities of the police and secret service campaign or in the course of criminal proceedings.

By the same token, even if the Hungarian minority seems well integrated (given the recent improvement in its situation), the same cannot be said for the Roma (gypsies), who constitute a sizeable minority in the country.

Lastly, the reforms concerning the protection of children in orphanages are a major step forward but have still to bear fruit.

The improvement now under way since the new government came to power suggest that Romania is on the way to meeting the political conditions laid down by the Copenhagen European Council."

In its 2001 Regular Report, the Commission found that:

"In its 1997 Opinion, the Commission concluded that Romania fulfilled the political criteria. Since then, the country has made considerable progress in further consolidating and deepening the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. Over the past year, further

⁴ In the meantime, through the entry into force of the Treaty of Amsterdam in May 1999, the political criteria defined at Copenhagen have been essentially enshrined as a constitutional principle in the Treaty on European Union. Article 6(1) of the consolidated Treaty on European Union reads: "The Union is founded on the principles of liberty, democracy, respect for human rights and fundamental freedoms and the rule of law." Accordingly, Article 49 of the consolidated Treaty stipulates that "Any European State which respects the principles set out in Article 6(1) may apply to become a member of the Union." More recently, these principles were emphasised in the Charter of Fundamental Rights of the European Union, that was proclaimed at the Nice European Council in December 2000.

positive developments have been noted. Romania continues to fulfil the Copenhagen political criteria.

The efficiency of the legislature has improved considerably as has the overall functioning of government. The reform of judicial procedures has continued and effective implementation of new legislation on public procurement should play an important role in the fight against corruption – although corruption remains a serious problem that is largely unresolved. Other particular concerns are the lack of progress in carrying out a strategic reform of the public administration and the need to further guarantee the independence of the judiciary.

Significant progress has been made in the field of human rights. Reform of the childcare system is well under way; homosexuality has been decriminalised; and important new legislation has been passed regarding the restitution of property and the treatment of asylum seekers and refugees. The introduction of probation represents an important reform of the penal system and several initiatives have been taken to address trafficking of human beings. Future reforms should seek to modernise the Penal Code and increase the public accountability of police officers as well as ensure the proportionality of their actions. Efforts to improve the actual living conditions in childcare institutions should continue.

New legislation extending the use of minority languages was approved, and a National Strategy for Improving the Condition of Roma adopted. Efforts now need to focus on the implementation of the strategy, with the aim of effectively combating widespread discrimination, and improving living conditions.

Romania has addressed the short-term Accession Partnership priorities related to the political criteria by improving the conditions of institutionalised children, making progress with the reform of childcare policy, developing a national strategy for Roma, and taking measures to provide support to minority programmes. As regards medium-term priorities, progress has been made towards meeting the medium-term priority related to childcare, and initiatives have been taken to increase the Roma's access to education. However, important actions are still needed in other areas: the Roma strategy has not yet been implemented; anti-discrimination legislation has been adopted but it is not yet operational; and the demilitarisation of the police has not yet started."

The section below provides an assessment of developments in Romania, seen from the perspective of the Copenhagen political criteria, including the overall functioning of the country's executive and its judicial system. Such developments are in many ways closely linked to developments regarding Romania's ability to implement the *acquis*, in particular in the domain of justice and home affairs. Specific information on the development of Romania's ability to implement the *acquis* in the field of justice and home affairs can be found in the relevant section (*Chapter 24 – Co-operation in the field of justice and home affairs*) of part *B.3.1.* of this Report.

Recent developments

The political situation was stable over the reporting period. There were no elections and the Social Democratic Party continued to rule in coalition with the small Humanist Party. Although this coalition does not hold a majority in either of the houses of Parliament, it has been able to comfortably secure parliamentary majorities by working together with

other parties – and in particular the Democratic Union of Hungarians in Romania with whom a protocol has been concluded instituting a wide ranging political partnership. Two votes of confidence were called by the Government itself. Both were passed with ease.

1.1. Democracy and the rule of law

Romania has achieved stability of institutions guaranteeing democracy and the rule of law. This was the conclusion of the 1997 Opinion and the subsequent Regular Reports, and has been confirmed by developments over the past year. This section focuses on the most significant developments since the last Regular Report.

The parliament

Parliament has demonstrated a capacity to process a considerable amount of legislation, although its ability to provide effective scrutiny has proved limited.

In 2001, the number of laws adopted by Parliament showed a marked increase over previous years, which were characterised by legislative blockages. This increase is due to a combination of revised parliamentary procedures and the strong position of the ruling party in both houses. This trend continued in 2002.

The combination of an increased volume of legislation, tighter deadlines and limited resources have had a negative impact on Parliament's ability to effectively scrutinise legislation. Given this situation, specific concerns exist relating to the transposition of the *acquis* where procedural deadlines are particularly short. Legislation through ordinances (see below under the *executive*) also serves to reduce the importance of Parliament in the legislative process.

While overall levels of staffing are adequate, there is a shortage of research staff with legal expertise to assist parliamentarians. The numbers of support staff for parliamentary parties are also low. These problems are magnified by the lack of a career development policy or training policy for existing staff.

With regard to transparency, information on the legislative process is widely available and most draft laws are published on the Internet. It remains difficult to follow the process of amending and adopting laws in real time – which limits the opportunities for external input into a key stage of the legislative process. The public cannot attend meetings of the specialised committees without their prior consent.

In June 2002, Parliament established a Committee to draft proposals for constitutional reform. These are to include reforms necessary for EU accession and improvements in the functioning of state institutions.

The executive

Several initiatives were taken to reform the executive and improve its functioning – the launching of a campaign of public administration reform, restructuring anti-corruption bodies, and the de-militarisation of the police. These reforms are welcome but are all at early stages of implementation and, to date, their impact has been limited. Considering the importance of these issues the accelerated implementation of the reform process

should be considered as a priority. Decentralisation of responsibilities to local government was already well advanced and has continued. By way of contrast, there has been little progress in improving the policy making process and the continued reliance on ordinances as a legislative tool is a cause for concern.

Following the major re-organisation at the beginning of 2001, few changes were made to the organisation of the Executive. The composition of the Cabinet remained largely stable. A number of new government agencies were established - but of these only the National Council for Fighting Discrimination is directly linked to implementation of the *acquis* (see the section on *Human rights and the protection of minorities*).

The Executive's practice of legislating through emergency ordinances, and to a lesser extent "ordinary" ordinances, has been strongly criticised by previous Regular Reports. These legislative instruments enter into force immediately and only need retrospective approval by the Parliament. This is a cause for concern since legislation can be adopted before adequate consultation has taken place (i.e. transparency is greatly reduced) and because Parliament's power to subsequently amend or reject legislation introduced by ordinance can create legislative instability.

The use of ordinances has not substantially decreased over the reporting period. In 2001 and 2002, the majority of legislation dealt with by Parliament consisted of emergency and ordinary ordinances - i.e. executive legislation already in force. Parliament's limited scrutiny capacity means that most ordinances are approved either without any amendments or with only minor changes. The use of these procedures remains a cause for concern and normal parliamentary procedures should be used in all but exceptional circumstances.

Important developments have taken place with regard to launching a reform of the Romanian public administration. The Prime Minister has established an inter-ministerial committee on administrative reform under his personal authority. A Central Unit for Public Administration Reform has been created within the Ministry of Public Administration and an inter-ministerial structure has been set up at the working level in order to develop reform proposals. Preparations are also underway to develop a "fast track" programme to recruit young professional managers to the Romanian civil service.

These initiatives, if sustained and supported by a clear strategy, could contribute significantly to improving the quality of Romania's public administration. This said, the reform of the civil service is still only at the design stage and the administration remains characterised by excessive bureaucracy, a lack of transparency and a limited capacity for policy execution.

The 1999 organic law on civil servants includes provisions that, once properly applied, could lead to improved practices and performance. However, the law is not fully or uniformly applied. The Civil Service Agency has the responsibility for this task but its mandate is unclear and its influence over line ministries is weak.

A considerable amount of secondary legislation related to civil service reform has been passed. Issues covered include disciplinary committees, performance evaluation, probationary periods for new civil servants, the functioning of parity committees, and the management of recruitment exams. However, certain elements may need further revision before they can be effectively implemented. A further concern related to the legislative framework is that work to date has focussed on relatively minor issues while there has

been little progress on fundamental issues such as remuneration, career structure and developing public accountability.

With regard to training of civil servants, Parliament approved the establishment of a National Institute for Administration. The Institute will be subordinated to the Ministry of Public Administration and will provide intensive training for new recruits as well as continuous training for existing civil servants. The Institute will also be responsible for managing a network of eight regional centres that will provide training for local officials and civil servants. It has been charged with preparing and implementing a national training strategy and will start training activities during the 2002/2003 academic year.

Human resource management is very limited and is essentially the responsibility of line ministries. There is no horizontal overview of the problems that exist and no strategic plan for addressing them. A reassessment of the allocation of human resources inside the central administration and a proper allocation of these to priority areas is badly needed. This could help reduce understaffing problems faced by several sectors of the civil service.

At the administrative level, policy co-ordination between ministries has further improved over the reporting period. The Government has demonstrated itself capable of effectively distributing responsibilities for major reforms between ministries – typically through the production of strategy papers or action plans. The production of this type of document has proved to be a feature of the government's medium to long-term policy planning, particularly in the context of EU enlargement and when responding to external pressures. However, these plans are often not based on impact/needs assessments and in only a few cases are implementation and monitoring mechanisms established.

In certain specific cases inter-ministerial committees have been formed to allow a better co-ordination of policies with horizontal impact – for example, the integration of environmental policies into other sectoral policies.

The main instrument for policy co-ordination and inter-ministerial co-operation remains the weekly meetings of the Government. However, many decisions are reportedly made without following the normal internal procedures. This situation often results in hastily prepared legislation being adopted without adequate consultation and without a sufficient assessment of feasibility and impact. The consequent need for amendment is an additional factor that adds to legislative instability.

Consultation with stakeholders has improved over the reporting period but remains inadequate. The Economic and Social Council has been provided with increased opportunities to comment on legislative drafts, but the time available to comment is usually short which limits the effectiveness of the consultation procedure. A structured dialogue has been held with the business community on horizontal measures to regulate the business environment. However, little progress has been made in improving dialogue between business and the Government on specific regulations concerning particular sectors where consultation procedures remain inadequate. Intensive negotiations have been held with the trade unions which have enabled the Government to renew the "social pact" it has with them (but not with the employers' federations) on the implementation of its economic policy. NGOs have been actively consulted in certain cases, such as on the law concerning public access to information, as well as on various minority and child

protection issues. However, these are exceptions and as a general rule NGOs are not involved in the policy dialogue.

The Ministry of European Integration is responsible for all issues related to EU accession. It has demonstrated itself capable of playing an effective co-ordinating function even though its capacity to deliver expert opinions on draft legislation remains limited. At the political level, the Inter-Ministerial Committee for European Integration has met during the reporting period – although both the level of representation and the frequency of meetings have been lower than originally foreseen. At a technical level, sectoral working groups have been organised and have met regularly. These bodies have been able to effectively prepare negotiation documents. However, they are not actively involved in assessing the feasibility of negotiation commitments or in monitoring their enforcement.

The process of decentralisation has continued over the reporting period with transfer of additional responsibilities to local authorities. Shifting responsibility to provide services has increasingly gone hand-in-hand with the decentralisation of political responsibilities and increased fiscal decentralisation. In this context it has been encouraging to note an improved capacity to assess and collect revenues from local taxes and fees.

Given the rapid pace of decentralisation, a major problem facing local administrations is that of limited management capacities to implement decentralised responsibilities. Systems for managing human resources are underdeveloped, training is limited and there has been a high turnover of local civil servants. Considerable efforts are still needed to improve financial management and to remedy shortages of IT equipment and IT skills.

Associations of local authorities have developed their role during the reporting period. These still tend to be politicised organisations. For the first time, central authorities have consistently consulted these associations on draft legislation with a significant impact at the local level.

With regard to the *demilitarisation of the police*, significant progress was made with the entering into force of a new Law on the Status of the Policeman in August 2002. This legislation explicitly stipulates that policemen are civilian public servants serving the rule of law. The law also passes the responsibility for dealing with crimes committed by policemen to civilian Prosecutors and Courts, makes it compulsory for policemen to respect human rights and fundamental freedoms, and calls for impartiality, non discrimination, proportionality, and gradualism by policemen when exercising their duty.

Other initiatives have been taken to support these legal developments. The use of conscription in the police is being phased out which has significantly improved the level of professionalism. While overall police training remains insufficient, the military component has been decreased and additional training has been provided on human rights issues. Some aspects of policing have been decentralised and pilot projects on community policing have been launched.

The judicial system

Reform of the judiciary has been limited during the reporting period and the main concerns raised in last year's Regular Report have not been addressed. In particular, the involvement of the executive in judicial affairs has not been substantially reduced, the courts remain over-burdened, the General Prosecutor has retained an extensive right to

introduce extraordinary appeals, and the combination of a lack of resources and an inadequate human resources policy means that the judicial system is severely strained.

The Romanian judicial system has four levels of courts: courts of first instance in the large cities, tribunals which are organised at the county level, court of appeal, and a Supreme Court of Justice. The Prosecutor-General is attached to the Supreme Court. The Supreme Court is also the supreme jurisdiction for the separate system of special military courts. In general, cases enjoy a judgement in substance in the first jurisdiction and two degrees of judicial redress: appeal on facts and appeal on law. There is also a Constitutional Court in Romania. This Court has a two-fold jurisdiction: the examination of laws before their promulgation by the President, and the examination of laws already in force when their constitutionality is challenged before ordinary courts.

The Superior Council of the Magistracy proposes the appointment of judges and prosecutors to the President and is responsible for disciplinary matters as well as judicial promotions. However, selection of Council members lacks transparency and, as in the past, the Minister of Justice has a strong influence over the Council. An amendment to the Law on Judicial Organisation has increased the number of members in the Council from 15 to 17 in order to increase representation of tribunals. In a separate, positive development the Minister of Justice issued an order stipulating that the promotion of judges and prosecutors is merit-based and decided following an open competition using written and oral tests. This promotion process is supervised by a commission composed of university professors, researchers, legal practitioners and experts working within the Ministry of Justice. Given that political influence over the judiciary remains a concern in Romania, further reforms are needed to strengthen the role of the Council and guarantee the independence of the judiciary.

The General Prosecutor, who is sub-ordinated to the Executive, has continued to use his discretionary power to bring extraordinary appeals against judicial decisions. The concerns expressed in last year's Regular Report, over allowing extraordinary appeals to be made even before other legal remedies have been exhausted and about the relaxation of the criteria for introducing such appeals, have not been addressed. This situation has been found contrary to the European Convention of Human Rights and undermines the principle of legal certainty.

The National Institute of Magistracy is the main entry point for a career as a judge or prosecutor and trainees are selected following highly competitive open competitions. The other common route into these professions is for lawyers to pass an examination. However, individuals with a doctorate in law or who have been magistrates, general inspectors or legal counsellors within the Ministry of Justice can be appointed as judges or prosecutors without having to pass a competitive examination. This raises the possibility of political appointments and could undermine the independence of the judiciary.

The National Institute of Magistracy is legally dependent on the Ministry of Justice for its funding, numbers of trainees, approval of programmes and trainers, and generally for the approval of decisions adopted by the Institute's Council. There has been no progress with the granting of self-governing status to the Institute. The centre providing initial training for Court Clerks became operational during the reporting period. Despite the fact that two regional centres for continuous training have been created they are not operational and the Ministry of Justice has not yet established a clear policy on in-service training for

judges and prosecutors. Although training provisions have been improved they remain inadequate and the quality of training for all judicial professions, including clerical staff, should be improved. Particular attention needs to be given to providing specialised training on issues such as economic crime, money laundering and the fight against corruption.

The total number of judges and judicial vacancies has not changed substantially over the reporting period. The average number of cases dealt with by each judge increased from 511 in 2000 to 531 in 2001, and this heavy workload is a particular problem in the tribunals and courts of appeal and has negative consequences for the quality of judgement. Working conditions remain poor and despite an evident need there has only been limited progress with the introduction of IT systems in courts and in prosecutors' offices, and in terms of improving court management.

The number of judges working in the Supreme Court increased over the reporting period, although the workload remains excessive. Additional staff resources as well as measures to reduce the number of cases forwarded to the Supreme Court are necessary.

The situation with regard to the enforcement of civil decisions has improved. Enforcement is the responsibility of private bailiffs and is carried out effectively in most cases.

The Romanian system of *legal aid* is operational but is limited and should be extended. There have been no changes over the reporting period, and in criminal cases, mandatory legal aid is provided in all cases of detention and to all minors. However, legal aid is only mandatory during hearings for cases where the punishment exceeds five years imprisonment and in cases where the court decides that the defendant is unable to defend himself. The Civil Procedure Code contains provisions for granting *legal aid* to persons who cannot afford the legal costs of a civil case. Legal assistance service are organized by the bars and payment is provided by the Ministry of Justice.

In order to address the issues set out above, the Romanian authorities are advised to draw up a comprehensive strategy to further reform and improve the functioning of the judiciary. Such a strategy should include an implementation plan with budgetary provisions.

Anti-corruption measures

Surveys indicate that corruption remains a widespread and systemic problem in Romania that is largely unresolved. Despite a legal framework that is reasonably comprehensive, and which has been expanded over the last year, law enforcement remains weak. New institutional structures have been created but are not yet fully operational. A further development has been the adoption of a National Plan and Programme for the Prevention of Corruption.

Corruption remains a common aspect of commercial operations but is also widely reported in dealings with public bodies as well as at the political level. Such high levels of corruption undermine economic development and erode popular trust in state institutions. Independent observers have concluded that there has been no noticeable reduction of corruption during the reporting period. A total of 343 persons were convicted for corruption in 2001, marginally more than in 2000 but fewer than in 1999.

The National Plan for the Prevention of Corruption was adopted in October 2001, along with the National Programme for the Prevention of Corruption. The two instruments establish target dates for the ratification of the international legal instruments related to fighting corruption, aim to complete the existing legal framework, set out plans for elaborating sectoral strategies for fighting corruption, and promote Romania's active participation in international anti-corruption programmes. These are important developments and ensuring their implementation should be a priority.

The major institutional development over the period was the setting up of the National Anti-Corruption Prosecutor's Office (NAPO). This new body replaces the existing anti-corruption section of the General Prosecutor's Office. The National Office only investigates corruption cases involving sums over €100 000 and relating to high-ranking officials. NAPO also has regional branches attached to each of the 15 Courts of Appeal. These branches handle corruption cases that fall outside NAPO's competence. Country-wide, and when fully staffed, NAPO will have 75 prosecutors, 150 judicial police officers, 35 financial experts, 50 auxiliaries and 10 administrative positions.

NAPO's activities are co-ordinated by the General Prosecutor of Romania and the office is headed by a specially appointed chief prosecutor. The NAPO chief prosecutor is formally appointed by the President of Romania, in accordance with a decision by the Superior Council of the Magistracy. This decision is in turn based upon a shortlist of names proposed by the Minister of Justice. The other prosecutors are appointed by the Minister of Justice, in accordance with recommendations made by the head of NAPO. The same procedure applies for revoking prosecutors' mandates.

The considerable role played by the Minister of Justice in this process could undermine NAPO's independence – a situation which may compromise the effectiveness of its investigations. Measures should be taken to strengthen the autonomy of the Office through a better definition of the status of the prosecutors, in particular the status of the chief prosecutor, and by giving prosecutors guarantees for permanence in office.

The new body enjoys largely the same legal powers as the previous (and ineffective) anti-corruption structures. The major innovations are the division of powers between NAPO and its regional branches and the fact that provision is made for a large number of expert posts. The ability to fill these posts will be a major test of the Government's commitment to this initiative, as previous anti-corruption bodies have been severely understaffed.

Despite the establishment of NAPO, overlapping and unclear institutional arrangements (between the Financial Guard, the Control Office of the Prime Minister and the police) when investigating corruption remains a serious problem.

There were several legislative developments during the reporting period. The Council of Europe's Civil Law Convention on Corruption was ratified in April 2002, the Criminal Law Convention on Corruption in July 2002, and the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime in August 2002. In October 2001 a law on free access to information of public interest was adopted. This law should play a major role in increasing transparency and thereby reducing corruption – although implementation has proved to be slow and inconsistent. A further step towards reducing corruption has been the development of public procurement through electronic tenders. It remains to be seen whether these measures will lead to any noticeable reduction in levels of corruption.

No progress has been made in making the funding of political parties more transparent or in addressing potential conflicts of interest of politicians and civil servants.

The concept of criminal liability of legal persons still needs to be introduced into Romanian Penal Code. Further secondary legislation is also needed to fully implement the 2000 anti-corruption law.

Romania is involved in the Stability Pact Anti-corruption Initiative sponsored by the OECD Secretariat, and participates in the Council of Europe's Group of States against Corruption (GRECO).

As a member of GRECO, Romania received an expert mission in October 2001. According to the evaluation report that was adopted in March 2002, successive Romanian governments have been concerned by the problem of corruption, and have made efforts to prevent and combat it. However, the undoubted reality of corruption in Romania is all the more worrying because the institutions most involved in fighting corruption, including the police and the judiciary, are also affected by the phenomenon. In conclusion, GRECO addressed specific recommendations to Romania, which it is strongly encouraged to follow-up.

1.2. Human rights and the protection of minorities

Romania continues to respect human rights and freedoms. This was the conclusion of the 1997 Opinion and the subsequent Regular Reports, and has been confirmed over the past year. The following section focuses on the most significant developments since the last Regular Report.

Romania has ratified the major human rights conventions (see annex). In principle, the European Convention for the Protection of Human Rights and Fundamental Freedoms has direct effect in Romania. In practice, this remains to be convincingly established.

In May 2002, Romania signed Additional Protocol No. 13 to the European Convention for the Protection of Human Rights and Fundamental Freedoms concerning the abolition of the death penalty in all circumstances.

As previously reported, Romania has signed but not yet ratified Additional Protocol No. 12 to the European Convention for the Protection of Human Rights and Fundamental Freedoms prohibiting discrimination on any grounds.

A law approving the 2000 Government Ordinance on Preventing and Punishing all Forms of Discrimination entered into force in January 2002. This law represents a step forward in terms of the fight against discrimination in Romania and the transposition of the *acquis*. However, amendments to the law will be needed in order to fully conform with the *acquis* based on Article 13 of the EC Treaty, notably with regard to indirect discrimination and the burden of proof (see chapter 13 - Social policy and employment).

A formal decision was taken to establish the National Council for Combating Discrimination in December 2001 and the necessary funds for its functioning were allocated from the 2002 state budget. The President and the Board of Directors of the Council of Combating Discrimination were appointed in August 2002. This is a significant development, as it has proved impossible to enforce anti-discrimination legislation without such a body. The decision setting up the Council states that it will

operate independently of any institution or public authority. However, in practice it is not an independent body as it remains administratively subordinate to the Government. A concern is that members from vulnerable groups and NGOs are not represented in the Council.

The Office of the Ombudsman deals with complaints lodged by persons whose civil rights and freedoms have been infringed by the public administration. In 2001, the institution received a total of 7 412 petitions (63% more than in 2000). A total of 2 970 petitions were declared admissible, and of these more than two thirds were either totally or partially solved during the year. As in previous years, the majority of cases related to property rights, while a significant number of other cases related to the right to a decent standard of living and to social assistance.

The main administrative change was the appointment of a new Ombudsman in October 2001, and the subsequent appointment of two deputy-ombudspersons. Other than these changes, staff numbers have not increased, and remain insufficient to deal with the growing number of petitions and with the Ombudsman's substantially increased remit (as a result of legislation on data protection).

Legislation adopted over the reporting period gives the Ombudsman the authority to establish regional offices and obliges the Constitutional Court to ask the Ombudsman's opinion on laws relating to human rights. The Government and Parliament have been given the option of consulting the Ombudsman on draft legislation concerning human rights and fundamental freedoms, though this is not an obligation. Despite these changes there has been no apparent improvement in the co-operation between the Ombudsman and other state institutions including Government ministries, local administrations and the courts.

Civil and political rights

Romania's progress with improving civil and political rights has been mixed. A number of important reforms have been initiated. Reform of the childcare system has continued and standards of child protection have improved. The Government has also prioritised the fight against trafficking in human beings and a number of important measures have been taken to address this problem. Progress has been made with the development of a probation system – although Romania's prisons are overcrowded and conditions remain extremely poor. Romania's asylum legislation was brought closer to the *acquis*. There has been no noticeable reduction in cases of excessive violence being used by police officers (in particular against the Roma community). Progress in developing safeguards to protect the freedom of expression has been very limited, and progress with the restitution of property has remained slow.

During the reporting period, Romania made significant progress with the reform of *child protection*, although large regional differences still exist in the implementation of the new measures. The number of children in residential care has been reduced from approximately 50 000 in 2001 to 43 000 in 2002. A further 40 000 children are protected in family-type care (placement with a substitute family or with a foster family).

Improvements have taken place with the financing of child protection activities. The budget allocated to childcare has been further increased. The main part of this financing is now transferred from the national budget to the county (*judets*) councils. Funding is

also channelled through the National Authority for Child Protection and Adoption to support national interest programmes dealing with: the closure of old-style institutions; social integration of street children; social and vocational integration of young persons leaving care institutions; and training of staff in child protection issues. However, the fact that budget appropriations are calculated as a function of the number of institutionalised children tends to favour institutionalisation in comparison to prevention of abandonment.

Closure of large, old-style institutions is ongoing: 31 institutions were closed during the course of 2001, and the closure of further 34 is under way. The move away from large institutions has been paralleled by a substantial increase in the number of professional foster parents and the range of alternative child protection services. Living conditions in most placement centres (decentralised childcare institutions) are adequate, although care standards in the remaining large, old-style institutions do not respect the individual needs of children. A further positive development is the adoption of a national strategy on maternity hospitals, which could help reduce the levels of abandonment of children in these hospitals.

The modification of the assessment procedures for children with disabilities is a welcome development although further efforts are needed to develop an inclusive educational policy for disabled children. In the absence of such a policy, the closure of special schools, some of which do not provide adequate living conditions, has been hampered.

Mainstreaming of child protection concerns into other policy issues has progressed, and the National Authority for Child Protection and Adoption has improved its relations with other ministries over the reporting period. The law to combat social exclusion includes measures for young people leaving residential care institutions and should have a positive effect on their integration into society. Given that the main reason for child abandonment is poverty, social legislation passed during the reporting period, and in particular the laws establishing a minimum wage, should help reduce the number of children in institutions.

The National Authority for Child Protection and Adoption is a professional body with a good management capacity. It is adequately staffed, although training could be improved.

Despite this overall progress, a general concern is that there are significant regional differences in the implementation of the reform programme. This situation is compounded by the absence of adequate national standards for child protection services and the fact that the National Authority lacks the mandate to perform inspections at the local level.

The moratorium on inter-country adoptions, noted in last year's report, is still in place. However, a Government Decree, adopted in December 2001, provided for adoption applications to be processed in cases where court procedures had been started prior to the introduction of the moratorium – as well as in certain exceptional cases. One result of the moratorium was a substantial increase in the number of national adoptions. The Romanian authorities have prepared new legislation on childcare and international adoptions and are also developing administrative structure and capacity in order to ensure that adoption decisions are made exclusively in the best interest of the child. This should be done prior to international adoption being resumed.

In October 2001, Romania became a party to the Optional Protocol to the Convention on the Rights of the Child on the sale of children, child prostitution and child pornography.

In November 2001, Romania ratified the Optional Protocol to the Convention on the Rights of the Child on the involvement of children in armed conflict.

There continue to be consistent and credible reports of *degrading treatment by the police* – in particular when dealing with persons belonging to the Roma minority. The use of physical violence to extract confessions is not unusual. The Romanian police have a comprehensive and systematised management approach to dealing with complaints. However, successful prosecutions against police officers are rare and internal police investigations have frequently been inconclusive. Given this situation, the recent transfer of responsibility for the investigation and prosecution of this type of offence to the civilian authorities represents a positive development. New procedures are also needed to improve controls over the use of firearms by the police in the line of duty. The Romanian authorities have not yet authorised the publication of reports made by the European Committee for the Prevention of Torture and are strongly encouraged to do so.

Romania remains a country of origin and of transit for the *trafficking in human beings*. The Romanian Border Police uncovered 269 cases of trafficked women in 2001 while the International Organisation for Migration estimates that as many as 20 000 women are trafficked from Romania each year. In response to this situation, a number of significant measures have been taken by the Romanian Government during the reporting period.

A law for combating trafficking in human beings was adopted in December 2001 and defines the concepts of ‘trafficking’ and ‘exploitation’ as well as setting out penal sanctions. This is a positive step, and addresses one of the weaknesses identified in the 2001 Regular Report. However, implementing rules have not yet been adopted and it is therefore unclear if this legislation is being applied in full. The Romanian authorities should also take particular care to ensure that legislation aimed at regulating emigration is not misused in order to punish victims of trafficking.

A National Action Plan on Trafficking in Women and Children has also been adopted which covers a wide range of objectives, from improving collaboration between the different agencies involved in combating trafficking, to information activities. Tangible results of the Plan have included the opening of a Centre for Victims of Trafficking, and the introduction of specific training on trafficking for the Police Anti-Crime Squad. Administrative structures have been developed with the appointment of a National Co-ordinator to combat trafficking and the setting up of a network of liaison officers within the Ministry of Interior and in Prosecutors’ Offices whose function is to co-ordinate Romanian activities with those carried out by EU Member States and other candidate countries.

Just over 9% of prison detainees are being held in *pre-trial detention*. No data are available on the duration of pre-trial detention in practice, but the legal limit for pre-trial detention is high – half of the maximum period of imprisonment for the crime with which an individual is charged. Judicial review is applied both during the pre-trial detention and during the judicial phase.

Romania’s prison population is high compared to the size of its population and *prison conditions* continue to be extremely poor. While certain positive developments have taken place over the reporting period these have only had a limited effect.

Despite a small reduction in the prison population, severe overcrowding is the most serious problem. While a considerable number of new cells have been built over the last

year, and a concerted programme of cell modernisation and refurbishment has been launched, the prison population still exceeds capacity by over 40%. There has been a gradual improvement in the treatment of inmates: the number of visits and food packages allowed has been increased, greater efforts have been made to find jobs for inmates, and education and recreational facilities have been developed. The training of prison staff has also improved over the last year. However, living conditions remain harsh and the poor quality of food, limited medical care, and unhygienic conditions are issues which still need to be addressed. Human rights organisations have also reported the use of excessive disciplinary measures, such as depriving inmates of food parcels and the use of chains for restraint. There have also been continued reports of physical violence in prisons – although there is no evidence of systematic abuse.

An important and positive development over the reporting period has been the evolution of the probation service. A total of 28 regional probation services have been established, and a budget allocation has been made for hiring 210 staff (although there have been certain difficulties in finding suitably qualified personnel). These regional services have laid the foundations of an effective probation system.

In crimes where the maximum sanction is less than 5 years imprisonment, and the accused is not a minor, there is no mandatory *legal aid* provided. This is a limitation to the right to legal representation is a human rights issue that needs to be addressed. Where legal aid is provided, an additional problem is that the quality of representation is often low.

The positive trend noted last year in the area of *asylum* has continued during the reporting period. Romanian asylum procedures are working effectively, handling times are complied with, country information has been improved, the National Office for Refugees enjoys good relations with civil society, and the overall professionalism of dealing with asylum claims has improved.

Although Romania's asylum legislation is largely in line with the *acquis*, certain shortcomings were noted in last year's Regular Report. The Government's recognition of family reunification as a right and clarification of the grounds for exclusion addressed two of these concerns. However, there are still gaps in the legal framework: those with humanitarian status receive fewer benefits than those with refugee status; time limits for processing cases at border points are too short; and asylum seekers can be kept in the airport transit zone for an excessive period of time. The principle of *non-refoulement* is guaranteed under Romanian law but a small number of *refoulement* cases have nonetheless been reported during the reporting period.

Further steps have been taken to improve assistance provided to refugees and asylum seekers. Detailed standards have been established regarding material assistance and feeding, and a programme has been developed to provide classes in the Romanian language to children of asylum seekers (an important development as this will allow children to attend school).

An Emergency Ordinance, adopted in March 2002, banned fascist, racist or xenophobic organisations as well as symbols relating to individuals guilty of crimes against humanity.

Freedom of expression is guaranteed in the Constitution and both the written press and electronic media are able to report freely. At the same time, restrictions on the freedom of expression do exist. Over the reporting period the progress made with guaranteeing freedom of expression was limited, while a number of developments raised questions

about Romania's compliance with international standards and practices.

The main development over the reporting period was the revision of the Penal Code. The crime of "offence to authorities" was repealed, the crime of "insult" will no longer be punishable with a prison sentence, and the maximum prison terms for "calumny against private persons" and "calumny against officials" were reduced. The amendments are limited and maintaining "calumny against officials" as a specific offence with a higher penalty than a similar offence against non-officials contradicts the case law of the European Court of Human Rights. No change has been made as regards the burden of proof (Art. 207), which is weighted against journalists, even though this provision is incompatible with the European Convention on Human Rights and was raised as a specific concern in last year's Regular Report.

Both Houses of Parliament passed a draft law on the right to reply that has been criticised by human rights organisations for giving disproportionate power to the plaintiff and thereby discouraging the media from presenting critical opinions or closely scrutinising controversial issues. The law was not promulgated by the President. In a separate development, procedural reasons were used to dismiss the Board of Control for Romanian State Radio (appointed by the previous Government) before it had completed its term of office. This allowed the current Government to appoint a new Board of Control. Taken together, these developments indicate the Government's increasing sensitivity to critical media reports and represent a worrying trend.

ProTV, the largest private television company, is heavily indebted to the Romania state and has applied to the tax authorities for a rescheduling of its outstanding tax liability. This makes the channel's continued operation dependent on the good will of the Romanian authorities.

Freedom of religion is guaranteed by the Constitution and is observed in practice. The Government does not restrict the observance of religious belief, although human rights organisations have reported cases of Orthodox clergy, sometimes working with local officials, restricting the religious activities of other churches.

There are 15 recognised religions in Romania, and while the possibility of registering new religions exists in principle, it has not been applied in practice. Non-recognised faiths are able to operate without restriction but do not benefit from the same legal advantages as recognised religions. The 1948 Decree on Religious Denominations is in need of reform, but there has been no progress in this regard over the reporting period.

As regards discrimination on the basis of *sexual orientation*, Parliament confirmed the decriminalisation of homosexuality during the reporting period (the measure was originally introduced by Emergency Ordinance in June 2001) and ensured that sexual offences are now governed by the same legislation irrespective of sexual orientation.

The Romanian Constitution provides for the *freedom of association* and the *freedom of assembly*. Both of these rights are respected in practice.

In Romania, the process of *restitution of properties* confiscated under the communist regime has three main components: restitution of buildings, restitution of agricultural and forest lands, and restitution of churches and related premises.

Although the legal framework for the restitution of buildings was established in early 2001, progress has been hindered by weak administration and by the absence of implementing legislation. An authority for the enforcement of the restitution law was created during the reporting period but this body is not yet fully functional.

The restitution of agricultural land and forests has continued over the reporting period. Progress has been relatively slow and varied considerably from region to region. In an effort to address this situation, the commissions responsible for restitution were re-organised and working procedures revised. It is too early to assess the effectiveness of these measures but it is unlikely that the Government will be able to meet its own target of completing 90% of agricultural and forestry restitution by the end of 2002.

In July 2002, Parliament adopted legislation that clarified the process of restituting property confiscated from churches. The legislation extends the scope of the previous law in several important respects. However, only church property is covered and there is presently no legal framework for the restitution of actual churches. This is a particularly important issue for the Greek-Catholic Church which had a large number of properties confiscated by the Communist regime but still has no legal redress. The Government has committed itself to producing specific legislation on this issue but delays in preparing such a law means that there has been no substantial progress.

Economic, social and cultural rights

The government has prioritised improving social conditions and there were important legislative developments in order to promote equal opportunities between women and men and to fight social exclusion and poverty. There is still a need to improve social dialogue and the role of trade unions at enterprise level remains limited.

During the reporting period, new legislation has been adopted to promote *equal opportunities* and equal treatment for women and men (*see Chapter 13 - Social policy and employment*). The principle of equal opportunities for men and women has also been introduced, as a basic principle into other legislation (such as the Law on Unemployment Insurance and the Promotion of Employment Stimulation). Given the lack of statistical records or previous case law, it is currently impossible to determine the extent of discrimination. This kind of information will be necessary before the effectiveness of new legislation can be assessed.

Implementation of the National Action Plan for Equal Opportunities continued over the reporting period, most notably with the initial steps towards setting-up a National Agency for Equal Opportunities by 2004. Training activities have also been developed to raise the awareness of civil servants responsible for the implementation of the law on equal opportunities.

Women remain under-represented in political life, with only 11% of deputies and 9% of senators. In the Government, five out of 28 cabinet ministers are women.

Fighting social exclusion and poverty is an explicit government priority and the reporting period has been characterised by intensive legislative activity. New legislation has sought to provide a social safety net while at the same time facilitating access to the labour market in order to develop the economic independence of the *socially vulnerable*. The National Plan for Poverty Prevention and the Promotion of Social Inclusion was finalised

in April 2002 and a law on Preventing and Combating Social Exclusion was adopted as one of the first instruments to implement this Plan. A National Strategy on Special Protection and Social Integration of *Disabled Persons* has also been drawn up.

Trade unions are amongst the most visible civil society organisations and the Government has continued its efforts to constructively engage with them. In January 2002 the Government concluded a Social Pact with the majority of trade unions. A further agreement was reached in June 2002 with the two unions that had not signed the original agreement. Following a request from the trade unions, the Ministry of Labour and Social Solidarity signed the European Social Security Code.

Against a background of industrial restructuring serious labour disputes have taken place – most frequently in the processing industry and in the public sector. At the same time, the Law on the Solution of Labour Disputes would appear to be working with over 50% of disputes solved through conciliation.

The need to improve social dialogue and the role of trade unions at enterprise level was noted in the last Regular Report - but no developments can be reported. There are concerns that implementation is not being respected in all cases.

Romania has submitted the second report on implementation of the Revised *European Social Charter* to the Council of Europe Secretariat General.

Minority rights and the protection of minorities

During the reporting period, positive developments continued to take place with regard to the treatment of minorities. Legislation extending the use of minority languages was implemented relatively smoothly and important steps were taken to implement the National Strategy for Improving the Condition of Roma, with a view to addressing the difficult situation faced by the Roma Community.

The Law on Local Public Administration allows the official use of minority languages in localities where speakers represent more than 20% of the population. This legislation is mainly applicable to the Hungarian minority and, in general terms, it has been successfully applied despite the reticence of some prefectures and local authorities. New legislation stipulates that communities with a minority population of over 20% will be obliged to employ police officers who know the mother tongue of the relevant minority. Progress has already been made with enforcing these new provisions. A further development was the amendment of legislation on the use of the national flag, anthem and coat of arms, in order to allow national minorities to use their own symbols at official gatherings.

Romania has a large Roma population – estimated at between 1 800 000 and 2 500 000⁵. *Discrimination against the Roma minority* continues to be widespread in Romanian society, and the social inequalities to which the Roma community is exposed remain considerable. Living conditions are poor, access to social services remains limited and human rights organisations have received credible reports of police harassment. Against

⁵ In some cases estimates are considerably higher than official figures, due at least partly to the reluctance of some Roma to identify themselves as such. In 1997, the official figure for the Roma population was 400 000.

this context, the Government has made steady progress in implementing last year's Roma Strategy, which is explicitly aimed at addressing discrimination.

During the reporting period, the structures for the implementation of the Roma Strategy were progressively established. At the county level, the Roma offices provided for in the strategy have become operational. Over 400 Roma have been hired as experts, the responsibilities of these experts have been clarified, and all 42 local Roma offices have elaborated Action Plans for the 2001-2004 period. The Roma Party has been the main interlocutor when making these appointments and efforts should be made to increase the involvement of other Roma organisations.

At the national level, 15 commissions have been established in ministries or national agencies for the implementation of sectoral strategies. In addition to experts from the ministries, these commissions also include a member designated by Roma organisations. There has also been significant progress with the implementation of sectoral policies. In the field of employment the Ministry of Labour and Social Solidarity has promoted Roma participation in labour market programmes. The Ministry of Health, and the Ministry of Education have also been active in the implementation of the strategy. A particularly important innovation was the official establishment of school and health "mediators" since this facilitates improved Roma access to public services in general and to education and health services in particular. Agreement was also reached with the Ministry of Interior to employ 100 policemen from Roma communities during the course of 2002.

Against this positive background, a weakness with the implementation of the Roma Strategy is that the full levels of funding envisaged in the original document have not been made available. This lack of financial support means that it has been impossible to carry out many of the planned activities and efforts have been restricted to less ambitious, and less costly actions. Other concerns are the absence of effective co-ordination mechanisms. Without these, the success of the strategy will rely upon the individual approaches taken by the different institutions involved.

One of the aspects of the Strategy that has not, to date, been satisfactorily addressed is that of housing. This is one of the largest problems affecting Roma communities, many of whom live in unacceptable conditions, without basic amenities and without security of tenancy. Certain local authorities have used this situation to attempt to move Roma into special neighbourhoods, but the Government has firmly rejected any such form of segregation.

Although the legal framework for addressing discrimination against Roma is not yet fully operational, courts did rule against employers and newspapers – for the first time – for publishing discriminatory job vacancies.

As regards the use of *minority languages*, slight increases were recorded during the 2001/02 school year in the number of mother-tongue educational units and the number of students being educated in their mother tongue. The Department for Inter-Ethnic Relations decided to finance the publication of textbooks for schools teaching through the medium of minority languages. The private Hungarian University "Sapientia" functioned well and completed its first academic year in 2001/02 with 450 students attending its courses.

No progress was noted with regard to the Csango minority: a non-homogenous group of between 60 000 and 70 000 Roman Catholic people living in the north-east of Romania

who speak a form of Hungarian. Reports from human rights organisations provide evidence that certain local authorities have obstructed attempts by Csango to be taught the Hungarian language (as an optional language). This would contradict current Romanian legislation, which provides the right to study a minority language if there is sufficient demand.

As reported in previous years, Romania is a party to the Council of Europe Framework Convention for the Protection of National Minorities. In March 2002, the Committee of Ministers of the Council of Europe concluded⁶ that Romania had made commendable efforts to support national minorities and their cultures. Further efforts were required in the fields of media, public employment and education - areas where particular attention would have to be paid to the numerically smaller minorities. The Committee concluded that, despite the determination of the authorities to speed up the social integration of the Roma, real problems remained regarding acts of discrimination, the wide socio-economic differences between Roma and the rest of the Romanian population, as well as ill-treatment by some law-enforcement officials.

1.3. General evaluation⁷

In its 1997 Opinion, the Commission concluded that Romania fulfilled the political criteria. Since then the country has made progress in consolidating and deepening the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. This has been confirmed over the past year. Romania continues to fulfil the Copenhagen political criteria.

The launch of a major programme of administrative reform is an important development and ensuring the successful implementation of these reforms should be considered as a priority. Significant progress was also made with the decision to demilitarise the police. This will increase the public accountability of police officers - although further actions are needed to ensure the proportionality of their actions. New institutional structures have been created for fighting corruption, which remains a cause for very serious concern, but they have yet to have an impact.

Romania still needs to improve the decision making and legislative processes. In particular, the Government's reliance on emergency ordinances should be reduced and parliament's ability to scrutinise legislation increased. Reform of the judiciary has been limited. A lack of resources means that the judicial system is severely strained and the executive's involvement in judicial affairs has not been reduced in practice. In order to address these issues, judicial reform should be made a political priority and a comprehensive strategy to improve the functioning of the judicial system should be drawn up.

Romania continues to respect human rights and freedoms. It has made significant progress with child protection, reducing the number of children in residential care and improving actual living conditions. Progress has also been made in promoting equal opportunities between men and women, with developing structures to reduce trafficking in human beings and with setting up the institutional framework to fight discrimination.

⁶ Resolution Res CMN (2002)5 of 13 March 2002.

⁷ See "Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2002) 700.

The development of a probation system has continued although prison conditions remain extremely poor. Additional steps need to be taken to strengthen safeguards for freedom of expression.

Positive developments took place with regard to the treatment of minorities. Legislation extending the official use of minority languages was implemented relatively smoothly. Important steps were taken to implement the National Strategy for Improving the Condition of Roma, with the aim of effectively combating discrimination and improving living conditions, although additional financial resources will be necessary to make further progress.

2. Economic criteria

2.1. Introduction

In its 1997 Opinion on Romania's application for EU membership, the Commission concluded:

“Romania has made considerable progress in the creation of a market economy”; it “would face serious difficulties coping with the competitive pressure and market forces within the Union in the medium term”.

In its 2001 Regular Report, the Commission found that:

“Romania has made progress towards establishing a functioning market economy and although it would not, in the medium term, be able to cope with competitive pressure and market forces within the Union, it has taken measures that would allow to develop its future capacity, provided that it keeps to the engaged economic reform path.”

In examining economic developments in Romania since the Opinion, the Commission's approach was guided by the June 1993 conclusions of the Copenhagen European Council, which stated that membership of the Union requires:

- the existence of a functioning market economy;
- the capacity to cope with competitive pressure and market forces within the Union.

In the analysis below, the Commission has followed the methodology applied in the Opinion and the previous annual Regular Reports. The analysis in this year's Regular Report takes stock of developments since the Opinion was drafted.

2.2. Summary of economic developments since 1997

Romania's macroeconomic performance has been mixed but is showing signs of improvement. Over the period, the average growth rate has been negative, inflation high and the sustainability of the external accounts a frequent source of concern. A lack of restructuring has underpinned a low rate of unemployment but a high rate of underemployment. Since mid-2000, however, macroeconomic trends have improved distinctly, building upon the cumulative impact of successive rounds of incomplete structural reforms, a more favourable external environment and, crucially, the adoption of a more balanced and responsive policy mix. Growth has resumed, inflation declined and external vulnerability decreased.

Main Economic Trends								
Romania		1997	1998	1999	2000	2001	Average	2002 latest
Real GDP growth rate	per cent	-6.1	-4.8	-1.2	1.8	5.3	-1.0	3.1 Q1
Inflation rate ^a	per cent	:	59.1	45.8	45.7	34.5	46.3	27.4 July ^c
- annual average								
- December-on-December	per cent	:	40.6	54.8	40.7	30.3	41.6	23.0 July
Unemployment rate								
- LFS definition	per cent	5.5	5.6	6.2	7.0	6.6	6.2	10.0 Q1
General government budget balance	per cent of GDP	-4.5	-3.2	-4.5	-4.5	-3.4	-4.0	
Current account balance	per cent of GDP	-6.0	-7.1	-3.6	-3.7	-5.9	-5.3	
	million ECU/€	-1,884	-2,647	-1,216	-1,471	-2,623 ^d	1,968	- 750 Jan.-May ^d
Gross foreign debt of the whole economy	per cent of exports of goods and services	82.6	84.7	81.7	64.1	:	:	
- debt export ratio	Million ECU/€	7,513	7,176 ^b	7,643	8,505	:	:	
Foreign direct investment inflow	per cent of GDP	3.4	4.8	2.9	2.8	:	:	
- balance of payments data	million ECU/€	1,071	1,812	977	1,110	:	:	434 Jan.-May ^d

Sources: Eurostat. National sources. OECD external Debt Statistics

^a PROXY HICP since 1996 (see methodological notes);

^b series break as a result of some technical changes to the definition.

^c Moving 12 months average rate of change.

^d Source: Website of the National Bank.

Despite notable advances, transition-related reforms still need to be completed. Romania is a late starter in the reform process, with key measures in the area of liberalisation and enterprise reform starting to be taken only in early 1997. Although further progress has been achieved since then, especially in the banking sector, reforms have failed to gain significant momentum as the authorities have struggled to implement stated policies in a difficult political and economic environment. Price and trade liberalisation has advanced with the progressive application of the Europe Agreement trade provisions, and, recently, a significant adjustment in administered prices. The weight of the private sector also increased as the privatisation of large state-owned enterprises started. Although still

awaiting privatisation, integrated energy companies have been unbundled and their markets partially opened up. The structure of the banking sector has been overhauled and the regulatory framework considerably strengthened in a belated response to serious financial difficulties. Progress has also been made on establishing the legal framework and basic institutions for a market economy. However, most of these reforms still need to be completed. Most importantly, budget constraints have been only partially tightened as poor payment discipline, large tax arrears, and weak bankruptcy procedures have allowed several nonviable enterprises to survive, hindering the reallocation of resources to more efficient uses.

Romania has not made progress in real convergence with EU per capita income levels. GDP per capita in purchasing power parity was only 25% of the EU average in 2001. Regional income disparities are moderate. At 35% of the EU average over the 1997-99 period, per capita income in the Bucharest region was some 40% higher than the national average and some 85% above the level in the poorest region. Since 1997, the economic activity rate has averaged 70% and the employment rate 65%. Both have declined over the period. Totalling 6.2% of the labour force on average, unemployment was considerably higher among the young and slightly more pronounced among male job-seekers. Although regional disparities in unemployment have been small, unstructured public enterprises and inefficient agricultural activities account for a significant share of employment in certain areas.

Main Indicators of Economic Structure in 2001		
Population (average)	Thousand	22,408
GDP per head ^a	PPS	5,900
	per cent of EU average	25
Share of agriculture ^b in:		
- gross value added	per cent	14.6
- employment	per cent	44.4
Gross fixed capital formation/GDP	per cent	19.0
Gross foreign debt of the whole economy/GDP ^c	per cent	21.3
Exports of goods & services/GDP	Per cent	33.5
Stock of foreign direct investment	Million €	5,496 ^d
	€ per head ^a	245
Long term unemployment rate	per cent of labour force	3.2

^a Figures have been calculated using the population figures from National Accounts, which may differ from those used in demographic statistics.

^b Agriculture, hunting, forestry and fishing.

^c Data refer to 2000.

^d Data refer to 1999.

2.3. Assessment in terms of the Copenhagen criteria

The existence of a functioning market economy

The existence of a functioning market economy requires that prices, as well as trade, are liberalised and that an enforceable legal system, including property rights, is in place. Macroeconomic stability and consensus about economic policy enhance the performance of a market economy. A well-developed financial sector and the absence of any significant barriers to market entry and exit improve the efficiency of the economy.

The consensus about the fundamental goals of economic policy has progressively broadened but fears of high political and social costs still deter a more resolute implementation of structural reforms. Support for macroeconomic stabilisation and structural reform has often proved to be shallow and narrow, contributing to the large gap between policy goals and achievements, and to a frequently disjointed decision-making process. There are, however, growing indications that the consensus about the essential aims of economic policy may be broadening. After lengthy debates, in March 2000 the government managed to agree on a Medium Term Economic Strategy, which was broadly endorsed by all political parties. The change of government at the end of 2000 did not lead to any fundamental modification of the ultimate goals of economic policy, which were strongly re-stated through the approval of Romania's first Pre-Accession Economic Programme in mid-2001 and the conclusion of a new IMF arrangement in October 2001. At the same time, improved co-ordination among ministries and between the government and the central bank facilitated the adoption of a more balanced policy mix. This progress, however, has not yet led to a significant acceleration in structural reforms leading, inter alia, to delays in disbursements from the IMF.

Although the economy has contracted in real terms relative to 1997, GDP growth resumed in 2000 on the back of rising domestic demand. Recording an average period growth of -1%, the economy has not fully recovered from the recession of 1997-1999, when real GDP contracted by a cumulative 11.7%, and investment by nearly 9%, as the economy struggled to cope with various negative shocks against a background of indecisive policy action and faltering investor confidence. After a modest rebound in 2000, however, GDP expanded by 5.3% in 2001 on account of three main factors. Private consumption boomed on the back of rising real wages and income. Stock building continued to rise, hinting at unresolved statistical problems in the estimation of GDP components or at a persistent accumulation of unsold products by enterprises with soft-budget constraints. Investment accelerated for the second year in a row, partly as a result of distortionary tax incentives offered to small and medium-sized enterprises (SMEs). Although the strengthening domestic demand led to an increasingly negative contribution by the external sector to growth, exports expanded at double-digit annual rates from mid-1999 until the last quarter of 2001, when growth slowed down sharply as the external economic situation worsened. The economic recovery, however, has remained resilient. In the first quarter of 2002, GDP increased by 3.1% as import growth came to a near halt while exports rebounded somewhat and domestic demand continued to expand, albeit at a slower pace.

The current account deficit has been high and its sustainability a frequent source of concern. Recent trends, however, point to an improved situation. The current account deficit has fluctuated around a period average of 5.3% of GDP. External financing was called into question when the deficit peaked at 7.1% of GDP in 1998 against the background of a severely misaligned exchange rate, a rising trade deficit, dwindling reserves, a bunching of debt repayments and adverse international financial conditions. To stave off a full-blown external crisis, the authorities accepted a large devaluation of the real exchange rate and tightened policies while continuing to service their foreign debt. Following two years of successful external consolidation, however, the current account deficit widened again to 5.9% of GDP in 2001, when the trade deficit rose to 7.5% of GDP on the back of the strengthening recovery and various one-off factors boosting import growth. Unlike in the past, however, the external deterioration was kept in check thanks to the timely tightening of the policy stance in the second half of 2001. In the first half of 2002, this combined with rebounding exports of goods, lower prices for energy imports and an underlying trend towards higher private transfers from abroad and lower service trade deficits to cause a significant reduction in the current account deficit. Financing the external deficit has also become less problematic thanks to a steady inflow of foreign direct investment (FDI), averaging nearly 3.5% of GDP, a positive error and omission item, rising to 2.6% of GDP in 2001, and improving borrowing conditions. In April 2002, Romania launched its first ten-year bond on the international market, reaping the benefits of various upgrades granted by rating agencies since 2000 and of its improving vulnerability indicators. The debt-to-GDP ratio remains low while its average maturity has lengthened. Reserves' import coverage has also been on a rising trend, reaching 4.4 months by June 2002.

Over most of the period, unemployment remained fairly low and relatively constant owing to the limited progress achieved in economic restructuring. The unemployment rate (ILO definition) averaged 6.2%. After rising moderately during the three-year recession, it decreased to 6.6% in 2001 on the back of the on-going recovery. In the first quarter of 2002, however, the unemployment rate rose sharply to 10%, possibly largely due to seasonality and administrative factors linked to the introduction of a minimum income guarantee scheme. Recent trends in the registered unemployment rate support this view. Unemployment is much higher among the young and of a long-term nature for more than half of job-seekers. Between 1997 and 2001, the activity rate decreased from 71.5% to 68.3%. Average employment in industry dropped by more than 15% and the workforce of public enterprises was cut by nearly a fifth. Yet, total employment decreased by less as the agricultural sector absorbed a large proportion of dismissed workers. Along with the relative stability of the unemployment rate, the resulting increase in the share of agricultural employment, reaching 44.4% in 2001, suggests the existence of large pockets of underemployment in the economy.

Inflation remains high but has declined steadily since mid-2000 on the back of a more coherent policy stance. Even excluding the 1997 spike caused by the belated liberalisation of the exchange rate and of energy and agricultural prices, the annual inflation rate has been high at 46.3% on average. Inflation has been the most visible symptom of the economy's structural weaknesses and macroeconomic imbalances. Since mid-2000, however, it has been on a steadily declining path. Unlike in the past, from mid-2001 onwards disinflation has been achieved despite simultaneous high but warranted increases in energy tariffs. After totalling 45.7% in 2000, average yearly CPI inflation fell to 34.5% in 2001. The year-on-year rate has also dropped sharply, decreasing to 23.0% by July 2002.

Due to more supportive conditions, the present monetary policy framework has led to increased macroeconomic stability. Monetary and exchange rate policies were relieved of their quasi-fiscal functions in early 1997 but the central bank initially remained unable to sustain a stance geared to price stability. Other policy objectives routinely took precedence in an environment characterised by a fragile external position, a weak financial sector, widespread financial lack of discipline, and unresponsive fiscal and income policies. Progress on these fronts, however, has allowed the monetary authorities to increasingly focus on disinflation. Within the framework of the managed float regime adopted in 1999, the exchange rate is used as the main anti-inflationary instrument as long as this does not endanger the external balance. Thanks to an improved external outlook, productivity increases and more supportive wage trends, the real exchange rate could appreciate some 17% against the euro between 1999 and 2001 without imperilling the external accounts. However, new challenges are emerging with strong capital inflows forcing the central bank to engage in costly sterilisation operations. These totalled some 16% of GDP in volume over 2001 and continued at a sustained rate over the first half of 2002. Nevertheless, broad money has expanded rapidly with the real year-on-year growth rate turning positive at the beginning of 2001 and accelerating to above 16% by June 2002. In view of the faster than expected disinflation in the first half of 2002, however, the authorities recently allowed real policy interest rates to drop after letting real money market rates rise over 2001. Various measures were also taken recently in an attempt to slow down an on-going rapid expansion in foreign-currency denominated credit.

The authorities have been adopting an increasingly responsible fiscal stance. At 4% of GDP on average,⁸ the general government deficit has remained under control despite direct banking sector restructuring costs of some 4.5% of GDP over 1999 and 2000. After peaking at 4.5% of GDP in 2000, the general government deficit was cut to 3.4% of GDP in 2001 thanks to a tightening of policy in the second half of the year. This restored a moderate primary surplus and made it possible to achieve the target agreed with the IMF despite lower-than-planned revenues. After rising sharply from very low levels, the gross debt ratio was stabilised in 2000 and cut to 23.3% in 2001. Developments during 2002 have remained broadly positive. Thanks to strict expenditure control and increases in excise taxes compensating a shortfall in revenues, the 2.6% of GDP deficit target for the year remains achievable. Relative to 1997, GFS-based data indicate that, at 30.5% of GDP, revenues have increased by nearly 2 percentage points thanks to a higher rate of collection of indirect taxes. After increasing on the back of rising interest payments until 1999, and higher non-interest spending in the run up to the 2000 election, expenditure has been brought back to about 34% of GDP with cuts in public investment counterbalancing a slight increase in current expenditure.

Despite recent progress, fiscal consolidation needs to be put on a sounder footing by tackling the remaining unresolved issues. Tax arrears have typically been tolerated and regularly cancelled. Under the latest IMF arrangement, for instance, monitored enterprises' arrears to the budget rose above the agreed targets, increasing by 13% in the first four months of 2002 after a temporary fall in the second half of 2001. Further undermining tax discipline, tax codes have also changed frequently, often to offer targeted incentives to specific economic groups. Some progress, however, has been

⁸ All general government deficit and debt data used were notified by the Romanian authorities to the European Commission in April 2002. Data are, however, only partially compliant with EU standards (ESA-95). At 4.3% of GDP, the average GFS-based general government deficit used as reference in the context of IMF programmes is somewhat higher than the equivalent ESA-95 figure.

achieved with the recent approval of more transparent procedures for the cancellation of tax arrears and, most notably, with the enactment of new VAT and profit tax laws that constitutes a significant effort towards the elimination of tax exemptions and distortionary tax incentives. The establishment of a new minimum income guarantee scheme in late 2001 was an important step towards the creation of a better-targeted social safety net. Measures are also being taken to improve the institutional framework for budgetary policy and tax administration. The 2002 budget was the first to be approved within the mandated time limits and a new improved public finance law was recently approved. The number of extra-budgetary funds has been reduced. Procedural and administrative changes are being carried out to address the systemic weaknesses affecting tax administration. However, significant medium-term challenges still need to be faced, including the reform of the increasingly unbalanced public pension system, the orderly implementation of on-going fiscal decentralisation and the need to support transition by providing an effective social safety net and adopting a more growth-enhancing structure of revenue and expenditure.

Romania has a mixed track record of policy-making geared towards economic stability. Although the policy mix has become more balanced of late, some concerns remain. By often failing to adopt the most appropriate macroeconomic policy mix and repeatedly holding back from advancing the structural reforms needed to support successive stabilisation programmes, the authorities have directly contributed to the boom-and-bust nature of Romania's economic performance. Signs of more responsible behaviour, however, have begun to emerge, most notably with the tightening of the inappropriately loose policy stance adopted in the run up to the general elections at the end of 2000 and at the beginning of the new administration. The adoption of a more coherent mix in the context of a new IMF stand-by arrangement was instrumental in halting the deterioration of the current account and supporting disinflation in the face of necessary increases in energy tariffs. So far, however, the authorities have failed, yet again, to put the process of macroeconomic stabilisation on a sounder basis, making insufficient advances in enterprise reforms and allowing the wage bill and the arrears stock of public enterprises to rise above the levels agreed with the IMF. Finally, in June 2002, the government signed an agreement with two trade unions providing for a 50% increase in the minimum wage and a reduction in the minimum income tax in 2003 that could endanger the future pace of disinflation. Safeguarding measures, including a tightening of the fiscal stance in 2003, were agreed only later with the IMF and will need to be strictly implemented to sustain stabilisation. In this regard, the sharp growth in money and credit observed since late 2001 also requires continued monitoring.

Most prices are liberalised. Despite diminished direct intervention by the authorities, poor payment discipline continues to affect the workings of the price mechanism. Currently, price regulations apply to eighteen goods, ten of which are included in the consumption basket accounting for a share of 20.4%. The responsibility for price administration is entrusted to the Competition Office and the energy regulators. Although formally independent, the energy regulators have not been immune from political pressure and administered prices have often lagged behind inflation. Recently, however, regulated prices have been adjusted over and above inflation. Most notably, since mid-2001 the prices for electricity, heating and natural gas have been brought progressively closer to international and cost recovery levels. To protect this achievement, electricity and heating tariffs were tied to the US dollar in July 2002. However, this important relative price adjustment has not fully fed through the economy because of a worsening in the collection rates of energy enterprises over 2001. Recent positive efforts to address this

problem include the establishment of escrow accounts for intra-sectoral payments, some disconnection of delinquent users, and rescheduling agreements conditional on the payment of current obligations. However, without more fundamental reforms, particularly with regard to the privatisation or liquidation of large loss-making public enterprises, poor payment discipline will continue to affect the functioning of the price system. Progress towards this goal will also require the authorities to continue refraining from the ad hoc protective trade measures used in the past.

The private sector has continued to grow but the weight of large loss-making public enterprises remains high. Averaging 63.7% over the period, the share of the private sector in GDP has steadily increased, climbing some 6.5 percentage points to 67.1% in 2001. By end-2000, private-majority establishments accounted for roughly three-quarters of all employment, turnover and export. However, public companies still accounted for more than 40% of enterprise investment and 75% of all tangible assets. With the weight of private ownership expanding in all sectors, the continuing influence of public ownership largely rested upon its dominant role within the energy sector, which accounts for 30% of total industrial turnover. In the agricultural sector, nearly all land is privately owned but the development of an effective land market is still at an early stage. Despite some progress, property titles are not yet fully clarified. This and the limited progress in the privatisation of agricultural companies hold back the consolidation of fragmented holdings.

Amid procedural changes, repeated delays and frequently untransparent procedures, privatisation has made some progress. The sluggish pace of privatisation recorded so far reflects the limited attractiveness of many enterprises on offer but is ultimately due to the authorities' failure to overcome the political and social obstacles to faster divestiture. Rather than accelerating the process, numerous changes in privatisation methods, conditions, and administrative responsibilities have contributed to its slow pace and facilitated the proliferation of opaque procedures that deter investors' interest. Progress has nevertheless been achieved since the Opinion, particularly with respect to small and medium-sized enterprises. Some success has also been achieved with respect to larger companies, most notably with the sale of Banca Agricola and SIDEX. In agriculture, 207 companies have been sold and 256 are undergoing privatisation out of a total of 739 entities. Preparations for the privatisation of various energy companies have also started to make progress, albeit slowly. On the whole, however, the divestiture of large enterprises has been protracted despite international assistance. As a result of the enduring difficulties encountered in privatisation, the authorities missed the privatisation targets agreed with the IMF and the World Bank for the first half of 2002. A recent flurry of new offers and the approval of yet another law aiming at accelerating privatisation will need to be judged on results.

Welcome initiatives to improve the institutional provisions for market entry and exit must be accompanied by a greater effort to impose market discipline throughout the economy. Since 1997, the annual increase in economic units recorded in the Trade Register has averaged 7%. The number of active enterprises, however, has declined by nearly 3%, reflecting a strong growth in the number of self-employed entrepreneurs. To facilitate market entry, administrative measures have been taken to reduce lengthy bureaucratic procedures and red tape. In particular, one-stop offices for simplified registration and authorising procedures were instituted in 2001. Important initiatives aimed at improving market exit have also been launched. In an attempt to streamline procedures, bankruptcy legislation for non-financial enterprises has been amended several times, most recently in

February 2002. Implementation, however, remains weak. In the banking sector, the bankruptcy legislation introduced in 1997 also failed to provide an effective exit mechanism. In October 2001, it was modified and extended to credit co-operatives. Despite these efforts, uncertainties about property rights, frequent changes in laws and regulations, and difficult access to financing continue to hamper market entry. More fundamentally, several nonviable industrial enterprises have been allowed to survive, hindering the reallocation of resources to more productive uses.

Having established most of the legal framework for a market economy, Romania must ensure its sustained implementation. Despite some improvements and strengthened efforts, Romania has made insufficient progress towards the establishment of a positive investment climate and favourable business environment. To this end, tax regulations should be streamlined. Legal certainty should also be strengthened, eliminating remaining uncertainties about property rights, refraining from changing regulations frequently and ensuring a non-discretionary interpretation of the law by improving courts' effectiveness.

The banking sector has strengthened considerably but still cannot provide effective intermediation between savers and investors. Its continued development depends on the completion of privatisation and the sustained implementation of an improved supervisory and regulatory framework. The development of the banking sector was seriously hampered by the slow pace of reform and by the misuse of public banks as instruments for subsidisation. A creeping banking crisis forced the authorities to act between 1998 and 2000 when several problem banks were closed or cleaned up and privatised, overhauling the structure of the sector. In 1997, seven state-owned banks held nearly 80% of all loans. In March 2002, only three state-owned banks remained, accounting for 35% of the credit stock. The largest one, BCR, is in the early stages of privatisation. The share of foreign institutions has also increased with thirty-two foreign-owned banks and branches accounting for more than half of total banking sector net assets, and three-fifths of all loans by March 2002. Largely due to the clean up or closure of problem banks, vulnerability indicators have improved dramatically. The capital-adequacy ratio increased from 14.5% at end-1997 to 27.1% in June 2002. The share of non-performing loans fell from 71.7% at end-1998 to 2.8% in June 2002 and prudential reports indicate that past due and doubtful claims dropped from over 250% of commercial banks' own capital at end-1998 to some 2.8% in June 2002. Taking advantage of much strengthened supervisory powers, the National Bank of Romania will need to rigorously apply the significantly improved prudential regulations to avoid any renewed deterioration in the financial health of the banking sector, especially in view of the on-going expansion of credit and deposits. Real year-on-year growth of deposits and credit to the non-government sector resumed in 2001 and accelerated strongly from a low base. The banking sector, however, remains underdeveloped. Total assets still amount to less than 30% of GDP, deposits to some 20% and domestic credit to little more than 10%. Occasional scandals point to persisting governance problems, at least among domestic banks. A low, albeit rising, average profitability depends upon a large spread between deposits and lending rates which equalled 16.4% in June 2002.

Although strengthened supervision and other institutional developments have set the stage for the growth of non-bank financial markets, these are still underdeveloped and will be unable to mobilise significant funds for years to come. The equity markets remain small with the total aggregate capitalisation of the Bucharest Stock Market and the over-the-counter RASDAQ amounting to some 7% of projected GDP in July 2002. Privatisation has recently been completed in the insurance sector which has grown

steadily but remains underdeveloped: gross insurance premiums collected in 2001 amount only to some 1% of GDP. To support the development of the non-banking financial sector, the authorities have been taking steps to strengthen the supervisory framework. In particular, regulations in the insurance sector have improved and the recently established supervisory body has begun to operate. The formation of a joint committee between the capital market regulator, the central bank and, as of April 2002, the Insurance Supervision Commission, has the potential to improve the surveillance of the local financial sector.

The capacity to cope with competitive pressure and market forces within the Union

The ability to fulfil this criterion depends on the existence of a market economy and a stable macroeconomic framework, allowing economic agents to make decisions in a climate of predictability. It also requires a sufficient amount of human and physical capital, including infrastructure. State enterprises need to be restructured and all enterprises need to invest to improve their efficiency. Furthermore, the more access enterprises have to outside finance and the more successful they are at restructuring and innovating, the greater will be their capacity to adapt. Overall, an economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the Union before accession. Both the volume and the range of products traded with EU Member States provide evidence of such integration.

The lack of macroeconomic stability and structural reforms has held back the reallocation of resources towards more productive uses. Several factors have hindered the restructuring of the economy, such as limited financial discipline, tax arrears and other forms of quasi-fiscal subsidies, sporadic price controls, ad-hoc trade restrictions, an underdeveloped financial sector and, until recently, a reluctance to adjust the relative level of administered prices. By depressing investor confidence and affecting the business environment, a volatile macroeconomic environment, an unstable legal framework, and a limited enforcement capability by inexperienced regulatory agencies also helped to slow down the process of restructuring.

To maintain and upgrade the country's human capital, Romania's education system should be strengthened and active labour market policies further developed. At 3.3% of GDP on average, general government spending on education has been stable but low. Schooling is compulsory for only eight years. The participation rate of students aged 16 to 24 is relatively low, albeit rising. Some 70% of students in upper secondary and post-secondary education are enrolled in vocational courses. A small but increasing percentage of total students is enrolled in post-secondary and tertiary education. As a result, despite some recent improvements, the average education level remains relatively low with less than 10% of the total labour force having completed tertiary education in 2000. Spending on R&D has dropped to less than 0.5% of GDP in 1999. Although passive measures still represent the bulk of labour-market policies, the authorities have designed and implemented an increasing array of active measures. These, however, are still heavily concentrated on subsidies to employment rather than training measures. Moreover, while labour-market policies can play a useful complementary role, they cannot supplement the restructuring measures needed to solve the extensive underemployment of labour resources in Romania.

Only sustained growth within a more stable macroeconomic environment will make available the resources needed to upgrade Romania's capital stock. The transport infrastructure is inadequate and suffers from a lack of investment with motorway construction resuming only recently for the first time since 1997. Energy sector infrastructure has also deteriorated. Forced to provide quasi-fiscal subsidies to the rest of the economy, energy companies have been left without the resources needed for investment. An obsolete capital stock and irrigation network have made the agricultural sector particularly vulnerable to the vagaries of the weather.

The level and quality of investment spending must increase to support the long-term development of the economy. Gross fixed capital formation averaged 19% over the period. After declining during the recession from 21.2% in 1997 to 17.7% in 1999, the investment ratio started rising again in 2000, reaching 19% of GDP in 2001. There are some doubts about the soundness of the business decisions underlying much of this investment activity as state-owned companies were responsible for more than 60% of all gross fixed capital formation carried out by enterprises. Despite the poor state of public infrastructure, gross fixed capital formation by the general government only amounted to 1.8% of GDP on average. FDI inflows are playing an increasing role even though the cumulative stock of FDI remained low on a per capita basis at €245 per head in 2001. Yet, since 1997, net FDI inflows have remained rather stable on an annual basis, equalling 3.5% of GDP on average. As a result, the 1997 FDI stock had doubled by 1999.

Despite important progress in some sectors, restructuring is still incomplete. The breadth and depth of enterprise restructuring has been uneven. The positive performance of some industrial sectors, like textiles, footwear, furniture, and electrical equipment, indicates that restructuring is beginning to bear fruit in those sectors where it has been carried out more aggressively, largely thanks to faster privatisation. Significant progress has also been achieved in some sensitive sectors, like banking, mining and shipbuilding. Despite a chronic gap between policy announcements and implementation, restructuring has also advanced in most other sectors, including agriculture, steel and energy, where the formerly integrated enterprises have been unbundled and slowly prepared for sale. However, privatisation and restructuring are not yet completed in most sectors and are at a relatively early stage in some. In particular, several large loss-making enterprises that actually subtract rather than add value have survived with little or no restructuring thanks to direct and indirect government support. This has weakened market incentives and deprived the budgetary and private sectors of scarce resources. It has also precluded a faster and deeper restructuring of the energy sector, which has become the main provider of quasi-fiscal support following the restructuring of the banking sector. Finally, as illustrated in the relevant chapter of this Report, serious economic and institutional weaknesses still hamper rural and agricultural development.

The structural composition of the economy reflects the incompleteness of the transition process. The share of the service sector in gross value added increased some 10 percentage points to 51.3% in 2001. The counterpart to this expansion in the tertiary sector has been an equally distributed decline in the share of gross value added produced by industry, down to 28.5% by 2001, and by agriculture. At 14.6 % of GDP in 2001, however, the latter's share is still relatively high while the increasing number of agricultural workers points to a large deterioration in sectoral productivity. Moreover, the sectoral structure of gross value added has been relatively stable since 1998.

A growing acknowledgement of the role played by SMEs could lead to a better environment for their development. Operating mostly in retailing and manufacturing, SMEs play an increasingly important role, explaining a rising share of turnover and gross value added, respectively 56.1% and 39.5% in 2000. Between 1997 and 2000, SMEs accounted for more than half of total turnover, a quarter of all exports, and a fifth of all investment carried out by enterprises. The share of employees working in SMEs also increased sharply, rising from 33% in 1997 to 47% in 2000. In line with SMEs' growing economic relevance, the authorities have taken various steps to facilitate their development, instituting a Ministry for SMEs in 2001. Notwithstanding these initiatives, Romania still lacks a coherent and effective SME strategy. In any case, apart from specific targeted programmes, SMEs would greatly benefit from faster progress towards more general and fundamental policy goals such as the completion of the privatisation process, the sound development of the financial sector, and the establishment of stable legal, regulatory and tax frameworks.

Although decreasing over the period, government intervention has continued to affect enterprises' competitiveness, thereby holding back the process of restructuring. Advances in domestic and external liberalisation coupled with progress in privatisation have reduced the influence of government policy and legislation on competitiveness. However, successive governments have continued to shelter a slowly diminishing number of sectors and enterprises from market discipline. This was achieved through the provision of explicit budgetary subsidies as well as through other less transparent and more pervasive forms of support. At different points in time, these have included controlling the price of key inputs for certain production sectors, writing off tax arrears to the budget on a regular basis, tolerating mounting inter-enterprise arrears, granting borrowing guarantees and implementing discriminatory trade and fiscal measures. Although some progress has been recorded on most of these aspects, it is still insufficient.

Under the impulse of increased liberalisation, Romania's economy has become more open and increasingly integrated with the EU. At 75.1% of GDP in 2001, the value of exports and imports of goods and services was some 15% higher than in 1997. Already Romania's main trading partner in 1997, the EU has further increased its predominant role. By 2001, it accounted for 67.8% of the total value of Romania's merchandise exports against 56.6% in 1997.

Increased trade integration has been accompanied by a sustained shift in specialisation away from heavy industries towards low value-added activities in light manufacturing. The share of metals, minerals and chemical products in the total value of merchandise exports has decreased, dropping from 33% in 1997 to 25% in 2001 while that of clothing, footwear and electrical equipment has increased from 38% in 1997 to 50% in 2001. Such trends reflect the progressive but incomplete dismantling of the artificial trade specialisation inherited from the control economy. With a more flexible exchange rate regime, relative unit labour costs have been broadly stable since mid-1999. Against this background, the strengthening of the private sector, particularly SMEs, and the development of a wide subcontracting network with foreign firms aimed at taking advantage of Romania's cheap labour have underpinned the growth of the most dynamic export industries. Without an increase in the proportion of local value added, however, Romania's export sector remains characterised by a high import requirement and dependent upon relatively low wage costs and favoured access to the EU markets within the framework of outward processing trade.

2.4. General evaluation⁹

Romania has continued to make progress towards being a functioning market economy, for which the prospects have improved. Sustained and full implementation of planned measures together with the completion of the reform agenda should allow Romania to be able to cope with competitive pressure and market forces within the Union in the medium term.

Some significant gains on macroeconomic stabilisation have been achieved over the last years. A more appropriate policy-mix is decreasing inflation, while growth has resumed and the external position remains sustainable. Considerable progress has been made on the creation of the necessary market institutions. The ongoing overhaul of the banking sector, the successive improvements in the supervisory and regulatory framework for the financial markets and the advances in privatisation have progressively tightened enterprises financial discipline. Price and trade liberalisation coupled, over the last year, with a significant adjustment of energy tariffs and important reforms of the tax system have set the stage for a more efficient allocation of resources. Restructuring is advancing in a number of sectors.

To build upon this progress, the authorities should give priority to establishing a track record on macroeconomic stabilisation grounded on further disinflation, by maintaining an appropriate policy mix and underpinning it with the enforcement of enterprises' financial discipline. Commitments to restrict the total wage bill in the public sector should be respected. The recent sharp growth in money supply and credit requires careful monitoring and a readiness to take prompt actions. Establishing enterprises' financial discipline requires improved tax administration and compliance, a consistent and transparent implementation of the latest measures to reduce the arrears of energy users, a determined and transparent use of the recently approved legal provisions for accelerating privatisation, and a readiness to liquidate loss-making enterprises. Completing privatisation in the banking sector, continuing the reform of public expenditures and budgetary procedures, and ensuring the implementation of improved regulatory and legal frameworks would also support the establishment of a functioning market economy and the development of Romania's capacity to cope with competitive pressure and market forces within the Union.

⁹ See "Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2002) 700.

3. Ability to assume the obligations of membership

Introduction

This section addresses the question of Romania's ability to assume the obligations of membership – that is, the legal and institutional framework, known as the *acquis*¹⁰, by means of which the Union implements its objectives. Alongside an evaluation of relevant developments since the 2001 Regular Report, this section seeks to provide an overall assessment of Romania's ability to assume the obligations of membership, and of what remains to be done. Furthermore, it includes an evaluation of Romania's track record since the 1997 Opinion. It also provides, for each of the negotiating chapters, a summary evaluation of the extent to which commitments made in the negotiations have been implemented, as well as an overview of transitional arrangements that have been granted.

This section is structured in accordance with the list of 29 negotiating chapters, and incorporates an assessment of Romania's administrative capacity to implement the *acquis* in its various aspects. Romania's progress in translating the *acquis* into its official language is assessed in a separate section.

In December 1995, the Madrid European Council remarked on the need to create the conditions for the gradual, harmonious integration of the candidate countries, particularly through the adjustment of their administrative structures. Taking up this theme, in Agenda 2000 the Commission underlined the importance of effectively incorporating Community legislation into national legislation, and the even greater importance of implementing it properly in the field, via the appropriate administrative and judicial structures. This is an essential precondition for creating the mutual trust indispensable for future membership.

In June 2002, the Seville European Council repeated how important it was that candidate countries should continue to make progress with the implementation and effective application of the *acquis*, and added that candidate countries must take all necessary measures to bring their administrative and judicial capacity up to the required level. Building on the assessment of Romania's administrative capacity provided in the 2001 Regular Report, the present Report seeks to add further depth and detail, focusing on the main administrative structures required for implementing the various aspects of the *acquis*.

In its 1997 Opinion on Romania's application for EU membership, the Commission concluded:

"Despite the progress that has been made, Romania has neither transposed nor taken on the essential elements of the acquis, particularly as regards the internal market. It is therefore uncertain whether Romania will be in a position to assume the obligations of membership in the medium term. In addition, considerable efforts will be needed in the areas of environment, transport, employment and social affairs, justice and home affairs as well as agriculture. More generally, substantial administrative reform will be indispensable if Romania is to have the structures to apply and enforce the acquis effectively."

¹⁰ A description of the *acquis* for each chapter can be found in the Commission's 1997 Opinion on Romania's application for EU membership.

In the 2001 Regular Report, the Commission found that :

"Romania has continued to make progress with the adoption of the acquis. However, advances in legal transposition have not always been matched by improvements in administrative capacity.

Romania's progress with internal market legislation has been mixed. Other than the adoption of new legislation on public procurement, little progress has been made with the free movement of goods and the framework legislation for the New and Global Approach has still not been adopted. The administrative infrastructure for standardisation, certification and market surveillance should be reinforced. Only limited progress has been made in aligning with the acquis on free movement of persons, and while progress has been made with insurance and banking supervision there has been no progress with transposing the acquis on financial securities markets. Legislation on the protection of personal data remains inadequate. New Romanian legislation on money laundering is a welcome development but a comprehensive system of exchange controls and other restrictions on capital movements still exists. The supervision of financial services should also be improved. Further progress was made in aligning with the company law and competition policy acquis – sectors where Romania has already achieved a high degree of transposition. This said, the supervision of intellectual property rights should be further developed as should the capacity to enforce state aid and anti-trust rules.

In the field of taxation, Romania has made some progress particularly with regard to excise duties. However, further alignment is still needed in the area of VAT and much remains to be done to modernise the tax administration – including the development of electronic data exchanges with the Community and Member States. Romania's adoption of an industrial strategy document is a welcome development and while some important progress has been made in privatisation considerable further efforts are still needed. Good progress has been made in promoting the SME sector and a series of measures have been taken to improve the business environment.

While Romania has made progress in aligning with several aspects of the agricultural acquis, restructuring of the sector has barely begun. The overall administrative capacity of the Ministry of Agriculture remains weak and Romania still needs to develop the ability to implement the management mechanisms of the Common Agricultural Policy. Inspection arrangements in the veterinary and phytosanitary fields also need to be upgraded. The newly adopted fisheries law brings the Romanian legislative framework largely in line with the acquis. However, efforts are still needed to strengthen administrative structures.

Romania has continued to make good progress in harmonising its transport legislation. Policy related to the energy sector has been inconsistent and therefore only limited progress can be noted. While there has been limited progress in the telecommunications sector in terms of transposition, extensive preparatory work has been carried out that should enable future reforms. Romania has made advances in aligning itself with the environmental acquis but does not have the administrative capacity to effectively enforce the newly adopted legislation and insufficient financial resources are allocated to the sector. Romania has made progress in aligning with several aspects of the consumer protection acquis but attention will be required to ensure effective enforcement. Romania has only made limited progress in the audio-visual sector.

Social policy is a priority for the government, and while progress has been made further alignment with the acquis is necessary, as are improvements in administrative capacity (in particular in the area of occupational health and safety and in strengthening labour inspectorates). Some progress was made in the area of regional policy during the reporting period - mainly in terms of improving institutional arrangements. However, the new structures remain fragile and considerable work is still necessary as regards programming, monitoring and evaluation and developing the capacity to manage and control public funds.

In the field of justice and home affairs, significant progress has been made in the fields of visa policy, border control and migration. However, there is still a need to adopt legislation in some important areas such as data protection and to further upgrade the capacity and infrastructure for border management.

Romania has increasingly resorted to trade policies that are incompatible with its international obligations and which represent a move away from the acquis. At the same time, the management of the OSCE Presidency demonstrated Romania's capacity to assume its responsibilities international leadership role in the field of foreign affairs. Romania has continued to make progress on harmonisation with the customs acquis although the operational capacity of the customs service should be improved and efforts should be intensified to develop systems that will allow the exchange of computerised data between the EC and Romania.

Despite some positive developments, the Romanian authorities have not yet succeeded in elaborating a comprehensive policy framework for internal financial control over public funds, and further efforts are needed to strengthen administrative capacity in this area. Romania has made some progress in reforming national budgetary procedures but further efforts are required both in relation to the national budget and own resources.

The overall capacity of the public administration to implement the acquis remains limited and represents a major constraint on Romania's accession preparations. While certain parts of the administration are able to function effectively there are many important sectors where the weakness of the administration is a serious cause for concern. These concerns extend beyond adoption of the acquis and also apply to the management of EC funds. There has been no significant progress in developing administrative capacity although this issue is beginning to be addressed by the government.

With regard to meeting short-term Accession Partnership priorities, Romania has met the priorities related to transport. While progress has been made in the areas of taxation, customs, and justice and home affairs none of the priorities identified for these sectors have yet been fully met. Some, limited progress has been made in addressing the priorities related to the internal market, agriculture, environment, employment and social affairs and the reinforcement of administrative and judicial capacity. Romania has started to address some medium-term Accession Partnership priorities. In transport and fisheries Romania is close to meeting the medium-term priorities. However, no substantial progress has been made in the cases of agriculture, environment, and employment."

3.1. The chapters of the acquis

As indicated, the following review of Romania's ability to assume the obligations of membership has been structured in accordance with the list of 29 negotiating chapters.

Accordingly, this section opens with an assessment of progress relating to the cornerstones of the internal market which are known as the “four freedoms”, and continues with a systematic review of progress on each of the chapters, covering all aspects of the *acquis*, including sectoral policies, economic and fiscal affairs, regional policy, environment, justice and home affairs, external policies, and financial questions.

Chapter 1: Free movement of goods

Progress since the last Regular Report

Since the last Regular Report, Romania has made some progress in this domain, notably with regard to the transposition of sector legislation and further alignment in the area of public procurement.

In the area of **horizontal and procedural measures**, Romania adopted framework legislation introducing *New and Global Approach principles* into domestic legislation in October 2001 and there has been acceleration in the transposition of New Approach legislation. At the same time, only limited progress was made with the transposition of the *acquis* related to market surveillance, product safety and safety checks at external borders. No significant progress can be reported with regard to the notification procedure and interchange of data between administrations.

Progress can be reported regarding the adoption of **sector specific legislation**. In the areas covered by *New Approach Directives*, this progress is linked to the adoption of framework legislation allowing for implementation of the *acquis* in this area. The main sectors concerned by this progress are equipment to be used in explosive atmospheres (ATEX), machinery, protective equipment, cableway installations, medical devices, recreational craft, legal metrology (non-automatic weighing equipment) and pressure equipment, as well as radio- and telecommunications terminal equipment.

As regards sectors covered by *Old Approach Directives*, some limited progress has been made in the transposition and implementation of the *acquis* on legal metrology and pre-packaging. Some progress can be reported on motor vehicles with the adoption by the Romanian authorities of CTAC 2002 (technical conditions motor vehicles must comply with in order to be admitted in traffic), which significantly increases the degree of legislative harmonisation in this sector. However, some vertical Directives in this field still have to be transposed. Progress can also be reported regarding legislation on textiles and cosmetics. With reference to pharmaceuticals, progress has been made in relation to the legislative framework for marketing authorisations but additional efforts are needed to reduce the time necessary for the treatment of files. The *acquis* on glass has now been transposed as well as Directives concerning footwear and wood.

As regards food safety and foodstuffs legislation (*see also Chapter 7 - Agriculture*) the process of transposition has accelerated considerably. Major elements of the vertical food directives have been transposed in addition to transposition of *acquis* in the areas of labelling, contaminants, flavourings and extraction solvents. Progress has also been made concerning transposition of the chemicals *acquis* with particular reference to chemical fertilisers and good laboratory practice. No significant progress can be reported in relation to the classification, packaging, and labelling of dangerous substances or as regards civil explosives.

A Government Decision intended to transpose the *acquis* on the return of cultural objects unlawfully removed from the territory of a Member State entered into force in April 2002.

There have been no developments on the transposition of the *acquis* on firearms.

As regards the development of Romania's administrative capacity for the implementation of horizontal and procedural measures and sector specific legislation improvements have continued during the reporting period. The Romanian Accreditation Body has initiated the evaluation process prior to opening negotiations on multilateral agreements concerning testing laboratories, product certification bodies, and quality management systems certification bodies. The Romanian standardisation institution has continued its programme of transposing European standards, having so far transposed more than 37% of European harmonised standards. In April 2002 the Romanian Standardisation Association (ASRO) signed a memorandum of understanding with the American standards body ASTM. This memorandum of understanding commits ASRO to adopt and promote ASTM standards. It will be necessary to clarify the implications of this commitment with those already taken by Romania in the framework of the Europe Agreement and the accession negotiation process.

With the adoption of framework legislation in the area of conformity assessment, progress has been achieved over the reporting period from the viewpoint of the institutional network. In order to improve the co-ordination of market surveillance activities, the Romanian authorities set up the "Inter-Ministerial Committee for Market Products and Services Surveillance and Consumer Protection" in September 2001. In the field of food safety a high number of ministries are still involved and a decision to establish the National Food Authority has not been taken. The overall administrative capacity to implement the *acquis* on industrial products has slowly improved over the course of the last year.

Since the last Regular Report, no major progress has been made as regards the **non-harmonised area**. In April the Romanian authorities adopted legislation intending to transpose the *acquis* on conformity checks with the rules on product safety on products imported from third countries. Legislative screening for elements in conflict with Articles 28-30 of the EC Treaty has hardly begun. Although certain legislative provisions incompatible with this part of the *acquis* have been repealed other provisions remain in place and new restrictions have been introduced, notably as regards the sale of second hand goods ostensibly for reasons of health and hygiene. The Romanian authorities have given no scientific or statistical evidence for the necessity of these measures.

Recent amendments to **public procurement** legislation, which entered into force in April 2001, have improved the level of alignment with the *acquis* in this area. Intensive efforts made by Romania have resulted in notable progress in the degree of transposition and implementation of the directives in this field. Domestic preference is due to be maintained until January 2005.

Overall assessment

Although Romania has transposed more horizontal and procedural measures and has indicated that it has implemented most New Approach Directives, several implementing texts have been found to be partially or not in line with EC legislation. These include

texts on lifts, toys, gas appliances, electromagnetic compatibility, low voltage and simple pressure vessels. Further improvements are needed in order to comply with the *acquis*. Some other implementing texts are still to be evaluated.

In the non-harmonised area, Romanian authorities should ensure that all legislation in conflict with Articles 28-30 of the EC Treaty is identified and amended by the date of accession. A full screening of Romania's legislation is necessary to ensure conformity with Articles 28-30 EC as well as a more consistent approach to regulation in this area.

To ensure the principle of mutual recognition, a clause on mutual recognition should be integrated into each piece of relevant Romanian legislation on goods by the date of accession.

As regards sector specific legislation for areas covered by Old Approach Directives, further steps are required in all sectors to complete alignment with the *acquis*.

As for administrative capacity, the Romanian standardisation and accreditation bodies have been in place for some years and continue to function appropriately. Efforts have been made to adopt European standards in order to meet the requirements for membership of CEN, CENELEC, and the European Telecommunications Standards Institute. Major efforts are still required to improve the overall administrative capacity to implement the *acquis* on industrial products which, despite improvements, requires reinforcement. Institutional weaknesses concerning conformity assessment bodies and laboratories remain and affect the implementation of the *acquis* on food safety. Particular efforts will need to be devoted to re-structuring the food control system, ensuring proper co-ordination between all the institutions involved, abolishing the pre-market approval system for foodstuffs, and preparing both the administration and food operators to apply the principles underpinning the EC food safety system. The lack of resources, both in terms of equipment and of staff, impedes the necessary improvement of the control services in this field. The achievements in the area of conformity assessment infrastructure require consolidation and reinforcement, particularly as regards administrative capacity. The capacity of the administration to design legislation on free movement of goods is still limited and should be reinforced.

As regards safety checks on products at external borders, Romania needs to make further efforts to establish appropriate customs and market surveillance infrastructure as well as effective administrative co-operation between competent authorities.

In the area of public procurement Romania has achieved a high degree of alignment with the *acquis*. Romania should complete the process of alignment in line with its timetable for adoption of further implementing legislation.

Conclusion

In its 1997 Opinion, the Commission noted that Romania would have to make considerable efforts before the situation developed to a point where Romania could fully and effectively implement the *acquis*. The Commission also stated that Romania would have to make very intensive efforts to align on Community rules concerning public procurement.

Since the Opinion considerable progress has been achieved in the field of legislative alignment - in particular over the past few years. This is largely due to the adoption of framework legislation on the principles of the New and Global Approach, which facilitates sector-specific legislation. Considerable progress has been made in the establishment of the necessary bodies to administer the *acquis*. A reasonable level of transposition has been reached in many areas but the level of administrative capacity and enforcement has not kept pace with this.

Negotiations on this chapter continue. Romania has not requested any transitional arrangements.

Romania should focus further efforts on intensifying the process of alignment. The administrative capacity still needs reinforcement and in some areas the required structures still need to be completed.

Chapter 2: Free movement of persons

Progress since the last Regular Report

In the area of free movement of persons some developments can be recorded during the reporting period.

As regards **mutual recognition of professional qualifications** a number of laws were adopted in July and August, which aim to transpose the *acquis* as regards medical doctors, dentists, nurses, midwives and pharmacists.

Romania has reversed the discriminatory measures in respect of lawyers that were highlighted in last year's Regular Report (*see chapter 3 – Freedom to provide services*).

No significant progress was made as regards **citizens' rights**.

As regards **free movement of workers**, a bilateral agreement on free movement of workers was concluded with Spain in January 2002 and ratified in July 2002. Agreements with Portugal and Luxembourg, signed in 2001, have subsequently been ratified. In August 2002 Romania adopted a law intended to transpose the *acquis* regarding organization and developing of certain economic activities by natural persons. Also in August 2002, the decision was taken to establish an Information and Documentation Centre for Migrant Workers within the Office for Labour Migration. The new Office will be responsible for the dissemination of information on Romanian and Community legislation.

With regard to the future **co-ordination of social security systems**, in November 2001, Romania signed an agreement on the export of social security benefits with the Netherlands, which was ratified in July 2002. In May 2002 it signed the European Social Security Code, which still has to be ratified by Parliament.

Overall assessment

Measures to ensure mutual recognition of professional qualifications and diplomas should be intensified, and the introduction of the necessary administrative structures and education and training programmes accelerated. The compliance with the *acquis* of the

recently adopted legislation on the mutual recognition of qualifications for doctors, nurses, dentists, midwives and pharmacists needs further assessment. Shortcomings identified in the curricula and training for these professions need to be overcome. It is important that appropriate provisions are in place to allow midwives to work autonomously. With respect to professional qualifications obtained before harmonisation, Romania should introduce measures to ensure that all its professionals can, as from accession, meet the requirements laid down by the directives.

By accession, it has to be ensured that all Romania's legislation is aligned with Community rules, in particular with respect to nationality, residence and language requirements. Legislation on mutual recognition will need to include simpler procedures to allow the provision of services. Romania should continue efforts to bring legislation in line with Community *acquis* in the area of right of residence. Romania should also amend the law on aliens' status to ensure full compliance with the *acquis* in this area. Preparations to align with the *acquis* on voting rights upon accession should continue.

Although some progress has been made with respect to equal treatment and work permits, further alignment with the *acquis* is needed. A clarification of existing arrangements is needed with regard to the employment and residence of migrant workers and their families as well as visa and residence requirements for self-employed persons.

Further progress is necessary to strengthen public employment services with a view to future participation in the European Employment Services (EURES) network. Particular emphasis should be placed on language training for staff.

As regards future co-ordination of social security systems, the development of sufficient administrative structures, in particular in relation to the training and recruitment of additional staff, is needed in order to apply Community provisions on social security from accession. Romania needs to ensure the financial stability of its social security system in order to be able to meet the additional costs arising from the application of Community provisions from accession, in particular in the health care field. Romania is encouraged to conclude further bilateral social security agreements, in particular with Member States, as these normally rely on the same principles as the Community rules in this field.

Conclusion

In its 1997 Opinion, the Commission concluded that without a major effort to harmonise legislation and set up and strengthen implementing structures in this field, it would not be possible to achieve recognition for Romanian diplomas and qualifications in the Community in the medium term. The Commission noted that the *acquis* had not been transposed, and that the situation was further exacerbated by the fact that institutions had not been set up to certify diplomas and implement the *acquis*.

Since the Opinion, limited progress has been made. The legislative framework remains inadequate but is now at a stage where the foundations for future progress have been laid. Bilateral agreements on access to labour markets have been signed or are being negotiated with a majority of EU Member States and elements of the administrative infrastructure have been put in place.

Negotiations on this chapter continue. Romania has not requested any transitional arrangements in this area. Romania has agreed to a transitional arrangement in respect of the free movement of workers put forward by the EU. Restrictions on the movement of workers from Romania to the EU will apply for a minimum two-year period as of the date of accession and may remain in force for a maximum of seven years.

Romania should focus further efforts on addressing shortcomings identified in the area of mutual recognition, in particular with respect to curricula and training. Romania is in the process of establishing the required administrative structures and these efforts will need to be maintained. It will also need to prepare, in good time, to meet the financial and administrative obligations which will result from application of the rules on co-ordination of social security.

Chapter 3: Freedom to provide services

Progress since the last Regular Report

Since last year's Regular Report, Romania has made significant progress in this area, notably as concerns the right of establishment for lawyers and in the field of insurance and financial securities.

In the area of **the right of establishment and the freedom to provide services** (other than financial services), Romania has taken steps to put an end to a number of discriminatory restrictions which were placed on the professional activities of Member States' lawyers in Romania. An amendment to the 1995 Law on the Legal Profession was approved by Parliament in August 2002 removing these restrictions.

Legislation aimed at transposing the *acquis* on *self-employed commercial agents* was adopted in August 2002. However the law adopted still requires residence in Romania. No developments can be reported concerning the freedom of establishment and the freedom to provide services for craftsmen, traders and farmers. However, the Romanian authorities set up a working group to identify barriers against the right of establishment and freedom to provide services in January 2002.

In the field of **financial services**, overall supervision of this sector was strengthened by the inclusion of the Insurance Supervisory Commission in the co-operation agreement previously in place between the National Bank of Romania and the National Securities Commission, thus providing a comprehensive forum for regulatory co-operation.

With regard to the *banking sector*, further progress has been made in the implementation of legislation approved in 2000 to extend normal prudential surveillance requirements to credit co-operatives. Considerable rationalisation of this sub-sector should be finalised by the end of 2002. Legislation in this area has already attained a high degree of alignment with the *acquis* and this has been reinforced by additional regulations concerning banking accounting systems, liquidity, supervision of foreign exchange positions, and licensing.

In the *insurance sector*, following the start-up of operations by the Insurance Supervisory Commission, a considerable number of norms have been published in line with the Supervisory Commission's regulatory timetable as well as with accounting regulations for the insurance sector, which came into force in January 2002. With the adoption of a new organisational structure and increase in personnel the Supervisory Commission has

started the process of re-authorisation of insurance companies, the number of which has dropped from 73 in 2001 to 48 currently operating. In addition, the Supervisory Commission has conducted 23 control actions resulting in 6 formal sanctions involving fines or the temporary or definitive interdiction of insurance activities in one or more classes of insurance.

With regard to *investment services and securities markets*, a number of major legislative developments have occurred, notably concerning the statute of the Securities Market Commission, undertakings for collective investment in transferable securities, regulated commodities markets, derivatives services and financial instruments, and securities financial services and regulated markets.

Concerning the **protection of personal data and the free movement of such data** and the **information society Directives**, Romania approved a law for the protection of individuals with regard to the processing of personal data and the free movement of this data in December 2001. In February 2002 Romania ratified Convention 108 of the Council of Europe. Most of the provisions of this law entered into force in March 2002. The Office of the Ombudsman is designated as the supervisory body under the law. A considerable amount of legislation for the implementation of this law has also been adopted. As concerns e-commerce, Romania approved a law transposing the e-commerce Directive in July 2002.

Overall assessment

In the *banking sector* Romanian legislation is now at a high degree of alignment with the *acquis*. The rules, policies, and practices broadly follow the Recommendations of the Basle Committee on Banking Supervision and the relevant EC directives. The degree of fragility mentioned in last year's Regular Report has diminished but the process of rationalisation continues, particularly as concerns smaller banks whose prudential ratings are unsatisfactory. Only the consistent application of the regulatory and supervisory framework over a period of time will fully re-establish confidence.

As regards the insurance sector, 2001 was the first year of operations for the Insurance Supervisory Commission. This first year has produced satisfactory results, both in terms of the creation of administrative structures and initial steps to improve sector supervision and rationalisation. Coming years will require a consolidation of this performance in order to further restructure this sector and complete the legislative framework, in particular as regards motor vehicle insurance.

The Romanian authorities have identified the essential steps necessary for the application of the securities markets *acquis*. In addition to ensuring sound financial markets progress in this area should be a principal objective in this domain. Steps are being taken to improve the level of training, as well as the physical infrastructure and equipment available to the National Securities Commission. It is essential that these activities be undertaken as rapidly as possible in order to allow adequate human resources to be made available to implement the new legislation.

In the field of the protection of personal data and the free movement of such data, the major pieces of legislation transposing the *acquis* are now in place, although some provisions of the Data Protection Act are still not in line with the *acquis*. The primary challenge now lies in implementation. However, there remains some concern about the

ability of the Ombudsman's Office to adequately ensure a satisfactory supervisory structure.

Conclusion

In its 1997 Opinion, the Commission concluded that the key decisions for the effective restructuring of the banking sector had been taken. However, with the sector then overwhelmingly still in state hands, the Opinion pointed out that respect for prudential rules and, above all, the National Bank's supervisory capacities would have to be reinforced to guarantee the sector's soundness. The central bank was still not totally independent and the banking sector remained fragile. As consolidation was bound to be a lengthy process, the Opinion predicted that there was no prospect of integrating the Romanian banking system into the internal market in the medium term. As regards financial securities, the Commission remarked that the market was still embryonic, supervision was inadequate and there were grounds for doubting its efficiency. In the field of insurance, the Opinion stated that Romania seemed to have a long way to go in terms both of the adoption and implementation of legislation and of the elimination of barriers to access to its market.

Since the Opinion, considerable efforts have been made to reform the sector, and alignment with the *acquis* has increased significantly over the past year. The supervisory and regulatory functions of the National Bank have improved and the Bank now enjoys effective independence from central government. The last two years have seen a considerable reinforcement of the supervision of the insurance and financial securities sectors, although both markets are still at an early stage in their development. Progress in the banking sector has led to an improvement in the solidity of the sector, despite some remaining problems.

Negotiations on this chapter have not yet been opened with Romania.

Romania should focus further efforts on completing legislative alignment, strengthening administrative capacity, and establishing a track record of efficient supervision. Further improvements in the institutional framework of financial supervision are still needed, particularly in the area of securities and insurance. The process of screening Romanian law in the area of non-financial services has only just begun and needs to be accelerated.

Chapter 4: Free movement of capital

Progress made since the last Regular Report

Progress has been made with cross-border capital flows since the last Regular Report. Some progress can also be reported on payment systems. As regards **capital movement and payments**, in December 2001 the National Bank of Romania issued a circular introducing a significant liberalisation of the controls on capital account outflows. The transactions covered by this circular include direct investments abroad by residents, loans and guarantees made by residents to non-residents, transfers related to insurance contracts and the physical export and import of financial assets (with the exception of cash). The National Bank circular also formalises a legally binding timetable for the liberalisation of certain transactions by 2004.

There have been no significant developments as regards laws governing foreign direct investment and the acquisition of real estate by non-nationals. The recent law on the acceleration of privatisation has not repealed the "special rights" or "golden share" provisions.

As concerns **payment systems**, the National Bank of Romania issued a regulation in January on large value fund transfers setting out the principles for performing and processing such transfers. These operations are presently performed by the National Society for Settlement by Transfer (TransFond S.A.). Other activities in this area will continue to be performed by the National Bank of Romania until TransFond S.A. becomes fully operational. In July, the National Bank of Romania issued a regulation to ensure compliance with the *acquis* on electronic payment instruments. As for the related *acquis* on **money laundering**, in August 2002 Romania ratified the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime.

Overall assessment

Current laws are ambiguous regarding restrictions on inward direct investment and are open-ended as concerns undefined "sensitive" sectors, where prior authorisation can be imposed through "special laws."

The Romanian Constitution forbids the purchase of real estate by non-nationals. Nevertheless, for companies established in the country, even if wholly foreign-owned, land purchases for the conduct of business are allowed according to sub-constitutional law.

The creation of a new inter-bank payment and settlement system is still at an early stage. Much of the *acquis* in payment systems remains to be transposed (including the introduction of effective redress procedures for settlement of disputes between bank and customers) and the payment infrastructure has to be improved.

The National Bank of Romania regulates and operates exchange control and oversees the payment system. The National Bank has sufficient staff and administrative capacity to ensure the effective application of legislation in these areas.

In the area of money laundering, the National Office for the Prevention and Control of Money Laundering is now operational and the increase in its investigative activity is noticeable. The Office has introduced important measures concerning the reporting obligations of financial institutions, but revision of the current legal framework to complete the process must be continued. In particular, Romania has not yet implemented procedures for customer identification when opening accounts at credit institutions. The Office deals with a large number of reports on suspicious transactions (almost 600 over the reporting period) and sent more than 200 cases to the General Prosecutor's Office. Criminal investigations were started in 68 cases, of which 22 resulted in a conviction for money laundering offences while the rest are still before the courts.

The ratification of the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime represents an important step in aligning Romanian legislation with the *acquis* in this field. However, the ratification of

the Convention needs to be followed by institutional and legal changes that will allow the provisions of the Convention to be enforced at the national level.

Compliance with the Recommendations of the Financial Action Task Force should be ensured.

Conclusion

In its Opinion in 1997, the Commission concluded that the trend in Romanian law was towards opening up the market to foreign direct investment. The very low level of investment was mainly attributable to administrative practices, which were often cited by investors and which substantially limit legal certainty and transactions. The Commission therefore pointed out that significant improvement in the administrative and judicial framework was a prerequisite for increasing investment. The Commission also remarked that free movement of capital had been established on paper, but constraints on the development of a competitive market needed to be eliminated in practice. Romania had introduced limited liberalisation of capital movements. The liberalised transactions, notably direct investment, concerned inward capital flows only.

Since the Opinion, alignment with the *acquis* has improved moderately and the process of liberalisation has been initiated. Although exchange controls and other restrictions on capital movements still exist, Romania is committed to a timetable for the abolition of certain restrictions.

Negotiations on this chapter continue.

Romania should focus further efforts on the alignment of legislation. The revision of the legal framework in the area of money laundering needs to be continued.

Chapter 5: Company Law

Progress since the last Regular Report

In the year under review some further progress was made as regards company law, accounting regulation, and the protection of intellectual and industrial property rights.

Regarding **company law** new legislation was largely confined to implementing legislation in the area of bankruptcy procedures including measures for creditor protection.

As regards accounting, Romania has already transposed much of the content of the 4th, 7th and 8th Accounting Directives. This process continued throughout the year with further transposition of the 4th Accounting Directive. Responsibility for overseeing the implementation of the 8th Accounting Directive on financial audit lies with the Romanian Chamber of Auditors, whose status as a public non-profit professional body was confirmed by Act of Parliament in the course of the reporting period. The number of auditors registered with the Chamber has now risen to 1 400.. The Chamber issued a number of standards for training in the course of the year.

In the field of **industrial and intellectual property rights**, the process of further alignment and transposition of the *acquis* has continued during the reporting period.

Romania adopted legislation concerning related rights for film producers. Additional legislation has been adopted to achieve approximation in the area of the protection of biotechnological inventions. Romanian legislation is now fully compatible with the provisions of the European Patent Convention and with the WTO TRIPS agreement.

Romania has a long tradition of legislation on industrial property rights and is a member of all the international conventions relevant to the *acquis*. Since the last Regular Report, Romania has taken further steps towards completing the process of becoming a member of the European Patent Convention. As regards enforcement, further legislation defining the role of the Romanian Copyright Office (ORDA) and its overall responsibilities for legislation in this area was adopted. However, additional clarification on ORDA's responsibilities in enforcement activities is still required, as well as further reinforcement in staffing. The number of actions taken and of seizures of counterfeited and pirated goods increased in 2002. While overall levels of piracy remain high, there has been a noticeable reduction as evidenced by statistics provided by the Romanian authorities and by industry sources.

No major developments can be reported as regards the **Regulation replacing the Brussels Convention** on jurisdiction and enforcement of judgements in civil and commercial matters and the **Rome Convention** on the law applicable to contractual obligations.

Overall assessment

In the area of accounting law, Romanian legislation is largely in line with the *acquis*. Romanian legislation now provides the framework for consistent application of the Harmonised Accounting Regulations in relation to Romanian Accounting Standards.

The body responsible for Accounting Standards is the Ministry of Finance through the Department of Accounting Regulations. Romania does not plan to create an independent accounting standards body before 2005, by which time it expects to have completed the implementation of the International Accounting Standards.

In the field of industrial and intellectual property rights, Romanian legislation is generally consistent with the *acquis*. Further alignment should be pursued in order to transpose the Directive on copyright in the information society and the Directive on the resale rights.

The Romanian Copyright Office and the Office for Inventions and Trademarks are the competent authorities to which right-holders can present applications for intellectual and industrial property protection. As regards administrative capacity, despite considerable progress, further improvements in staffing and budgets remain necessary. Efforts to improve statistical reporting should also be continued.

The import into Romania of pirated and counterfeit goods is a particular concern and results in large quantities of such goods in circulation (estimated by private industry at 70% for music products, 75% for software products and 60% for videos). Further progress remains necessary with implementing border controls and enhancing co-operation between enforcement bodies involved in industrial and intellectual property protection. The creation of an efficient inter-institutional network is vital in making progress in the fight against piracy and counterfeiting. Communication and co-operation between customs, police, border police, the Ministry of Justice and the judiciary need to

be improved and the joint training programmes now established should be pursued in the future.

Conclusion

In its Opinion in 1997, the Commission concluded that the legislative effort made with regard to intellectual property attested to Romania's desire to conform to the *acquis*. The Commission added that the implementation would have to be watched closely. As regards company law, Romania's assimilation of the *acquis* would present no major problems.

Since the Opinion, Romania has continued the process of alignment with the *acquis* on company law. Improved administrative structures and intensified co-operation between general law enforcement agencies has led to a recent decline in the level of piracy and counterfeiting. Nevertheless, this remains a serious problem and the enforcement of intellectual and industrial property rights is a particular concern.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements in this area and has agreed to a proposal put forward by the EU concerning industrial property rights for pharmaceutical products and Community Trademark. Romania is generally meeting the commitments it made in the accession negotiations in this field.

Romania should focus further efforts on reducing the level of piracy and counterfeiting. Further transposition of the *acquis* is necessary as concerns Economic Interest Groupings, as well as for provisions on the jurisdiction and enforcement of foreign judgements in civil and commercial matters.

Chapter 6: Competition policy

Progress since the last Regular Report

Since last year's Regular Report, Romania has made some progress but many enforcement and administrative issues remain open.

In the **anti-trust** field, with respect to implementing legislation, regulations on research and development agreements, specialisation agreements and vertical restraints as well as guidelines on horizontal co-operation agreements have been adopted.

The Competition Council has continued to build on its enforcement record over the past year and in 2001 it issued 435 decisions in anti-trust cases, one of which was a prohibition.

In the field of **state aid**, Romania adopted implementing legislation concerning regional aid, aid to small and medium-sized enterprises, aid to rescue and restructure firms in difficulty, research & development aid, training aid, and environmental protection aid. These regulations will only come into force in January 2003. Romania has proposed a regional aid map for joint adoption by the Association Council. The state aid survey for 1996-1999 was completed in March 2002 and broadly follows the methodology and presentation of the "Survey on State Aid in the European Union".

The state aid enforcement record of the Competition Council is still developing. In 2001, the Council adopted 48 state aid decisions, none of them dealing with non-notified or existing aid. The quality of the decisions needs to be improved.

There are still a large number of incompatible fiscal aid schemes which need to be aligned. Existing benefits also need to be converted into compatible aid.

Romania has presented its steel restructuring programme to the Commission although the viability plans of the individual enterprises still need further elaboration. In the steel industry aid for restructuring can only be given if the national and individual restructuring programmes of the companies include necessary measures for reaching viability and making cuts in production capacity, in line with the requirements set out in Protocol 2 of the Europe Agreement.

Overall assessment

In Romania there are two competition authorities: the Competition Council and the Competition Office. The co-operation between the two authorities needs to be improved and their responsibilities need to be strengthened. Under the current legislation the competition authorities are only occasionally consulted on new laws and comments are not taken into account systematically. The competition authorities should be given the right to oppose legislation restricting competition, and it should be made clear that legislation on competition takes precedence over legislation on businesses and legislation under which state aid is provided. Both the Competition Office and the Competition Council require further strengthening in terms of human resources and training.

As regards anti-trust, Romanian legislation is broadly in line with the *acquis* provisions. However, the individual notification requirement should be abolished. Romanian competition law currently obliges companies to apply for an exemption even if an agreement would fall under the block exemptions. Excessive notification requirements do not allow the Competition Council to focus its resources more effectively on cases representing the most serious distortions of competition. The most important challenge for the Competition Council is to pursue a more pro-active approach including own-initiative investigations and a deterrent sanctions policy.

In view of the planned modernisation and decentralisation of the application of the EC anti-trust rules, training efforts should be pursued, in particular with regard to the judiciary.

As regards state aid, further transposition of the substantive state aid rules is still necessary. Application of the state aid rules is not comprehensive and numerous state aid measures are not notified to the competition authorities. The Competition Council should take a firmer and more pro-active approach to ensure the effective application and enforcement of the state aid rules, including non-notified aid, and the alignment of existing aid schemes and legislation under which authorities at various levels grant aid. There is also a need to raise awareness among administrations granting state aid of the policy and legislative provisions in this area.

There are continuous problems with the treatment of debt cancellation – a form of state aid which is widely practised by public bodies, especially when state-owned companies

are privatised. Implementation of state aid policy in sensitive sectors is still at an early stage.

Conclusion

In its 1997 Opinion, the Commission concluded that notable progress had been made towards the approximation of legislation in the field of anti-trust. However, the Commission also concluded that, as regards state aid, not much progress had been achieved so far and a considerable effort would be necessary to fulfil the requirements in the field of state aid control over the medium term, in particular as regards the establishment of transparency through a credible aid inventory and the adoption of the necessary rules for the credible monitoring of state aid.

Since the Opinion, some progress has been made with the transposition of the *acquis* in respect of both state aid and anti-trust. At the same time, Romania's enforcement record in both areas needs to be improved. Knowledge and awareness of competition law remain limited in Romania, in particular among other authorities that are meant to co-operate with the Competition Council and the Competition Office. On legislative alignment, administrative capacities and enforcement record Romania is only partially in line with the requirements of the *acquis*.

Negotiations on this chapter continue. Romania has not requested any transitional arrangements in this area.

Romania should focus further efforts on continued institutional strengthening and on training staff in both the Competition Council and the Competition Office. It should address the questions of the alignment of incompatible state-aid schemes and the enforcement of competition rules in respect of non-notified aid schemes and existing aid.

Chapter 7: Agriculture

Progress since the last Regular Report

Romania has continued to make progress with transposing certain aspects of the agricultural *acquis*, and the process of restructuring the agricultural sector has accelerated. However, the pace of reform is uneven across the sector.

In 2001, agriculture accounted for 14.6% of Romania's gross value added as opposed to 12.2% in 2000¹¹. Agricultural employment represents 44.4% of the national labour force and around 70% of the rural labour force¹².

Favourable weather conditions in 2001 combined with an increase of the area cultivated led to an exceptionally high production of grains. However, drought during the first part of 2002 has compromised an important part of this year's grain crop. The livestock sector continued last year's downward trend and prompted the Government to approve a national recovery programme.

¹¹ The source for all agricultural statistics is EUROSTAT unless otherwise specified.

¹² Eurostat Labour Force Survey (LFS). Agricultural employment is defined in LFS terms as economically active persons who gain a significant part of their income from agriculture.

In 2001, overall agricultural trade¹³ between Romania and the EC increased significantly, largely due to the “double-zero-agreement” to liberalise trade in agriculture. EC imports of agricultural products originating in Romania increased by 28% to €289 million. EC exports to Romania increased by 37% to €454 million. The trade balance in favour of the Community amounted to €165 million compared to €107 million in 2000. EC imports were dominated by live animals, vegetables and oilseeds. Meat, tobacco and miscellaneous edible preparations were the main export goods from the EC.

The 2002 state budget allocated to agriculture and forestry is ROL 11.6 thousand billion (€445 million). Although there was a major change in the type of domestic support measures, the level of budgetary support for agriculture and forestry in 2002 remained similar to 2001 in real terms. The Ministry of Agriculture, Food and Forestry also manages an extra budgetary fund called “*Development of Romanian Agriculture*” made up of receipts from privatisation of state owned farms.

There was a noticeable change in the focus of agricultural policy during the reporting period with the voucher-for-inputs scheme, (targeted at small family farms) being replaced by a direct payment system for several agricultural crops and a premium system for animal products. Legislation from 2002 defined two basic categories of farm (family farms and commercial farms). A consequence of this legislation is that commercial farms are eligible for domestic support while family farms can only receive free consultancy services and incentives to practise organic farming.

In a welcome development, the Ministry of Agriculture, Food and Forestry set up a policy formulation department headed by a State Secretary. This department was subsequently merged with the European Integration Department.

Since the last Regular Report, the privatisation of state owned farms has continued - but at a slower pace than expected by the Government. Privatisation of state farms is considered the cornerstone of the whole process of agricultural privatisation. The agricultural sector also includes many commercial companies other than farms. While a total of 214 agricultural commercial companies have been privatised most of them are loss-making and have accumulated large debts - which makes them unattractive for privatisation. A recently approved law provides for the cancellation of outstanding debts to the state budget.

Restitution of both agricultural and forested land has continued slowly over the reporting period. The legal framework for land restitution was once again amended in 2001 which led to further delays in the process. Since the legal framework is now complete it should be possible to accelerate the pace of restitution - although the Government’s objective of completing land restitution by the end of 2003 appears overly ambitious.

Horizontal issues

Romania only envisages full implementation of institutional and legislative requirements regarding the *EAGGF Guarantee and Guidance fund acquis* by 2007.

¹³ Source of trade figures: WTO definition of agricultural products, figures from EUROSTAT COMEXT (see U.E. 12/15: Commerce des produits agricoles 1998-2000, 1 Partie D.G. AGRI / G.2 Analyses quantitatives, prévisions, statistiques, études, 2001, pp. 10-57 et 86-89.)

There has been no noticeable progress with preparations to establish the *Integrated Administration and Control System (IACS)*. There has been no progress in developing a computerised database or with the introduction of an alphanumeric system for parcel identification. However, the land cadastre legislation was amended in order to improve institutional arrangements. The National Office for Cadastre Geodesy and Cartography was reorganised and merged with offices belonging to the Ministry of Agriculture and Forests. A cadastre strategy was approved in 2002 but it focuses more on technical matters (*geodetic networks*) than on improving service and performance standards.

Progress has been made over the reporting period to complete the legal framework for *organic farming* and the number of Romanian farms using organic farming methods is increasing. Regulations to enforce the law in this area were introduced by a Government Decision establishing rules for the production of vegetable, animal and processed organic products as well as setting out the way in which these rules are checked by the National Authority for Organic Products.

There has been some progress in developing the network of returning holdings and in setting up the basic institutional elements (National Committee, liaison agency) for the *Farm Accountancy Data Network*. A specific unit was created within the Ministry of Agriculture Food and Forests to deal with this issue.

Common Market Organisations

Newly adopted legislation on farm organisation allows farmers and processors to organise themselves to play a role in common market organisation management. Several inter-branch organisations are emerging and the preparation of administrative structures for the operation of common market organisations is slowly taking shape.

The Government adopted a law in January 2002 on the Organisation and Operation of Agricultural and Food Markets. This law sets the general framework for common market organisations and introduces elements for price regulation (intervention price, target price, reference price, minimum guaranteed price, threshold price), trade mechanisms (export refunds, export premia, reference tariffs) and intervention stock and warehouse receipts. It defines and introduces a range of market intervention instruments that have been taken over from the CAP - although further clarifications are needed regarding the implementation of these provisions. The state intervention foreseen by the law does not designate specific market mechanisms for each specific sector. Instead, the law provides for the creation of a National Authority for Agriculture and Food Product Markets, which issues decisions regarding conventions to be established by the Ministry of Agriculture, Food and Forestry with individual commodity councils or inter-branch organisations.

With regard to *arable crops*, the new legal framework should facilitate the setting up of intervention agencies and centres required for intervention and withdrawal of produce. In the *sugar* sector an inter-branch organisation has been set up.

There has been no progress in developing administrative structures for the management of common market organisations for *specialised crops*. However, in April 2002, a new wine law set up the basic elements of the common market organisation for wine (planting rights, oenological practices, distillation, controls). Last year's legal framework for designation of origin and protection of geographical indications for wines and alcoholic beverages was amended with new legislation replacing the previous vineyard law. The National Office for the Denomination of Origin for Wines and other Wine Products was

reorganised as a Directorate within the Ministry of Agriculture and 15 inspectors were appointed.

No progress was made as regards *animal products*.

Rural development and forestry

The Ministry of Agriculture, Food and Forestry is responsible for *rural development*. Current rural development activities mainly consist of providing subsidies for the purchase of agricultural machinery and equipment, although support for the establishment of micro-enterprises and SMEs has been included in the 2002 agricultural budget. Some pilot rural development activities have been undertaken that are in line with the *acquis* (investments in agricultural holdings, improvement of marketing and processing of agricultural products, development and diversification of economic activities in rural areas, development of rural infrastructure). With the conferral of management of aid to the SAPARD Agency under the Ministry of Agriculture for the implementation of three measures, Romania has made further progress in the preparation of the restructuring of its agricultural sector (*see also Section A.b. - Relations between the European Union and Romania*).

As regards *agri-environmental measures*, a manual of Good Agricultural Practice has been prepared.

There have been several legal developments in the *forestry* sector. The Ministry of Agriculture, Food and Forestry approved the regulation to be used by the National Forest Administration for selling fuel wood to the population. Rules for building forest roads during the period 2000-2010 were also approved. There have been some developments with setting up structures for management of private forests and 5 private structures (Forestry Offices) started operation during the reporting period.

Veterinary and phytosanitary issues, including food safety

Over the reporting period important progress has been made in terms of transposing the EC **veterinary acquis** and there is now a timetable for full transposition and implementation. Since September 2001, legal acts have been approved in the following areas: common measures, animal welfare, veterinary control, control of animal diseases and animal health, animal waste treatment, public health protection and animal nutrition. However, no evaluation of the applicability of the new legislation has been made.

Efforts have been made over the reporting period to improve the laboratory infrastructure and to accredit laboratories. In September 2001 the Institute of Diagnosis and Animal Health officially inaugurated new laboratories for molecular biology, transmissible spongiform encephalopathies and major viruses. The central reference laboratories and some important regional laboratories have received new equipment. The rehabilitation of laboratories is a priority of the Ministry and is considered as a key part of a larger programme to modernise the animal health infrastructure. Romania has joined the Animal Disease Notification System (ADNS).

In the **phytosanitary field** good progress has been made with transposing the *acquis*. Romania has continued efforts to harmonise legislation in the field of *plant health (harmful organisms)*. Standards were introduced to regulate phytosanitary measures regarding the import, export and transit of plant and vegetable products. The measures

also cover the circulation of plant and vegetable products within Romania and the registration of producers, storage facilities and dispatch centres.

Ministerial Orders were adopted in January 2002 regarding the phytosanitary quality control of imports and exports of seeds and plant propagating materials. The regulation specifies the tasks of importers, exporters and the competent authority to comply with the import and export requirements. The Central laboratory for Seeds Quality Control in Bucharest was re-accredited by the International Seed Testing Association (ISTA).

In the field of pesticide residue control, a national monitoring programme has been established by the Ministry of Agriculture, Food and Forestry. Controls have been put in place only for imported fruit and vegetables and the Border Inspection Posts have the option to take a sample for analysis. There is not yet a system in place to trace non-compliant products, although a system for registration of producers has been operational since February 2002. To be in line with the *acquis*, this monitoring should equally cover domestic production.

The Phytosanitary Directorates of the Ministry of Agriculture, Food and Forestry have organised specific training courses on the enforcement of transposed legislation. Efforts have continued to further develop the phytosanitary computerised information system.

As regards **food safety** (see also Chapter 1 - *Free movement of goods*), some progress has been made, particularly regarding the inspection of food establishments and the start of measures to deal with BSE. A national plan for restructuring of agri-food establishments was agreed in June 2002.

Overall assessment

Legal measures for restructuring the agricultural sector may result in a more stable and transparent set of rules for *privatisation of state owned farms* and development of the sector. However, focusing domestic support on a small percentage of large-scale farms could have negative social and economic implications for rural communities. The new state support policy should be more targeted at the development of a market oriented agricultural policy and should give much more consideration to rural development.

The ability to develop a coherent agricultural policy remains a problem in Romania, although the new policy formulation department should help improve the situation. Although there has been a slight improvement in the administrative capacity of the Ministry of Agriculture, Food and Forestry, the current situation remains typified by an inappropriate allocation of human resources between central and local services. Instability of middle and top management remains a problem.

After many years of neglect, Romania has accelerated the transposition of the agricultural *acquis*. However, there are serious concerns that new legislation in these highly technical fields has not been matched by necessary increases in staff and other resources. This situation raises doubts as to Romania's capacity to effectively enforce the new laws. The rapid transposition also places a great pressure on the agri-industry to comply with new legislation. Communication and awareness-raising as regards the transposition is limited and reduces the sector's ability to adapt to these changes.

As regards **horizontal issues**, further efforts are needed in areas such as land registration, inter-branch organisations, quality policy, and the Farm Accountancy Data Network (FADN).

The preparation of the administrative and horizontal structures necessary for the operation of **common market organisations** is at a very early stage. The internal support policies are still based on measures that are not compatible with the CAP and a change in agricultural policy is needed to achieve sustainable agriculture. While the new wine law represents a positive development in the area of specialised crops, enforcement measures remain to be developed, in particular regarding the vineyard register.

Recent initiatives demonstrate that Romania is moving towards the development and implementation of a coherent **rural development** policy. These initiatives should be reinforced and further developed. The implementation of the SAPARD programme will assist in this task.

The very rapid transposition of the EC **veterinary acquis** has resulted in many new tasks and responsibilities being assigned to the National Sanitary Veterinary Agency (NSVA) and its subordinated services – but so far the transposition of legislation has not been followed by a commensurate allocation of additional human and financial resources. There are serious doubts as to the capacity of the veterinary administration to enforce the newly adopted legislation. In addition, the current sanitary veterinary framework law dates from 1974, and no longer provides an appropriate legal framework for sanitary veterinary activities.

As with the veterinary *acquis*, the rapid transposition of **phytosanitary** legislation has not been matched by additional human and financial resources. This is likely to limit enforcement capacities.

As regards **food safety** (*see also Chapter 1 - Free movement of goods*), the reorganisation of some of the bodies dealing with food safety (i.e. the national food laboratory and the plant hygiene laboratory), is needed in order to improve effectiveness in this area. A reliable animal identification and registration system is still missing in Romania. Most farms are not registered and only a small proportion of the bovine population is registered for selection and reproduction purposes. As regards animal waste treatment, severe deficiencies still have to be corrected.

Conclusion

In its 1997 Opinion, the Commission noted that limited progress had been made in adapting to the Community *acquis*. The Commission added that particular efforts were needed on: implementation and enforcement of veterinary and plant-health requirements and upgrading of establishments to meet EC standards (in particular with regard to the inspection and control arrangements for protecting the EU external borders); strengthening of the administrative structures to ensure the necessary capacity to implement and enforce the policy instruments of the CAP; and restructuring the agricultural and agri-food sector to improve its competitive capacity. The Commission's conclusion was that fundamental reforms were necessary before Romania would be able to meet the obligations of membership.

Since the Opinion, Romania has made progress towards alignment with the agricultural *acquis*, in particular over the last year. Legislative developments have not yet been matched by the development of administrative structures able to effectively implement the *acquis*. Structural reforms in the agricultural sector have brought concrete results in terms of the privatisation of state owned farms and the agri-food industry. However, the pace of restitution of agricultural and forested land has been slow.

Negotiations on this chapter have not yet been opened with Romania.

Romania should focus further efforts on reinforcing the administrative capacity to implement and enforce the *acquis*, in particular in the veterinary and phytosanitary fields, and accelerating the structural reform of the agricultural and agri-food sectors. Considerable investments are required to complete cadastre reform and the registration of property titles in the land book offices.

Chapter 8: Fisheries

Progress since the last Regular Report

Over the past year, some progress has taken place in the fisheries sector.

Concerning **resource management, inspection and control** implementing legislation was adopted concerning the recording and transmission of data on maritime fishing activity, the regulation of fishing licences and quota distribution amongst licence holders.

In August 2002, legislation was adopted establishing the National Company for the Management of the Fisheries Fund as well as a Fisheries Inspectorate. Inspectors have been given considerable additional powers.

Inspection operations, under the authority of the Ministry of Agriculture, Food and Forestry in collaboration with the Ministries of Waters and Environmental Protection and the Interior, continued to make progress. In the course of 2001, 151 infringements were detected and the Coast Guard and the Fisheries inspectors opened 75 criminal investigations.

The 2001 Fisheries Law introduced a fishing vessel register, but appropriate administrative structures still have to be established. A total of 11 fishing vessels are licensed and registered. No progress can be reported regarding connection to the EC fishing vessel register.

In the field of **structural actions**, no progress can be recorded.

Concerning **market policy**, Romania formally adopted a list of commercial denominations of fish species and aquatic life which may be traded on Romanian territory. The supply of fish in Romania is funnelled through several distribution channels. Some of the companies are vertically integrated covering all stages from fishing to retailing. A total of 10 professional associations have been set up representing, respectively, the interests of producers and traders (three), Danube Delta fishermen (five) and Black Sea fishermen (two). However, there is no indication as to their compliance with the EC conditions for recognising such organisations.

As concerns **state aid to the fisheries sector**, support is now provided to preserve animal genetic heritage including freshwater fish. In total, the new measure concerns ten farms and research institutes. No other state aid for the fisheries sector exists. Romanian Black Sea fisheries continue to benefit from VAT exemptions for diesel oil.

As regards **international fisheries agreements**, Romania became a member of the International Organisation for the Development of Fishing in Central and Eastern Europe (EUROFISH) in October 2001. Negotiations still continue on a new convention for fishing in the Black Sea.

Overall assessment

Existing weaknesses as regards administrative structures remain to be addressed. The institutional set-up has yet to be streamlined and some administrative responsibilities still need to be clarified between the Ministry of Agriculture, Food and Forestry and the Ministry of Waters and Environmental Protection. The Fisheries Department within the Ministry of Agriculture, Food and Forestry, although recently reinforced, remains understaffed.

In the field of resource management, inspection and controls, Romania has a licensing scheme for marine fishing vessels. Licences specify the type of fishing, allowed gears and area of operation. The size of Romania's fishing fleet has continued to decline and aquaculture has become relatively more important, particularly in the Danube delta. The legislative framework in Romania is largely in line with the *acquis*.

Control activities have again increased but fisheries control in Romania is still weak. No full-time enforcement service exists and the inspectors carry out many other tasks. More emphasis should be put on training fisheries inspectors and providing appropriate equipment, as well as on increasing the number of inspectors for controlling sea fisheries.

Romania still needs to set up a market-monitoring instrument and improve the collection of statistics. Development of a research strategy remains among Romania's short-term priorities in fisheries.

Romania is party to several international fisheries conventions and is a member of the General Fisheries Commission for the Mediterranean.

Conclusion

In its 1997 Opinion the Commission concluded that significant efforts were needed in order to adapt the sector for accession. At the same time the Commission noted that the integration of the Romanian fishing industry into the Common Fisheries Policy would not cause major problems. The Commission also remarked that the industry in Romania was outdated and required modernising.

Since the Opinion, Romania has adopted the necessary framework legislation, but progress in establishing the administrative structures has been slow. Considerable further work is needed to achieve compliance with the *acquis*.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is generally meeting the commitments it has made during the accession negotiations in this field.

Further efforts should focus on implementing the recently adopted legislation governing the functioning of the main administrative structures.

Chapter 9: Transport policy

Progress since the last Regular Report

During the reporting period, Romania has made further progress in harmonising its legal framework, in particular in the field of road transport, and has started to reorganise the institutions responsible for inland waterways and maritime transport in order to improve their efficiency.

Regarding **Trans-European Transport Networks**, the rehabilitation of Romania's national infrastructure is ongoing. Considering the costs that are involved, budgetary constraints are the main limiting factor.

As far as **land transport** is concerned, progress was made with harmonising legislation in the area of *road transport*. An Ordinance of January 2002 introduced the concept of tariffs for the use of road transport infrastructure: the level of road user charges will gradually increase with a view to ending discrimination between Romanian and Community hauliers. An Ordinance of January 2002 established the driving times and rest periods for drivers performing national road transport activities: there is to be gradual implementation in order to align with the *acquis* by 2006. Romania has continued to align its legislation with the *acquis* on the transport of dangerous goods by road. The EC/Romania Transport Agreement entered into force in June 2002 and the European Agreement on International Occasional Carriage of Passengers by Bus (INTERBUS) was ratified in June 2002.

On *railways*, the law regarding rail transport of dangerous goods was adopted in December 2001, further harmonising Romanian legislation with the *acquis* in this field.

In the *inland waterways sector*, no progress was made with the alignment of technical requirements for Romanian vessels with those of the EC.

As concerns **air transport**, more implementing legislation on the harmonisation of technical requirements and administrative procedures in the field of civil aviation was approved. Romania also adopted legislation on the investigation of civil aviation accidents and incidents. Restructuring of the national carrier continued: a cost reduction programme is under way; most of the non-profitable long-haul lines have been cancelled; and the use of the commercial fleet has been optimised.

With regard to **maritime transport**, further significant legislative alignment can be noted. A framework law on Maritime and Inland Waterway Transport was adopted in June 2002, which will form the legal basis for alignment with a number of provisions of the *acquis* regarding both non-safety and maritime safety issues. The law also establishes the institutional framework for implementing the *acquis* on maritime safety, in particular by setting up a new body, the Romanian Naval Authority, through the merger of the

existing bodies. It will be fully responsible for flag state implementation, Flag State control and Port State control.

Furthermore, the authorities have continued their policy of "cleaning up" their national shipping registry, and the total number of vessels flying the Romanian flag has decreased to 43. However, these positive developments have not yet resulted in acceptable detention rates. According to 2001 statistics under the Paris Memorandum of Understanding, the percentage of Romanian flag vessels detained following Port State control has increased again to 23.5%, despite improving considerably from 29.6% in 1999 to 19.1% in 2000. This compares with an average for EU-flagged vessels of 3.1% in 2001.

Overall assessment

As regards Trans-European Transport Networks, Romania is implementing its long-term rehabilitation plan. Special emphasis should be given to ensuring the necessary administrative capacity (both in qualitative and quantitative terms) to prepare for the significant investments that will be needed in road and rail infrastructure.

On road transport, Romania has made steady progress in terms of legislative alignment. Romania also needs to strengthen its administrative capacity to enforce newly adopted legislation related to social, technical and fiscal issues. In particular, Romania should ensure that the roadside inspection of vehicles does not give rise to any *de facto* discrimination between Romanian and EC hauliers and/or vehicles.

As regards railways, Romania is now well advanced in terms of legislative alignment with the relevant *acquis*; in particular, infrastructure management has been separated from the provision of rail transport services. The reorganisation of the railway sector is practically completed.

Concerning inland waterways, Romania has made no progress in restructuring its fleet in order to meet future competition and to comply with the technical standards set by the *acquis*. These delays mean that the inevitable restructuring process will become considerably more difficult.

Concerning air transport, Romania has continued to transpose the *acquis* and has started to improve the management of its national carrier in order to prepare it for competition with foreign companies by the time of accession. Thanks to these measures, the carrier's losses have been significantly reduced, but major additional reforms will be needed to reach a financial equilibrium. Romania should continue with the necessary legislative alignment in the sector. Proper attention should be given to the necessary strengthening of administrative capacity in the sector.

As regards maritime safety, Romania's detention rate remains worryingly high and the Romanian flag is still on the Black List of the Secretariat of the Paris Memorandum of Understanding on Port State Control. Romania has reorganised its institutions in order to avoid duplication and excessive dilution of responsibilities - but whether these changes lead to an actual improvement in safety standards remains to be seen. Romania needs to enhance maritime safety and considerably intensify its efforts to decrease the detention rates for inspected ships.

Conclusion

In its 1997 Opinion, the Commission noted that Romania had made progress in the adoption of the *acquis* in the transport sector. However, its entry into the internal transport market would remain subject to rapid alignment to the *acquis* (particularly with regard to safety in the shipping and road haulage sectors). The Commission also concluded that Romania would need to make resources available to improve transport infrastructure and to lay the foundations for the future trans-European transport network, and that Romania's administrative structures, and in particular those bodies supervising areas such as safety, needed to be rapidly and substantially reinforced.

Since the Opinion, Romania has made steady progress with the transposition of the transport *acquis* and with the establishment of the required administrative structures - although the degree of progress has varied considerably depending on the transport sector. Most work has been carried out with regard to road and railway transport while positive developments were also recorded in the area of aviation. Progress in the area of maritime safety and inland waterways was more limited. Additional legislative efforts are needed to complete the process of legislative alignment. Institutional mechanisms and budgetary means for implementing the *acquis* also need to be developed.

Negotiations on this chapter continue.

Romania should focus further efforts on developing institutions able to enforce the new legislation, and securing the necessary funding to make the heavy investments required by the *acquis*. Further efforts will also be needed to implement the fiscal and social/technical *acquis* in the road sector, to transpose and implement the *acquis* in the aviation and maritime sectors, to considerably improve the maritime safety record, to restructure the inland waterways fleet to meet EC standards, and to strengthen the maritime safety authority while also guaranteeing its independence.

Chapter 10: Taxation

Progress since the last Regular Report

Since the last Regular Report, Romania has made some progress, particularly in the alignment of its VAT legislation.

In the area of **indirect taxation**, Romania has made significant progress in aligning with the *acquis* by the adoption of a consolidated law on VAT in June 2002. The law introduces a comprehensive definition of taxable persons, reduces the list of incompatible VAT exemptions, and introduces VAT exemptions provided for under the *acquis*. The law also establishes principles for determining the place of taxation and sets out new provisions for the right of deduction. In an attempt to tackle fraud on VAT refunds, the new VAT law has introduced heavy criminal penalties.

New legislation on excise duties entered into force in January 2002. Among other provisions, excise duties were increased for all harmonised product categories and the definitions were reviewed, bringing them closer to the *acquis*. The taxable regime applicable to alcohol has been unified, with the same duty rate applied to both ethyl alcohol and spirits.

As regards **direct taxation**, a revised Profit Tax Law was adopted in June 2002. Under the new law, the reduced rate of 5% on profits made from exports will be phased out completely by January 2004. Certain fiscal facilities for small and medium-sized enterprises and taxpayers established in disadvantaged areas and free zones will also be gradually eliminated.

As regards **administrative co-operation and mutual assistance**, no progress can be reported.

Over the reporting period, Romania has continued to modernise its tax administration and to improve the revenue collection system. Measures have been taken to reduce tax arrears. Assistance and information to tax payers have been further developed. Also, a strategy to improve the administrative capacity of the tax administration was approved in February 2002. The strategy covers the period until December 2006 and will be revised each year. Romania has also committed itself to develop a Code of Ethics by mid-2003.

Overall assessment

Although the new VAT law represents an important step forward, alignment remains incomplete in a number of areas, such as exempted activities – with or without the right of deduction. Rules which are not compatible with the *acquis* also exist, including the general rules on the chargeability of the tax, rules on the place of taxation, and rules on the payment of VAT. Romania still has to transpose provisions concerning the special VAT schemes.

Concerning excise duties, while recent legislation represents progress, a major effort is still needed (mainly regarding the alignment of the scope of exemptions as well as of rates and structure of all harmonised product categories). Furthermore, Romanian legislation does not appear to contain provisions to allow small foreign breweries, that are not registered as taxpayers in Romania, to benefit from the same reduced rates as locally registered breweries. In this respect, it has to be emphasised that the *acquis* does not permit differentiated taxation levels based on origin. The duty suspension scheme, and in particular the provisions on tax warehouses, still needs to be adopted. Given the complexity of this essential part of the excise *acquis*, Romania should urgently start preparing for its transposition and implementation.

Concerning direct taxation, Romania will have to align its legislation further with that of the *acquis*. Legislation will have to be reviewed in order to eliminate potentially harmful tax measures, so as to comply with the Code of Conduct for Business Taxation to the same extent as current Member States upon accession. The Commission's initial technical assessment of potentially harmful measures applied in Romania is ongoing.

Despite efforts made during the reporting period, the administrative capacity of the Romanian tax authorities remains weak and fraud on VAT refunds has reached significant proportions. The revenue collection and the refund systems are in need of major improvement. The elaboration and application of the Code of Ethics should be given a high priority in order to address issues related to corruption and to improve administrative practices.

As regards interconnectivity, no detailed plans concerning the VAT Information Exchange System have been drawn up. Romania will need several years to complete these tasks and be in a position to meet the obligations of the *acquis*.

Conclusion

In its 1997 Opinion, the Commission stressed that the *acquis* in respect to direct taxation should present no significant problems. As regards indirect taxation, the Commission pointed out that, although a start had been made, a sustained effort was required to comply with the EU *acquis* concerning VAT and excise duties.

Since the Opinion, Romania has made progress towards alignment with the taxation *acquis* although this has been at a slow pace. Transposition of legislation on indirect taxation has continued over recent years although it is not yet complete. Further, legislative adjustments are still needed, also in the area of direct taxation. Despite recent efforts, only limited results have been achieved in modernising the tax administration

Negotiations on this chapter continue.

Romania should focus further efforts on addressing outstanding legislation to complete transposition of the *acquis*, as well as on reinforcing its capacity for implementation and enforcement. Administrative reforms should focus on improving the revenue collection and the refund systems as well as reducing fraud on VAT refunds.

Chapter 11: Economic and Monetary Union

Progress since the last Regular Report

A detailed assessment of the various aspects of Romania's economic policy has been given above, in the Chapter discussing the economic criteria (B-2). Therefore, the present section is limited to a discussion of those aspects of the Economic and Monetary Union *acquis* – as defined by Title VII of the EC Treaty and the other relevant texts – which candidate countries should implement before accession, i.e. the prohibition of direct public sector financing by the central bank, the prohibition of privileged access of the public sector to financial institutions and the independence of the national central bank. As to the process of liberalisation of capital movements, upon the completion of which compliance with the EMU *acquis* is conditional, this aspect has been covered above, in the section on *Chapter 4 – Free movement of capital*.

Since the last Regular Report, Romania has made only limited progress with adopting the EMU-related *acquis*.

As regards the **prohibition of direct public sector financing by the central bank**, no legislative progress can be reported - although no recourse to such financing has been made since 2000.

Similarly, no progress was made during the reporting period with the **prohibition of privileged access of the public sector to financial institutions**.

Concerning the **independence of the central bank**, an Emergency Ordinance of October 2001 amended the Statutes of the National Bank of Romania and explicitly discharged

the Bank's directors from civil or criminal liability for supervisory actions taken in good faith.

Overall assessment

Romania will participate in EMU upon accession with the status of a country with a derogation under Article 122 of the EC Treaty. It will need to implement the necessary changes to its institutional and legal framework by the date of accession.

As regards the prohibition of direct public sector financing by the central bank, legislative amendments are necessary to fully align with the *acquis*, particularly as regards the purchase of government securities. The Romanian authorities have agreed a timetable for the modification of the relevant statutory provisions by the end of 2004.

Romania also needs to further align its legislation with the provisions of the *acquis* prohibiting privileged access of public sector authorities to financial institutions. Romania is to amend legislation regarding the functioning of the deposit guarantee fund in the banking system by the end of 2004.

In the area of central bank independence, further alignment is needed in order to make the legislative framework compliant with the *acquis*. Romania has identified the legal texts requiring amendment and has approved a timetable for their modification by the end of 2004.

Conclusion

In its 1997 Opinion, the Commission concluded that it was premature to judge if Romania would be in a position, by the time of accession, to participate in the euro area; that would depend on a successful structural transformation permitting it to attain and adhere permanently to the convergence criteria, though these were not a condition of accession. The Commission also pointed out that Romania's legislation was not fully compatible with EC rules and that monetary and exchange rate policies still had to show a significant stability oriented record.

Since the Opinion, while overall policy has stabilised legislative alignment has remained limited.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangement. Romania is generally meeting the commitments it has made in the accession negotiations in this field.

Romania should focus further efforts on pursuing the alignment of its legislation with the *acquis* in this area.

Chapter 12: Statistics

Progress since the last Regular Report

Romania has continued to make progress over the past year.

As regards **statistical infrastructure**, the regional offices subordinated to the National Statistical Institute (INS) have been reorganised and concentrated into 8 offices, and total staff numbers have decreased substantially over the last years. In order to compensate for the low numbers of staff, training has been given a high priority in the national statistical system. A new training centre for officials was opened during the reporting period. It is also open to staff of other public bodies, thereby contributing to the training of users.

Concerning **demographic and social statistics**, a good level of compliance has already been reached and further progress was made during the reporting period. A census of population and housing was carried out in March 2002 and will benefit the whole statistical system. Most other statistical surveys are in place or have been tested.

Efforts have been made to improve the infrastructure for production of **regional statistics**. The establishment of 8 regional offices has facilitated the collection of data at level 2 of the Nomenclature of Territorial Units for Statistics (NUTS-II level) and staff from regional offices have received specialised training.

No new developments can be reported for **classifications and macro-economic, business and transport statistics** - although the current situation is already quite good.

For **external trade**, the customs administration and the INS are cooperating in order to develop additional data control and to improve the quality of primary data. First steps towards the preparation for INTRASTAT, the system which monitors trade among Member States, have been taken.

During the past year, Romania has made progress in testing the methodologies and questionnaires for surveys related to **agricultural statistics**. However, considerable efforts are still required in order to establish a permanent observation system for agricultural statistics that has a reasonable coverage. Preparations have been made for carrying out the agricultural census, scheduled for late 2002, which will provide the basis for redesigning the survey system. A pilot survey to prepare for the General Agricultural Census was carried out during August 2002.

Overall assessment

Concerning classifications, national classifications providing direct implementation of European classifications and nomenclatures are in force. They are applied in statistical surveys as well as for other administrative purposes, which enhances the use of administrative sources for statistical purposes.

In the field of macro-economic statistics, the main steps have been taken and legal compliance is generally high. However, there is a continued need to develop the quality and coverage of statistics, which is only possible with sufficient and qualified staff. For business statistics, Romania has achieved a reasonable level of compliance. Some gaps concerning production statistics have been filled. Priority should now be given to improving the quality and timeliness of statistics.

Renewing and developing IT capacity remains an important issue that should be addressed. This should include further training for central and regional staff in order to make effective use of the equipment and the software applications.

Conclusion

In its 1997 Opinion, the Commission concluded that, provided that progress continued to be made, Romania should be able to comply with EC requirements for official statistics within the next few years.

Since the Opinion, Romania has made good progress, especially over the last three years. Major developments have taken place in reforming national legislation, redesigning household and business surveys, conducting a population census, and maintaining the necessary administrative capacity. All provisions required by the *acquis* are now in place, including protection of confidentiality and the creation of a Statistical Council. The National Statistical Institute (INS) is an independent state agency and the regional organisation of the INS appears appropriate for a large country such as Romania.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements in this area. Romania is generally meeting its commitments made in the accession negotiations in this field.

Romania should focus further efforts on upgrading statistical methodologies and improving the quality and completeness of data. Further efforts are also needed to develop the capacity of staff within the statistics administration and care should be taken that levels of staffing are not further decreased.

Chapter 13: Social policy and employment

Progress since the last Regular Report

Some progress has been made since the last Regular Report.

With regard to **labour law**, no major legislative development can be recorded pending the adoption of the new Labour Code.

In the field of **equal treatment** for women and men, a law on Equal Opportunities and Treatment for Women and Men was adopted in May 2002. The law aims to eliminate direct and indirect discrimination on the basis of gender and forbids it in the fields of employment, education, health, culture, information and senior management positions. The law also establishes a mechanism for resolving disputes. The penal code was modified to introduce the specific crime of sexual harassment. No progress was made with regard to allocation of funds for the implementation of the National Plan for Equal Opportunities.

In the area of **health and safety at work**, Parliament adopted a law on insurance against accidents in the workplace and professional diseases in May 2002. According to the law, insurance is mandatory for all employers and the contribution to the national insurance fund is made proportional to the risks existing in a given enterprise. The levels of staffing in central and local labour inspectorates increased over the reporting period.

In the area of **social dialogue**, the majority of labour conflicts have been resolved by conciliation procedures in the framework of the Law on Labour Conflicts since it entered into force in January 2002. In January 2002 the Government concluded a Social Pact with the majority of trade unions. A further agreement was reached in June 2002 with the two

unions that had not signed the original agreement. The difficulty in concluding a single agreement reflects a worsening relationship between the Government and the trade unions. The Economic and Social Council played a more significant role as an advisor on legislative acts – although autonomous sectoral social dialogue continues to be weak and is mainly limited to the public-sector and to large enterprises.

On **public health**, a ministerial order on reorganising the national network for surveillance and control of communicable diseases was adopted in March 2002. It defines the responsibilities of the bodies involved in the national surveillance of communicable diseases, clarifies the information flow, and prioritises the diseases for surveillance in line with EC provisions (although limited laboratory capacity means that not all diseases on the EC priority list are yet covered). Legislation on combating the effects of the use of tobacco products was adopted in June 2002.

Romania has jointly with the European Commission continued the work on an **Employment Policy Review**, with a view to finalising the Joint Assessment on Employment Policy Priorities (JAP). The purpose is to examine the progress made by Romania in adapting its employment system for preparing its future participation in the European Employment Strategy after accession. This document, in its final stage, sets out the key priorities and tasks in the field of labour market for the pre-accession period. The situation on the labour market seems to have improved slightly and at 6.6% in 2001 the unemployment rate stopped rising. Unemployment was 7% amongst men and 6% amongst women. Despite the overall reduction in unemployment, levels of long term unemployment remain high.

A law on Unemployment Insurance and Employment Stimulation was adopted and entered into force in March 2002. The law aims to develop active measures for fighting and preventing unemployment. In August 2002, the Government approved the National Action Plan for Employment.

As regards the future establishment of the European Social Fund (ESF), the Government designated the Ministry of Labour and Social Solidarity as the National Authority for the overall co-ordination of ESF-type activities and as the Managing Authority for the ESF after accession. The National Agency for Employment was designated as the paying authority.

As a follow-up to the Gothenburg European Council, where the EU invited the candidate countries to translate the EU objectives into their national policies, the Commission and Romania have initiated a joint co-operation exercise to prepare for future participation in the EU **social inclusion** process after accession. This exercise consists of joint identification of the social exclusion challenges and relevant policy responses. The Statistical Office of Romania co-operates with Eurostat to produce data on poverty and social exclusion. Preliminary figures suggest that the overall income disparities seem to be rather moderate with a relatively high poverty rate after social transfers of 17%, and a particularly high risk of poverty for members of the Roma community.

Fighting social exclusion and poverty is a Government priority and intense legislative activity characterised the reporting period. In December 2001, a law on the National Assistance System was adopted. The law aims at establishing a consistent and unified national system, defining the legal framework for providing social services and making local communities responsible for people in difficulty. In February 2002, the law on

employment insurance and employment stimulation was adopted, which sets out measures for preventing unemployment and combating its social outcomes, including for persons with disabilities. In July 2002 the Government decided to set up an inter-ministerial commission concerning social assistance and adopted a Social Programme.

The National Plan on Poverty Prevention and Social Inclusion Promotion was adopted in July 2002. The Law on Preventing and Combating Social Exclusion was adopted as one of the first instruments for implementing this Plan. The Law aims at guaranteeing access of marginalised people, especially the young and Roma, to basic rights: employment, proper housing, health assistance, and education.

A national strategy on special protection and social integration of disabled persons was drawn up as a first step of a true reform of the policy in favour of disabled persons, including closure and/or restructuring of old-type residential institutions. In December 2001, the Government issued an emergency ordinance decreasing the disabled persons' contribution to the Special Solidarity Fund and delegating financial responsibility to local authorities.

As regards other areas of **social protection**, preparatory steps have been taken to press ahead with the pension reform (Government Decisions on pensions recorelation and on indexation of pensions, setting-up of an inter-ministerial group for creating a single administrative structure in charge of collection, audit, and contribution to the social insurance budget).

With respect to **anti-discrimination**, a law approving the 2000 Government Ordinance on Preventing and Punishing all Forms of Discrimination entered in force in January 2002. The National Council for Combating Discrimination was established in August 2002. These are positive developments although amendments to the law will be needed in order to fully conform with the *acquis*. (See *Political criteria - 1.2 Human rights and the protection of minorities*).

Overall assessment

As regards labour law, Romania still needs to adopt a revised Labour Code. This would represent an important step towards ensuring full alignment with the Community *acquis*.

Regarding equal treatment for women and men, further efforts are needed to align Romanian legislation with regard to burden of proof, protection of the rights of pregnant women, and free access to night work.

Regarding health and safety at work, despite progress with legal transposition, considerable work remains to be done with respect to the effective implementation of the *acquis*. Particular attention should be paid to improving co-operation between the Ministry of Labour and Social Solidarity and the Ministry of Health and Family. The capacity of the Labour Inspectorate should also be improved.

The framework for establishing a national surveillance system for communicable diseases was adopted but the system needs to be substantially reorganised before complying with the *acquis*. A well functioning information system needs to be put in place, laboratory capacity should be reinforced, laboratory standards need to be brought up to EC levels, and staff training should be intensified. Current tobacco legislation is partially aligned

with the *acquis*, but it still needs to be completed. Draft legislation transposing the new EC Directive needs to be adopted and implemented.

Basic health indicators reflect the low level of public health in Romania and infant mortality remains high while life expectancy is low. The incidence of some communicable diseases also gives rise to concern. The 2002 budget allocation is limited and a lack of resources continues to limit the quality of and equal access to health services. The Ministry of Health and Family is undergoing continuous organisational changes, which inevitably have a negative impact on policy implementation. The recommendations made in the 2001 Regular Report remain valid and Romania should place greater emphasis on strategic planning of human and financial resources in order to make efficient use of scarce public funds.

Despite social dialogue with regard to conflict resolution and the involvement of the Economic and Social Council in legislative consultations, autonomous social dialogue should be actively promoted, especially at the sectoral level and in small and medium sized enterprises, in order to improve its coverage (both in terms of percentage of the labour force and of enterprises covered by collective agreements). Further steps should be taken to strengthen the administrative capacity of the social partners, and in particular private employers. The tripartite social dialogue should be extended to new policy areas including employment and social inclusion.

Regarding employment policy, the Joint Assessment of the Employment Policy Priorities of Romania (JAP) will represent an important element in preparing the Romanian employment system for participation in the European Employment Strategy after accession. It is therefore important to ensure effective monitoring of the phasing-in of the commitments contained in the JAP. The reform of vocational education needs to be completed and adapted to the long-term needs of the labour market. Ensuring access to education for everybody and in particular for minority groups is of high priority. The Law on Unemployment Insurance and Employment Stimulation will represent a significant step forward and should be treated as a priority. Employment policies need to be focused on active and preventive measures that contribute to the transformation of the economy. With regard to preparation for Structural Funds, the early designation of the bodies responsible for ESF management will only make sense if training and institution-building measures are undertaken in order to define, finance and efficiently implement ESF-type measures.

A national integrated strategy on promoting social inclusion, taking into account the EU objectives, needs to be developed. As poverty and social exclusion are multidimensional by nature, it is important to promote an integrated approach mobilising various governmental bodies and all relevant stakeholders in the process. It is also crucial to improve and develop social statistics on poverty and social exclusion in line with agreed EU indicators.

As regards other areas of social protection, sustained efforts are required to clarify the institutional responsibilities of all bodies and authorities concerned. The precarious state of social protection in Romania is mainly due to the economic situation, but is also caused by the weak administrative capacity to collect contributions to the social insurance funds, the lack of appropriately trained personnel, and the lack of co-operation between ministries. At the local level, the distribution of responsibilities is still unclear and fragmented and local structures are understaffed. Difficulties occur in implementation of

the legislation due to lack of a common methodology and a lack of expertise. A common approach to social inclusion should urgently be developed at national level.

The success of recent legislative measures will depend upon the Government's ability and to build the required administrative capacity, both at national and local level, and to allocate sufficient and predictable budgetary resources.

Although the adoption of the law on the prevention of all forms of discrimination is a positive step, further efforts are needed to ensure alignment with the *acquis* on anti-discrimination, notably with regard to indirect discrimination and the burden of proof.

Conclusion

In its 1997 Opinion, the Commission concluded that Romania would need to make very considerable progress in all areas of social policy, with regard to both the approximation of laws and the strengthening of enforcement structures. Specific issues requiring attention included health and safety at work, public health, and labour market and employment policy.

Since the Opinion, Romania has made good progress in aligning with the *acquis*, especially over the last two years. Legislative progress has been particularly good with regard to the equal treatment of men and women, social assistance and social inclusion, and anti-discrimination. Despite these developments, additional legislative efforts are needed. Institutional mechanisms and budgetary means for implementing the new legislation also need to be developed.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is generally meeting the commitments it made in the accession negotiations in this field.

Romania should focus further efforts on the adoption of a new labour code, continued transposition and implementation of the health and safety at work *acquis*, further promotion of social inclusion, fully aligning anti-discrimination legislation with the *acquis*, protecting the rights of pregnant women, and providing free access to night work. Further work is also needed with regard to inter-institutional co-operation, decentralising social responsibilities to the local level, budgetary organisation, ensuring adequate staff numbers, and effective training of personnel.

Chapter 14: Energy

Progress since the last Regular Report

Since the last Regular Report, Romania has made progress in preparing for the internal energy market, in particular as regards the level of market opening, pricing policy, and restructuring of some utilities. However, progress in implementing key structural reforms and improving administrative capacity has been limited.

Concerning **security of supply**, an Emergency Ordinance adopted in April 2002 established an oil stock monitoring system in Romania. While the country has sufficient storage capacity to meet the requirements of the *acquis*, Romania does not have the requisite stocks of oil products. The Ordinance stipulates that the level of these oil stocks

will be gradually increased, and will be 50% financed by the state, through the National Agency for State Reserves, and 50% by private operators.

Significant progress has been made in the field of **competitiveness and the internal energy market**. In the *electricity sector*, following a Government Decision in January 2002, market openness was increased to 33%, with licensed suppliers and eligible customers defined by the regulatory authority. In practice, the contracts signed between licensed suppliers and eligible customers amount to around 8% of the market.

Electricity prices were adjusted several times and now reflect production costs to an acceptable degree. Prices have also been indexed with the US dollar, which prevents some of the negative effects of inflation. An Ordinance adopted in March 2002 gave the Prime Minister responsibility for appointing the President of the National Electricity Regulatory Authority (ANRE), which reinforces its independence vis-à-vis the Ministry of Industry and Resources. In addition, two regional distribution companies have been prepared for privatisation.

Tests with a view to future interconnection with the Western European UCTE (Union Co-ordinating the Transport of Electricity) were finalised and the monitoring of the inter-connected operation with UCTE is currently being carried out.

In the *gas sector*, the rate of market opening was increased from 10% to 25%, and the regulatory authority has selected 45 eligible customers. As with the electricity sector, gas prices have been adjusted to reflect production costs, they are now indexed with the US dollar, and the president of the National Gas Regulatory Authority (ANRGN) is appointed by the Prime Minister.

The Government has adopted an action plan for the improvement of bill collection in the energy sector, including the disconnection of non-paying companies. However, problems of non-payment remain acute in the state sector (state-run industries, local authorities or public services). Although there are no reliable figures available, the energy bill collection rates remain at an insufficient level.

In the sectors of *oil* and *solid fuels*, no major developments have been recorded.

As far as **energy efficiency and renewable energy** is concerned, little substantial progress was made during the reporting period. In October 2001, the Romanian Fund for Energy Efficiency was legally established but it is not yet operational.

In the field of **nuclear energy**, Romania operates, at the Cernavoda Nuclear Power Plant, a Canadian-designed CANDU 6 type reactor with a nominal capacity of 700 MWe. This unit has been licensed following the Canadian licensing requirements for similar reactors in Canada. Cernavoda Unit 1 provides 11% of the country's electricity. Unit 2 of Cernavoda is being completed and is expected to be operational by 2005 – 2006.

As regards nuclear safety, Romania has continued to develop the legislative and regulatory framework. However, no progress has been achieved in dealing with spent fuel and nuclear waste.

Legislation has been harmonised with the adoption of orders for approving EURATOM safeguards, on radiological safety norms in September 2001, and on international transit of nuclear materials through Romanian space in February 2002.

As part of the Strategic Plan for Safety Analysis, a technical agreement was concluded between the National Company Nuclearelectrica and a Korean nuclear power company in order to assist the Romanian operator to develop its capability to perform accident analyses at Cernavoda Nuclear Power Plant. This Strategic Plan is scheduled to be finalised by 2004.

Overall assessment

As regards security of supply, Romania has adopted legislation that should provide the basis for future compliance with the *acquis* on oil stocks. While storage capacities are sufficient, required oil stocks will have to be built up.

In the electricity sector, important steps have been taken to adjust electricity prices to reflect production costs and to establish the legal framework for market opening. Similar positive reforms have taken place in the gas sector. However, there has been a continued lack of progress with restructuring the state-owned energy producer Termoelectrica in order to improve its management and to make its production costs competitive. The key priority should now be a thorough reform of Termoelectrica in order to reduce production costs of thermal power plants.

Poor collection of energy bills remains a fundamental problem in Romania which impacts negatively on the financial situation of the utilities and prevents them from making the necessary investments to modernise their networks and improve their efficiency. This situation distorts the entire Romanian economy and Romanian efforts should be devoted to ensuring a genuine improvement of bill payment. For the solid fuels sector, it is important that Romania continues with its restructuring efforts and, for the hard coal sector, ensures compliance with the Community state aid *acquis*.

Romania does not devote the necessary resources to improving energy efficiency and to promoting renewal energy. The present efficiency of production means and networks is very poor, mainly due to a lack of investment. The Romanian Agency for Energy Conservation is in charge of promoting energy efficiency but has very limited financial and human resources - which is a demonstration of the low priority Romania gives to energy efficiency. This is particularly worrying, since the energy intensity of the economy is very high (estimated at around 8 times the EC average).

The European Union has repeatedly emphasised the importance of a high level of nuclear safety in candidate countries. In June 2001, the Council of the European Union took note of a Report on Nuclear Safety in the Context of Enlargement. This report contains recommendations to all candidate countries to continue their national safety improvement programmes, including the safe management of spent fuel and radioactive waste, and regarding the safety of their research reactors. During the first half of 2002, a special Peer Review on nuclear safety assessed the progress made by candidate countries in implementing the 2001 Report's recommendations. This exercise under the auspices of the Council resulted in a Status Report, published in June 2002, which concludes that Romania has accepted and addressed all the recommendations contained in the Report on Nuclear Safety in the Context of Enlargement of June 2001.

Most recommendations have been adequately addressed. Romania should devote further attention to six recommendations: to systematically consider and implement relevant safety improvements for similar plants adopted in Canada; to strengthen the co-operation

between the Nuclear Safety Regulatory Authority (CNCAN) and the Canada Nuclear Safety Commission; to install an emergency Operating Centre at Cernavoda; to pay attention to the continued financial resources of the operator, as well as to the preservation of its management's and staff's competence; and to complete the update and regulatory reviews regarding fire and seismic hazard assessments at Cernavoda.

The Status Report recommends further monitoring with regard to four recommendations: to ensure the implementation of relevant safety improvements adopted in similar CANDU plants in Canada; to ensure the timely implementation of the Strategic Plan for Safety Analysis of Cernavoda Unit 1 and the development of the Safety Analysis Report for Cernavoda Unit 2; and to ensure that sufficient resources are allocated to the Nuclear Regulatory Authority in order to strengthen its capabilities.

Salaries at CNCAN remain low when compared with employees in the nuclear industry and there is a steady turnover of personnel, who leave the institution to work for Cernavoda or other industries that pay better salaries. Romania is therefore encouraged to address this specific issue and to further strengthen the resources and capabilities of CNCAN within a stable framework.

The unresolved issues of spent fuel and nuclear waste will have to be addressed in the short-term.

In order to ensure compliance with Euratom requirements and procedures Romania should give due attention to preparing the implementation of Euratom safeguards, in particular regarding the direct reporting of nuclear material flows and inventories by the persons or bodies operating nuclear installations or storing nuclear material. Romania has concluded a Full Scope Safeguards Agreement with the International Atomic Energy Agency.

Conclusion

In its 1997 Opinion, the Commission concluded that Romania had to step up considerably its efforts in the energy sector in order to prepare for integration. The following areas were identified as requiring particularly close attention: the adjustment of monopolies; energy pricing; emergency preparedness, including the building-up of mandatory oil stocks; state interventions in the solid fuels sector; and development of energy efficiency. The Commission added that, although no major difficulties were foreseen for compliance with the Euratom Treaty, Romania should implement some international nuclear norms. Nuclear safety standards, especially those related to plant operation, should be handled appropriately and longer-term solutions needed to be found for radioactive waste.

Since the Opinion, Romania has made progress in aligning itself with the relevant *acquis*. However, many structural issues still have to be addressed in the energy sector. Legislative alignment is limited and the new administrative structures remain to be consolidated.

Negotiations on this chapter continue.

Romania should focus further efforts on addressing the structural problems that are facing the sector: non-payment of energy bills, restructuring of Termoelectrica, and improving

the efficiency of its energy networks. It should also move away from its current energy production-oriented policy, and towards a policy based on energy saving. Romania should take the necessary measures to ensure the full and timely implementation of legislation in the energy sector as well as strengthening the administrative capacity of the newly established bodies (in particular the energy regulators, the energy efficiency body and the nuclear safety authority). Romania should ensure compliance with Euratom requirements and procedures and take measures for the progressive building up of oil stocks.

Chapter 15: Industrial policy¹⁴

Progress since the last Regular Report

Since the last Regular Report, Romania has made progress in developing a coherent industrial policy. Substantial progress has also been noted in the steel restructuring process, while progress with privatisation has been relatively slow.

As regards **industrial strategy**, in April 2002 the strategic document “Industrial Policy of Romania” and the corresponding Action Plan were amended in order to increase their usefulness as operational policy instruments and to ensure coherence between interrelated policy areas. The changes made represent substantial improvements over the initial version that was adopted in 2001. Over the reporting period, implementation measures have mainly focused on improving the business environment, attracting foreign investment and accelerating the privatisation process.

The Ministry of Industry and Resources established a specific Directorate-General for Syntheses, Strategies, Industrial Policy and Development programmes, although the effectiveness of this change still remains to be seen. In June 2002, the first meeting of the Consultative Forum took place. The forum is comprised of all stakeholders (institutional, corporate, social, academic and civil society) and is to be consulted periodically on the implementation of Romania’s industrial policy.

Romania continues to lag behind other candidate countries in terms of attracting foreign direct investment (*see Section B.1.2. – Economic criteria*). In an effort to improve investment promotion, the Romanian Agency for Foreign Investments (ARIS) was established in March 2002. ARIS replaces two bodies that had overlapping competences and as such is a welcome development. It is headed by a state secretary, and its responsibilities cover strategy design, legislative harmonisation, assistance to foreign investors and local companies, and investment promotion. Further legislation is, however, needed for the Agency to become fully operational, and adequate resources still need to be allocated.

In 2002 Romania witnessed steady growth in both domestic and foreign investments. The share of gross fixed capital formation in GDP averaged 19% and the investment ratio also improved over the reporting period although levels remain low. Inflows of foreign direct investment represented 2.9% of GDP in 2001.

¹⁴ Developments concerning Industrial policy should be seen in relation to the overall enterprise policy, including the SME policy (*see Chapter 16 - Small and medium-sized enterprises*).

Since last year, some progress has been made with **privatisation and restructuring**. In March 2002, new legislation was adopted to speed up the privatisation process. This is, in itself, tacit recognition that previous privatisation efforts had been disappointingly slow. The law incorporates recommendations from the IFIs and its major features include new privatisation methods and the possibility to settle debts before contract signature.

A Government Ordinance from February 2002 clarified the relationship between the Authority for Privatisation and Management of State Assets (APAPS) and investors. However, in November 2001, a new Office of State Ownership and Privatisation in Industry (OPSI) took over APAPS's responsibility for companies in strategic sectors (energy, oil and gas, mining, defence). OPSI is part of the Ministry of Industry and Resources and its portfolio represents 75% of total state assets.

Considerable progress has been made with restructuring of the steel industry. Privatisation of the steel company SIDEX was successfully concluded in 2001 and approximately 80% of steel production is now privately owned. The closure of production facilities at the Hunedoara steel plant means that progress has also been made with the implementation of restructuring measures. A revised steel restructuring programme was also produced during the reporting period. The national plan along with individual viability plans forms the basis of Romania's efforts to fulfil its obligation under the Europe Agreement as concerns state aid in the sector.

Overall assessment

Following the development of an industrial policy, the key challenge for the Romanian authorities is implementation. Progress in this area has been slowed by a lack of effective co-ordination between the various ministries involved and relevant stakeholders. A number of co-ordination bodies have been established in order to rectify the situation, but these are not fully operational. The Inter-Ministerial Group, which is supposed to meet monthly and ensure overall policy co-ordination, only met twice during the reporting period. The Task Force established at expert level meets on an *ad hoc* basis and only deals with operational issues. Problems have also arisen due to the overlapping responsibilities of the Ministry of Industry and Resources and the Ministry for Development and Prognosis (which share responsibility for the implementation of industrial policy), and the Ministry for SMEs and Co-operatives.

Romania would seem to be steadily, if slowly, enhancing its international credibility in the area of foreign direct investment. Improving the investment climate has consistently been given a high priority by policy makers and there has been a greater willingness to consult and listen to the concerns of investors. This said, levels of investment will remain low until the general problems of corruption, excessive bureaucracy and an unstable legislative climate are addressed (*see also Chapter 16 – Small and medium-sized enterprises for progress in implementing the business environment*).

Recent legislative measures may help boost the privatisation process, but these are yet to be applied. The Romanian authorities should take great care to ensure that current privatisation practices (e.g. debt-for-equity swaps, the possibility of using a special administrative regime to accelerate privatisation, and direct negotiations with potential buyers) do not further reduce the financial discipline of enterprises. The benefits of splitting the responsibilities for privatisation between APAPS and OPSI are not clear since OPSI does not (yet) have the experience or the political stature of APAPS.

Experience over the last year demonstrates that increasing transparency in the privatisation process should be a priority for both institutions.

While undoubted progress has been made, restructuring of the steel industry remains a challenge that needs to be tackled in order to fulfil Romania's obligations under the Europe Agreement concerning state aid. It should be noted that an important element of any industrial policy is the control of state aid and the compatibility of support schemes with EC rules, which will have to be examined (*see Chapter 6 - Competition policy*).

Conclusion

In its 1997 Opinion, the Commission concluded that Romanian industry was not well advanced in the process of adapting to a market-based economy. The need to end state monopolies and reduce excessive state involvement in enterprises was noted, as was the need for far-reaching restructuring in individual sectors.

Since the Opinion, Romania has internalised the principles of EC industrial policy. However, while progress has been made in certain areas, Romania has been slow in addressing and implementing necessary structural reforms. Limited privatisation has been a particular problem. Romania's policy towards industry generally complies with the principles of EC industrial policy. However, underlying structural weaknesses (economic, administrative and legal) remain and limit the effectiveness of the industrial policy and its various instruments.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is generally meeting the commitments it has made in the accession negotiations in this field.

Romania should focus its further efforts on finalising the privatisation process in a fully transparent manner, attracting investment by simplifying and stabilising the business environment, and developing the administrative capacity and structures necessary to implement its Industrial Policy Strategy. Great care will have to be taken that the policy of restructuring is implemented in a manner which conforms to the competition and state aid *acquis* so as to create efficient competitive firms.

Chapter 16: Small and medium-sized enterprises¹⁵

Progress since the last Regular Report

Romania has continued to prioritise SME development over the reporting period, and while further improvements can be noted, additional efforts to improve the business environment are essential.

As regards **SME policy**, in April 2002, Romania endorsed the European Charter for Small Enterprises as the basis for its action to support and develop small enterprises. The European Charter, adopted by the European Council in June 2000, is the reference document in the field of enterprise policy within the socio-economic strategy set up at the

¹⁵ Developments concerning SME policy should be seen in relation to overall enterprise policy, including industrial policy (*see Chapter 15 - Industrial policy*).

Lisbon European Council. The reporting process on the implementation of the European Charter in Romania started in May 2002.

The Ministry for SMEs and Co-operatives has also prepared a revised version of the SME strategy, setting a number of short- and medium-term objectives. The new strategy will be supported by a number of national programmes covering *inter alia* micro enterprises and start-up financing.

In an attempt to improve access to finance, the Romanian authorities established a third guarantee fund, the National Credit Guarantee Fund. The Ministry for SMEs and Co-operatives is also responsible for the management of a wide range of multi-annual programmes. Support measures include investment promotion, providing access to training and consulting services, setting up the national network of consultancy centres, supporting export activities, and the establishment of business incubators.

Romania has made some progress with improving the **business environment**, and the Ministry for SMEs and Co-operatives has continued with the implementation of its Action Plan for Removing Barriers to SMEs. New legislation has attempted to simplify the registration and authorisation procedures for new companies and improvements have been made to the functioning of the "Single Offices" (one-stop-shops for company registrations). Other initiatives include developing information materials for entrepreneurs, creating a statistical database of SMEs, producing an Annual Report on the SME sector, and publishing the SME Sector Development Strategy.

A number of horizontal reforms are also likely to have a positive impact on the SME sector. These include amendments to the Code of Civil Procedure designed to accelerate court procedures, increasing the number of judges assigned to commercial litigation, and new legislation to accelerate bankruptcy procedures and reduce inter-enterprise arrears.

New VAT measures helped align Romanian legislation with the *acquis* but have also removed a number of tax exemptions which had previously been granted to SMEs. Due to their incompatibility with Romania's WTO and Europe Agreement obligations, reduced tax rates on profits generated by exports will be eliminated by 2004 (*see also Chapter 10 – Taxation and Chapter 26 – External relations*). Other legislation introduced a legal deadline for VAT refunds, which cannot exceed 30 days. This is a positive development - although until implementing legislation has been developed the law cannot be applied and there is some concern that implementation will be restricted by the absence of sanctions for authorities that miss the 30-day deadline.

In April 2002 a Government decision established the legal obligation for the administration to consult with "business associations and other NGOs" on draft legislation with an impact upon the business environment. While it does address a key issue, it is too early to judge the impact of this legislation. Even if consultation on business environment measures does improve, sectoral ministries should also be obliged to consult businesses on sector-specific legislation.

The Romanian **SME definition** is broadly in line with the EC recommended definition and no developments have been made over the reporting period.

Overall assessment

Priority issues identified in last year's report were the need for a simplification of enterprise licensing, a binding timetable for streamlining the existing legal framework, and a reduction in the cost and bureaucracy involved in gaining access to services provided by public utilities. No substantial progress has been achieved with these issues. Similarly, there has been no noticeable reduction in the large number of bodies that are authorised to conduct inspections and audits of businesses. Continued legislative instability, such as revisions to VAT and Profit Tax legislation, has made it difficult for SMEs to develop business plans with any degree of certainty.

Although the relationship between the banking sector and SMEs has recently improved, access to finance remains a serious difficulty. In an unstable macro-economic climate, banks are unwilling to accept long-term risks and the cost of credit remains very high. Against this background, government support measures are welcome – although there are concerns that support from the National Credit Guarantee Fund may be allocated on a discretionary basis.

The establishment of the Ministry for SMEs and Co-operatives has provided a degree of institutional stability to the sector. It has consolidated its position as the promoter of SME interests, the source of legislative acts which impact upon the sector, and as moderator between the various stakeholders (other ministries, SME representative organisations, trade unions, chambers of commerce, business support centres). However, insufficient personnel and a high turnover of senior staff put a strain on the Ministry's efficiency and risk undermining its effectiveness.

There is still a considerable policy overlap between the Ministry for SMEs and Co-operatives, the Ministry for Industry and Resources and the Ministry for Development and Prognosis. A specific concern is that the Ministry for SMEs and Co-operatives' Action Plan for Removing Barriers to SMEs overlaps with the activities of the Task Force responsible for drafting an Action Plan for Removing Administrative Barriers to Business (led by the Ministry for Development and Prognosis). A clearer definition of the respective tasks of these two bodies, as well as much more effective co-ordination, is needed.

Conclusion

In its 1997 Opinion, the Commission concluded that there was a clear need for greater coherence in SME policy, and that it would be necessary to strengthen the existing support structures, to simplify the legal and administrative environment, and to increase SMEs' access to financing.

Since the Opinion, Romania has taken a number of initiatives to support SMEs and their importance in the overall economy has increased substantially. Although Romania has prioritised the development of the SME sector and Romania's enterprise policy broadly meets the EU objectives and policies, the legal and administrative environment remains difficult and restricts SME development.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is generally meeting the commitments it made in the accession negotiations in this field.

Romania should focus future efforts on fully implementing the Action Plan for Removing Barriers to SMEs, and on addressing improvements required in the legal and administrative environment. Measures should also be taken to ensure that there is effective co-ordination between the many different agencies involved in the sector.

Chapter 17: Science and research

Progress since the last Regular Report

Since the last Regular Report, Romania has made some progress in the area of science and research.

Implementation of the National Plan for Research, Technological Development and Innovation has started and 1 045 projects have been selected for financing.

The Inter-Ministerial Council for Science, Technology and Innovation (CISTI) was re-organised in December 2001 and given the responsibility for drawing up and implementing strategies and programmes for research, development and innovation. CISTI also advises on proposals for updating the National Plan.

In August 2002, the Ministry of Education and Research was nominated as the State Authority for Research and Development. A National Council for Certifying Research was also established and a legal status was defined for Research and Development personnel.

A Government Ordinance from February 2002 on scientific and technological parks established a framework for cooperation between enterprises and research units from universities. This legislation aims to promote the transfer of technological research to enterprises and to establish research poles attracting foreign investment at the regional level.

Romania has continued to be associated with the **Fifth EC Framework Programme**, as well as with the **Fifth Euratom Framework Programme** and overall levels of participation improved in 2001. Romania is preparing for participation in the **Sixth Framework Programme (2002 – 2006)**. An action plan with the aim of improving participation in EC Framework Programmes was adopted for the period 2003-2004.

Funding for RTD activities increased in nominal terms but the real increase was very limited and overall levels of expenditure remain low.

Overall assessment

Romanian participation in the Fifth EC Framework Programme should be improved since Romania is still not able to reap the full benefits from its considerable financial contribution. The assessment of last year's Regular Report remains valid and reinforcement of research-related administration capabilities, cooperation practices and co-financing possibilities, and the strengthening of research-related infrastructure, are all necessary in order to ensure Romania's successful participation.

The institutional framework for Research and Development has been progressively developed. However, Romania's gross domestic expenditure on research and

development as a percentage of GDP remains very low and needs to be increased significantly.

Conclusion

In its 1997 Opinion, the Commission concluded that making Romanian research competitive at the international level would need greater efforts, but that no major problems should be expected.

Since the Opinion, Romania has fully associated itself with the Fifth Framework Programme and the financial and institutional framework for participation in the Programme is well established. Romania has adopted the National Plan for Research, Technological Development and Innovation as the basic reference for Romanian research activities. Efforts to encourage co-operation between enterprises and the research sector have also been made.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is generally meeting the commitments it has made in the accession negotiations in this domain.

Romania should focus further efforts on reinforcing research-related administrative capacity and infrastructure, in order to increase the benefits from association with the relevant Community Framework Programmes.

Chapter 18: Education and training

Progress since the last Regular Report

Progress has been made since the last Regular Report.

During the reference period, Romania continued to participate in the second generation of the Leonardo da Vinci, Socrates and Youth **Community programmes** (*see section A.b – Relations between the European Union and Romania*). Implementing legislation for the application of the **Directive concerning education of children of migrant workers** was approved in October 2001.

Several initiatives were taken over the reporting period to promote **reforms in the field of education, training and youth**. Scholarships are now granted to children from families living on the minimum income and to adults in literacy programmes. In order to improve the quality of education and continued studies for children in rural areas, a system of commune school centres was set up. Steps have also been taken in all counties for the integration of children with special needs into a normal school environment.

In order to develop teacher training, a Strategy for Initial and Continuing Training of Educators and Education Managers for 2001-2004 was adopted in November 2001. This represents an important step towards a structural reform of the education system.

In the area of vocational education and training, local Development Committees for Social Partnership in Vocational Education and Training were recognised through a Ministerial Order. These are consultative structures which are consulted by the County School Inspectorates on a number of issues (e.g. school network, educational offer,

qualifications, specialisations). In a separate measure, a Government Decision from December 2001 regulated the certification of qualifications.

In June 2002, legislation was adopted establishing the legislative and institutional framework for the vocational training of adults. The legislation is in line with the principle of life-long learning and represents significant progress, even though further legislation and institutional reforms will be needed before the law can be effectively implemented.

Overall assessment

Participation in the relevant Community programmes is satisfactory and the established national agencies are functioning.

In order to fully transpose and implement the Directive concerning education of children of migrant workers, attention should focus on the definition of beneficiaries and the free teaching of Romanian.

The Romanian education system suffers from low levels of funding and even though expenditure has slightly increased it remains insufficient.

There have been a number of positive developments such as increased access to education for people with limited income. The Strategy for Initial and Continuing Training of Educators and Education Managers is a welcome initiative, although it is not clear if sufficient resources have been allocated to allow for its effective implementation. The decentralisation of funding of pre-university education to local authorities, which took place in 2001, has been implemented without major problems. The introduction of a compulsory year of pre-school education is being implemented on a pilot basis.

However, there have also been setbacks. Implementation of the 1997 decision extending compulsory school education from 8 to 9 years, which was supposed to start in the school year 2003-2004, has been postponed. The Romanian authorities still have to develop an overall plan to reform the education system. The absence of a structured vocational training system for adults remains a serious problem.

Conclusion

In its 1997 Opinion, the Commission concluded that no major problems should be expected in this field.

Since the Opinion, Romania has continued to reform the education system although low levels of Government funding limit the impact of the reforms. Progress has been made with the transposition of the *acquis* although further work is necessary. A number of important social inclusion measures have also been put in place. Participation in the relevant Community programmes is satisfactory and the established national agencies are functioning effectively.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is generally meeting the commitments it has made in the accession negotiations in this domain.

Romania should focus future efforts on completing alignment with the *acquis* and ensuring that reform initiatives are supported by adequate levels of funding.

Chapter 19: Telecommunications and information technologies

Progress since the last Regular Report

Progress since the last Regular Report has been significant, particularly as regards primary legislation.

Concerning the **liberalisation of the telecommunications market**, the planned date for the liberalisation of the fixed-line telephony market remains the end of 2002. Until that date, the incumbent maintains a monopoly on these services. However, liberalisation has already taken place in other markets, such as cellular mobile telephony, data transmission, the provision of internet services, cable television and satellite networks. Fixed network penetration reached 18% and is growing slowly. Further network modernisation and price rebalancing will be needed. Penetration in mobile services has also reached 18%. There are two GSM operators and UMTS licences have yet to be issued.

At the end of May 2002 the Government approved an Emergency Ordinance creating the general framework for communications regulation. The legislation creates a National Agency for Communications Regulation (ANRC) whose primary role is to act as a regulatory authority implementing national policies in the field of electronic communication and postal services. The ANRC will be led by a president and a vice-president for a period of five years. The overall framework legislation is intended to transpose the most recent Community legislation in this area, adopted in April this year.

The adoption of legislation providing the **regulatory framework** is a major step towards achievement of Romania's target date for full alignment with the *acquis* in this area by the end of 2003. The legislation creates a regulatory framework as regards authorisation procedures for electronic communication networks and services, the allocation of numbering resources and management of the radio frequency spectrum. As part of the basic policy objectives it provides the framework to promote competition in the communications market.

In February 2002 Romania adopted legislation introducing the single European emergency number 112, including the obligation of free and available access to this number from both fixed and mobile telephone operators. In January 2002 Romania adopted legislation transposing the *acquis* as regards access to electronic communication networks and associated infrastructure. The same legislation provides the framework for ensuring the interoperability and interconnectivity of these networks.

As regards **postal services**, legislation approved in January 2002 creates a general framework for postal service regulation and universal service provision. With the creation of the ANRC, the latter will also take over regulatory responsibility in this sector. There is a considerable degree of liberalisation in the sector. Restrictions remain for the moment on regular mail, parcels below 2 kg and money order and wire transfers. In the direct-mail market segment 10 private operators have been assigned licences.

Overall assessment

Now that the framework legislation has been adopted, the Ministry of Information Technology and Communications will need to follow up this achievement in the coming year with the adoption of implementing legislation and with institution building efforts in order to ensure that the ANRC can assume its functions in time for liberalisation of the fixed-line telephony market at the start of 2003. Last year's assessment concerning the considerable amount of training and financial investment that will be necessary to ensure adequate administrative capacity in this area for the new regulatory authority remains valid.

The above remarks are equally pertinent for postal services, as the ANRC will also be responsible for this sector.

Overall, legislative transposition is on course to meet the Government's targets. The major challenge will be ensuring that the administrative architecture necessary to implement this legislation is set up in a timely fashion and operates effectively and independently of both the Romanian authorities and the sector operators.

Romania has not yet been able to evaluate the economic implications of fully implementing the universal service *acquis* so as to achieve affordability and a decision on this point remains outstanding.

Conclusion

In its 1997 Opinion the Commission remarked that Romania could have some difficulty in adopting the EC model of telecommunications liberalisation, because of slow sector development and delays in liberalisation. However, the Commission expressed the view that with the implementation of new legislation during the next few years, Romania could be expected to fully achieve the approximation to EC regulation in the medium term. The Commission concluded that the competitiveness of the sector would crucially depend on the acceleration of the modernisation programme for networks and services, on the increase in foreign investment, as well as on market-oriented and flexible management of the public network operator.

Since the Opinion, Romania has made good progress although the adoption of legislation has taken somewhat longer than initially envisaged. Nevertheless, the regulatory framework now has the potential to be fully aligned with EC legislation in the near future and Romania has made important progress in preparation for liberalisation of the communications and postal markets.

Negotiations on this chapter are ongoing. Romania has not requested any transitional arrangements.

Romania should focus further efforts on creating an efficient and independent regulatory administration and on adopting implementing legislation. It should continue to transpose the updated telecommunications *acquis* and complete the implementation procedures as soon as possible.

Chapter 20: Culture and audio-visual

Progress since the last Regular Report

Romania has made good progress in this area since the last Regular Report.

In the **audio-visual** sector, a new framework law to align with the Television Without Frontiers Directive was adopted in June 2002. Cooperation between the various Romanian bodies involved in the legislative process has also improved significantly.

Implementing legislation for advertising, teleshopping and sponsorship was adopted in March 2002. Conditions for applying the right of reply were set in a decision of the National Audio-visual Council (NAC) on the obligations of broadcasters to record radio and TV programmes. The framework for broadcasting audio-visual programmes of local interest was established through an NAC decision in March 2002.

No major changes can be recorded regarding the administrative capacity of the NAC, and even though the number of control activities has been steadily increasing staffing levels remain the same as last year. A new IT network has improved communication between headquarters and regional offices. Within the Ministry of Culture and Religious Affairs, which has the right of legislative initiative in the audio-visual field, the Department for Harmonisation, Media and Audio-visual has been disbanded and most staff who had previously dealt with audio-visual issues have left.

Both houses of Parliament have approved legislation ratifying the Council of Europe Convention on Trans-frontier Television and its amending Protocol – although the Convention has still to be promulgated by the President.

In the field of **culture**, the Association Council Decision allowing Romania's participation in the "Culture 2000" was adopted in October 2001.

Overall assessment

With the adoption of the new audio-visual law, Romania is now well advanced in terms of transposition of the *acquis*, although a few minor adjustments are needed in order to reach full alignment. Elements of Romania's legislation relating to the broadcasting of European works will come into force on accession, taking into account Romania's international obligations.

In terms of administrative capacity, the increasing number of control activities being carried out by the National Audio-visual Council is a reflection of improved management abilities, although there is still a need for further training. However, disbanding the audio-visual unit in the Ministry of Culture and Religious Affairs raises questions as to the future role of the Ministry following the adoption of the audio-visual law.

Conclusion

In its 1997 Opinion, the Commission concluded that even if necessary structural adaptations of the industry were made, sustained efforts as regards legislative changes would have to be followed through in order for Romania to meet EC requirements in the audio-visual sector in the medium term.

Since the Opinion, Romania has made significant progress in the legislative field and, to a lesser degree, with improving its administrative capacity. Legislative alignment is now well advanced. The necessary administrative structures are in place.

Negotiations on this chapter continue. Romania has not requested any transitional arrangements.

Romania should focus further efforts on making the final legislative adjustments and should continue to reinforce its administrative capacity.

Chapter 21: Regional policy and coordination of structural instruments

Progress since the last Regular Report

Since the last Regular Report, limited progress has been made in preparing for the implementation of structural policies.

No further developments can be reported regarding **territorial organisation** or with the **legislative framework**.

With regard to **institutional structures**, Romania has identified the preliminary institutional and programming structure for Structural Funds implementation as well as a preliminary structure for operational programmes. Two Government Decisions of January 2002 designated the management structures for implementation of the European Social Fund: the Ministry of Labour and Social Solidarity has been designated as Managing Authority and the National Agency for Employment as Paying Authority. Inter-ministerial working groups have been established which should lead to improved administrative co-ordination at the national level. A Government Decision from February 2002 limited the Ministry of Development and Prognosis' activities to the central level, and eliminated the territorial offices foreseen in a former Government Decision.

With regard to **programming**, in December 2001 Romania submitted its National Development Plan (NDP) 2002-2005 to the Commission - which presented its comments in March 2002.

No major developments can be reported with preparations for implementing the **partnership principle** or with regard to **monitoring and evaluation, financial management and control**.

Although efforts have been made to develop the infrastructure for producing **regional statistics**, and staff from regional offices have received specialised training, there is still a lack of reliable **statistics** at the regional level.

Overall assessment

Romania's 1998 Regional Development Act established a provisional NUTS classification designating eight development regions corresponding to NUTS level II, with 42 counties corresponding to NUTS level III. This classification was agreed with the Commission.

Romania has already started to identify the bodies responsible for the preparation and implementation of the Structural Funds and the Cohesion Fund after accession. However, there is still a need for continued efforts and the Romanian authorities should further elaborate the management and programming structures at both national and regional levels. Considerable additional preparation is needed to bring the capacity of the Romanian administration up to the level required for Structural Funds and Cohesion Fund implementation. Substantial efforts are also needed to develop the structures and coordination mechanisms to manage financial assistance from the European Social Fund in the context of the European Employment Strategy and the inclusion process.

Significant efforts will be needed to improve the quality of the existing NDP before it can serve as the basis for a future development plan. The NDP should be further embedded into the national budgetary and policy-making processes. The programming work should continue.

With regard to programming, the capacity to discuss and clarify development priorities is very limited at both national and regional levels. The lack of co-ordination and co-operation between ministries, as well as with relevant agencies and social and economic partners, remains a problem and there should be further progress in the preparation of projects (the project pipeline).

A considerable amount of work will be necessary before Romania meets Structural Funds requirements for monitoring and evaluation.

Romania's progress in the field of financial management and control remains insufficient.

Conclusion

In its 1997 Opinion, the Commission concluded that Romania showed an increasing political awareness of the need for a regional policy. Romania's administrative capacity to manage EC funds and conduct an integrated regional development policy clearly needed to be improved. The Opinion pointed out that significant work was still required in defining a legal basis, identifying and clarifying the respective roles and responsibilities of existing authorities and strengthening an adequate administrative structure before Romania would be able to apply Community rules and channel the funds from the EC structural policies.

Since the Opinion, Romania has made progress in legislative terms and, more recently, has started to develop its administrative capacity. However, there is still a need for continued efforts and Romania does not yet have a clear and consolidated cohesion policy.

Negotiations on this chapter continue. Romania has not requested any transitional arrangements.

Romania should focus further efforts on designing the management and implementation system for the Structural Funds. Particular attention should be given to clarifying the role of the regional levels and strengthening inter-ministerial cooperation and partnership. Systems and procedures for effective monitoring, financial management and control

should be established. Administrative capacity needs to be significantly improved with regard to programming, including identification and preparation of projects.

Chapter 22: Environment

Progress since the last Regular Report

During the reporting period, Romania has made progress with transposition of the environmental *acquis* - although much of the new legislation appears to have been adopted without due consideration for the administrative and financial resources necessary for its implementation.

Integration of the environment into other policies is hardly progressing, although the Inter-Ministerial Committee, which is responsible for co-ordination between ministries to ensure that environment is taken into account by all concerned sectors met in February 2002 for the first time since 1999. Recent medium-term and long-term energy strategies, which concentrate on increasing energy production without giving due attention to either the environmental effects of increased energy production or the potentials for improving energy efficiency, are cases in point.

In the field of **horizontal legislation**, no developments can be noted regarding environmental impact assessment legislation, which is a key issue in the Romanian context.

As far as **air quality** is concerned, a Government Order on volatile organic compounds from storage and distribution of petrol was adopted, as was a governmental decision on the emission of gaseous and particulate pollutants from internal combustion engines.

On **waste management**, a substantial amount of legislation was adopted concerning the waste framework, packaging and packaging waste, incineration of waste, landfill of waste, and hazardous waste.

A considerable amount of legislation was also adopted on **water quality**. Standards have been set for surface waters intended for abstraction of drinking water. An action plan was prepared for reducing pollution of ground waters and of the aquatic environment. Norms have been set regarding the discharge of waste water, the quality of surface waters to support fish life, the quality of water intended for human consumption, and the quality of bathing water. In addition to legislative measures, meetings of the Inter-Ministerial Committee for Water Management resumed, and the committees responsible for water basin management commenced their activities.

As far as **nature protection** is concerned, legislation was adopted during the reporting period related to zoos.

As regards **industrial pollution control and risk management**, progress was limited to the adoption of an Emergency Ordinance on industrial pollution prevention, reduction and control. Although this legislation is of considerable importance, a very substantial amount of work is necessary before it can be implemented (e.g. the list of enterprises that will be covered by this law still has to be drawn up). As far as enforcement is concerned, a National Environmental Guard has been created by transferring staff from

Environmental Protection Inspectorates – but no additional staff or resources have been allocated.

With regard to **chemicals and genetically modified organisms**, progress was limited to the adoption of an Ordinance on animal welfare. No progress has been achieved in the field of **noise**.

On **nuclear safety and radiation protection**, (*see also chapter 14 – Energy*), Romania has largely completed the transposition of the Directive laying down basic safety standards for the protection of workers and the general public from ionising radiation. Transposition has been completed for the directives on the protection of outside workers, and on health protection of individuals to ionising radiation in case of medical exposure. Standards have also been adopted on the safe transport of radioactive materials.

As regards **administrative capacity**, the Ministry of Water and Environmental Protection remains understaffed. The situation has deteriorated since the last Regular Report and the total number of vacancies has increased. There have been no substantial measures taken during the reporting period to increase the limited capacity of the 42 local Environmental Protection Inspectorates, which are responsible for the implementation of environmental policy (permitting, inspections, enforcement).

The budget allocated for environmental protection has been slightly increased but remains extremely low. The National Environmental Fund is still not operational, although most of the implementing legislation has now been adopted.

Overall assessment

At face value, the list of environmental legislation that Romania has adopted during the reporting period is impressive. However, most of the legislation has been prepared without full consultation of stakeholders (other ministries, economic operators, and NGOs), without a precise assessment of the implementation costs, and without securing the financial and human resources necessary for its enforcement. It is therefore likely that many of these laws will prove impossible to implement and will have to be amended.

Adoption of legislation on environmental impact assessment has been delayed and should be treated as a priority by the Romanian authorities. Real progress has been limited regarding air quality, waste management, industrial pollution and risk management. In the case of nature protection, most of the *acquis* has been transposed. However, in the areas of noise and chemicals and genetically modified organisms additional work is necessary.

Romania has ratified the Kyoto Protocol.

Last year's Regular Report concluded that Romania did not have sufficient administrative capacity to implement its existing environmental legislation. Since then the body of legislation has grown very considerably, but staff levels have not increased and conditions remain poor. Romania urgently needs to build up the capacity of the local Environmental Protection Inspectorates (EPIs) in order to improve permitting, monitoring, inspection, and enforcement. The creation of the National Environmental Guard does not represent increased enforcement capacity since its staff have all been transferred from the EPIs without any additional means being provided.

Considerable investments will need to be secured over the medium and long-term in order to ensure the implementation of the environmental *acquis*.

Conclusion

In its 1997 Opinion, the Commission concluded that Romania would have to place a higher priority on environmental issues, implement focused environmental accession strategies and work programmes, significantly increase financial and other resources and develop its administrative capacity. It was estimated that if these steps were taken, full transposition of the *acquis* could be achieved in the medium to long term. The Opinion also noted that compliance with legislation requiring a sustained high level of investment could be achieved only in the very long term.

Since the Opinion, Romania has transposed a considerable amount of legislation, but has not developed the administrative or the financial resources to implement it. This means that Romania is still far from complying with the environmental *acquis*.

Negotiations on this chapter continue.

Romania should focus further efforts on developing implementation capacities and should ensure that laws include realistic deadlines and cost assessments, and are only proposed following sufficient consultation. At the local level, significant resources are needed to improve the status of existing staff, to recruit new inspectors, and to train them adequately. Co-ordination between ministries on environmental issues needs to be improved and Romania should integrate environment protection requirements into the definition and implementation of all other sectoral policies so as to promote sustainable development.

Chapter 23: Consumers and health protection

Progress since the last Regular Report

In the field of consumer protection, further progress has been made since the last Regular Report.

On **safety related measures**, the framework law on consumer protection was modified in January 2002 by incorporating existing provisions on general product safety and liability of producers into the law. The legislation on dangerous imitations was modified and brought into line with the *acquis*.

As regards **non-safety related legislation**, no developments can be recorded.

As regards **market surveillance**, the authority of the consumer protection inspectors was extended to allow temporary and permanent closing down of commercial units. This complements the existing rights to impose sanctions, i.e. fines, definitive or temporary prohibition of marketing, or withdrawal from the market of products. The National Authority for Consumer Protection continued to provide information and advice to consumers. As a new service, a free-phone line for consumer complaints and a payable phone line for consumer information were opened. During the period between September 2001 and August 2002, 22 450 consumer complaints were received by the authority including 390 complaints submitted by consumers' associations.

The National Authority for Consumer Protection functions as the contact point for TRAPEX (Transitional Rapid Exchange of Information System). Under TRAPEX, 47 non-food notifications of dangerous products that could be found on the Romanian market were received between January and June 2002. As regards the development of administrative capacity for the implementation of consumer protection legislation, a decision to increase the staffing of the National Authority for Consumer Protection by the end of this year was suspended. Training seminars on enforcement issues, handling of complaints, inter-institutional co-ordination and the use of laboratory tests were held for inspectors from regional offices.

Progress can be noted in inter-ministerial co-operation. The Inter-Ministerial Committee for Products and Services, Market Surveillance and Consumer Protection resumed its activities and a strategy for its functioning was adopted. Its activities include, *inter alia*, developing and improving the market surveillance system and legal and institutional arrangements in the area, including clarification of the roles of the bodies involved in market surveillance and ensuring transparency of procedures. Consumer organisations are still not represented as formal members of the committee.

Some progress has been achieved in other areas of consumers' representation. An Unfair Terms Commission and a Product Safety Commission were established in January 2002. The commissions are independent consultative bodies, composed of representatives of the public administration, consumers and other relevant bodies. The commissions provide a channel for NGOs to get involved in the decision-making process.

The number of consumer associations has decreased slightly from last year in Romania. There are now 119 consumer associations organised into 16 federations, one confederation and one inter-regional convention.

Overall assessment

The implementation of the five-year strategy of the National Authority for Consumer Protection has started smoothly and a number of activities have been initiated. Although the increasing trend of consumers' complaints may demonstrate increased consumer awareness and better information about the possibilities of claiming their rights, ensuring that citizens are fully aware of their rights as consumers remains an important task for the National Authority for Consumer Protection and consumers' associations.

Consumers' representation improved through their participation in the two consultative commissions that were established during the reporting period. However, full representation in the Inter-Ministerial Committee for Products and Services, Market Surveillance and Consumer Protection still remains to be achieved.

Despite the staff cuts reported last year, the National Authority for Consumer Protection managed to maintain its control and monitoring activities at the same level, although mainly concentrating on food safety. Strengthening the administrative capacity of the institution remains a priority and additional training should be organised for staff of the National Authority for Consumer Protection as well as for personnel from other relevant institutions such as the police, customs and the magistracy.

Co-operation between all actors in the area of consumer protection should also be strengthened and a further clarification of their respective tasks is needed. The 2002-2004

strategy for the Inter-Ministerial Committee for Products and Services, Market Surveillance and Consumer Protection should therefore improve the organisation of market surveillance activities, clarify the roles of competent bodies, and eliminate overlapping activities. Market surveillance activities should also be oriented to a larger extent to check the safety aspects of non-food consumer products and more resources devoted to laboratory testing.

Conclusion

In its 1997 Opinion, the Commission concluded that Romania had taken the approximation process quite far. Although the Government still needed to put through various amendments or new draft laws, the Romanians were close to meeting EC standards on consumer protection. However, the Commission also noted that problems remained with respect to the effective application of the *acquis*, particularly since the lack of resources made it difficult for Romania to enforce existing legislation.

Since the Opinion, Romania has continued legislative alignment at a steady pace and managed to carry out an extensive legislative agenda during the last four years. Implementation structures are in place although administrative capacity is limited and the degree of co-operation between different actors involved in consumer protection should be improved.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is generally meeting the commitments it made in the accession negotiations in this domain.

Romania should focus further efforts on completing transposition of EC legislation in areas such as consumer credit, time-share, injunctions, sales of consumer goods and associated guarantees. Romania should place particular emphasis on the implementation and enforcement of existing legislation which means ensuring that the administrative structures are able to operate effectively. This is particularly important with regard to market surveillance, and increasing consumers' and producers' awareness of the new regulations. The role of consumer associations in developing and implementing consumer policy should be further promoted.

Chapter 24: Co-operation in the field of justice and home affairs

Progress since the last Regular Report

Since the 2001 Regular Report, progress has been made in all areas of justice and home affairs apart from migration and drugs. However, the implementation capacity remains weak.

Romania adopted several pieces of legislation on **data protection** at the end of 2001 (*see chapter 3 – Freedom to provide services*). The Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data and its additional protocol were ratified in February 2002. A new directorate in the Romanian Ombudsman Office has been designated as the independent supervisory authority. A public register of all data-processing operations has been created on the basis of the new law.

As far as **visa policy** is concerned, over the past few years Romania has brought its visa policy largely in line with the policy of the EU. As a result, since January 2002 Romania has enjoyed a visa-free regime with all Schengen Member States. Romania adopted provisions that entered into force at the same time as the visa-free regime which stipulate that Romanian nationals travelling to countries where an entry visa is not required must prove that they have sufficient resources to cover the intended stay abroad, a return ticket and valid health insurance. Romania does not yet comply with the *acquis* as regards the list of countries whose nationals do not need a visa to enter the EU. During the reporting period bilateral agreements to lift visa obligation entered into force with Latvia, Liechtenstein, Malta and Venezuela. A visa obligation was introduced in January 2002 for nationals of Bosnia-Herzegovina and Romania has decided to introduce the visa obligation for nationals of FYROM from the beginning of 2003. Romania does not yet require visas for nationals of the Federal Republic of Yugoslavia, the Republic of Moldova, the Russian Federation, Turkey and Ukraine. New consular instructions entered into force in July 2002 stipulating that visas can only be issued by diplomatic and consular missions. This puts an end to the practice of issuing visas at border crossing points.

As regards **external borders and Schengen**, Romania presented a Schengen Action Plan in December 2001, which will be updated on a yearly basis. The process of decentralising the border police and providing it with a more manageable command structure has continued. Legislation on the Romanian state border and on the organisation and functioning of the border police was adopted and entered into force in May and in March 2002 respectively. The professionalisation of the border police has continued to improve through the ongoing replacement of conscripts with professional staff. The total number of posts within the Romanian border police is approximately 19 100, of which about 15 450 are filled.

An Inter-Ministerial Group for Integrated Border Management was established in October 2001 with the task of facilitating communication and co-operation between authorities responsible for border control activities. A memorandum for creating a joint single clearance for border control was concluded between the border police and the customs administration in February 2002 and entered into force in June 2002. Plans to conclude agreements on integrated border management with neighbouring states have not been successful to date. The gradual exchange of the old type of passports for a new type with additional security features started in January 2002, with old passports being replaced when they expire.

As regards **migration**, progress has been rather limited. With regard to uniform residency permits, Romania adopted in June 2002 legislation for the issuing of new Romanian identity and state border crossing documents for third country nationals. Over the last year, readmission agreements were ratified with Albania, Austria, Croatia, Hungary, the Republic of Moldova and Sweden. Agreements with Lebanon and Norway were signed. The Directorate for Aliens and Migration Issues, which is the central co-ordinating body, has concluded co-operation protocols with the General Directorate for Combating Organised Crime and Drugs Traffic and with the national carrier in order to return illegal aliens to their country of origin or of departure. In June 2002 the Government concluded an agreement with the International Organisation for Migration on co-operation in the field of voluntary humanitarian assisted repatriation.

As regards **asylum**, in November 2001 Romania published the list of safe third countries and the list of countries where there is no risk of persecution. In an effort to better align with the *acquis* both lists were modified in August 2002. A Government Decision on refugee integration was adopted in November 2001. In March 2002 legislation was adopted establishing a procedure for reunification of refugees with their family members. This legislation remedies the most significant shortfalls in the previous legislation on family reunification.

While the number of asylum-seekers arriving in Romania has rose significantly from 1 503 in 2000 to 2 435 in 2001, but declined again in the first eight months of 2002, when a total of 796 applications were registered. At 4.8% in 2001, the combined approval rate of persons recognised as refugees and persons granted conditional humanitarian protection at first instance remained low compared to Western European countries. This rate has risen to 6.5% during the first eight months of 2002. There are three reception centres for asylum seekers with a capacity of 770 places. The National Refugee Office has sufficient staff and in 90% of the cases processed in 2001 a decision was taken within the legal deadline of 30 days.

In the field of **police co-operation and the fight against organised crime**, the Law on the Organisation and Functioning of the Police was adopted in May 2002 and the Law on the Status of Policemen was adopted in June 2002. In December 2001 a Law on the Prevention and Combating of Trafficking in Human Beings and an Action Plan for Combating Trafficking in Human Beings were adopted. The reform of the General Inspectorate of the Police, which started in 1999, should be achieved in 2002. In July 2002 Romania and Bulgaria signed a protocol aiming at combating trans-border organised crime more efficiently. Other international agreements were concluded with the Czech Republic, Armenia and Albania. In an effort to combat trafficking in human beings, in May 2002 legislation was adopted stipulating the sanctions for acts committed by Romanian citizens abroad or by stateless persons registered in Romania.

As regards the **fight against terrorism**, Romania adopted an ordinance sanctioning certain terrorist acts and certain encroachments upon public order as well as an ordinance to prevent the financial and banking systems being used to finance terrorist acts. An Inter-Ministerial Council has been set up to supervise the implementation of UN Security Council Resolution 1373/2001. In April 2002 the Supreme Defence Council (CSAT) adopted a National Strategy for Preventing and Fighting terrorism.

As far as the fight against **fraud and corruption** is concerned, in July 2002 the Parliament approved legislation establishing the National Anti-Corruption Prosecutor's Office (*see also section B.1.1. – Democracy and the rule of law*). The new Office began functioning in September 2002. It transforms the present anti-corruption section within the General Prosecutor's Office, and its territorial branches, into a structure with special status. The Head of the National Anti-Corruption Prosecutor's Office is appointed by the President of Romania based on a decision by the Superior Council of the Magistracy. This decision is in turn based upon a shortlist of names proposed by the Minister of Justice. As for Prosecutors, they are appointed by the Minister of Justice in accordance with recommendations made by the Head of the Office. The same procedure applies for revoking prosecutors' mandates. Romania ratified the Council of Europe Civil and Criminal Law Conventions in April and July 2002 respectively. The Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime was ratified in August 2002.

No significant progress has been made in the field of **drugs**. A joint unit of the border police and the customs administration was created to evaluate information concerning drugs trafficking in Constanța harbour. Special joint control teams consisting of customs officials and representatives of the South Eastern Co-operation Initiative (SECI) have been created. In 2001, 25 tonnes of drugs (including 41 kg heroin) were confiscated. According to Romanian figures for the first five months of 2002, 41 tonnes (including 70 kg heroin) were confiscated. In June 2002 Romania ratified the 1995 Agreement on Illicit Traffic by Sea. New legislation on precursors was adopted in June 2002.

As regards **money laundering** (*see also Chapter 4 - Free movement of capital*), in August 2002 Romania ratified the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime. Regulations on organising and functioning of the National Office for the Prevention and Control of Money Laundering were adopted in May 2002. The National Office for Prevention and Control of Money Laundering Operations sent 143 cases to the General Prosecutor's Office in 2001 and 157 cases in the first eight months of 2002. However, the number of criminal proceedings and convictions that followed these investigations has been very low.

As regards **customs co-operation**, anti-fraud control teams have been set up for preventing, detecting and sanctioning customs fraud. Twenty-seven mobile surveillance teams have been created in order to strengthen the control of customs operations. An Action Programme Against Corruption in the Customs Administration and a Sector Action Plan Against Corruption were elaborated as a part of the National Programme on Prevention of Corruption and the National Action Plan Against Corruption. At the beginning of 2002 the Code of Conduct and Discipline of the Customs Staff was issued. The Code defines proper and improper professional and personal conduct, the acts considered as generating corruption and the penalties that can be applied. In the first half of 2002 16 customs officers were fired for disciplinary reasons, including for corruption cases. Over the same period, 15 customs officers were suspended from duty following penal investigations into corruption cases. A number of co-operation agreements have been signed between the Customs Administration and other institutions such as the border police, the national police, the financial guard and the Office for Copyrights. In June 2002 an Emergency Ordinance on setting up "single windows" at the border crossing points of Romania was taken. Mutual assistance agreements were concluded with customs agencies from Bulgaria, the Federal Republic of Yugoslavia, the Republic of Moldova and Ukraine.

As far as **judicial co-operation in criminal and civil matters** is concerned, Romania ratified the optional Protocol to the United Nations Convention on the Rights of the Child on the Sale of Children, Child Prostitution and Child Pornography. The EU Joint Action of February 2002 concerning actions to combat trafficking in human beings and sexual exploitation of children has been partially implemented through the law on the Prevention and Combating of Trafficking in Human Beings, which was adopted in December 2001.

Romania also adopted domestic legislation transposing the European Convention on Mutual Assistance in Criminal Matters (including its first additional protocol) and ratified the additional protocol to the European Convention concerning the Transfer Abroad of Convicted Persons in December 2001.

Overall assessment

The **data protection** legislation adopted at the end of last year should be promptly implemented and the Ombudsman's Office should be given sufficient resources to enable it to function as a fully operational and independent supervisory authority. Romania should take steps to implement the *acquis* on the use of personal data in the police information system.

Romania has further aligned its **visa policy** with that of the European Union. However, further steps towards full alignment are required - in particular as regards the list of countries whose nationals need a visa to enter the EU and the list of countries whose nationals are exempted from such an obligation. Romania should take appropriate measures to make the features of the national visa sticker more secure. Administrative capacity remains insufficient: the National Visa Centre is understaffed and technical equipment available to visa issuing services remains poor. Romania should step up efforts to provide all diplomatic and consular offices with technical equipment for detecting forged and falsified documents, focusing in particular on high-risk countries.

As regards **external borders**, the process of modernising agencies and procedures has continued and more efficient structures have started to emerge. The Memorandum of Understanding concluded between the customs authorities and the border police is a positive development, provided it is fully implemented in practice. However, co-ordination between all border authorities needs to be further improved. The training system should be further developed to ensure that border controls are only carried out by specially trained professionals. Romania also needs to fully implement its plan to terminate the use of conscripts at all its borders by the end of 2002. There are currently over 3 600 vacancies in the border police and considerable efforts will be needed to fill these posts. The modernisation of equipment at border posts has continued but further investments are required. A multi-annual investment plan should be elaborated in order to speed up the modernisation of border infrastructure.

The **Schengen** Action Plan which the Romanian authorities have presented needs to be further elaborated and should cover all policy areas included in the Schengen *acquis*. A clear distinction should be made between the requirements that must be applied upon accession to the EU and those which are connected with the eventual Council Decision on the lifting of internal border controls. Romania should continue its efforts to establish an operational National Information System containing Schengen-compatible data.

As to **migration**, considerable efforts in terms of both legal approximation and administrative capacity are still required. Legislation needs to be amended in several areas such as entry and stay of third-country nationals for the purposes of employment, self-employment and studies, long-term residents and unaccompanied minors. In order to comply with the *acquis*, Romania must also introduce the possibility of lodging an appeal with suspensive effect against expulsion decisions and return measures. Romania has concluded 27 readmission agreements in total. It should continue these efforts, focusing above all on risk countries.

Since the adoption of the Law on the Status and Regime of Refugees in 2001 Romania's **asylum** legislation has been made largely compatible with the *acquis*. Some shortcomings in this law have been addressed during the past year, although problems remain regarding the protection regime for persons who have been granted humanitarian

protection, as well as concerning the *non-refoulement* principle and the detention of asylum-seekers.

The National Refugee Office has an adequate number of staff, who are generally well trained. However, training of personnel in other services directly involved in asylum and refugee matters (police, immigration and border guards) remains necessary. The recently modified lists of August 2002 are now in line with the criteria adopted in 1992 on countries in which, in general, there is no serious risk of persecution and on safe third countries. They are also in line with the Resolution adopted on 30 November 1992, on a harmonised approach to questions concerning host third countries.

In the field of **police co-operation and the fight against organised crime**, the newly adopted legislation should be implemented and an effective reform of the police should be carried out without delay. A co-operation agreement with EUROPOL has not yet been concluded but the pre-condition for such an agreement has been established with the adoption of data protection legislation. Romania has signed the 2000 UN International Convention against Transnational Organised Crime (Palermo Convention) and its additional Protocols on trafficking of persons and smuggling of migrants. The additional Protocol on firearms remains to be signed. Despite legislative progress and improvements related to the fight against trafficking of human beings, Romania remains an important country of origin, transit and to some extent destination of trafficked women and children. Efforts in this area will need to be sustained. Public confidence in the police remains low and efforts should continue to establish a more citizen-oriented police force.

The operational capacity of the police as well as the flow of information between all institutions working in the field of law enforcement, including the judiciary, will need to be improved. Statistical instruments for measuring the crime rate should be improved, while new methods of technical crime investigation, including the development of forensic investigation should be further developed. In terms of international police co-operation, Romania should further develop the network of police liaison officers and should continue to implement its obligations under the Pre-Accession Pact on Organised Crime.

Romania has taken appropriate measures in the **fight against terrorism**. It still has to ratify the 1999 United Nations Convention for the Suppression of the Financing of Terrorism.

When it comes to the **fight against fraud and corruption** a major concern remains the ineffectiveness of preventing and combating corruption related crimes. Romania should pay more attention to the fact that prevention through transparency and accountability standards is as important as repressive tools. The considerable role played by the Minister of Justice in the establishment of the National Anti-Corruption Prosecutor's Office could jeopardise its independence - a situation which may compromise the effectiveness of its operations. In order to strengthen the autonomy of the Office the status of the prosecutors, in particular the status of the chief prosecutor should be better defined. The criteria for deciding which cases need to be investigated should be reconsidered and clarified. Romania should intensify its preparations for alignment with the 1995 Convention on the Protection of the European Communities' Financial Interests and adopt the relevant legislation. Romania should ensure that the recently ratified conventions in this field are implemented in all their aspects.

As far as **drugs** are concerned, the Inter-Ministerial Committee for Fighting Against Drugs should be made operational as soon as possible and its capacity to improve policy co-ordination should be developed. The National Focal Point still needs to be established. Romania should speed up preparations for participation in the European Information Network on Drugs and Drug Addiction of the European Monitoring Centre for Drugs and Drug Addiction. It should adopt a national drug strategy in line with the EU Drugs Strategy 2000-2004.

Trafficking of drugs remains a problem and considerable efforts are needed to intensify the fight against it. In the first instance, Romania should strengthen both the administrative capacity and co-ordination of its law enforcement services, especially the police and customs.

Further steps have been taken in fighting money laundering and related crimes, especially as regards alignment with the *acquis*. The National Office for the Prevention and Control of Money Laundering has improved its enforcement record, mostly by creating a general framework for the reporting obligation of other institutions. However, the Office has insufficient staff to tackle the increasing number of cases it has to deal with.

Problems remain related to certain regulatory loopholes and further efforts are therefore required to step up inter-agency co-operation as well as to improve co-operation at the international level. Apart from continuous training for the staff of the National Office, specialised training should also be organised for police officers, prosecutors and judges dealing with money laundering cases.

Romania has addressed deficiencies in **customs co-operation** by setting up control teams and mobile surveillance teams and by signing co-operation agreements. Measures have also been taken to fight corruption in the customs administration. These should be implemented without delay. Training of customs officials in professional ethics should be further developed. Inter-agency co-operation needs still to be improved, especially between the border police and the financial guard, customs and the economic branch of the police specialised in tax crimes. In terms of legal approximation, Romania should start its preparation for accession, which will require the implementation of the Convention on Mutual Assistance and Co-operation between the Customs Administration (Naples II) and the 1995 Convention on the Use of Information Technology for Customs Purposes.

As far as **judicial co-operation on civil matters** is concerned, Romania has continued to ratify the international conventions included in the *acquis*. However, in the civil area, Romania has still not ratified the Hague Convention of 1965 on Service of Documents; the Hague Convention of 1970 on the Taking of Evidence Abroad; the Hague Convention of 1980 on International Access to Justice; and the European Convention of 1980 on Recognition and Enforcement of Decisions Concerning Custody of Children. Romania should take further measures to ensure the implementation of the recently adopted Community instruments in the area of judicial co-operation in civil matters, notably as regards mutual recognition and enforcement of judicial decisions. Direct contacts between the competent judicial authorities should be made possible.

As regards **judicial co-operation in criminal matters**, Romania needs to start to prepare for the implementation of the Convention on Mutual Assistance in Criminal Matters. It should take the necessary steps to ensure the full implementation upon accession of the

instrument applying the principle of mutual recognition and in particular the Framework Decision on the European arrest warrant and the Framework Decision on the execution of orders freezing property or evidence. Preparatory measures are needed in order to participate effectively in the European Judicial network, and in Eurojust.

Romania has ratified all the **human rights instruments** covered by the *acquis*.

Conclusion

In its 1997 Opinion, the Commission concluded that Romania was facing particular challenges in the justice and home affairs area. Romania had only made limited progress towards meeting the necessary conditions of the justice and home affairs *acquis* and it would be difficult to meet the (present and future) *acquis* requirements in the medium term. The Commission went on to say that the necessary progress in this field was dependent on a more general institutional reform which derived from the political process.

Since the Opinion, Romania has made steady progress, especially in the last two years. It has started to make fundamental reforms in most areas and has speeded up alignment with the *acquis*. Romania is now in the process of developing various multi-disciplinary strategies and started important reforms aiming at improving the functioning of its law enforcement bodies. A notable exception to this general trend is the judiciary. However, notwithstanding progress achieved, considerable further work remains to be done on legal approximation and above all on strengthening administrative capacity.

Negotiations on this chapter continue. Romania has not requested any transitional arrangements.

Romania should focus further efforts on legal approximation in areas such as migration, Schengen, co-operation in the field of drugs, and judicial co-operation. Romania should continue efforts to increase the administrative capacity and inter-agency co-operation of law enforcement bodies. Particular attention should be given to bodies in charge of combating fraud and corruption. Finally, major efforts are required to reinforce the capacity of the judiciary and to ensure its full independence.

Chapter 25: Customs union

Progress since the last Regular Report

Romania has made good progress in the field of customs since the last Regular Report.

With the **customs *acquis***, further progress has been made with alignment with the EC Customs Code and its implementing provisions in areas including the regime applicable to precursors used in the illicit production of drugs, inward processing, simplified procedures, end use and transit. Provisions were adopted in November 2001 on the application of the Romanian Integrated Customs Tariff (TARIR) which builds upon the EC Integrated Tariff (TARIC). In July 2002 the Government adopted a law ratifying Romania's accession to the Convention on Temporary Admission.

As regards **administrative and operational capacity** to implement the *acquis*, some further progress has been made. Based on co-operation protocols the Customs

Administration co-operates with bodies in charge of protecting intellectual and industrial property rights. An Inter-Ministerial Group for Integrated Border Management has been set up to ensure communication and efficient co-operation between bodies with border control responsibilities. However, co-operation between customs and the border police has been limited. The IT development strategy and plan have been applied since the beginning of 2002. In accordance with these documents, the Romanian Integrated Customs Information System is in the process of being consolidated and developed, aiming at the complete installation and operation of IT systems compatible with those of the EU in time for accession.

Regarding border security, measures have been taken to improve border infrastructure and to modernise equipment. This is especially the case with the northern and eastern borders where 15 customs offices have been equipped with automatic vehicle control devices. Customs offices have also been equipped with X-ray devices and detectors for smuggled goods, drugs and explosives. Following the adoption of the law concerning drug precursors anti-drug control units have been set up at the central and territorial level. Customs co-operation agreements exist between Romania and Bulgaria, the Federal Republic of Yugoslavia, the Republic of Moldova and Ukraine. Risk analysis structures have been set up to combat customs fraud.

The professional training of customs officers is carried out by the School for Public Finance and by the Regional Training Centres which have been established to meet the specific training needs of customs staff. Training systems work effectively with over 2 500 customs officers and officials, from both central and regional levels, receiving training during the 2001–2002 academic year. At the beginning of 2002, the Code of Conduct and Discipline for Customs Staff was issued. The code defines improper professional and personal conduct and stipulates the penalties that can be applied.

Overall assessment

Co-operation between customs services and other enforcement bodies, especially the border police, has improved over the reporting period but additional efforts need to be made.

Continuous attention is needed in order to ensure the uniform application of customs procedures in the whole of the customs territory, to develop customs ethics, and to combat fraud and corruption by increasing the use of risk analysis methods and strengthening the intelligence function within the customs administration.

As regards computerisation, since July 2001 Romania has had a clear strategy on how to reach interoperability. Romania is making a sustained effort to achieve a satisfactory level of IT operational capacity and, if work proceeds as planned, Romania will have sufficient time to meet its obligations by its planned date of accession.

Conclusion

In its 1997 Opinion, the Commission concluded that it would be necessary to align Romania's customs administration to the duties that had to be carried out by a modern customs organisation. The Commission also noted that it seemed unlikely that Romania would be ready to fulfil the responsibilities of an EC customs administration within the next few years.

Since the Opinion, Romania has made progress on aligning its legislation with the *acquis*, although less progress has been made with regard to developing administrative capacity and fighting corruption within the customs administration. Romania has now achieved a good level of harmonisation of its customs legislation but administrative capacity is still weak.

Negotiations on this chapter continue. Romania has not requested any transitional arrangements.

Romania should now focus further efforts on completing the approximation of the customs legislation, in particular with regard to rules of origin, the status of free zones, and dual-use goods and precursors. Additional efforts are also needed to reduce levels of corruption within the customs administration and to prepare in advance for the application of measures that will be introduced at the time of accession.

Chapter 26: External relations

Progress since the last Regular Report

Since the last Regular Report Romania has continued to align with the *acquis* on common commercial policy and to co-ordinate positions and policies within the World Trade Organisation (WTO) with the EU, in particular with regard to the Doha Development Agenda negotiations.

Romania has continued to align with the *acquis* on common commercial policy and has made considerable improvements with respect to meeting its obligations under the WTO and the Europe Agreement. Romania has coordinated with the EU when developing positions and policies within the World Trade Organisation, in particular with regard to the preparation of the Doha Development Agenda negotiations.

As regards the **common commercial policy**, upon accession Romania will be required to align its tariffs with those of the EC. Romania's applied tariffs currently average 19.1% (MFN) on all products, 31.7% on agricultural products, 21.4% on fishery products and 15.6% on industrial products. By comparison, EC tariffs currently stand at 6.3% on all products, 16.2% on agricultural products, 12.4% on fishery products and 3.6% on industrial products. As from January 2002, Romania eliminated all remaining customs duties for imports of industrial products originating in the EU and the free trade area for these products was fully accomplished.

Last year's report noted that Romania had increasingly resorted to trade policies that were incompatible with its international obligations including the Europe Agreement. However, following intensive bilateral consultations with the European Commission, the Romanian authorities have taken the necessary steps to remove these trade irritants.

As regards **bilateral agreements with third countries**, Romania ratified a free trade agreement (FTA) with Lithuania in May 2002. Following the commitments given in the Stability Pact Memorandum of Understanding on Trade Liberalisation and Facilitation, formal negotiations were held to establish FTAs with the Republic of Yugoslavia and FYROM. Exploratory talks were held with the Republic of Albania and with Bosnia Herzegovina. In the case of Croatia, Romania has consistently supported Croatia's accession to CEFTA, which would establish a free trade area between the two countries.

Within CEFTA, Romania signed the Additional Protocol No. 10 relating to the liberalisation of agricultural and food trade, and the Additional Protocol No. 11 relating to the origin for goods.

In June 2002, the responsibility for commercial policy (together with the Foreign Trade Department and all its staff) was transferred from the Ministry of Foreign Affairs to the Office of the Prime Minister. In operational terms, the Foreign Trade Department is headed by a State Secretary who reports directly to the Prime Minister. For all administrative issues, the department relies upon the General Secretariat of the Government. The responsibilities of the department are largely unchanged.

Romania is not an international donor and does not have a **development policy** although contributions are made to certain United Nations development programmes and funds. Romania is a consistent provider of **humanitarian aid**, most usually to countries in the Balkan, Black Sea and Central Asian regions that have been hit by natural disasters.

Overall assessment

The EU and Romania have established a framework for co-operation regarding WTO issues both at ministerial and at departmental level. Romania has been supportive of EU policies and positions within the WTO framework, in particular also during the preparation for and the launching of the Doha Development Agenda. This close co-operation should continue.

Close co-ordination should continue in order to ensure the smooth alignment of Romania's GATS commitments with the EC's commitments and MFN exemptions. Steps have been defined to this extent. Romania is a signatory to the Information Technology Agreement and a member of the WTO plurilateral Agreement on Trade in Civil Aircraft. With regard to the WTO Agreement on Textiles and Clothing (ATC) co-ordination has taken place within the third stage of integration under the ATC to align Romania's integration programmes with those of the EC.

In addition to its bilateral free trade agreements with Israel, Lithuania, the Republic of Moldova, Turkey and EFTA, Romania is a member of CEFTA and was president of CEFTA's Joint Committee in 2001. Romania needs to ensure that the Union fully informed about existing trade agreements and about any negotiations aimed at the conclusion of new trade agreements with a third country. Prior to accession, Romania will need to renegotiate or renounce all international agreements concluded with third countries that are incompatible with its future obligations as an EU Member State. Decisive steps are needed, as a matter of urgency, to bring bilateral investment treaties in conformity with the Treaty obligations. Failure to do so will mean that the conflict between the bilateral investment treaties and Treaty obligations will need to be resolved in the Accession Treaty.

Further transposition is needed to align Romania with the core EC regulation on dual use goods. Full alignment to the *acquis*, in particular the general export authorisations, can only take place upon accession. Romania keeps industry regularly informed of developments in this field and has developed bilateral contacts with the EU Member States to exchange best practices on export control issues.

Where medium and long-term export credits are granted, further efforts are needed to align with the *acquis*.

Staff levels in the Foreign Trade Department are adequate, and trade officials are well qualified and able to effectively manage Romania's commercial policy. Over the reporting period the department has successfully improved its control over the formulation of trade policy. It has been able to resist pressures for protectionist trade measures that have been made by vested domestic interests as well as by other ministries (in particular the Ministries of Agriculture and Industry). As a result, Romania's respect of its international trade commitments improved significantly.

It is too early to assess the impact of the latest institutional changes on this situation, i.e. the loss of a minister with direct Cabinet responsibility for trade issues. A more general concern is that frequent institutional changes inevitably reduce the ability of the Foreign Trade Department to function effectively. A period of institutional stability should be considered as a priority.

The administrative infrastructure which needs to be in place with respect to customs services is discussed in the chapter on customs union (*Chapter 25 – Customs union*). Control of exports and imports of *dual-use goods and technologies*, is the responsibility of the National Agency for the Control of Strategic Exports and of Prohibition of Chemical Weapons (ANCESIAC). There are no dedicated structures for managing development and humanitarian aid.

Conclusion

In its 1997 Opinion, the Commission concluded that Romania should be able to meet Community requirements in this field in the medium term, provided that it reinforced its efforts to eliminate existing trade barriers in order to align itself more closely with the Community trade regime.

Since the Opinion, trade barriers have been progressively eliminated, and Romania has achieved a generally high level of alignment with the *acquis*.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is generally meeting the commitments it has made in the accession negotiations in this field.

Romania should focus further efforts on ensuring that the capacity exists to fully implement and enforce the EC *acquis* in this field upon accession and on taking decisive steps, as a matter of urgency, towards the renegotiation or abrogation of its bilateral investment treaties in full conformity with its EU membership obligations. A mechanism should also be established to thoroughly screen all trade-related legislation in order to ensure that it is compatible with Romania's international obligations.

Chapter 27: Common foreign and security policy

Progress since the last Regular Report

Over the last year Romania has confirmed its good track record in Common Foreign and Security Policy and has continued to align its policy with that of the European Union.

Romania is an active participant in the **political dialogue** established by the Association Agreement and has played a constructive role within the framework of the Common Foreign and Security Policy (CFSP), including meetings at the level of Political Directors, European Correspondents and Working Groups. Romania has shown a keen interest in the development of the European Security and Defence Policy (ESDP) as part of the CFSP, and has participated in exchanges on this subject with the EU in the EU + 15 format (i.e. non-EU European NATO members and candidates for accession to the EU).

Romania has continued to align its positions with **EU statements and declarations** and, when invited to do so, has associated itself with the Union's **common positions and joint actions**. Romania has continued to comply with **international sanctions and restrictive measures** imposed by the UN and the EU.

Relations with Hungary have improved, with the conclusion in December 2001 of a Memorandum of Understanding on the implementation of the Hungarian "Status Law" with regard to Romanian nationals (the law itself grants preferential status to ethnic Hungarians living in selected third counties). Romania made a positive contribution to the handling of this matter and the tensions noted in last year's Regular Report have diminished considerably. Good cooperation with Bulgaria has continued and relations with the Federal Republic of Yugoslavia and FYROM have improved. There has been no significant change in relations with Ukraine and a dispute over border demarcation remains unresolved.

Romania confirmed its willingness to contribute to both the EU Rapid Intervention Force and to EU civilian instruments for crisis management. It played an active role in the Capabilities Improvement Conference in November 2001 (where it presented an upgraded offer including police personnel) as well as in the EU +15 Defence Ministers' meeting in May 2002. The Romanian President approved the country's participation in the EU-led police mission in Bosnia and Herzegovina that should begin in 2003.

As regards defence co-operation, Romania is an active contributor to the International Security Assistance Force (ISAF) operation in Afghanistan, and in April 2002 the Romanian Parliament approved the participation of an infantry battalion and of a nuclear, biological and chemical company in Operation "Enduring Freedom". Romanian troops are members of the Stability Force in Bosnia and Herzegovina (SFOR) and of the Peacekeeping Mission in Kosovo (KFOR). Romania has contributed 8 military observers to the OSCE monitoring mission in FYROM.

Romania has ratified the Rome Statute establishing the International Criminal Court. In August 2002 Romania signed a bilateral agreement with the USA on the non-surrender of each others' nationals to the International Criminal Court. Regrettably, this decision was taken without adequate prior consultation with the EU. It does not comply with the guiding principles laid down by the Council on 30 September 2002.

Romania has passed new anti-terrorism legislation, including measures against the financing of terrorism, and has aligned with the EU Plan of Action of September 2001. Romania has also aligned with all EU Common Positions on combating terrorism and has acceded to the relevant international conventions relating to terrorism.

Overall assessment

Romania has continued to play an important role as a regional leader in efforts to strengthen stability and security in South-Eastern Europe and has been an active participant in the work of the Stability Pact (co-chairing its third Working Table on security issues during the reporting period). Romania has been active in regional fora such as the Southeast Europe Cooperation Process and the Southeast Europe Security Cooperation Steering Group. Romania was Chair-in-Office of the OSCE during 2001 – a responsibility that it carried out efficiently, effectively and in cooperation with the EU.

Romania has subscribed to the content and principles contained in the EU Code of Conduct on Arms Exports, and continues to respect and implement the Code's criteria.

The officials in Romania's Ministry of Foreign Affairs are well qualified and have the ability to successfully implement the provisions relating to CFSP. The Ministry of Foreign Affairs has a European Correspondent but does not yet have a permanent Political Director. However, arrangements do exist to assume the Political Director's tasks in co-operation meetings with the EU and Romania intends to make relevant changes at a later stage. Measures to improve administrative capacity are ongoing and during the reporting period a diplomatic academy was created within the Ministry of Foreign Affairs. The academy's main functions are training of Ministry staff and carrying out research in the field of international relations.

The Ministry of Foreign Affairs is connected to the Associated Correspondents' Network information system, through which the EU communicates with associated partners within the CFSP.

Conclusion

In its 1997 Opinion, the Commission concluded that Romania should be able to effectively fulfil its obligations in the field of foreign and security policy.

Since the Opinion, Romania has made steady progress in aligning with the CFSP *acquis*, and its overall performance in this field has been satisfactory.

Negotiations on this chapter have been provisionally closed. Romania has not requested any transitional arrangements. Romania is meeting the commitments it made in the accession negotiations in this field.

Romania should focus further efforts on ensuring that its foreign policy orientation remains in line with the Union's developing foreign and security policy, adopting the legislation on economic sanctions, and finalising the development of administrative structures. In particular, Romania should ensure that its national policies conform to the EU's common positions, and should defend these positions in international fora.

Chapter 28: Financial control

Progress since the last Regular Report

Since last year's Regular Report, Romania has made further progress in this area.

In the area of **Public Internal Financial Control (PIFC)**, the Government adopted a policy paper in November 2001 which defines the framework for the organisation of the public internal financial control system. It also describes the principles for the development of internal audit within budget spending centres and envisages the establishment in the Ministry of Public Finance of a Central Harmonising Unit for Internal Audit. The Directorate for Preventive Financial Control in the Ministry of Public Finance has been strengthened by the recruitment of additional staff, and the deconcentration of preventive financial control functions to county level has been initiated in 10 counties. A Code of Ethics for internal auditors was adopted in June 2002.

In the area of **external audit**, a law adopted in February 2002 on the organisation and functioning of the Romanian Court of Accounts provides clarification of the Court's mandate to conduct audits relating to the privatisation of public companies and public procurement. The law contains provisions for reducing the number of members of the Court of Accounts. The ensuing dismissal of all the members of the Court is in conflict with the principle of independence of the supreme audit institution, as established by the relevant international standards.

Romania has made some progress as regards the **control of structural action expenditure**. The law on the organisation and functioning of the Romanian Court of Accounts, adopted in February 2002, defined the responsibilities of the Court for the audit of EC financial assistance, including SAPARD funds and related co-financing. The Court has continued the development of methodological norms for external control procedures relating to certification of the accounts of the SAPARD Agency. In July 2002 the Commission adopted a Decision provisionally conferring management authority for SAPARD, on a fully decentralised basis, to the SAPARD Agency. With respect to ISPA, Romania has made efforts in setting up the required management and control systems, and is in the process of finalising the assessment of the compliance of the national institutions and procurement procedures with the requirements for extended decentralisation. Romania has established a timetable for extended decentralisation of PHARE and ISPA implementation.

The Prime Minister's Control Department has been designated as the anti-fraud co-ordination service, responsible for the co-ordination of all legislative, administrative and operational activities related to the **protection of EC financial interests**. A start has been made with the implementation of effective co-operation with OLAF through this co-ordinating service. In order to reinforce inter-institutional co-ordination within Romania, a working group on the protection of the Communities' financial interests has been set up involving the relevant Romanian institutions and bodies.

Overall assessment

With regard to Public Internal Financial Control, Romania needs to complete the establishment of functionally independent internal audit units in all budget-spending centres, focusing on systems-based procedures and performance-audit functions. Furthermore, appropriate working methods should be defined for the Central Harmonising Unit at the Ministry of Finance. Both the internal audit units and the Central Harmonising Unit need to be adequately staffed with well-trained and experienced personnel and therefore appropriate and adequate human resources and training policies should be put in place. The draft Internal Audit Law should be finalised and adopted, as should the draft Preventive Financial Control Act. The Internal Audit

Committee provided for under the draft Internal Audit Law should be established and made operational. Manuals for financial management and control systems and internal audit should be developed and audit trails should be defined. Preparations should continue for the decentralisation of ex ante financial control from centralised financial control to resident financial controllers in the spending units by the end of 2003.

In the area of external audit, Romania needs to reinforce the independence of members of the Court of Accounts through an amendment to the relevant article of the Constitution, in order to ensure the Court's financial independence and enhance its overall operational capacity. A comprehensive set of standards for external audit, conforming to internationally accepted external audit standards and in line with the EC *acquis*, should be developed and implemented. Effective staff training should be further developed. Romania also needs to enhance the formal procedures for parliamentary scrutiny of the Court's audit findings and to improve the transparency and dissemination of the Court of Accounts' reports.

As regards the control of structural action expenditure, Romania should concentrate efforts on the need to strengthen national public internal financial control systems and external audit services.

In the area of the protection of EC financial interests, Romania should pursue its efforts to develop an effective co-ordination structure, and should give priority to the development of mechanisms for administrative enquiries and for the judicial follow-up of anti-fraud investigations.

Conclusion

In its 1997 Opinion, the Commission concluded that major efforts were essential to strengthen the internal financial control functions.

Since the Opinion, significant steps forward have been taken, both as regards definition of the role of the Romanian Court of Accounts as the national external audit body in line with international standards, and as regards introduction of modern financial management and control as well as internal audit arrangements within the bodies responsible for public expenditure.

Negotiations on this chapter continue. Romania has not requested any transitional arrangements.

Romania should focus further efforts on implementing sound financial control systems by completing alignment, further developing its legislative framework and administrative capacity to protect the Communities' financial interests, and completing and strengthening the required institutional structures.

Chapter 29: Financial and budgetary provisions

Progress since the last Regular Report

Romania has made progress in this area since the last Regular Report.

Further progress has been achieved through the adoption of a new *Public Finance Law* which aims at improving **national budget formulation and execution**, in particular by introducing a three-year programme-based framework for budgetary procedures. This framework ensures improved arrangements for co-financing the EC pre-accession instruments. The new law also continues the process of decentralisation by increasing the range of public services financed out of local budgets. The preparation of the 2002 state budget introduced programme-based budgeting for the main spending ministries for the period 2003-2005. The reform of budgetary procedures and public expenditure management has been accompanied by successful efforts to improve the timeliness of the budgetary process. At the same time, the number of extra-budgetary funds has been reduced to seven, compared with eleven two years ago.

As regards **own resources** and preparation of the system of contributions to the European Community budget, the Ministry of Public Finance has set up an Office for Special Assessments within the General Division of Public Revenues Management and Monopolies of the Ministry. This unit is responsible for co-ordination between the various services which will be involved in calculating Romania's contribution to the EC budget and the VAT base, and for ensuring that they are familiarised with the budgetary requirements related to Romania's accession to the EC.

As regards VAT, consolidated legislation, which entered into force in June 2002, has significantly improved the level of alignment (*see chapter 10 – Taxation*).

Overall assessment

The integration of the medium-term financial outlook into the 2002 budgetary process is a positive step in improving the management of public budgetary resources. Efforts should be continued to create the capacity to effectively implement the multi-annual budgetary mechanisms defined in the Public Finance Law, particularly with a view to ensuring co-financing of EC pre-accession instruments. As regards traditional own resources, Romanian customs legislation is already largely in line with the EC *acquis* and progress has been achieved in alignment with the EC Customs Code and its implementing provisions. However, for the purpose of own resources, Romania needs to develop its reporting system on cases of fraud and irregularity, and certain other reporting and accounting requirements (the 'A' and 'B' accounts) will need to be set up in time for accession. Also, the systems and procedures necessary for sugar levies are not yet in place. Romanian law does not currently include any provisions requiring that producers of sugar, isoglucose or insulin syrup pay levies on sugar production, nor has an entity been identified to carry responsibility for levy collection.

As regards VAT, Romania has achieved a reasonable degree of alignment, although a number of issues remain to be tackled. For the purposes of own resources, considerable efforts are required in order to be able to calculate the weighted average rate in accordance with ESA-95 and to determine the impact on the VAT base of any special arrangements agreed under the Taxation Chapter. Romania should continue to participate in the VAT simulation exercise, which is the key tool for effectively testing its capacity regarding the VAT resource. Sustained efforts are also needed to improve the actual collection of VAT.

As regards the GNP resource, Romania's statistical system is largely in line. Implementation of the ESA-95 concept should be continued, along with the ongoing

process of quality and methodology improvements in the calculation of GNP and the national accounts, including enhancing their exhaustiveness.

Following the establishment of the co-ordination unit on own resources in the Ministry of Public Finance, considerable efforts will be needed to define the necessary procedures, organisational arrangements and capabilities to fulfil the administrative requirements in this area. In addition to the need for central co-ordination for the proper collection, monitoring and payment of funds to and from the EC budget, administrative capacity should be strengthened in the context of the relevant policy areas described elsewhere in this report, such as Financial Control, Agriculture, Customs, Taxation and Regional Policy.

Conclusion

In its 1997 Opinion, the Commission concluded that, in order to ensure that own resources could be established, monitored and made available in line with Community regulations, Romania would have to overhaul its current customs system. In addition, for the purpose of accurately calculating the GNP resource considerable improvements would have to be made to the national accounts to ensure that they were reliable, homogeneous and complete. Also, improving the statistics for drawing up the VAT own resource base was considered essential to bring Romania's VAT system fully into line with the Community directives.

Since the Opinion, Romania has achieved considerable progress with alignment in the areas of customs and VAT. Romania's statistical system is largely in line with requirements. Progress has been achieved in calculating the GNP resource through harmonisation with the ESA-95 standards, but this work has not yet been completed.

Negotiations on this chapter have not yet been opened with Romania.

Romania should focus further efforts on preparations for application of the *acquis* on own resources, and on creating a framework for transparent and efficient financial flows to and from the EC budget. Romania should continue implementation of the ESA-95 concepts and pay particular attention to quality and methodology improvements in the calculation of GNP and the national accounts, including enhancing their exhaustiveness. Romania should also work to improve the calculation of the VAT base.

3.2. Translation of the *acquis* into the national languages

Applicant countries are required to translate the various legal texts constituting the *acquis* into their national languages by the time of their accession. Primary and secondary legislation alone represents a considerable volume of texts, roughly estimated at 60 000-70 000 pages of the Official Journal. In the framework of the translation of the *acquis*, the Court of Justice has defined a set of key judgements to be translated as a priority (representing about 15 000 pages). To help the candidate countries in this process, assistance is being provided under the Phare programme. With the help of TAIEX, a dedicated database has been set up to act as a repository of all translated acts and as a tool through which candidate countries forward their translations to the Commission and the Council. The legal revisers of the Commission and the Council vet the submitted texts; they meet regularly and liaise with representatives of the centralised Translation Coordination Units in each country.

In Romania, the Translation Co-ordination Unit is established within the European Institute of Romania (EIR). It is responsible for managing all translation activities and functions effectively (but remains understaffed considering the volume of translation work that is required). Translations of the *acquis* are published on the EIR's website and are available free of charge. In parallel with the translation work, research on terminology has continued. The Internal Market Glossary and the Customs Glossary have been finalised.

As at September 2002, 9 750 pages of revised text and 41 200 of unrevised text were registered in the dedicated Commission database. Translation work is continuing, although current efforts are particularly focussed on speeding up the revision of translated texts. Sustained efforts are needed to ensure quality control and the technical uniformity of texts.

Due attention must also be paid to the training of conference interpreters.

3.3. General evaluation¹⁶

Since the 1997 Opinion, Romania has made steady progress with the adoption of the *acquis*. However, in many areas, there has been an increasing gap between progress in legal transposition and the limited ability of the Romanian administration to implement and enforce the newly adopted legislation.

Over the last year, Romania has accelerated the process of legislative transposition and has continued work, albeit at a slower pace, on developing the administrative structures required by the *acquis*.

Overall, and in view of Romania's target date for accession, Romania's progress has been reasonable and national legislation has been aligned with the *acquis* in many areas. Administrative capacity building will require a comprehensive, structural reform of both the public administration and the judicial system.

In the area of the internal market, framework legislation on the New and Global Approach has allowed accelerated alignment with the sector-specific *acquis* on *free movement of goods*. Considerable progress has also been made in the establishment of bodies to administer the *acquis*. Further efforts should concentrate on improving standardisation and certification, on reinforcing market surveillance systems, on restructuring the food control system, and on effectively implementing public procurement legislation. The foundations for future progress with the *free movement of persons* have been laid, although further transposition is necessary to address shortcomings in the area of mutual recognition and administrative capacity should be strengthened in all areas. Considerable efforts have been made to facilitate the *free movement of services*, although the newly developed institutional framework for supervising financial services still needs to be supported. Liberalisation has continued in the area of *free movement of capital* and Romania is committed to a timetable for dismantling exchange controls and other restrictions on capital movements. Further efforts are particularly needed to revise the legal framework in the area of money laundering. Romania has aligned with most of the *acquis* on *company law*, although the level of piracy and counterfeiting remains a serious

¹⁶ See "Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2002) 700.

problem and enforcement should be improved. In the area of *competition policy*, some progress has been made with the transposition of the *acquis*, mainly in the field of anti-trust, but Romania's enforcement record in respect of both state aid and anti-trust needs to be improved. The restructuring of the steel sector will need to be closely monitored.

Romania has made steady progress towards alignment with the *taxation acquis* although further adjustments are needed and the ability to implement and enforce tax legislation remains limited. Despite a high level of harmonisation with the *customs acquis*, further legislative alignment is needed as are efforts to reduce levels of corruption within the customs administration. Work should continue on developing IT systems to allow the exchange of computerised data between Romania and the EC. In order to develop a successful *industrial policy* and to promote *SME* development further efforts are needed to simplify and stabilise the business environment.

Alignment with the *acquis* on *agricultural policy* has accelerated, although legislative developments have not yet been matched by the development of administrative structures able to effectively implement the *acquis*. Structural reforms have only been slowly introduced. Inspection arrangements should be improved in the phytosanitary sector and, even more urgently, in the veterinary sector. In the area of *fisheries*, Romania has adopted the necessary framework legislation, although there have been delays in the establishment of the required administrative structures.

On *social policy and employment*, some progress has been made but considerable further work remains on legal transposition in the areas of labour law, equal opportunities, and health and safety at work.

Progress with *regional policy* has been slower and Romania does not yet have a clear and consolidated cohesion policy. Work has begun on developing administrative capacity, but continued efforts are needed to design management and implementation systems.

Romania's progress in the *transport* sector has been mixed: good with regard to road and railway transport, reasonable in the area of aviation, but only limited in the case of maritime safety. The key issues facing Romania are developing institutions able to enforce recently adopted legislation and securing the funding to make the heavy investments required by the *acquis*. Despite progress in terms of legislative alignment, many structural issues still have to be addressed in the *energy* sector and new operating structures need to be consolidated. Despite having transposed a considerable amount of *environmental* legislation, Romania has neither the administrative nor the financial resources to implement it. Future efforts should focus less on legislative alignment and more on developing implementation capacities as well as securing resources for environmental investments. Alignment with the *consumer protection acquis* has continued and implementation structures are in place - although inter-institutional co-operation should be improved.

Steady progress has been made with aligning with the *telecoms acquis* and progress has been made with preparing for the liberalisation of the communications and postal markets. Future efforts should focus on developing the newly established regulatory administration into a truly efficient and independent body, and on the evaluation of the economic implications of full implementation of the universal service *acquis*.

Romania has started to make structural reforms in the area of *justice and home affairs*, although a considerable amount of work remains to be done on legal approximation and

above all on strengthening administrative and judicial capacity. Despite recent reforms, including the adoption of a Schengen Action Plan, the efficiency of all police forces is limited and border infrastructure and management need to be improved. Major efforts are required to increase the efficiency of the judiciary.

In the area of *external relations*, trade barriers have been progressively eliminated, and Romania has achieved a generally high level of alignment with the *acquis*.

Progress has been made with regard to *financial control* and modern systems of financial management and control are being introduced. Further work is necessary to protect the Communities' financial interests, administrative capacity needs to be strengthened with regard to public internal financial control, and the independence of the Court of Audit should be guaranteed.

The overall *capacity of the public administration* to implement the *acquis* remains limited and represents a major constraint on Romania's accession preparations. While certain parts of the administration are able to function effectively there are many important sectors where the weakness of the administration is a serious cause for concern. These concerns extend beyond adoption of the *acquis* and also apply to the management of EC financial assistance. This issue is beginning to be addressed by the Government which has announced a major reform programme. However, these reforms are only at the design stage and still need to be carried out.

In the accession negotiations, 13 chapters have been provisionally closed. The commitments made in the negotiations are with a view to accession in 2007 and are generally being met.

C. Conclusion¹⁷

In its 1997 Opinion, the Commission concluded that Romania fulfilled the political criteria. Since then the country has made progress in consolidating and deepening the stability of its institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. This has been confirmed over the past year. Romania continues to fulfil the Copenhagen political criteria.

The launch of a major programme of administrative reform is an important development and ensuring the successful implementation of these reforms should be considered as a priority. Significant progress was also made with the decision to demilitarise the police. This will increase the public accountability of police officers - although further actions are needed to ensure the proportionality of their actions. New institutional structures have been created for fighting corruption, which remains a cause for very serious concern, but they have yet to have an impact.

Romania still needs to improve the decision making and legislative processes. In particular, the Government's reliance on emergency ordinances should be reduced and parliament's ability to scrutinise legislation increased. Reform of the judiciary has been limited. A lack of resources means that the judicial system is severely strained and the executive's involvement in judicial affairs has not been reduced in practice. In order to address these issues, judicial reform should be made a political priority and a comprehensive strategy to improve the functioning of the judicial system should be drawn up.

Romania continues to respect human rights and freedoms. It has made significant progress with child protection, reducing the number of children in residential care and improving actual living conditions. Progress has also been made in promoting equal opportunities between men and women, with developing structures to reduce trafficking in human beings and with setting up the institutional framework to fight discrimination. The development of a probation system has continued although prison conditions remain extremely poor. Additional steps need to be taken to strengthen safeguards for freedom of expression.

Positive developments took place with regard to the treatment of minorities. Legislation extending the official use of minority languages was implemented relatively smoothly. Important steps were taken to implement the National Strategy for Improving the Condition of Roma, with the aim of effectively combating discrimination and improving living conditions, although additional financial resources will be necessary to make further progress.

Romania has continued to make progress towards being a functioning market economy, for which the prospects have improved. Sustained and full implementation of planned measures together with the completion of the reform agenda should allow Romania to be able to cope with competitive pressure and market forces within the Union in the medium term.

¹⁷ See "Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the progress towards accession by each of the candidate countries", COM (2002) 700.

Some significant gains on macroeconomic stabilisation have been achieved over the last years. A more appropriate policy-mix is decreasing inflation, while growth has resumed and the external position remains sustainable. Considerable progress has been made on the creation of the necessary market institutions. The ongoing overhaul of the banking sector, the successive improvements in the supervisory and regulatory framework for the financial markets and the advances in privatisation have progressively tightened enterprises financial discipline. Price and trade liberalisation coupled, over the last year, with a significant adjustment of energy tariffs and important reforms of the tax system have set the stage for a more efficient allocation of resources. Restructuring is advancing in a number of sectors.

To build upon this progress, the authorities should give priority to establishing a track record on macroeconomic stabilisation grounded on further disinflation, by maintaining an appropriate policy mix and underpinning it with the enforcement of enterprises' financial discipline. Commitments to restrict the total wage bill in the public sector should be respected. The recent sharp growth in money supply and credit requires careful monitoring and a readiness to take prompt actions. Establishing enterprises' financial discipline requires improved tax administration and compliance, a consistent and transparent implementation of the latest measures to reduce the arrears of energy users, a determined and transparent use of the recently approved legal provisions for accelerating privatisation, and a readiness to liquidate loss-making enterprises. Completing privatisation in the banking sector, continuing the reform of public expenditures and budgetary procedures, and ensuring the implementation of improved regulatory and legal frameworks would also support the establishment of a functioning market economy and the development of Romania's capacity to cope with competitive pressure and market forces within the Union.

Since the 1997 Opinion, Romania has made steady progress with the adoption of the *acquis*. However, in many areas, there has been an increasing gap between progress in legal transposition and the limited ability of the Romanian administration to implement and enforce the newly adopted legislation.

Over the last year, Romania has accelerated the process of legislative transposition and has continued work, albeit at a slower pace, on developing the administrative structures required by the *acquis*.

Overall, and in view of Romania's target date for accession, Romania's progress has been reasonable and national legislation has been aligned with the *acquis* in many areas. Administrative capacity building will require a comprehensive, structural reform of both the public administration and the judicial system.

In the area of the internal market, framework legislation on the New and Global Approach has allowed accelerated alignment with the sector-specific *acquis* on *free movement of goods*. Considerable progress has also been made in the establishment of bodies to administer the *acquis*. Further efforts should concentrate on improving standardisation and certification, on reinforcing market surveillance systems, on restructuring the food control system, and on effectively implementing public procurement legislation. The foundations for future progress with the *free movement of persons* have been laid, although further transposition is necessary to address shortcomings in the area of mutual recognition and administrative capacity should be strengthened in all areas. Considerable efforts have been made to facilitate the *free movement of services*, although

the newly developed institutional framework for supervising financial services still needs to be supported. Liberalisation has continued in the area of *free movement of capital* and Romania is committed to a timetable for dismantling exchange controls and other restrictions on capital movements. Further efforts are particularly needed to revise the legal framework in the area of money laundering. Romania has aligned with most of the *acquis* on *company law*, although the level of piracy and counterfeiting remains a serious problem and enforcement should be improved. In the area of *competition policy*, some progress has been made with the transposition of the *acquis*, mainly in the field of anti-trust, but Romania's enforcement record in respect of both state aid and anti-trust needs to be improved. The restructuring of the steel sector will need to be closely monitored.

Romania has made steady progress towards alignment with the *taxation acquis* although further adjustments are needed and the ability to implement and enforce tax legislation remains limited. Despite a high level of harmonisation with the *customs acquis*, further legislative alignment is needed as are efforts to reduce levels of corruption within the customs administration. Work should continue on developing IT systems to allow the exchange of computerised data between Romania and the EC. In order to develop a successful *industrial policy* and to promote *SME* development further efforts are needed to simplify and stabilise the business environment.

Alignment with the *acquis* on *agricultural policy* has accelerated, although legislative developments have not yet been matched by the development of administrative structures able to effectively implement the *acquis*. Structural reforms have only been slowly introduced. Inspection arrangements should be improved in the phytosanitary sector and, even more urgently, in the veterinary sector. In the area of *fisheries*, Romania has adopted the necessary framework legislation, although there have been delays in the establishment of the required administrative structures.

On *social policy and employment*, some progress has been made but considerable further work remains on legal transposition in the areas of labour law, equal opportunities, and health and safety at work.

Progress with *regional policy* has been slower and Romania does not yet have a clear and consolidated cohesion policy. Work has begun on developing administrative capacity, but continued efforts are needed to design management and implementation systems.

Romania's progress in the *transport* sector has been mixed: good with regard to road and railway transport, reasonable in the area of aviation, but only limited in the case of maritime safety. The key issues facing Romania are developing institutions able to enforce recently adopted legislation and securing the funding to make the heavy investments required by the *acquis*. Despite progress in terms of legislative alignment, many structural issues still have to be addressed in the *energy* sector and new operating structures need to be consolidated. Despite having transposed a considerable amount of *environmental* legislation, Romania has neither the administrative nor the financial resources to implement it. Future efforts should focus less on legislative alignment and more on developing implementation capacities as well as securing resources for environmental investments. Alignment with the *consumer protection acquis* has continued and implementation structures are in place - although inter-institutional co-operation should be improved.

Steady progress has been made with aligning with the *telecoms acquis* and progress has been made with preparing for the liberalisation of the communications and postal markets. Future efforts should focus on developing the newly established regulatory administration into a truly efficient and independent body, and on the evaluation of the economic implications of full implementation of the universal service *acquis*.

Romania has started to make structural reforms in the area of *justice and home affairs*, although a considerable amount of work remains to be done on legal approximation and above all on strengthening administrative and judicial capacity. Despite recent reforms, including the adoption of a Schengen Action Plan, the efficiency of all police forces is limited and border infrastructure and management need to be improved. Major efforts are required to increase the efficiency of the judiciary.

In the area of *external relations*, trade barriers have been progressively eliminated, and Romania has achieved a generally high level of alignment with the *acquis*.

Progress has been made with regard to *financial control* and modern systems of financial management and control are being introduced. Further work is necessary to protect the Communities' financial interests, administrative capacity needs to be strengthened with regard to public internal financial control, and the independence of the Court of Audit should be guaranteed.

The overall *capacity of the public administration* to implement the *acquis* remains limited and represents a major constraint on Romania's accession preparations. While certain parts of the administration are able to function effectively there are many important sectors where the weakness of the administration is a serious cause for concern. These concerns extend beyond adoption of the *acquis* and also apply to the management of EC financial assistance. This issue is beginning to be addressed by the Government which has announced a major reform programme. However, these reforms are only at the design stage and still need to be carried out.

In the accession negotiations, 13 chapters have been provisionally closed. The commitments made in the negotiations are with a view to accession in 2007 and are generally being met.

D. Accession Partnership and Action Plan for strengthening administrative and judicial capacity: Global assessment

Romania's progress and overall state of preparation in respect of the Copenhagen criteria has been examined and conclusions drawn above. The present section assesses the extent to which the priorities of the Accession Partnership have been met and the measures foreseen under the Action Plan implemented according to schedule. It should be noted that both the Accession Partnership and the Action Plan have a time perspective of two years covering 2002 and 2003, providing for another 15 months for priorities to be met. Furthermore, much has already been achieved based on previous Accession Partnerships. The present one focuses on remaining specific and well-circumscribed topics identified as requiring more work to prepare Romania for membership. Therefore the analysis below only focuses on these specific topics and does not give an overall picture of the state of preparation of Romania in each domain.

The purpose of the Accession Partnership is to set out in a single framework:

- the priority areas for further work identified in the Commission's Regular Report;
- the financial means available to help candidate countries implement these priorities;
- the conditions which will apply to this assistance.

The Accession Partnerships are revised on a regular basis, to take account of progress made, and to allow new priorities to be set. The Council adopted a revised Accession Partnership for Romania in January 2002, based on a proposal from the Commission.

The revised Accession Partnership has served as the point of departure for the Commission and Romania to develop jointly an Action Plan to strengthen Romania's administrative and judicial capacity.

The purpose of the Action Plan is to identify jointly the next steps required for Romania to achieve an adequate level of administrative and judicial capacity by the time of accession, and ensure that all necessary measures in this regard are taken, providing Romania with targeted assistance in areas that are essential for the functioning of an enlarged Union.

Developing adequate administrative and judicial capacity for EU membership is a demanding and wide-ranging task, which requires detailed preparations in each and every domain covered by the Union's policies and legislation. In preparing individual Action Plans, the Commission has taken a comprehensive approach. All priorities from the revised Accession Partnerships which relate to the development of administrative and judicial capacity have been included in the Action Plans. Each of these priorities is treated separately in the Action Plans, and specific measures have been designed to address each of them.

In the following, progress in addressing each of these priorities is reported. For ease of reference and to avoid repetitions, wording from the *Accession Partnerships* is rendered in italics. As regards the measures foreseen by the Action Plan, implementation is checked against timetables and reported.

Political criteria

Democracy and the rule of law

The 1999 law on civil servants is not yet fully applied and the body of *secondary legislation governing the civil service* still needs to be completed and revised. Steps have been taken to initiate a *comprehensive public administration reform package* - a reform strategy has been adopted and an inter-ministerial committee announced to oversee the implementation of the strategy. However, the main elements of the strategy have not yet been implemented and, to date, there has been no substantial improvement in ensuring the *political independence and accountability of civil servants*, or with developing a *career structure based on transparent promotion and assessment*. In accordance with the Action Plan, a National Institute for Administration has been set up to improve *training provision* – although it is not yet operational. The overall process of policy formulation remains weak. While *consultation procedures between ministries* have improved, *consultation with stakeholders* during the drafting process is limited. Not all draft legislation is *screened for its budgetary implications or its compatibility with Romania's international obligations*. There has been no significant reduction in the *use of ordinances, and emergency ordinances, as a legislative tool*. Efforts have been made to match the devolution of responsibilities to local levels of government with increased fiscal decentralisation. The *provision of financial resources* to local government has increased – although certain difficulties remain. The establishment of a National Anti-Corruption Prosecutor's Office, as set out in the Action Plan, may help *clarify the competencies of all bodies involved in anti-corruption activities, and improve co-ordination between these bodies*. However, the office is not yet fully operational and it is premature to assess its effectiveness. Romania has *ratified relevant international conventions against corruption*. The notion of *criminal liability of legal persons* still needs to be introduced into Romanian Criminal Law. Romania still needs to improve the functioning and independence of the judiciary by *introducing objective criteria for recruitment and career development* for judges and prosecutors. The training measures set out in the Action Plan have been implemented and while the *in-service training of judges, prosecutors and law clerks* has improved it remains inadequate. The Ministry of Justice has not yet established a clear policy on continuous training for judges and prosecutors. The *availability of legal aid* has remained unchanged. The *enforcement of civil decisions* has improved as it is now the responsibility of private bailiffs. In line with the measures set out in the Action Plan, the foundations have been laid for an *effective probation system*. New probation centres have been opened and specialised probation officials have been recruited and trained. Despite this development, there has been no significant reduction in the use of *pre-trial detention*. Romania has adopted *legislation on police organisation and the statute of police officers* which will bring police officers under the jurisdiction of civilian courts and complete the demilitarisation of police forces. There is still no *effective system for examining complaints of police misconduct*. The section of the Penal Code dealing with *offence against authorities* has been revised – although the amendments are limited and the revised legislation does not resolve contradictions with the case law of the European Court of Human Rights.

Human rights and the protection of minorities

Romania has made good progress in implementing *reform of the child care system in accordance with the National Strategy on the Protection of Children in Need*. Budget provisions for children in care have been increased, and initiatives have been taken to

address the particular problems of *children with chronic diseases and handicaps* – although additional efforts are needed to develop an inclusive educational policy for disabled children. In the absence of such a policy, the *closure of special schools* has been hampered. Measures have also been taken to support the *integration of young people leaving residential care institutions* into society. New legislation on international adoption has been prepared and based upon the provisions of the Action Plan, and efforts have been made to develop the administrative capacity that would be required to implement this legislation. While this process has been carried out the *moratorium on international adoption* has remained in place. In line with the Action Plan, steps have been taken to develop *administrative capacity* in order to implement the Government Strategy on the improvement of the situation of Roma. The local structures for implementation of the Strategy have been established and measures have been taken to re-enforce the capacity of the national office for Roma. This said, the levels of *financial support* provided for the Strategy's implementation have been inadequate and in this respect the Action Plan has not been fully implemented. Romania has *adopted a National Strategy on the Improvement of the Situation of Persons with Handicaps*. Effective implementation of the strategy will depend upon sufficient *budgetary support and developing administrative capacity*, both at national and local levels – a process that is on-going in line with the measures foreseen in the Action Plan. In accordance with the Action Plan, Romania has *established the institutional framework in order to implement legislation on the prevention and combating of all forms of discrimination*. However, the institution concerned (the National Council for Fighting Against Discrimination) is not fully compatible with the *acquis*.

The Accession Partnership priorities related to the political criteria have been partially met. For those priorities also covered by the Action Plan the actions foreseen in the Action Plan are largely on track.

Economic criteria

Macroeconomic stability has improved noticeably in Romania although progress with the *implementation of structural reforms* has been slow. The *privatisation process* has continued, but only slowly, and the Government has not been able to meet its own privatisation programme. A variety of measures have been taken to *stimulate domestic and foreign investment*, but although Romania witnessed a steady growth in both domestic and foreign investments, overall levels of investment remain low. Despite a number of high-profile initiatives, actual progress in *simplifying legal and administrative procedures* has been limited and the *rules governing privatisation and business operation* still suffer from instability and a lack of transparency. New *bankruptcy procedures* were introduced in 2002 but it is not yet possible to assess if the new legislation is being effectively implemented. A revised *plan for restructuring the steel sector* has been produced and progress has been made with the implementation of restructuring measures. Romania is in the process of developing *individual viability plans* for steel enterprises. *Restructuring of the national air carrier* has continued and a cost reduction programme has led to a significant *reduction in losses* – although additional reforms will be needed to reach a financial equilibrium. The *land market* in Romania is progressing, although the market in land sale lags behind the rental market. Efforts have been taken to develop a *policy for agricultural land consolidation*, and progress with the *issuance of land titles* is continuing, albeit more slowly than anticipated. Romania has not yet developed a *policy framework for rural credit and rural financial infrastructure compatible with IFI and EC*

financial support. In line with the provisions set out in the Action Plan, Romania has taken a number of initiatives to support SMEs – notably through the implementation of an Action Plan for the Removal of the Administrative Barriers from the Business Environment. Despite these efforts, the overall *economic, legal and administrative environment* remains difficult. New legislation has attempted to *simplify the registration for new companies* but there has been no substantial progress with the *simplification of enterprise licensing.*

The Accession Partnership priorities in this area have only been partially met. The Action Plan measures are being implemented although additional efforts are needed.

Ability to assume the obligations of membership

Chapter 1: Free movement of goods

Implementation of the New Approach directives has accelerated considerably over the reporting period. The programme for *strengthening the national system for conformity assessment* set out in the Action Plan has begun. *New legislation on pharmaceuticals, chemicals, cosmetics, textiles, footwear, legal metrology, and motor vehicles* has been passed or is in the process of being drafted. Work on the *adoption of EN standards* continues as planned. In order to *prepare a market surveillance system*, an Inter-Ministerial Committee for Market, Products and Services Surveillance and Consumer Protection, a Commission for Unfair Terms, and a Commission for Safety have been created - as mentioned in the Action Plan. In the context of *preparing the administration to implement EC principles of food safety*, Romania still needs to set up a National Food Authority. Other measures listed in the Action Plan have started as foreseen (work on the provision of information to economic operators in the food industry, the equipment of three reference laboratories and the reinforcement of inter-ministerial co-operation). As foreseen in the Action Plan, training of officials from both central and local government has started in order to *ensure an appropriate implementation of the new legislation on public procurement.* An inter-ministerial working group has been created to *screen legislation in the non-harmonised area* but work is still at an early stage. Overall, most of the Accession Partnership priorities in the area of free movement of goods have been met. Implementation of the measures under the Action Plan is largely on track.

Chapter 2: Free movement of persons

No significant progress has yet been made on alignment with the *acquis on mutual recognition of professional qualifications.* However, the training programme mentioned in the Action Plan to reinforce institutional capacity in the field of recognition of professional qualifications (directives on the general system of recognition and sectoral directives) is being implemented. As mentioned in the Action Plan, Romania is implementing a capacity building programme within the National Health Insurance House and District Health Insurance Houses in order to *develop the administrative structures for the co-ordination of social security systems.* Overall, the Accession Partnership priorities in the area of free movement for persons have been partially met. Implementation of the measures under the Action Plan is largely on track.

Chapter 3: Freedom to provide services

With regard to *aligning with securities markets acquis*, a number of major legislative developments have occurred concerning the statute of the Securities Market Commission, undertakings for collective investment in transferable securities, regulated commodities markets, services and derivative financial instruments and securities financial services and regulated markets. As mentioned in the Action Plan, Romania is implementing training and administrative programmes within the supervisory authorities for the banking, insurance and securities markets in order to *reinforce the supervision of financial services*. Romania has also established the inter-institutional co-operation structures as foreseen in the Action Plan. The Accession Partnership priorities in the area of freedom to provide services have been met to a large degree. Implementation of the measures under the Action Plan is largely on track.

Chapter 4: Free movement of capital

Romania has revised its legislation to incorporate the *recommendations of the Financial Action Task Force*. As mentioned in the Action Plan, a review of the National Office for the Prevention and Control of Money Laundering is planned for the near future for the purposes of implementing the recommendations. Overall, the Accession Partnership priorities in the area of free movement of capital have been met. Implementation of the measures under the Action Plan is largely on track.

Chapter 5: Company law

As mentioned in the Action Plan, Romania has approved and is implementing plans to improve training and *strengthen administrative capacity in the main enforcement bodies for intellectual and industrial property rights*. Steps have been taken, in line with the Action Plan, to improve co-operation between the Romanian Copyright Office and the police, customs authorities and the judiciary. A programme to strengthen the *capacity to enforce border legislation* is also underway and *training programmes for judges and prosecutors* are being implemented. While the encouraging decline in reported levels of piracy is evidence of *increased inter-agency co-operation*, the enforcement of legislation in the area of protection of intellectual and industrial property rights, especially at borders, is still a source of concern. The efforts of all law enforcement institutions involved in the protection of intellectual and industrial property rights to improve co-operation should be pursued. Although transposition continues, Romania is slightly behind its own timetable for the *adoption of the Company Law acquis*. Overall, most of the Accession Partnership priorities in the area of company law have been met. Implementation of the measures set out in the Action Plan is slightly delayed.

Chapter 6: Competition

Romania has continued with its programme of *legislative transposition in both the state-aid and anti-trust sectors*, although further efforts are needed, in particular in the field of state aid. Programmes to *strengthen the capacity of the competition authorities*, as mentioned in the Action Plan, are ongoing but need further enforcement. Little progress can be reported as regards the *alignment of incompatible state-aid schemes*. Romania has completed the *state-aid inventory and submitted an annual report* for the period 1996-1999. A *regional aid map* was agreed. As mentioned in the Action Plan, Romania is implementing *awareness raising programmes aimed at market participants and aid grantors* and *training programmes aimed at the judiciary*, but efforts need to be

intensified. The Accession Partnership priorities in the field of competition have been partially met. Implementation of the Action Plan is slightly delayed.

Chapter 7: Agriculture

Romania intends to carry out an *agricultural census* starting at the end of 2002, for which preparations are under way. With conferral of management for the SAPARD Agency approved in July 2002, Romania has taken a step forward in *preparing the administrative structures for the design, implementation, management, monitoring, control, and evaluation of EC-funded rural development programmes* – although it still has to elaborate a national rural development strategy and will have to earmark financial resources for restructuring the agricultural sector and rural communities. Romania is implementing a programme of institutional reform in the Ministry of Agriculture, Food and Forestry. A programme of *administrative strengthening to improve policy formulation and economic analysis* is also being carried out, as mentioned in the Action Plan. Although Romania is currently implementing an *animal identification programme* in line with its calendar for implementation, work on the *creation of a General Cadastre and Land Registration system* has encountered delays. As mentioned in the Action Plan, training and technical assistance programmes are in place in the various institutions responsible for *veterinary, phytosanitary and food safety legislation*. Substantial efforts have been made to reform the different veterinary and phytosanitary administrations and their respective laboratory structures. Many of these actions are at an early stage of implementation although overall the priorities are being satisfactorily addressed. Major reforms of veterinary and phytosanitary administrations are being implemented to ensure their capacity to enforce the *acquis*, including on the *testing of animal diseases, and in particular transmissible spongiform encephalopathies*. The Romanian authorities are also in the process of implementing a strategy to *upgrade inspection arrangements, including at future external borders*. These programmes are at an early stage of development although they remain in line with the calendar outlined in the Action Plan. While Romania has adopted a programme to *strengthen the administrative capacity to implement the food safety strategy*, work is still at an early stage. Romania has encountered delays in the *establishment of a vineyard register and control systems in the wine sector* - although implementation of a programme of administrative restructuring and reinforcement is under way. The Accession Partnership priorities in the area of agriculture have been partially met. Implementation of the measures under the Action Plan is partially on track.

Chapter 8: Fisheries

Although framework legislation is in place, delays have been encountered in establishing the National Company for the Management of the Fisheries Fund and *creating a Fisheries Inspection*. Romania has *established a compliant fishing register* although administrative capacity in this area is still weak. Delays have been encountered in the implementation of the administrative strengthening programmes intended to address fisheries management structures. The Accession Partnership priorities in the area of fisheries have been partially met. Implementation of the measures under the Action Plan is delayed.

Chapter 9: Transport policy

Romania has made progress in *legal alignment*, but *administrative capacity in road transport* still has to be strengthened in order to enforce the adopted legislation. In line with the Action Plan, training programmes are being implemented at both managerial and execution level and steps are being taken to strengthen the capacity for roadside inspections. The measures planned to *retrofit haulage vehicles with speed limitation devices and recording equipment* are ongoing, but monitoring should be reinforced. Although a framework law on maritime and inland transport was adopted, considerable efforts still have to be made to ensure alignment with the *acquis*. With the Romanian fleet rated as a very high risk in the latest Paris MOU report, the situation remains worrying with regard to *implementation of the maritime safety acquis*. However, as foreseen in the Action Plan, a new body, the Romanian Naval Authority, has been set up through the merger of the existing bodies, which should avoid duplication and dilution of responsibilities. No progress has been made with *restructuring and modernising the Romanian Danube fleet and further efforts are necessary to improve the administrative capacity of the inland waterway sector*. In the railway sector, Romania is in line with most of the requirements of the *revised railways acquis*. Romania has partially met the Accession Partnership priorities in this area. The measures set out in the Action Plan are being implemented as planned.

Chapter 10: Taxation

Romanian law has been brought closer to the *acquis* in the areas of *VAT legislation and excise duties* although further extensive adjustments are still needed. Romania still has to ensure that existing and future legislation complies with the *principles of the Code of Conduct for Business Taxation*. As mentioned in the Action Plan, major initiatives have been launched to *modernise the tax administration and improve the revenue collection system*. The Action Plan also provides details of a programme, that has now been completed, to develop the norms and procedures necessary for *the organisation and administration of the Taxpayer Registry*. A *Tax Administration Strategy* was approved in February 2002. The Action Plan is also the basis for an on-going national programme for the *improvement of revenue collection*, and a programme to improve the form and the content of tax returns and to simplify the declaration procedures is due to be completed at the end of the third quarter of 2002. Work to *develop a Code of Ethics* by mid-2003 is continuing according to schedule. *Initial and continuous training* is provided at the School of Public Finance and curricula have been developed which cover the majority of the activities of the tax administration. Romania will need several years before it can *develop IT systems for the exchange of electronic data* and be in a position to meet the obligations of EU membership. Romania is therefore somewhat behind in this area. Overall, the Accession Partnership priorities in the area of taxation have been partially met. Implementation of the measures under the Action Plan is largely on track.

Chapter 12: Statistics

A *population census* was carried out in March 2002, and efforts have been made to *strengthen statistical capacities, including at regional level*. The regional statistical offices have been reorganised and concentrated into 8 offices, and training has been given a high priority with the opening of a new training centre for officials as foreseen in the Action Plan. However, total staff numbers have decreased and the lack of adequate resources, particularly human resources, remains a problem. The Accession Partnership

priorities in this area have been partially met. Implementation of measures under the Action Plan is largely on track.

Chapter 13: Social Policy and Employment

A national policy for employment has been defined and approved as scheduled in the Action Plan. Preparation for European Social Fund type activities has started and related training is ongoing. Similarly, actions aimed at strengthening the capacity of the National Agency for Employment have started, in line with the Action Plan, as has the reform of the social assistance system. Important pieces of secondary legislation have either already been adopted or are planned for before the end of 2002. No major progress has been made with improving the co-operation between local employment services and local social assistance services, and despite commitments given in the Action Plan these services remain understaffed and staff is insufficiently trained. The Action Plan objective of strengthening the capacity of the local employment services is due to be completed by the end of the year. With regard to alignment and proper enforcement of EC legislation in the fields of labour law, equal opportunity between men and women, health and safety at work, notably through the adoption of the new Labour Code, progress has been made in adopting legislation and preparing legislation and the administrative capacity of the Labour Inspectorates improved. The anti-discrimination law has not yet been implemented. In the field of public health, the national network for surveillance and control of the communicable diseases was reorganised but the main commitments taken in the Action Plan aiming at strengthening the capacity to manage health sector reform will not be completed before end of 2002. The legislation to strengthen social partners capacity has been partially adopted and training is being delivered, but in accordance with the Action Plan much remains to be done in the coming years. With regard to developing a national policy for future participation in the European strategy on social inclusion, work is continuing in line with the commitments made in the Action Plan. A new institutional framework is being created, and progress has been made with implementation of the Law on guaranteed minimum income, adoption of an anti-poverty strategy and preparation for the Joint Inclusion Memorandum. The Accession Partnership priorities have been partially met. Implementation of the measures under the Action Plan has started.

Chapter 14: Energy

Little progress has been made with developing and implementing an Energy Strategy in line with EU energy policy objectives. The priority given to energy efficiency remains low and Romania does not devote the necessary resources to improve this situation. The reorganisation of energy conservation bodies planned in the Action Plan has not had any measurable results. Romania has made significant progress in establishing an internal energy market. Utilities have been unbundled, progressive opening of the market is on track, and the regulatory body's independence has been strengthened. No substantial progress has been made with establishing strict and transparent financial discipline in order to phase in a programme of cost recovery and reduction of arrears. An action plan for improving bill collection has been adopted but it is not strictly implemented, and the problem of arrears remains a burden for the whole sector. Some progress has been made with the oil stock acquis - a monitoring system has been adopted and a financing scheme for increasing oil stocks has been defined, but still needs to be implemented. Most recommendations in the Council Report on Nuclear Safety in the Context of Enlargement have already been addressed and work is continuing on the others. Further efforts are

needed to *strengthen the resources and capacities of the national regulatory authority for nuclear safety*. Most measures in the Action Plan relating to nuclear issues are being implemented. Overall, the Accession Partnership priorities in the energy sector have been partially met. The implementation of measures under the Action Plan is slightly delayed.

Chapter 15: Industrial policy

A number of new measures have been taken to *improve the access of enterprises (particularly SMEs) to investment finance* including the establishment of the National Credit Guarantee Fund. The strategic document "Industrial Policy of Romania" and the corresponding Action Plan represent a *market-oriented competitiveness strategy including sectoral restructuring programmes*. Implementation measures have mainly focused on improving the business environment, attracting foreign investment and accelerating the privatisation process. The Accession Partnership priorities in the area of industrial policy have largely been met.

Chapter 19: Telecommunications and information technology

The adoption of legislation providing the regulatory framework is a major step towards *transposition of the acquis on telecommunications*, as foreseen in the Action Plan, and should allow Romania to meet its target date for full alignment with the *acquis* by the end of 2003. As regards *postal services*, legislation approved in January 2002 creates the general framework for postal service regulation and universal service provision. At the end of May 2002 the Government approved an Emergency Ordinance on the general framework for communications regulation. The legislation creates a *national regulatory authority* – the National Agency for Communications Regulation (ANRC). Romania is also implementing a programme designed to create the required administrative structures and capacity in order to ensure that the ANRC will be operational before the end of 2002, as foreseen in the Action Plan. The Accession Partnership priorities in the area of telecommunications and information technology have been met to large extent. Implementation of the measures under the Action Plan is largely on track.

Chapter 20: Culture and audio-visual policy

A new audio-visual law was approved in order to *align legislation with the acquis*, and actions were launched to *strengthen the capacities of the independent television/radio regulatory authority*. In line with the Action Plan, the upgrading of equipment in headquarters and local control offices is taking place as planned. The other planned actions, which include the training of staff, database restructuring, and the setting up of a department for protection of minors are due to start before the end of 2002. The Accession Partnership priorities in this area have been met. Implementation of the measures under the Action Plan is on track.

Chapter 21: Regional policy and co-ordination of structural instruments

The *national policy for economic and social cohesion* is neither fully defined nor *developed* in Romania. Nevertheless, the *National Development Plan was regularly updated and improved*. The timetable for the next programming exercise, foreseen in the Action Plan, has been modified due to the importance of the tasks to be achieved for moving towards an operational National Development Plan. As regards the *monitoring and evaluation system and the collection of relevant statistical indicators*, the measures foreseen in the Action Plan are scheduled for the end of 2003, so no progress can be

reported. The *strengthening of the institutional and administrative capacity in charge of programming and managing Structural Funds* has been partly carried out. A Managing Authority and a Paying Authority have been nominated, but there is not yet a *clear division of responsibilities at national and regional level*. Some improvement in *staff recruiting* does not compensate for the *lack of career profiles and sufficient training*. *Inter-ministerial co-operation* remains weak and difficult. Preparations to *comply with basic financial management and control provisions* are on-going. The Accession Partnership priorities in the field of regional policy and co-ordination of structural instruments have been partially met. Implementation of measures under the Action Plan is lagging behind.

Chapter 22: Environment

Substantial progress has been made with the *transposition of the acquis in the sectors of waste management, water quality, industrial pollution control and risk management*. However, implementation issues have not been sufficiently taken into account and *enforcement* is weak. Secondary legislation is needed to complete the implementation of horizontal legislation. The *elaboration of directive-specific implementation plans, including financing plans* has started but still needs to be completed. There has been no substantial progress in *improving capacities for policy preparation and economic analysis at the national level or with developing the enforcement capacity of the Environmental Protection Inspectorates at local level*. All entities remain understaffed and most of measures covered by the Action Plan have not yet started. Despite the re-activation of the Inter-Ministerial Committee, there has been no meaningful *integration of environmental protection requirements into sectoral policies*. The Accession Partnership priorities have not been met. Implementation of the measures contained in the Action Plan is delayed.

Chapter 23: Consumers and health protection

Alignment of legislation has continued, but progress in *strengthening market surveillance and enforcement authorities* is slow. The *implementation of the five-year strategy for the National Authority for Consumer Protection* has started as planned. The overall responsibility for a market surveillance system was given to the National Authority for Consumer Protection as laid out in the Action Plan, but the strengthening of its administrative capacity remains to be seen. Further improvement of information technology infrastructure and modernisation of decentralised laboratories have not been addressed yet. Overall, the Accession Partnership priorities have been partially met. The implementation of the measures under the Action Plan is largely on track.

Chapter 24: Co-operation in the field of justice and home affairs

The *legislation on the Romanian State Border and on the Organisation and Functioning of the Border Police* was adopted. *The use of conscripts as border police* is being rapidly phased out and the establishment of an Inter-ministerial Group for Integrated Border Management represents a first step towards *developing an integrated border management strategy*. The establishment of a National Anti-corruption Prosecution Office could help *improve the co-ordination between law enforcement bodies from prevention to prosecution* as foreseen by the Action Plan. However, the Office is not yet fully operational and Romania cannot be said to be *implementing an integrated strategy for the fight against corruption*. Due to delays in adopting the appropriate legal framework,

Romania's participation in EUROPOL is still pending. No progress has been made with *developing and implementing a national drugs strategy*. Romania has recently started to *establish a national focal point for contacts with the European Monitoring Centre on Drugs and Drug addiction*. Romania ratified the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime in August 2002. The measures contained in the Action Plan to *strengthen the administrative capacity of the National Office for Preventing and Fighting Money Laundering Operations* are in the process of being implemented. As foreseen in the Action Plan Romania presented a *Schengen Action Plan* in December 2001. This should be further elaborated in order to cover all areas included in the Schengen Convention. It will be monitored and updated on a yearly basis. Romania has also made progress with *alignment of visa legislation and practice* but does not yet fully comply with the *acquis*. Romania has taken a wide range of measures in order to *ensure the implementation of Community instruments in the area of judicial co-operation in civil matters*. However, Romania still needs to *align its legislation with the Convention on the Protection of the Communities' Financial Interests and its Protocols*. Overall, the Accession Partnership priorities have been partially met. The implementation of the measures under the Action Plan has started.

Chapter 25: Customs union

Romania has *continued efforts to implement the customs ethics policy* and at the beginning of 2002, the Code of Conduct and Discipline for Customs Staff was issued. An Inter-ministerial Group for Integrated Border Management has been set up to ensure communication and efficient co-operation between bodies with border control responsibilities. Objectives of the Group include *reducing waiting times at the border*. The Customs Administration co-operates on a permanent basis with bodies in charge of protecting intellectual and industrial property rights in order to *fight cross-border movement of pirated and counterfeit goods*. As set out in the Action Plan, a large number of co-operation protocols have been signed with various agencies, in order to *reinforce administrative and operational capacity in the field of customs enforcement*. *Centralised training has been developed* and, as stipulated in the Action Plan, a large-scale training programme is being implemented at both central and regional levels and covering both initial and in-service training. As regards computerisation, the Romanian customs administration has a clear *IT strategy* on how to achieve interoperability which it is in the process of implementing, and in accordance with commitments given in the Action Plan, Romania is making a sustained effort to *develop IT systems to permit the exchange of computerised data between the EC and Romania*. Overall the Accession Partnership priorities in this area have been met to a large extent. Implementation of the measures under the Action Plan is on track.

Chapter 28: Financial control

Romania has prepared and adopted a *Policy Paper on Public Internal Financial Control* covering managerial responsibility in budget spending centres, ex-ante controls performed by Ministry of Finance delegated financial controllers, and development of functionally independent internal audit structures. The Action Plan identified the need for significant further efforts to *define the organisational and human resource needs for effective implementation of public internal financial control* in all budgetary spending centres in accordance with the requirements of the Policy Paper. These efforts have been initiated, but substantial further work is needed. Efforts are continuing to *strengthen and*

modernise external audit procedures at the Romanian Court of Accounts in line with international standards and best practise. As regards protection of Community financial interests, an anti-fraud co-ordination service has been designated, and the further development of the legislative and administrative framework is underway, including the reinforcement of inter-institutional co-operation. While the accreditation of the SAPARD Agency represents progress as regards the correct use and financial control of EC pre-accession funds, significant further efforts will be needed to allow the introduction of extended decentralisation of the ISPA and Phare programmes. The Accession Partnership priorities have been partially met. The implementation of the measures under the Action Plan is slightly delayed.

Annexes

**Human Rights Conventions ratified by the Candidate Countries,
15 September 2002**

<i>Adherence to following conventions and protocols</i>	BG	CY	CZ	EE	HU	LV	LT	MT	PL	RO	SK	SI	TK
ECHR (European Convention on Human Rights)	X	X	X	X	X	X	X	X	X	X	X	X	X
Protocol 1 (right of property)	X	X	X	X	X	X	X	X	X	X	X	X	X
Protocol 4 (freedom movement et al.)	X	X	X	X	X	X	X	X	X	X	X	X	O
Protocol 6 (death penalty)	X	X	X	X	X	X	X	X	X	X	X	X	O
Protocol 7 (ne bis in idem)	X	X	X	X	X	X	X	O	O	X	X	X	O
European Convention for the Prevention of Torture	X	X	X	X	X	X	X	X	X	X	X	X	X
European Social Charter	O	X	X	O	X	X	O	X	X	O	X	O	X
Revised European Social Charter	X	X	O	X	O	O	X	O	O	X	O	X	O
Framework Convention for National Minorities	X	X	X	X	X	O	X	X	X	X	X	X	O
ICCPR (International Covenant on Civil and Political Rights)	X	X	X	X	X	X	X	X	X	X	X	X	O
Optional Protocol to the ICCPR (right of individual communication)	X	X	X	X	X	X	X	X	X	X	X	X	O
Second Optional Protocol to ICCPR (death penalty)	X	X	O	O	X	O	X	X	O	X	X	X	O
ICESCR (International Covenant on Economic, Social and Cultural rights)	X	X	X	X	X	X	X	X	X	X	X	X	O
CAT (Convention against Torture)	X	X	X	X	X	X	X	X	X	X	X	X	X
CERD (Convention on the Elimination of All Forms of Racial Discrimination)	X	X	X	X	X	X	X	X	X	X	X	X	O
CEDAW (Convention on the Elimination of All Forms of Discrimination against Women)	X	X	X	X	X	X	X	X	X	X	X	X	X
Optional Protocol to the CEDAW	O	X	X	O	X	O	O	O	O	O	X	O	O
CRC (Convention on the Rights of the Child)	X	X	X	X	X	X	X	X	X	X	X	X	X

X = Convention ratified
O = Convention NOT ratified

BG=Bulgaria; CY=Cyprus; CZ=Czech Republic; EE=Estonia; HU=Hungary; LV=Latvia; LT=Lithuania;
MT=Malta; PL=Poland; RO=Romania; SK= Slovak Republic; SV=Slovenia; T=Turkey

Statistical data

	1997	1998	1999	2000	2001
Basic data	in 1000				
Population (at 1 st of July)	22,546	22,503	22,458	22,435	22,408
	in km2				
Total area	238,391	238,391	238,391	238,391	238,391
National accounts	1000 Mio Lei				
Gross domestic product at current prices	252,926	373,798	545,730	800,308	1,154,126
	1000 Mio ECU/euro				
Gross domestic product at current prices	31.2	37.4	33.4	40.2	44.4
	ECU/euro				
Gross domestic product per capita f) at current prices	1,400	1,700	1,500	1,800	2,000
	% change over the previous year				
Gross domestic product at constant prices (nat. currency)	-6.1	-4.8	-1.2	1.8	5.3
Employment growth	-3.8	-2.3	-4.5	2.5	:
Labour productivity growth	-2.3	-2.5	3.5	-0.7	.
	in Purchasing Power Standards				
Gross domestic product per capita f) at current prices	5,100	5,000	5,100	5,500	5,900
Structure of production	% of Gross Value Added g)				
- Agriculture	19.6	15.8	14.7	12.2	14.6
- Industry (excluding construction)	33.5	29.1	27.7	28.2	28.5
- Construction	5.7	5.5	5.6	5.6	5.5
- Services e)	41.8	49.3	51.8	54.0	51.3
Structure of expenditure	as % of Gross Domestic Product				
- Final consumption expenditure	86.4	90.3	88.8	86.0	86.2
- household and NPISH	74.2	84.1	85.4	82.9	:
- general government	12.3	14.5	12.6	12.4	:
- Gross fixed capital formation	21.2	18.2	17.7	18.9	19.0
- Stock variation e)	-0.5	-0.4	-1.6	0.8	2.9
- Exports of goods and services	29.2	22.6	28.0	33.0	33.5
- Imports of goods and services	36.2	30.7	32.9	38.7	41.6
Inflation rate	% change over the previous year				
Consumer price index	:	59.1	45.8	45.7	34.5
Balance of payments	In Mio ECU/euro				
- Current account	-1,884	-2,647	-1,216	-1,471	-2,623 j
- Trade balance	-1,746	-2,341	-1,025	-1,823	:
Exports of goods	7,434	7,405	7,978	11,223	:
Imports of goods	9,180	9,747	9,003	13,047	:
- Net services	-365	-583	-393	-275	:
- Net income	-284	-394	-386	-304	:
- Net current transfers	511	672	587	931	:
-of which: government transfers	56	46	53	76	:
- FDI (net) inflows	1,071	1,812	977	1,110	:
Public finance	In % of Gross Domestic Product				
General government deficit/surplus c)	-4.5	-3.2	-4.5	-4.5	-3.4
General government debt	16.5	18.0	24.0	24.0	23.3

Financial indicators	in % of Gross Domestic Product				
	Gross foreign debt of the whole economy d)	24.1	19.3	23.2	21.3
	as % of exports				
Gross foreign debt of the whole economy d)	82.6	84.7	81.7	64.1	:
Monetary aggregates	as % of exports				
- M1	2.1	1.7	1.6	1.9	2.3
- M2	7.0	7.2	7.3	7.7	9.7
- M3	:	:	:	:	:
Total credit	5.7	6.8	6.0	4.9	5.9
Average short-term interest rates	% per annum				
- Day-to-day money rate	86.0	80.9	80.8	44.8	41.0
- Lending rate	72.5	55.4	65.7	53.8	45.4
- Deposit rate	55.7	37.3	45.8	32.9	26.6
ECU/EUR exchange rates	(1ECU/euro=.. Leu)				
- Average of period	8,112	9,985	16,345	19,922	26,004
- End of period	8,859	12,814	18,345	24,142	27,817
	1991=100				
- Effective exchange rate index	0.6	0.5	0.3	0.2	0.2
Reserve assets	Mio ECU/euro				
- Reserve assets (including gold)	2,780	1,981	2,455	3,637	5,514
- Reserve assets (excluding gold)	1,987	1,175	1,519	2,652	4,456

External trade	Mio ECU/euro				
	Trade balance	-2,596	-3,202	-1,979	-3,055	-4,688
Exports	7,481	7,381	8,055	11,365	12,685
Imports	10,077	10,583	10,034	14,420	17,373
	previous year = 100				
Terms of trade	101.2	105.1	103.8	103.5	102.0
	as % of total				
Exports with EU-15	56.6	64.5	65.5	63.8	67.8
Imports with EU-15	52.5	57.7	60.7	56.6	57.3

Demography	per 1000 of population				
	Natural growth rate	-1.9	-1.5	-1.4	-0.9	-1.8
Net migration rate (including corrections)	-0.6	-0.3	-0.1	-0.2	0.02
	per 1000 live-births				
Infant mortality rate	22.0	20.5	18.6	18.6	18.4
Life expectancy :	at birth				
Males:	65.2	65.5	66.1	67.0	67.7
Females:	73.0	73.3	73.7	74.2	74.8

Labour market (Labour Force Survey)	% of population				
	Economic activity rate (15 - 64)	71.5	70.3	69.8	69.6	68.3
Employment rate (15-64), total	67.2	65.9	65.0	64.2	63.3
Employment rate (15-64), male	73.4	71.9	70.4	69.5	68.6
Employment rate (15-64), female	61.1	60.1	59.7	59.0	58.2
Average employment by NACE branches	in % of total				
- Agriculture and forestry	40.9	42.0	44.0	45.2	44.4
- Industry (excluding construction)	26.0	24.8	23.4	22.1	21.8
- Construction	4.3	4.0	3.6	3.7	4.0
- Services	28.8	29.3	28.9	29.0	29.7
	% of labour force				
Unemployment rate. total	5.5	5.6	6.2	7.0	6.6
Unemployment rate. males	5.2	5.8	6.9	7.5	7.0
Unemployment rate. females	5.9	5.5	5.5	6.4	6.0
Unemployment rate of persons < 25 years	17.4	16.8	17.3	17.8	17.6
	as % of all unemployed				
Long-term unemployment share	48.0	43.8	45.2	49.2	48.6

Infrastructure	in km per 1000 km2				
Railway network	47.7	46.2	46.1	46.2	46.2
	km				
Length of motorways	113	113	113	113	113

Industry and agriculture	previous year = 100				
Industrial production volume indices	92.8a	86.2a	97.8a	107.6a	108.2ph
Gross agricultural production volume indices	103.4	92.5	105.2	85.8	:
Agricultural production indices of goods and services b)	:	:	104.0	85.2	122.7i

Standard of living	per 1000 inhabitants				
Number of cars	116.0	125.0	133.0	139.0	144.0
Main telephone lines	151.9	161.2	168.3	173.8	185.9
Number of subscriptions to cellular mobile services	9.0	24.5	50.1	90.0	205.0
Number of Internet subscriptions	:	:	:	:	:

P = provisional figures

- a) Indices are calculated at structure of 1995.
- b) "Agriculture production indices of goods and services" represent the volume index and it is calculated reporting the value of the agriculture production of goods and services for a certain "n" year, expressed in "n-1" year prices, to the value of the agriculture production of goods and services from the "n-1" year, expressed in "n-1" year prices. The name of the new indicator "Agriculture production of goods and services" was given in order to distinguish it from the old indicator "Gross agricultural production volume indices" which was referring to the gross production and it was not comprising the value of the agriculture services.
- c) Data not fully verified: statistical treatment of financial defeasance does not appear to be in accordance with ESA95 methodology. The impact on the deficit is not yet known.
- d) Series break after 1997.
- e) These figures include changes in inventories, acquisitions less disposals of valuables and the statistical discrepancy between the GDP and its expenditure components
- f) Figures have been calculated using the population figures from National Accounts, which may differ from those used in demographic statistics.
- g) Including FISIM.
- h) Indices are calculated at structure of 1998
- i) Semi-final figure
- j) Source: Website of the National Bank

Methodological Notes

Inflation rate

As part of the preparations for the common currency the EU Member States (MSs) have designed a new *consumer price index* in order to comply with the obligations of the EU Treaty. The aim was to produce CPIs comparable between Member States. The main task was to harmonise methodologies and coverage. The result was the Harmonised Index of Consumer Prices (HICP). A similar exercise has been started with Candidate Countries (CC). In respect to enlargement, it is equally important that their economic performance is assessed on the basis of comparable indices. Some progress has already been made towards adapting the new rules. Since January 1999 CCs report monthly to Eurostat so-called proxy HICPs that are based on national CPIs but adapted to the HICP coverage. They are not yet fully compliant with the HICPs of the MSs. In the table, the proxy HICPs are back-calculated to 1995 (rates from 1996).

Finance

Public finance: The government deficit and debt statistics of the Candidate Countries are provisional, in the sense that they do not yet fully comply with EU methodological requirements. Broadly speaking, the general government deficit / surplus refers to the national accounts concept of consolidated general government net borrowing / net lending of ESA95. General government debt is defined as consolidated gross debt at end-year nominal value. The series are available from 1997; the 1996 data are an approximation derived from the IMF's GFS methodology.

Gross foreign debt is of the whole economy, covering both short- and long-term, but excluding equity investment and money market instruments. The source for stock of outstanding debt is OECD, while the source of GDP is Eurostat. For the ratio of gross foreign debt to exports, the national accounts definition of exports of goods and services is used (source: Eurostat). The data for 2000 are Eurostat estimates, based on joint OECD/IMF/BIS/World Bank series.

Monetary aggregates are end-year stock data, as reported to Eurostat. Generally, M1 means notes and coin in circulation plus bank sight deposits. M2 means M1 plus savings deposits plus other short-term claims on banks. M3 means M2 plus certain placements in a less liquid or longer-term form. Not all countries produce an M3 series. Total credit means loans by resident monetary financial institutions (MFIs) to non-MFI residents.

Interest rates: Annual average rates based on monthly series reported to Eurostat. For Romania, lending rates refer to bank lending to customers other than banks (all maturities). Deposit rates refer to bank deposits of customers other than banks (all maturities). Day-to-day money rates are overnight interbank rates.

Exchange rates: ECU exchange rates are those that were officially notified until 1 January 1999, when the ECU was replaced by the euro. Euro exchange rates are reference rates of the European Central Bank. The effective exchange rate index (nominal), as reported to Eurostat, is weighted by major trading partners.

Reserve assets are end-year stock data, as reported to Eurostat. They are defined as the sum of central bank holdings of gold, foreign exchange, SDRs, reserve position in the IMF, and other claims on non-residents. Gold is valued at end-year market price.

External trade

Imports and exports (current prices). The data is based upon the special trade system, according to which; external trade comprises goods crossing the customs border of the country. Trade data excludes direct re-exports, trade in services and trade with customs free zones as well as licenses, know-how and patents. Value of external trade turnover includes the market value of the goods and the additional costs (freight, insurance etc.). The term FOB means that all costs incurred in the course of transport up to the customs frontier are charged to the seller. The term CIF means that the purchaser pays the additional costs. Exports are recorded here on FOB basis and imports on CIF. External trade includes all exchanges of goods between Romania and other countries having as its objective: import of goods directly for consumption, imported goods taken out of customs warehouses or free zones in order to be consumed, export of national products as well as export of imported goods declared for domestic consumption and imported goods under financial leasing system. The goods are classified according to the Combined Nomenclature on which the customs tariff is based. Value of export data is given in FOB external effective prices for exports and in CIF for imports. External trade statistics are customs statistics, values being registered in USD. Data for 1999 are provisional and can be rectified due to delayed arrival, modification or cancellation of customs declarations from previous periods.

Terms of trade. The indices are calculated yearly by the „unit value” method (Paasche index).

Imports and exports with EU-15. Data declared by the Republic of Romania.

Demography

Net migration rate. Crude rate of net migration (recalculated by EUROSTAT) for year X, is: population (X+1) - population (X) - Deaths (X) + Births (X). This assumes that any change in population not attributable to births and deaths is attributable to migration. This indicator includes therefore also administrative corrections (and projection errors if the total population is based on estimates and the births and deaths on registers). Figures are in this case more consistent. Further, most of the difference between the Crude rate of net migration provided by a country and the one calculated by Eurostat is caused by under reporting or delay in reporting of migration.

Labour force

The European Labour Force Survey is conducted in spring each year in accordance with Council Regulation (EEC) No. 577/98 of 9 March 1998. A detailed description of the sampling methods, the adjustment procedures, the definitions and the common Community coding currently used in the labour force survey is presented in the publications ‘Labour Force Survey – Methods and definitions, 1998’ and ‘Labour Force Survey in central and east European countries – Methods and definitions, 2000’.

All definitions apply to persons aged 15 years and over, living in private households. The concepts and definitions used in the survey follow the guidelines of the International Labour Organisation. Persons carrying out obligatory military service are not included.

Persons in employment were those who during the reference week did any work for pay or profit for at least one hour, or were not working but had jobs from which they were temporarily absent. Family workers are included. For self-employed and unpaid family workers from agriculture, the minimum duration is 15 hours.

As from 2001 (Commission Regulation (EC) No 1897/2000 of 7 September 2000), unemployed persons comprise persons aged 15 to 74 who were:

- (a) without work during the reference week, i.e. neither had a job nor were at work (for one hour or more) in paid employment or self-employment;
- (b) currently available for work, i.e. were available for paid employment or self-employment before the end of the two weeks following the reference week;
- (c) actively seeking work, i.e. had taken specific steps in the four weeks period ending with the reference week to seek paid employment or self-employment or who found a job to start later, i.e. within a period of at most three months.

Comparability with results prior to 2001: unemployment results used to refer to persons aged 15 and more. Persons who found a job to start later used to be considered as unemployed with the unique condition to have no job in the reference week; however, the new condition on time limit of at most three months is not yet applied.

Duration of unemployment is defined as:

- (a) the duration of search for a job, or
- (b) the length of the period since the last job was held (if this period is shorter than the duration of search for a job).

The active population is defined as the sum of persons in employment and unemployed persons.

Inactive persons are those who are not classified as persons in employment nor as unemployed persons.

Employment rates represent employed persons aged 15-64 as a percentage of the same age population.

Unemployment rates represent unemployed persons as a percentage of the active population aged 15 years and more.

Economic activity rates represent the active population aged 15-64 as a percentage of the population of the same age.

Infrastructure

Railway network. All railways in a given area. This does not include stretches of road or water even if rolling stock should be conveyed over such routes; e.g. by wagon-carrying

trailers or ferries. Lines solely used for tourist purposes during the season are excluded as are railways constructed solely to serve mines; forests or other industrial or agricultural undertakings and which are not open to public traffic. The data considers the construction length of railways.

Length of motorway. Road, specially designed and built for motor traffic, which does not serve properties bordering on it, and which:

(a) is provided, except at special points or temporarily, with separate carriage ways for the two directions of traffic, separated from each other, either by a dividing strip not intended for traffic, or exceptionally by other means;

(b) does not cross at level with any road, railway or tramway track, or footpath;

(c) is specially sign-posted as a motorway and is reserved for specific categories of road motor vehicles.

Entry and exit lanes of motorways are included irrespectively of the location of the signposts. Urban motorways are also included.

Industry and agriculture

Industrial production volume indices. Since 1996, IPI is computed based on a sample of representative products, constituted in series-witness, for which quantitative and value data are collected, these covering 76% of total industrial activity. The successive aggregation of industrial production indices are compiled using a system of constant weights, which corresponds to the structure by activities of the gross value added at the cost of factors from the base year. Starting with 1998, the base year is 1995. Data for 1996 and 1997 are recalculated using the 1995 weights. Data on industrial production are provided by all the enterprises with 50 employees and over, having industry as the main activity. For the food industry due to its specific, smaller economic units (20-49 employees) these are also sample surveyed, as well as those having agriculture as their main activity but with industrial subunits specialised in the manufacture of food products. Units belonging to handicraft and consumption co-operatives which are surveyed only yearly are not included. Indices are not adjusted.

Gross agricultural production volume indices. Indices based on evaluation of all individual products of gross agricultural production in constant prices of the year preceding the examined one. Data for 1999 are provisional.

Standard of living

Number of cars. Passenger car: road motor vehicle, other than a motor cycle, intended for the carriage of passengers and designed to seat no more than nine persons (including the driver).

The term "passenger car" therefore covers microcars (need no permit to be driven), taxis and hired passenger cars, provided that they have less than ten seats. This category may also include pick-ups. Passenger cars exclude minibuses.

Telephone subscribers. Phone subscriptions include subscriptions of natural and legal persons (including subscriptions for fax and mobile phones).

Sources

Total area, external trade, infrastructure, demography, industry and agriculture, labour market, standard of living (except Internet connections): National sources.

National accounts, inflation rate, balance of payment, public finance, finance: Eurostat.

EXHIBIT C



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Country: Romania
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Major Trends and Outlook

Romania's transition to a market economy has been protracted and painful. The legacy of the communist regime, centralization, a high degree of bureaucracy, and no experience of partial reforms such as those undertaken in other Central European economies during the 1980s left Romania with one of the longest paths toward a market economy.

The successive governments which ruled the country between December 1989 and November 2000 avoided serious economic reform, fearing "shock therapy" and its anticipated social costs, mainly the attendant mass lay-offs. In spite of drawing up several reform packages meant to establish clear restructuring and privatization procedures, eliminate subsidies, establish a more efficient banking system, introduce a modern tax system, and, most importantly, encourage foreign investment, they lacked the courage and, ultimately, the will to implement reform. Lenient government attitude towards the accumulation of arrears by state-owned enterprises coupled with inefficient bankruptcy procedures indirectly subsidized unprofitable behavior while good corporate governance was undermined by vested interests. This practically paralyzed whole segments of the economy. An unpredictable investment climate together with lack of labor mobility, a weak tax base, and bad loan portfolios at banks inhibited the growth of the new private sector.

Especially slow was the progress in industry restructuring and privatization. At the end of 2000, although 7,244 out of a total of 8,472 state firms had been privatized, the state sector still accounted for 68.3 percent of industrial production. This was due to the fact that 80 percent of Romania's industrial core (mining, iron-and-steel, aluminum, power generation, oil processing, transportation, etc.) still remain in state hands, awaiting privatization or liquidation. Large successful privatizations in 2000 included just Braila Shipyard, Tulcea Shipyard, aircraft manufacturer Aerostar Bacau, bearing manufacturer Rulmenti Barlad, oil refinery Petromidia, and oil drilling equipment manufacturer Upetrom. Privatization of state farms, which cover 10 percent of Romania's agricultural land, has not fared better: gaps in privatization regulations and the negative influence of special interest groups have slowed the process considerably.

In spite of difficulties, and after years of contraction, Romania's economy started an upward trend in 2000. The GDP grew 1.6 percent vs. 1999, to \$36,724.9 million, although the agricultural year was bad. Industrial output increased by 8.2 percent over 1999 levels. The most dynamic growth was registered in ready-made clothes (+54 percent), machines and equipment (+28 percent), chemicals, synthetic fibers and yarns (+24 percent), and steel (+22 percent). The energy sector was up 9.4 percent, the processing industry, 8.9 percent, and the extractive industry, 7.3 percent. Decreases were recorded for electronics, radio-TV and communications equipment (74 percent), and road transportation means manufacturing (22 percent). In the agricultural sector (forestry and fisheries included), total output registered a fall of 15.8 percent, primarily due to severe drought. Significant reductions in livestock and poultry inventories led to lower levels of meat and poultry output. During the first seven months of 2001, the positive trend in industrial production continued. Agriculture, too, is expected to perform better in 2001, which will contribute to a further increase in the GDP.

The domain of foreign trade registered dramatic disruptions during the 1990's. The decrease in domestic production, the dissolution of the Comecon market, and the costs of observing U.N. sanctions against Iraq and Serbia (two of Romania's traditional trading partners) were the main factors causing a sharp decline in Romanian exports and a significant increase in the country's balance of trade deficit. However, in 2000 exports reached \$10,366.5 million (FOB), which represents a 21.9 percent increase versus 1999. The largest shares were textiles and apparel (24 percent), iron and steel products (16 percent), electric machinery and equipment (14 percent), and footwear (8 percent). This positive trend in export performance is expected to continue.

Romania's economy relies heavily on imports, of which up to 50 percent are raw materials (mainly oil and gas). Romania is also a net importer of minerals, machinery and electrical devices, cotton, and hides. Since 1990, imports of food products and consumer goods have been significant. In 2000, imports were up 25.6 percent versus 1999. CIF imports reached \$13,054.5 million, of which 57 percent came from European Union countries, 20.5 percent from Eastern and Central Europe, and 12.9 percent from developing countries. The balance of trade deficit in 2000 was \$1.7 billion in FOB/FOB prices and \$2.7 billion in FOB/CIF prices.

Trade relations with the United States have been strengthened by the U.S. - Romanian trade agreement (1993), the bilateral investment treaty (1994), and the August 1996 granting of unconditional MFN treatment. In 2000, the United States ranked seventh in Romanian imports (after Italy, Germany, Russia, France, U.K. and Hungary) and sixth in Romanian exports (after Italy, Germany, France, Turkey, U.K.). According to U.S. Department of Commerce statistics, U.S. exports to Romania increased by 32.09 percent versus 1999, reaching \$233 million. They were led by machinery (85.4 million), aircraft (33.2 million), optic and medical instruments (26.5 million), and mineral fuel (22.9 million). U.S. imports from Romania increased by 6.21 percent versus the previous year, reaching \$470 million. They were led by iron and steel products, apparel, machinery, footwear, and furniture.

Principal Growth Sectors

Information and Communication Technology - The ICT sector is probably the

most dynamic component of the country's economy, and definitely one that is receiving priority attention from the government. To emphasize the importance of the sector, the government has created an ICT Promotion Group headed by the Prime Minister. It started its activity in March 2001, and one of its main tasks is to examine and approve all major ICT projects initiated by public institutions or national companies. Already 22 such projects have been approved and will be opened to international tenders. They range from the modernization of wireless communications and TV networks to developing broadband applications, to introducing e-government, e-commerce and e-procurement, to providing Internet access to thousands of schools. The growth of the sector will be closely linked to the full deregulation of the telecom market as of January 1, 2003. In the fall 2001, the Ministry of Communications and IT will launch tenders for two licenses for wired telephony and four licenses for 3G telecommunications. Investment associated with creating these new national wired-telephony and 3G networks will amount to several billion dollars. The rapid growth of the whole sector will be also sustained by the strength of Romania's large pool of highly skilled labor in engineering and electronics manufacturing, as well as by its high number of software developers. Of the country's approximately 2000 software development companies, half are already exporting part of their services to Western European and American markets. As of July 1, 2001, IT companies enjoy salary tax exemption for IT specialists whose activity produces an annual revenue in excess of \$10,000.

Power Generation - In 2000, Romania produced 51.578 GWh electricity, of which 60.5% was produced by thermal power plants, 28.5% by hydropower plants, and 11% by the Cernavoda nuclear plant. The Romanian Government's policy aims to increase power output via upgrading existing facilities. Total investment over the next 10 years will amount to \$12-15 billion. The investments would mainly target the completion of the second unit of Cernavoda nuclear plant (\$750 million), the completion of hydropower plants, and the rehabilitation of thermal power plants.

Agribusiness - With 15 million hectares agricultural land, and excellent conditions for a wide variety of crops, as well as for animal production, farming can be a source of substantial wealth for Romania. Currently, 90 percent of the sector is in private hands. Of the 700 state farms awaiting privatization, 300 are scheduled to be sold by the end of 2001, and the balance by end 2002. After years of structural and managerial problems coupled with lack of adequate access to credits, the sector is receiving more attention. In addition to implementing a system of subsidies for specific products to stimulate production, the government has also developed, in cooperation with the World Bank, a plan for the rehabilitation of approximately 1.5 mil hectares in drought-prone areas. By financing the building of small irrigation modules, the irrigation rehabilitation and reform project will give an impulse to farming in the respective areas. There are also projects meant to encourage an increase in the number and quality of agricultural equipment used by individual farmers. The food-processing industry has known a dynamic growth, and it was one of the first sectors to be tapped by foreign companies, which formed a large number of joint ventures with local Romanian enterprises. As the Romanian market for food products becomes more sophisticated and demanding, foreign investment in agribusiness will have a greater role to play.

Real Estate Development – Since the mid-1990s, the sector has been booming. The most impressive growth was recorded in the construction of stand-alone

houses, especially in residential areas of large cities or in tourist resorts, for the use of the country's newly rich. Modern office buildings, including class A office space, have also proliferated, especially in Bucharest and a few other large cities. Many developers have taken advantage of the privatization process to buy large well-located idle industrial facilities that present great potential for further industrial, retail or warehousing development. Probably the most important segment of the market, which is still in an incipient stage, will be represented by urban developments to be built with the support of the government, in a large number of cities, under the provisions of the mortgage law. Almost all municipalities have drawn plans for such developments, and foreign investors are welcome to compete for their implementation. So far, real estate developments by foreign investors have concentrated on office space. Such investment proved to be successful, with high returns, rapid growth of invested capital, rental payments indexed to stable foreign currencies and occupancy by the highest quality international tenants. As this segment of the market is currently threatened by an oversupply, the foreign investment market is now focussing on small to medium-size properties with prices in the range of \$1-2 million. These properties are used as offices mostly by medium-size international companies and can offer annual returns of 18-22 percent. During the next two years, the Romanian market is expected to continue to witness major real-estate transactions as the country risk is decreasing and more foreign business is expected to come to Romania.

Services - Although the services sector has undergone rapid change since 1990, it is far below Western standards. As the Romanian economy develops, and especially in view of the changes that will be brought about by the information society, the following services are expected to register the fastest growth: banking, insurance, accounting, auditing, legal and financial consulting, advertising and media development. The development of the tourist industry will generate an increase in the market for hotel and restaurant services and leisure activities. Several large Western companies specializing in consulting, legal services, accounting, auditing, and advertising are already offering their services in Romania.

Government Role in the Economy

In the complex process of transition to a market economy, the government has an essential role to play in creating the legal framework for the structural and systemic changes meant to foster economic reform.

Completing the **restructuring and privatization** of the economy is currently the government's main task. Industry restructuring aims at reducing losses in the economy and it implies, among other things, a correct approach to the problem of arrears. A structural reform plan drafted by the previous government in cooperation with the World Bank aimed at reducing losses in the economy by 30 percent. In USD equivalent, total arrears at the end of October 2000 amounted to \$2.2 billion. However, failure to address the problems of some of the largest loss-makers, coupled with the government's decision to extend new direct support to companies slated for restructuring, have resulted in the first half of 2001 in a continued growth of losses. In short, despite limited progress in some areas, there has been no change in the pattern of accumulating additional inter-company and budgetary arrears. Social considerations prevailing over economic reasoning, the government granted debt rescheduling or forgiveness to highly indebted state companies (such as the National Tobacco Company). Large loss-

makers (such as "Tractorul" Brasov) have enjoyed sovereign guarantees and piecemeal deals (custom duty and VAT exemptions for imported equipment).

A new EU-inspired law on state aid came into effect in January 2000, aiming to regulate and keep under control state aid in any form (as either direct state subsidies, debt rescheduling schemes, or discount prices). However, implementation has been slow and preferential debt rescheduling by the Ministry of Finance and the Ministry of Labor has resulted in major distortions on the market. Furthermore, state aid schemes continue to be non-transparent.

During its first seven months in office, Romania's current government has used a rhetoric that strongly supports the idea of fast privatization. Yet, in actual fact, institutional reorganization (the creation of a new Privatization Authority to replace the State Ownership Fund and the division of responsibility for privatization among the Privatization Authority, pertinent economic ministries, and local administrations) has slowed privatization down. Moreover, the new government tends to preserve state ownership in the companies deemed profitable and to allocate resources to investigations into past privatizations rather than complete new ones. The government promises that, with the assistance of the World Bank's Private Sector Adjustment Loan (PSAL), which has been recently reactivated, 64 large state-owned enterprises will be privatized within a year. Attracting foreign investors remains the goal of the privatization process.

When restructuring and privatization are completed and the basic elements of a market economy are in place, the government's role in the economy will diminish. In the meantime, the government plays an extremely important part in the economy.

Balance of Payments Situation

Romania's consolidated budget for 2001 anticipates receipts of \$12,398.4 million and expenditures of \$14,484.8 million. The programmed deficit for 2001 has been set at \$2,086.4 million, up 5.0 percent from 2000. Revenues to be generated by privatization (estimated at \$280 million) and by the recovery of bad loans (estimated at \$87.6 million) will be used for partial payment of domestic public debt (T-bills amounting to \$1,085.8). The budget also provides for significant increases in social benefits, subsidies, and funds for education, infrastructure, and the intelligence services. In spite of excise tax hikes, the weight of indirect taxes in the budget decreases to 38.1 percent, while direct taxes are projected to generate a majority of revenue due to higher social security contributions. The corporate income tax brings lower revenues (7.3 percent) than the personal income and wage tax (9.2 percent combined).

Romania's current account for 2000 posted a deficit of \$1.4 billion, up from \$1.3 billion in 1999. Current account deficits are financed largely via loans and grants from international financial institutions (IFOs) and bilateral donors.

At the end of February 2001, Romania's medium and long-term external debt amounted to \$9.9 billion, while the short-term debt amounted to \$355.3 million. Romania's most important IFO creditors were the World Bank (\$1,996.7 million), the EBRD (\$785.0), the IMF (\$437.9 million) and the EU (\$205.1million). Main foreign government creditors included Germany (\$291.3 million), Canada (\$174.5 million), Japan (\$108.0 million), Italy (\$42.6 million), and the United States (\$40.1

million). U.S. credits consisted mostly of loans granted by USDA (with the GSM Program having a large share) and loans through the U.S. Eximbank.

As of end-February 2001, the National Bank's foreign currency reserves stood at \$2.6 billion (\$3.5 billion, gold and SDRs included) and the commercial banks' reserves reached \$4.1 billion. At the same time, Romania registered \$361.0 million short-term commercial claims against foreign countries, plus claims worth \$3.0 billion from economic transactions prior to December 1989.

During the year 2000, Romania received limited financial assistance from IFIs. The World Bank's Agriculture Structural Adjustment Loan (ASAL) was finished in December 2000, after Romania received \$300 million, losing the last tranche due to failure to privatize all state-owned farms. The World Bank's Private Sector Structural Adjustment Loan (PSAL1 - \$300 million) was fully consumed, and both tranches released. The government is prepared to discuss the conclusion of PSAL 2, also in the amount of \$300 million. To conclude an agreement, the government must continue the privatization of state-owned banks (BCR), complete the liquidation/restructuring program started within PSAL1, privatize at least 30 large firms, set a target for arrears and loss cuts, and improve the business environment.

In June 2000, the IMF acknowledged significant improvements in Romania's external position, as a result of strengthened policies introduced to avert a financial crisis: large reduction of the current account deficit, a strong rebound in exports, and a steady recovery of foreign exchange reserves. The strengthened policies that generated this adjustment were laying the basis for renewed growth and declining inflation. As a result, the Executive Board of the IMF approved during the June 2000 meeting the extension of the credit to February 28, 2001. However, policy slippages, with respect to the performance targets on the reduction in domestic arrears and keeping public sector wages under tighter control, prevented the conclusion of the second review under the stand-by arrangement and the approval of a new letter of intent with the current government for a new stand-by agreement. With increased foreign exchange reserves and lower current account deficits, Romania would need a new accord with the IMF only in order to improve its image on the international capital markets (with an effect on foreign direct investment and borrowing terms).

Romania has sought to diversify its sources of external financing. In November 2000, the government resumed the tapping of international private capital markets, with a Eurobond issue in the amount of EUR 150 million, with a maturity of five years, at an annual interest of 11.5 percent. The issue was brokered by ING Barings and Schroeder Salomon Smith Barney. In March 2001, the issue was re-opened with Deutsche Bank and JP Morgan for another EUR 150 million, also with a maturity of five years, at an annual interest rate of 11.25 percent.

Unfortunately, Romania's international country risk ratings do not make it easy for the country to borrow from the private international credit market. Romania's current international credit ratings are: Fitch IBCA: long-term foreign currency rating of Romania to 'B' from 'B-' (B minus); long-term local currency rating to 'B' from 'B-' (B minus) while the Short-term foreign currency rating remains unchanged at 'B'. The Long-term rating Outlook is stable; Moody's: B3 for long-term bonds and Ca1 for long-term bank deposits; Standard & Poor's revised Romania's long-term foreign and local currency ratings to positive from stable; Single 'B' minus long-term foreign currency credit; Single 'B' long-term local currency credit; 'C' short-term foreign currency credit and debt; 'C' short-term local currency credit. In May 2001, the GOR assigned Credit Suisse First Boston and JP Morgan to broker an Eurobond issue in amount to USD 500 million with a maturity of seven years. Targeted interest will be in the range 11.5 percent-11.7 percent.

Infrastructure Situation

Transportation - Due to its strategic location at the crossroads of Europe and Asia, Romania has the potential to become one of the busiest transport areas in Central and Southern Europe. Improving the condition of the country's road network, restructuring railways, and upgrading the seaport of Constanta have become imperative.

Romania has a network of public roads totaling 198,589 kilometers, out of which 14,810 km are national roads which carry 65% of the total road traffic, 36,000 km are county roads, and the rest

local roads. Only 114 kilometers are motorways, and only 5,600 kilometers are classified as European-class roads. This is an inadequate road network under the current conditions, when total traffic on main Romanian roads has increased by about 60 percent and international traffic by about 300 percent. To improve the condition of the road network, Romania has obtained loans from multilateral lending institutions for the following major projects in this sector:

- First two phases of the national road rehabilitation program (\$ 692 million). The project provides for the rehabilitation of 1,725 km of national roads, is funded by the World Bank, EBRD, and the European Investment Bank and is almost completed;
- Border crossing upgrading (\$ 10,5 million funded by EU-PHARE).
Six main border-crossing points are already modernized to ensure adequate flow of international road traffic;
- Road safety (\$ 14,2 million). This includes signing and marking of about 5,000 km of roads designated as European;
- Rehabilitation of Bucharest-Pitesti motorway (96 km, \$ 90 million).

Additional infrastructure projects have been discussed with the World Bank, EBRD, and EU-PHARE for motorway extension and building a new bridge over the Danube at Calafat-Vidin, along the Pan-European Transport Corridor IV.

The Romanian Government supports the redesigning of the Pan-European Corridor IV crossing Romanian territory from West to East and Pan-European Corridor IX, which crosses Romania from North to South and connects the Republic of Moldova and Bulgaria. The objectives for the next ten years include the complete rehabilitation of 5,600 km of European class roads with funding supplied through international loans coupled with foreign grants and local funding, the modernization of another 1,550 km of national roads (valued at \$ 4,300 million) with government and municipalities funding, and the resumption of the motorway building program (especially Pan-European Transport Corridor IV, from the port of Constanta to the Western border, and the links with Corridor IX, Bucharest-Giurgiu and Bucharest-Siret).

Romania's plans for the construction of new motorways in the next 10 years cover 10 sections located along Corridor IV, with a total length of 580 km, and require \$ 3.6 billion.

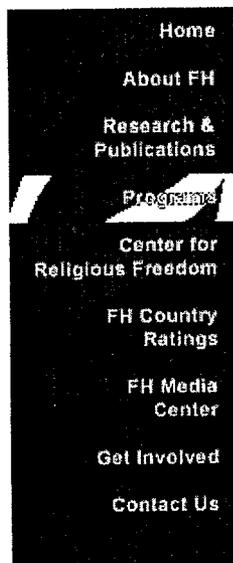
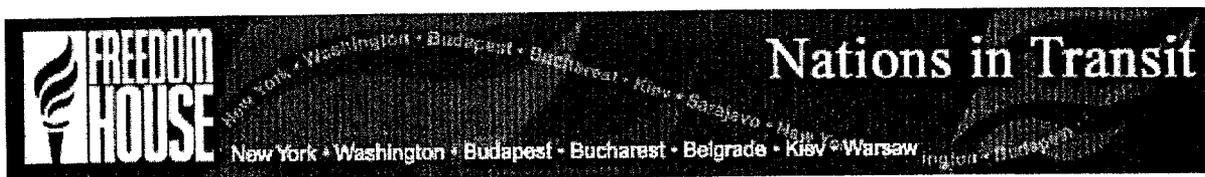
Romanian railways rank seventh in Europe in freight tonnage with about 18 million kilometer - tones transported yearly. In 2000, the Romanian National Railway Company (SNCFR) owned about 11,365 kilometers of track (out of which 45 percent is electrified), about 65,000 freight cars, 4,300 passenger coaches and 1,900 electric/diesel locomotives. It employed about 105,000 people. SNCFR has recently launched an ambitious rehabilitation program until 2004, providing for the refurbishing of 2000 passenger coaches, 7,300 freight cars, 170 locomotives, and procurement of track maintenance and needed spare parts. Railway modernization projects, which include the extension of the Bucharest subway network, enjoy the support of the World Bank, EBRD and EU-PHARE.

Telecommunications - Romania's telecommunications system has been deregulated, expanded, and modernized to a great extent during the last ten years. Public operators have been granted autonomy and are scheduled to be fully privatized; private operators have proliferated in mobile telephony, CATV, radio/TV broadcasting, data transmission, and VSAT communications.

Basic telephony services are still the monopoly of the national operator Romtelecom, but as of January 2003 they will be liberalized. Romtelecom was partially privatized in late 1998, when OTE, the Greek national operator, bought 35 percent of its shares. Romtelecom has about 4.5 million lines, of which 60 percent are digital. The average wire-based teledensity is 17 percent (30 percent in urban areas, but only 4 percent in rural areas, where some 2,000 villages still have no telephone service at all). Romtelecom's projects for the year 2001 include further digitalization of its network, the launching of such services as ISDN, Voice over IP, XDSL, and the setting up of its own Internet service provider (ISP).

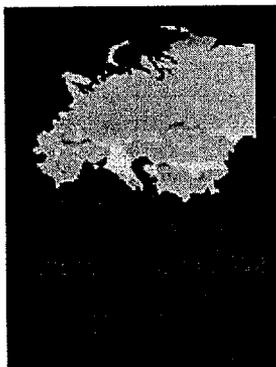
Wireless communications. Radiocom is the national radio-communications operator. It provides broadcasting and data transmission services through its national microwave network (partially digital), national radio and TV transmitters and transponders network, and satellite earth stations (fully digital). It also provides transmission capacities for public and mobile telephony, paging, trunked radio, cable TV, and data transmissions. Cellular services (NMT 450), nation-wide paging and VSAT services are offered through joint venture operations. In early June 2001, Radiocom inaugurated Romania's first pilot project for point-multipoint data transmission in the 26 GHz

EXHIBIT D



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ROMANIA



Polity: Presidential-parliamentary democracy

Economy: Capitalist-statist (transitional)

Population: 22,400,000

GNI per capita at PPP \$ (2000): 6,360

Capital: Bucharest

Ethnic Groups: Romanian (90 percent),

Hungarian (7 percent),

other, including German and Roma (3 percent)

Size of private sector as % of GDP (mid-2001): 65

The scores and ratings for this country reflect the consensus of Freedom House, its academic advisors, and the author of this report. The opinions expressed in this report are those of the author.

↕↕ and ↗↗ indicate score changes of .25 or more. ↘ and ↗ indicate changes of less than .25.

NATIONS IN TRANSIT SCORES

	1997	1998	1999-2000	2001	2002
Democratization	3.95	↗ 3.85	↗↗ 3.19	↘ 3.31	3.31
Rule of Law	na	na	4.25	↘ 4.38	↘ 4.50
Economic Liberalization	4.63	↗ 4.50	↗↗ 4.17	↗ 4.00	↗ 3.92

KEY ANNUAL INDICATORS

	1995	1996	1997	1998	1999	2000	2001
GDP per capita (\$)	1,564.2	1,562.9	1,564.8	1,858.9	1,563.4	1,644.4	1,743.3
Real GDP growth (% change)	7.1	3.9	-6.1	-5.4	-3.2	1.6	4.0
Inflation rate	32.3	38.8	154.8	59.1	45.8	45.7	34.2
Exports (\$ millions)	7,910.0	8,061.0	8,431.0	8,302.0	8,503.0	10,366.0	11,560.0
Imports (\$ millions)	9,487.0	10,555.0	10,411.0	10,927.0	9,595.0	12,050.0	14,450.0
Foreign Direct Investment (\$ millions)	417.0	415.0	1,267.0	2,079.0	1,025.0	1,009.0	900.0
Unemployment rate	9.5	6.6	8.9	10.3	11.8	10.5	8.6
Life Expectancy (years)	69.5	69.1	69.0	69.3	69.8	69.9	71.0

INTRODUCTION

In 2001, after much stagnation and confusion, Romania made the most out of a situation that had seemed nearly hopeless the year before. When the incumbent President Emil Constantinescu refused to seek reelection at the end of 2000 and the ruling coalition fielded no fewer than four different presidential candidates, it became clear that the political bickering and infighting among democratic forces would severely curtail their power. What was less obvious, however, was the extent to which voters would penalize these forces by throwing the ruling Christian Democratic Peasant Party (PNTCD) out of Parliament. Consequently, the last round of the presidential election pitted a former Communist and an ultranationalist against each other. Given the circumstances, it is fortunate that the former Communist won.

As a result, 11 years after the fall of Nicolae Ceausescu, Romania is again governed by some of the very same players—initially of suspect democratic credentials—who took power following the December 1989 revolution. Ion Iliescu, reelected for the third time in 2000, first became president in 1990; Adrian Nastase, the current prime minister, was foreign affairs minister between 1990 and 1992. In addition, Defense Minister Ioan Mircea Pascu, Minister of Public Administration Octavian Cozminca, President of the Senate Nicolae Vacaroiu, and many others held positions in the first or second Iliescu governments between 1990 and 1996.

However, times have changed, and some of the players seem to have changed their ways. For instance, the reconciliation between President Iliescu and the former king, who in 1990 was thrown out of the country at gunpoint, took everybody by surprise. Some call it masterful theatrics, others a stroke of political genius. Either way, some observers remain skeptical about the depth and sincerity of the democratic conversion and the efficacy of democratic give-and-take in a country that now has only a feeble opposition.

To be sure, there are bright faces in the government and eager professionals in the president's office. Also, one hopes that the political veterans who head the two chambers of Parliament grew wise during their four years as the opposition. As in many other Eastern European countries, a leftist party has returned to power and is now responsible for consolidating the country's democratic institutions and for pushing toward rapid integration into Euro-Atlantic structures, namely the European Union and NATO.

Given the international situation after September 11, 2001, and in light of the achievement of some long overdue domestic reforms, it is likely that Romania will join NATO sooner or later. More problematic, however, remains Romania's integration into competitive European and global economic structures. Part of the problem rests precisely in the ideological pedigree of some members of the current

leadership, for whom economic liberalism seems a constraint of international politics rather than a necessity born out of the conviction that free, competitive markets are desirable engines for growth and human development. In spite of an important economic comeback, Romania remains a laggard in terms of liberalization, privatization, and economic restructuring. Almost 40 percent of the economy is still in state hands, and about 25 percent of the industrial sector is owned by five so-called investment funds that sometimes manage assets based on political clientelism rather than economic efficiency.

The true test for Romania's new leadership will be its ability to relinquish the economic privileges of the state and thus cut deeply into the political support it receives from the country's current political elite. That is, the government's liberal and democratic credentials will be tested on the basis of genuine acceptance of fair and open competition over favoritism and political clientelism.

DEMOCRATIZATION

Political Process

1997	1998	1999-2000	2001	2002
3.25	3.25	2.75	3.00	3.00

In 2001, two key political events changed Romania's domestic picture and international standing. The first was a domestic phenomenon: all the main political parties with the exception of the ultranationalists and the Hungarian Party, changed their leaderships. Today, a new generation of younger politicians is in command. From the political Left to the Right, these parties include the Social Democratic Party (PSD), the Democratic Party (PD), the National Liberal Party (PNL), and the PNTCD (the former ruling party). The second event was an international breakthrough. For the first time ever, Romania held the chairmanship of a key international organization: the OSCE. Coincidentally, the president of the OSCE's Parliamentary Assembly is also a former Romanian foreign affairs minister.

As the European Union has noted, Romania's political system is relatively stable. Yet stability comes not from a balance of political forces, but from a tendency to confuse the interests of the ruling party with those of the state. The fact that now, as before 1996, the ruling party is the heir of the former Communist Party occasionally keeps Romania stuck in old "command and control" solutions that have been proven unworkable elsewhere. The ruling establishment still appears to consider statism, centralism, and political clientelism as the most expedient means of achieving its goals. In short, the Romanian political system tends to be inclined more toward a dominant-power model than toward a consolidated democratic one.

Unlike other former Communist countries in which political change occurred peacefully a decade ago, in Ro-

mania the fall of Nicolae Ceausescu was violent. Since then, violence has been used on several occasions as a political tool, including in 1990, 1991, 1992, and 1992 during the rampages of the Jiu miners on the capital, Bucharest. In addition, the 2000 presidential elections brought to the forefront of the political scene a fanatical ultranationalist leader, Corneliu Vadim Tudor, a former Ceausescu sycophant whose proposed political program was based on "machine-gun order and justice." Tudor advanced to the presidential runoff, and his party is now the second largest in Parliament.

Also contributing to potential instability in Romania is the country's precarious economic situation and the crisis in its banking system. The fall of the FNI Investment Fund in 2000 wiped out about 3,500 billion lei in savings, or about \$1.5 billion. The fact that the state-owned savings bank was involved in guaranteeing the Fund made people particularly angry and distrustful toward the state and resulted in repeated protests around the country and a lawsuit brought by about 32,000 people against FNI.

Nevertheless, the Romanian political system is surprisingly stable. One mark of this stability is the fact that since enactment of the new Constitution in December 1991, the country has held three series of presidential, parliamentary, and local elections. In two of these, in 1996 and 2000, power changed hands from the incumbents to the opposition. Another factor of stability has been the inclusion of the country's Hungarian minority in the government. In 1996, the PNTCD invited the Democratic Union of Hungarians in Romania (UDMR) to join the ruling coalition. In 2000, the PSD courted the Hungarian minority while at the same time it waged a diplomatic war with Hungary over the minority's access to various employment, health, and educational benefits in Hungary.

Consensus over foreign policy and economic policy also adds to stability. There is widely shared agreement among political parties across the spectrum on the desirability of rapid integration with NATO and the EU. In addition, parties of both the Right and the Left support economic growth and liberalization.

Finally, and perhaps most subtly, stability is also contingent on who is in power and on the means deemed acceptable to achieve political ends. In 2001, the PSD returned to power after spending four years in the opposition. After the bickering and infighting of the former Democratic Convention (the center-right coalition that held power between 1996 and 2000), the hierarchical discipline of the PSD has brought relative orderliness to the administration of government. However, such stability is misleading, for it resulted in the concentration of power in the hands of a single dominant party rather than a balance of power between the government and the opposition.

Although the PSD does not hold an absolute majority in Parliament, it controls much of the state apparatus and administration, both in the central ministries and at the local level. And its power is growing. For example, a study

released by the Institute for Public Policy in Bucharest, in the fall of 2001, documented the PSD's magnetic effect as the party in power: 22 percent of all mayors elected in the summer of 2000 have switched their political affiliation, and of these, 82 percent have opted for the PSD. As a result, the PSD has increased its hold on local power from 35.5 percent of elected mayors in 2000 to 50 percent by the end of 2001.

Previously, the PSD was known as the Party of Social Democracy of Romania (PDSR). The PDSR changed its name in summer 2001 following its merger with the tiny Social Democratic Party of Romania. The merger was motivated by the PDSR's desire to be admitted into the Socialist International, in which the smaller party was a member. Owing to its Communist legacy and checkered democratic record, the PDSR had been refused membership repeatedly since 1990. The trick paid off, and the PSD now enjoys its new status as a member with consultative rights in the Socialist International.

Romania's political shake-up was also confirmed at the national level during the parliamentary and presidential elections of 2000. Although they were marked by relatively low voter turnout (slightly over 55 percent), the parliamentary elections of 2000 resulted in a complete redistribution of power when the ruling National Peasant Party lost control of both the Camera Deputatilor (Chamber of Deputies) and the Senat (Senate). Its former coalition partners also scored poorly. In the voting for seats in the Chamber of Deputies, the PDSR (now the PSD) took 44.9 percent of the vote; the ultranationalist Greater Romanian Party (PRM), 24.3 percent; the PD, 8.9 percent; the PNL, 8.7 percent; and the UDMR, 7.8 percent. The remaining 18 seats (5.2 percent) were distributed among the non-Hungarian minorities that receive 1 seat in Parliament regardless of their population size. The total number of deputies in the Chamber of Deputies is 345. In the Senate, the situation was similar. The PDSR took 46.4 percent of the body's 140 seats; the PRM, 26.4 percent; the PD, 9.29 percent; the PNL, 9.29 percent; and the UDMR, 8.59 percent. There is no difference between the competencies of the two chambers—a subject that is discussed repeatedly with regard to plans to modify the Constitution.

The Organization for Security and Cooperation in Europe deemed the 2000 parliamentary elections "transparent, free, fair, and equal." However, the OSCE did comment on the absence of a permanent electoral commission and suggested that regulations on domestic observers be liberalized.

Following the 2000 parliamentary elections, the PDSR formed a minority government led by Adrian Nastase. Nastase was chosen to head the PDSR following Ion Iliescu's election to the presidency the same year, because Romanian law prevents a sitting president from having a party affiliation. Hence Iliescu, who founded the party, had to relinquish his post. Nastase was foreign affairs minister between June 28, 1990, and October 16, 1992. This is the

first time since 1991 that Romania has had a political rather than a technocratic prime minister.

Romania's presidency is held by Ion Iliescu, leader of the group that took power in 1989 following the execution of Nicolae Ceausescu. Iliescu is a former Communist Party leader who fell out of Ceausescu's favor in the early 1970s and became a symbol of sorts for communism's "silent majority"—true believers who were frustrated by the abuses of the country's two dictators, Ceausescu and his wife, Elena. Although Iliescu had won the presidential elections of 1990 and 1992 and the new Constitution specifically limits the number of presidential mandates to two, Iliescu argued that he had exercised only one mandate since the adoption of the Constitution in 1991. Thus, he was able to run again in 2000 unchallenged by the Constitutional Court.

The 2000 presidential elections were a moment of relative drama in Romanian politics. In the summer of 2000, incumbent President Emil Constantinescu decided not to seek reelection. Although he had received international recognition for aligning with NATO forces during the Kosovo conflict of 1999, Constantinescu's standing in domestic polls was poor and the coalition that had brought him to power in 1996 unraveled when the Liberals decided to field their own presidential candidate. With Constantinescu out of the race, the incumbent democratic coalition fielded no fewer than four different presidential candidates, each garnering 11 percent or less of the vote.

In the first round, Ion Iliescu received 36.35 percent of the vote, and the ultranationalist Corneliu Vadim Tudor came in second with 28.34. Theodor Stolojan, a former prime minister who represented the Liberals, came in third with 11.78 percent; and Mugur Isarescu, the incumbent prime minister, came in fourth with 9.53 percent. With the exception of the Hungarian minority candidate, who received 6.22 percent of the vote, all other candidates scored under 3 percent. Since no candidate received more than 50 percent of the vote, Iliescu and Tudor advanced to a second round. Iliescu defeated Tudor 66.7 percent to 33.2 percent. Voter turnout was 57.5 percent, and the OSCE deemed the elections free and fair.

The general trend in voter turnout over the last decade has been downward. In national elections, turnout was 86.2 percent in 1990, 76.1 percent in 1992, and 70 percent in 1996. For municipal elections, turnout was 72 percent in 1992 and 46 percent in 2000. There are no figures on female voter participation, and less than 10 percent of all members of Parliament are women. However, for the first time in 11 years, the government has five women ministers.

Although Romania's electoral system is multiparty based, there is only a handful of viable parties. Their number shrank recently when Parliament set a 5 percent minimum threshold for representation. For the 2000 elections, the number of parties registered for the competition was 80, and only 5 made it past the threshold. To register, a party must have no fewer than 10,000 founding members, with at least 300 in each of a minimum of 15 (out of 40) counties.

It is difficult to get exact figures on party membership. The parties themselves inflate their figures, and there is no independent viable statistic. According to some data, the PD has 130,000 members; the PNL 134,000; the UDMR, 530,000; and the PSD, 684,000.

One of the most organized and disciplined parties is the UDMR. The UDMR represents the Hungarian ethnic minority, which accounts for about 10 percent of Romania's population. The party regularly receives around 7 percent of the votes, whether in parliamentary or presidential elections. It advocates local autonomy and decentralization. In 2000, it obtained passage of a law that allows administrative authorities to speak Hungarian in those localities in which the ethnic minority exceeds 20 percent of the population.

In addition to the Hungarian minority, which is by far the largest, other ethnic groups are represented in Parliament. These include Armenians, Germans, Italians, Greeks, Macedonians, and Poles. Each group receives an automatic seat in the Chamber of Deputies.

In November 2001, the Pro Democracy Association launched a project to change the country's electoral code. The proposed code seeks to increase public participation in political life and improve the relationship between elected officials and voters by replacing the party list system with a direct voting system. At present, only the president and local mayors are elected this way. Under the proposed code, two-thirds of all members of Parliament would be elected in direct voting. The system would also be applied for elections of local and district counselors. By law, the Pro Democracy Association's initiative needs 250,000 signatures for Parliament to consider it. If it ultimately proves successful, it would be the first civic initiative to be transformed into law. It would not only help improve the transparency and accountability of the electoral system, it would also give a boost to democratic forces and civil society.

The 2000 elections left Romania's democratic and centrist forces divided between two equally weak parties: the PNL and the DP. The fact that the two parties are archenemies, in terms of both ideology and personalities, further obscures their voices in Parliament. This is a worrisome situation, especially since the largest party in opposition is the ultranationalist and undemocratic PRM.

As a result, Romania is in some ways closer to a de facto electoral authoritarian regime than to a balanced pluralist system. This is not because the government keeps the opposition out of the political game, but because the opposition is too weak to have an effective voice. Ironically, the prime minister, aware of the danger of being perceived as a de facto authoritarian, complains loudly about the opposition's weakness. This leaves a great burden on the shoulders of civil society to carve a space for open dialogue and extraparliamentary policy debate. However, in spite of a relative increase in the number of organizations, the voice itself of civil society is increasingly atomized and feeble.

Civil Society

1997	1998	1999-2000	2001	2002
3.75	3.75	3.00	3.00	3.00

The most recent data available from the National Institute for Statistics indicates that the number of NGOs in Romania is approximately 25,226. However, most analysts believe that the number of truly active NGOs is around 10 percent of that figure. In 2001, an active coalition of 7 or 8 leading NGOs supported the adoption of a Freedom of Information Law and gave prompt reactions every time the ruling party tried to introduce limitations. This kind of direct—and growing—civic participation in the legislative process is one of the most remarkable developments of the post-Ceausescu period.

Romanian civil society was quite vibrant in the early 1990s when groups of writers, artists, and musicians engaged the public in spirited debates about policy and kept checks on governmental actions. Due to their support, the Democratic Convention won the 1996 parliamentary elections, and many civil society representatives were offered positions in the administration. However, only a handful accepted. The rest soon became the government's most vehement critics because they were frustrated by the slow pace of reform and by the Democratic Convention's seeming inability to exercise control over the state apparatus.

Romanian nonprofit organizations are predominantly urban. In addition, the southeastern portion of the country exhibits the lowest levels of civic life. Out of the estimated 25,000 organizations, almost 2,000 are mutual credit associations, a little more than 1,900 are labor unions, and about 120 are employers' associations.

To encourage the emergence of new voluntary associations, Parliament adopted the Law on Nonprofits in 2001. This law, which replaces one dating to 1924, defines volunteering and establishes a policy framework for companies that use volunteers. Nevertheless, volunteerism in Romania remains relatively weak. A 1996 estimate shows that only 6 percent of the total adult population belong to an association (excluding labor unions).

Women are not particularly active in creating their own associations. Only about 70 officially registered NGOs focus on gender-related issues. Feminists believe this number is low because institutionalization of the country's women's movement has been rushed and imposed from the outside. "We do not have a movement based on the experiences and the problems of women in Romania; we have abruptly institutionalized strategies primarily for intervention rather than for emancipation," explains the head of the largest feminist association in the country. Most gender-based associations group women on the basis of professional affiliation: women doctors, managers, university graduates, and the like. However, these organizations are somewhat cut off from the larger political debate and do not necessarily seek to change gender-related legisla-

tion or to suggest policies or strategies that empower women.

Unlike women, the main ethnic minorities are relatively well organized and effective. According to the latest census, minorities represent about 12 percent of the population, a drop from the 29 percent they represented in the 1930s before the Communist takeover. The country's main minorities are the Hungarian and the Roma, followed by relatively small numbers of Germans, Ukrainians, Russians, Jews, Turks, Tartars, Czechs, Poles, Greeks, Albanians, and Italians. Today, there are 18 officially recognized minorities in Romania. Each, except for the Hungarians, is represented with one seat in Parliament.

Romania's Hungarian minority is represented by the UDMR, an umbrella organization that is part political party, part cultural association, and part social service provider. Between 1996 and 2000, the UDMR belonged to the ruling coalition known as the Democratic Convention. This provided the minority with a stronger voice than ever before and allowed for the passage of legislation that puts Romania among the countries with the best legal protections of minority rights. One such example is the right to use one's mother tongue in dealing with local administrations. Also, after fierce political debates over a state-financed Hungarian university, Romania accepted the establishment of the private Hungarian Language University, which receives state support from Hungary. The university offered its first classes in October 2001.

The Hungarian University of Transylvania is a private, independent, nondenominational institution situated in four cities in Transylvania: Cluj, Oradea, Miercurea-Ciuc, and Targu-Mures. Even though it caters to Romania's approximately two million ethnic Hungarians, it is open to students of any nationality who meet its admissions requirements. In addition to the \$7 million provided annually by the Hungarian Parliament, the university receives funding from the Sapientia Foundation, which, in turn, receives money from the four Hungarian historical churches of Transylvania: the Roman Catholic, the Calvinist Reformed, the Evangelical, and the Unitarian.

Romania's other sizable minority, the Roma, is not represented in Parliament by a particular party. However, the year 2001 marked a watershed for Roma civil society groups when several of them struck an informal alliance with the PSD and, together with constant international pressure, helped ensure that the Roma cause will finally receive substantial governmental and international funding. In May 2001, a number of Roma organizations established the Roma Framework, a federation that seeks to monitor the implementation of the Strategy for the Improvement of the Roma Situation, which the government adopted on April 25, 2001. Twenty-five of the most effective Roma organizations from around the country have so far joined the group.

Also in 2001, the Health and Family Ministry signed an agreement with the Roma Party, the country's main Roma

association, on the provision of special health and social integration services to this minority community. The Roma Party intends to collect the equivalent of 7 percent of the minimal wage from each member of the Roma community and then to distribute the funds through the Public Health Departments to the 15 counties in which most of the nation's Roma community lives. Roma organizations have also received substantial funding from the European Union through mechanisms such as the Partnership Fund for the Roma, which was endowed with 2 million euro in 2001. Among the partnership's projects was the launch of a Roma news agency in October 2001.

Romanian civil society also includes religious organizations. Since Romania has no law on religions, many groups such as the Baptists, Presbyterians, and Jehovah's Witnesses obtain legal status in the country as associations. According to a 1999 study published on the occasion of Pope John-Paul II's visit to Romania, there are more than 700 associations and foundations of a religious nature in the country. Of these, about half are affiliated with the nation's 15 recognized religions and cults besides the official state church, the Orthodox Church. In Communist times, decisions regarding the organization of the Orthodox Church were subject to the approval of the state. Now, the patriarch and his collegium make decisions independently.

Most churches in Romania organize charitable activities. Even though charity and social work are not a prominent part of the Orthodox tradition, the Romanian Orthodox Church has established a foundation, Diaconia, that is responsible for social programs. Another group, Caritas, is the most active organization working on behalf of the Roman and Greek Catholic Churches.

The registration and activity of NGOs is governed by Ordinance 26/2000, which was signed into law in 2001. The new law simplifies the registration procedure for associations, while toughening provisions for the registration of foundations. Previously, using a law dating from 1924, it was relatively easy to register a not-for-profit entity as a foundation and to use its tax-exempt status to shield commercial interests. As a result, between 1990 and 2000, hundreds of foundations were registered for no other purpose than the importation of tax-exempt cars. The new law aims to curb this practice. Although NGOs may compete for government contracts and procurements, several issues remain to be clarified under Ordinance 26/2000.

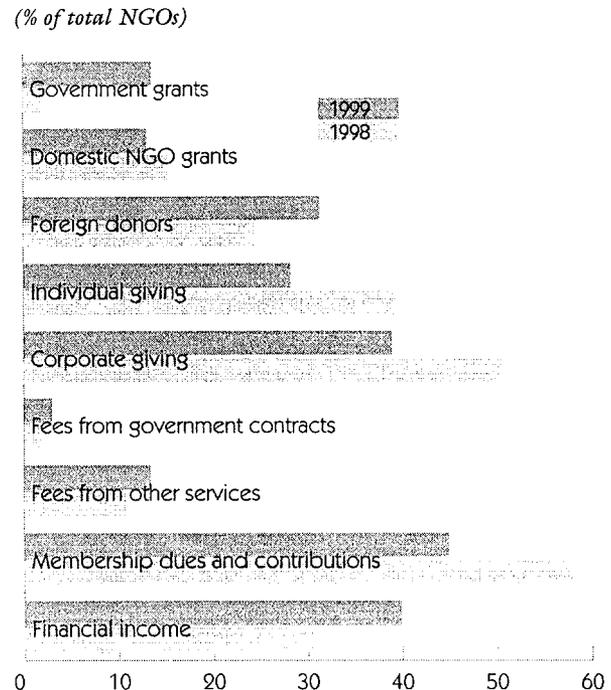
NGOs remain exempt from customs taxes and the 19 percent value-added tax. They may engage in commercial activities if they fold their profits back into the organization. NGO income is taxed at the same rate as income generated by for-profit corporations. Law 204/2001 establishes low deduction rates for charitable contributions: 10 percent maximum off the taxable base for sponsorship of cultural, artistic, social, humanitarian, and environmental programs; 8 percent maximum off the taxable base for education, human rights, research, and sports (except soccer); and 5 percent maximum for social and community programs,

professional associations, and soccer. This law is the result of the lobbying and advocacy efforts of NGOs.

Romanian NGOs have benefited from extensive access to foreign training and expertise. In turn, several Romanian organizations now specialize in providing training to other domestic groups in everything from proposal writing to fund-raising to accounting and communication. There is ample documentation in Romanian, including an electronic newsletter about the field.

For many Romanian NGOs, 2001 proved to be a difficult year as funding through major grant programs shrank. Some NGOs had to cease their activity altogether. Others experienced major upheavals and personnel reshuffling. In general, grant money is the primary source of funding for Romanian NGOs. Local support is an increasing revenue source, having gone from 2 percent to 13 percent in just one year owing to an influx of EU funds for capacity building in local administrations. The EU remains a key donor to Romanian NGOs, while American and other Western bilateral funds are drying up. Organizations such as the Open Society Foundation have shifted their strategy away from grant making and toward operational programs, thus obliterating a vast source of domestic funding. Due to the unhealthy economic situation, the trend is worsened by a decrease in corporate funding and in membership fees. Chart 1 below indicates the portion of NGOs using funds from various sources.

Chart 1. NGO Funding Sources

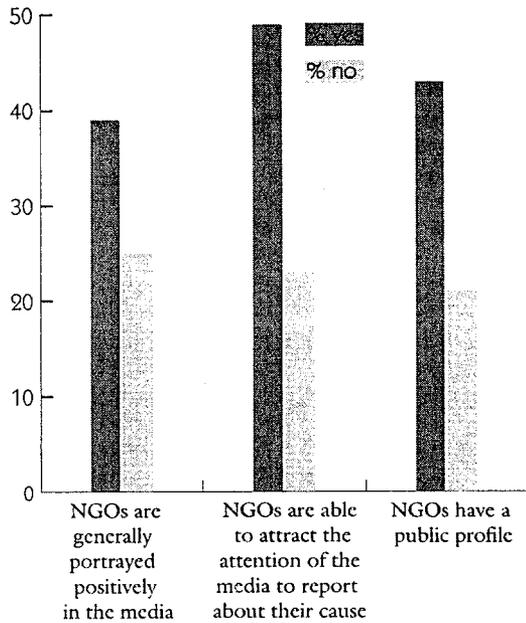


Source: Foundation for the Development of Civil Society-Romania. Percentage of 764 NGOs surveyed.

Ironically, the decrease in grant funds has also had a positive effect by forcing NGOs to think more creatively about fund-raising. New events such as celebrity auctions, corporate runs, and television fund drives have been tested recently. A group of lawyers from the Romanian Helsinki Committee has also drafted a law to regulate charitable fund-raising activities and will present it for discussion to government officials and members of Parliament in 2002.

Even though NGOs have a relatively high media profile, the perception of their usefulness is mixed. Both state officials and the general public have mixed feelings, owing to the number of corruption cases associated with NGOs in the last decade. In 2001, though, NGOs received positive media coverage for their involvement in key public interest issues such as domestic violence and corruption. The chart below, from the Civil Society Foundation, provides an overall summary of public perceptions of NGOs.

Chart 2. Public Perceptions of NGOs



Source: Foundation for the Development of Civil Society-Romania.

The organizations in Romania that pride themselves most on providing beneficial services are trade unions. Before 1989, all Romanian workers automatically belonged to a union. Although the proportion belonging to unions in 2001 remained high at about 59 percent, the number has been decreasing annually as state enterprises have been closed. There are no reliable figures on private sector unionization, but there are a number of professional and business associations, including about 20 associations that group the interests of management.

Unions in Romania are organized at three levels: by company, by branch, and at the national level. There are about 15 national trade union confederations, but only 5 are officially recognized by both the government and management as interlocutors. These are the National Syndicate Confederation (CNSRL-Fratia), which represents 48 federations primarily in the mining sector; the National Union Bloc (BNS), which groups 39 federations in the service, automotive, and agricultural sectors; the Alfa Workers Confederation, which has 29 federations in electronics and industry; the Democratic Confederation of Syndicates, which groups 22 federations primarily in education and culture; and the Meridian Confederation, which represents 27 federations in heavy industry.

Article 37 of the Constitution and a law adopted in 1991 stipulate that trade unions are free to function without political interference and that any such interference is illegal. However, before the 2000 elections, the two main unions, BNS and CNSRL-Fratia, actually sought political influence by trading votes in exchange for representation on the PDSR's lists. Thus, the former head of CNSRL-Fratia, Miron Mitrea, is now the minister of transport, and many union heads are now parliamentarians. Most, if not all, were elected on the ruling party's lists.

The Romanian Constitution guarantees the usual civil and political liberties, including the right to freedom of association, assembly, and expression. Military personnel, members of the police force, and magistrates are forbidden from organizing or entering into politics. In 2000, for instance, an association set up by the military was deemed illegal and was subsequently dismantled.

The most vigorous participants in the public sphere are labor unions, but they limit their activities primarily to street protests. Street protests are the method of choice for the general public as well. On the political and policy scene, the most active actors—other than political parties—remain NGOs. An increasing number of think tanks are doing research and policy analysis, but for the moment they have a better audience abroad than in the domestic policy-making process.

Romania's education system is free of political propaganda and is effective at training students in math and science. The system performs less well in the humanities and the social sciences, where mind-sets are hardest to change. There are an increasing number of private educational establishments, especially in higher education, but their accreditation is problematic.

Independent Media

1997	1998	1999-2000	2001	2002
4.25	4.00	3.50	3.50	3.50

The battle for an independent media was one of the most powerful rallying cries of civil society in the early 1990s, when the only news available was provided by state radio

and television and the government's democratic credentials were highly doubtful. And precisely because of domestic and international pressure, Romania's audiovisual media were, paradoxically, among the first in the former Communist bloc to liberalize. The media scene thus became competitive early on, at first only in the provinces. By 1995, though, the country's two main private broadcasters were beginning to challenge state-run television at the national level as well. ProTV was financed by foreign and repatriated Romanian interests. Antena 1 had more obscure funding because its founder had been in charge of Nicolae Ceausescu's foreign trade accounts prior to 1989. The competition between the two broadcasters quickly improved production standards, but for a long time their editorial slant remained skewed toward their respective political and financial interests.

By 2001, Romania's media scene was much more complex. The main television station is still state-owned Romanian Television (TVR), which broadcasts on three channels: TVR1, TVR2, and TVR International. TVR also has regional stations in Timisoara, Cluj, Craiova, and Iasi. The country's other television stations are private. ProTV and Antena 1 are now carried on cable and reach about 50 percent of the population. Smaller broadcasters such as Prima, Tele 7 ABC, and B 1 TV broadcast primarily in Bucharest.

Romania's private radio market is smaller but no less competitive. State-owned radio broadcasts on five different stations. The main state channel, Radio Romania Actualitati, reaches almost 95 percent of the population. There are also several private FM stations with national reach, including Radio Contact, Europa FM, Pro-FM, Uniplus, Delta, and Radio 21. Together, they reach 27.86 percent of the public, and competition is fierce. For instance, Europa FM, a Hachette-Lagardere French investment, has national coverage and competes both with public radio and with the network of local radio stations that have limited reach in various urban areas.

The government keeps a tight rein on state television and radio, both of which have excellent penetration in the countryside. In spite of boasting a financially successful record and positive results overall, the general director of state-run Romanian Radio was removed in 2001 by the governmental majority in Parliament primarily because he was a holdover from the previous administration.

The state no longer funds any print media. *Vocea Romaniei*, a propaganda weekly funded by the government, was discontinued in 1996. However, the state finances the Romanian Cultural Foundation (FCR), which publishes books and monthlies for international distribution. The FCR also publishes a major domestic political weekly called *Dilema*.

With the exception of state-run radio and television and the funding extended to FCR, the rest of Romania's media is in private hands. The country's main dailies are *Adevarul* (circulation 171,000 per day) and *Evenimentul Zilei* (135,000 per day). The others, such as *Romania Libera*,

Ziua, *Jurnalul National*, and *Libertatea*, have a daily circulation of less than 100,000 each. In total, Romania's 15 national dailies have a cumulative circulation of 1.5 million, which represents a decrease of 15 percent compared to the figures for 2000.

Studies show that the total number of persons who read newspapers has decreased from 6.25 million (28.4 percent of the total population) in 1999 to 5.51 million (25 percent) in the second quarter of 2001. Part of the reason is economic: in times of crisis, newspapers are a luxury. Also, the larger penetration of cable and national private channels in the provinces diminishes the appeal of the printed press.

Romanian media outlets are organized on a commercial basis. However, they are not necessarily totally independent or editorially unbiased. The shrinking advertising market and huge unpaid debts to state tax authorities have had an adverse impact on editorial independence. The best example is ProTV, formerly one of Romania's most liberal-minded broadcasters. In 2001, a personal disagreement between the station's owner and a presidential adviser turned into a political fight. As a consequence, ProTV's \$23 million debt in unpaid taxes was made public and there were rumors that the station was slated for closure. Although the broadcaster survived, its criticism of the government disappeared. Likewise, the owner of Antena 1 is the head of a small party that now belongs to the government. As a result, the station now abstains from criticizing the government.

Most media outlets are owned by large corporations that do not want to cross swords with the state. The written press are feisty but sometimes prone to political vendettas. Unbiased opinions or dispassionate accounts of mere facts are rare—journalists and newspaper directors are passionate about their points of view and hence rather prone to political ax grinding. But even so, the media have successfully performed their watchdog role, unearthing countless corruption scandals and exposing abuse.

Newspapers have been distributed through alternative private channels since 1990. The state-owned distributor RODIPET handles only 30–35 percent of the market. As of 2001, two representatives of the publishers' association—of whom one, however, is also a presidential adviser—sit on RODIPET's board of directors.

The Audio-Visual Council should be the main regulatory body for television and radio. However, since the 2000 elections, it has become an increasingly hollow institution. For instance, in November 2001, the government arbitrarily decided to strip the council of its prerogative to grant frequency licenses and shifted that responsibility to the Communications Ministry, thereby obliterating the Audio Visual Council's key function. Apparently, the move was made without prior consultation with council members. As a consequence, key high-power frequencies will now be licensed by a politically appointed minister rather than by an independent public authority.

Romania's Constitution guarantees press freedom and the right to free expression. Aided by international press organizations, the country's media outlets have resisted governmental attempts to introduce a press law. However, more problematic is the persistence in the penal code of punishments for libel in general (Article 205), for "the distribution of false information" (Article 206), and, most worrisome, for libel of public officials (Article 238). The punishment for libel is two years in prison. For distributing "false information," the penalty is five years, and for libeling public officials, it's six months to five years. The Romanian Helsinki Committee has proposed the adoption of the German model, which punishes only libel committed in bad faith, but arbitrariness can still creep all too easily into the definition of "bad faith." Also, journalists are demanding the abrogation of Article 238 (libel of public officials) on the grounds that it is unconstitutional. The Constitution stipulates that all citizens are equal before the law (Article 16). On October 23, 2001, Parliament adopted the Law on Public Information, which should help give the press and the public more access to nonclassified information.

Romania's main journalistic association, the Romanian Press Club, is in fact a publishers' association (most newspaper directors and publishers are also editors in chief). This group is run by an enormously powerful directorate that functions much like a cartel, attempting to fix both market and editorial positions. Its members are a close-knit and relatively closed group of the most entrepreneurial and influential newspaper directors in the country. The exact number of women who are part of the club is not known. There are few other media associations. Some, such as the Romanian Journalists Society, have survived since the pre-1989 days. Others, such as the post-1989 independent Association of Romanian Journalists, have disappeared altogether.

The independent Journalism Center dispenses training and defends press freedoms alongside local associations. The center is part of a regional initiative supported by American funds.

Figures for the penetration of the Internet are not always reliable. Some estimates, such as those from the research institute HVB Romania, consider the number as high as 1.9 million (8.5 percent of the population). Other estimates, such as those of Roland Berger Strategy Consultants, put the number at under 750,000 (about 3.34 percent). There are no legal restrictions to Internet access. The emerging information technology and communications sector holds great promise for the country's future economic development, especially since Romanian universities produce skilled computer programmers, most of whom currently emigrate owing to the lack of domestic opportunities. Telecommunications access is still limited and expensive, and certain legal constraints make it difficult to leverage the Internet for electronic commerce or electronic business applications. In 2001, though, Parliament adopted the Law on the Electronic Signature.

The most worrisome aspect of Romania's media sector is its poor financial viability. The current level of advertising spending is only \$7 per capita (or between six and eight times less than that in the Czech Republic, Hungary, or Poland). In addition, the proliferation of the media means that all outlets cannot be financially viable. Therefore, many have been forced to survive through unorthodox means such as being sponsored by business moguls who are generally associated with political parties, or by accepting gifts in exchange for positive coverage, or by being dependent on advertising from state-run companies. In fact, many business owners consider the media not as a potentially profitable business in its own right, but as a means to gain political influence, which, in turn, can be traded for financial gain. This explains the persistence of a large number of financially unprofitable media outlets.

Governance and Public Administration

1997	1998	1999-2000	2001	2002
4.25	4.00	3.50	3.75	3.75

The Romanian Constitution enshrines the principles of separation of powers and government accountability. Although the current prime minister thinks that the separation of powers is an "obsolete concept" and has sought "more collaboration than competition" among state powers, the relationships between legislative and executive authorities can still be defined as a system of checks and balances. That is because the prime minister must still request from Parliament a vote of confidence for his cabinet and his government's program and because Parliament can still withdraw its support and dismiss the government.

Romania has a bicameral Parliament, and each chamber has equal status and identical legislative functions. This creates delays and redundancies because both chambers must approve all laws. Part of the debate on modifying the Constitution is about this particular issue.

Article 58(1) of the Constitution states that "Parliament is the supreme representative body and the sole legislative authority of the country." However, the proposal of legislative initiatives is the prerogative of the government, parliamentary deputies and senators, and even citizens. All legislative initiatives must be registered with Parliament so that they can be debated in commissions and then in the plenum.

The Constitution allows for the delegation of lawmaking authority to the government. For example, under a special law, the government may adopt specific kinds of ordinances during parliamentary recesses. In addition, the government may adopt emergency ordinances that enter into force immediately and need only retrospective approval by Parliament.

Romania's legislative process, combined with the government's rush to implement reforms, has proved a

rather lethal combination for parliamentary authority. The previous government legislated effectively through simple and emergency ordinances in 507 cases. Only 475 normative acts followed their natural course through Parliament. It is interesting to note that this kind of information is not available for the current government. The figures for 2001 were not disclosed, and the only promise given was that they would be published in 2004 at the end of Parliament's current mandate.

The forms of parliamentary control are simple and censorship motions, questions and interpellations, and any other forms of information that Parliament is free to request. Between 1996 and 2000, there were 9 simple motions and 4 censorship motions, all of them rejected. There were also between 470 and 730 questions and interpellations per year. The Constitution requires Parliament to open its sessions to the public. However, there is no mechanism for public hearings.

At the national level, the acts of Parliament, the presidency, or the government must be published in the *Monitorul Oficial* as a prerequisite of their validity. Moreover, the *Monitorul Oficial* publishes transcriptions of non-classified debates from both chambers of Parliament. Even though a Ministry of Public Information was created after the 2000 elections, the European Commission continues to deem the amount of information available from the government and from public administrations as inadequate, especially information pertaining to social issues.

A new Law on Local Public Administration went into force in May 2001. Proposed by the previous administration and mandated by EU accession negotiations, which require decentralization, the current law represents a considerable improvement over the old law. The most significant change is the provision in Article 17 that allows the use of ethnic minority languages for administrative purposes in localities where at least 20 percent of the population belong to the same ethnic group.

The new law also increases the responsibilities and authority of local councils and mayors. Local administrations have their own budgets and enjoy the right to impose and collect local taxes. Local budgets include also capital revenues, proceeds from the state budget, and transfers from the state budget. However, in practice, the financial relationship between central and local levels of government remains unclear, and delays in financial transfers from the central government have caused problems.

The legal framework for decentralizing power to local government is largely complete. In each *judet* (county), the government appoints a prefect who represents the decentralized public services of the ministries and other central authorities. At present, the government aims to raise public awareness and to fully involve local collectivities in managing local and regional problems.

Romania met the short-term EU accession requirements on its civil service administrative capacity when it passed the Law on Civil Service in 1999. The legal status of civil

servants is now essentially in line with European practices. However, the current government has repeatedly violated a key provision of the new law regarding the political neutrality of public administrations. By using a loophole in the law, it has fired large numbers of staff in key ministries, government agencies, and the presidential administration and replaced them with politically obedient personnel. The law effectively prevents layoffs on political grounds—for instance, after elections—precisely to avoid changes that are disruptive to the creation of a competent and politically neutral civil corps and in order to break the pattern of harmful political obedience within the administration. That is, under the law, layoffs are permitted only when an institution is dismantled. So after the 2000 elections, key governmental bodies were dismantled and immediately reinstated under a different name in order to allow for the firing of staff who were suspected of political disloyalty. For instance, the body formerly known as the Romanian Presidency is now called the Presidential Administration Office and is allegedly a new institution.

RULE OF LAW

Constitutional, Legislative, and Judicial Framework

1997	1998	1999-2000	2001	2002
4.25	4.25	4.25	4.25	4.25

The Romanian Constitution was adopted in 1991. In the last two years, its revision has been the object of some political debate, especially during the 2000 electoral campaign. The debates intensified at the end of 2001. First, the PNL has demanded that a formal guarantee rather than mere "protection" of property rights be enshrined in Article 41 of the Constitution. Second, several parties agree that the attributes and responsibilities of the two chambers of Parliament should be reviewed in order to avoid backlogs and duplications. Third, an increasing number of voices have proposed that the president be elected by Parliament rather than by popular vote. A fourth point that has little resonance inside Romania but is advocated by millions of Romanians abroad is the abrogation of Article 16(3) of the Constitution, which bars persons with dual citizenship from employment in public administration and from holding elected office. This policy deprives the state apparatus of the potential contribution of qualified Romanians trained abroad.

All parties, with the exception of the PRM, agree on the need for constitutional reform and have decided in principle that a distinct parliamentary committee should be formed to deal with the issue. The stated intent is to finish the reform process by the end of the legislative mandate in 2004. Constitutional reform requires the approval of two-thirds of Parliament and a national referendum.

Romania's Constitution is interpreted and enforced by a Constitutional Court of eleven judges. Of these, two are named by the president, three by the Chamber of Deputies, three by the Senate, and three by the government for a term of nine years. At the request of a certain number of parliamentarians, the Court can determine the constitutionality of new legislation. If legislation is deemed unconstitutional, it must be abrogated. However, Parliament can override the Court's decision with a two-thirds majority vote. In 2001, there was one key instance in which the opposition asked the Constitutional Court to rule on proposed legislation. The case involved a controversial bill that would have given inordinate powers to the secret services, the successor to Ceausescu's political police. The Court rejected the proposed legislation but did so on procedural rather than substantive grounds.

After the adoption of a new criminal code in 1996, several of the law's articles were deemed abusive of human rights. In 1997, the Parliamentary Assembly of the Council of Europe asked Romania to abrogate Article 200 on making homosexuality a crime, Article 205 on libel, Article 206 on calumny, Article 238 on insulting public officials, and Article 239(1) on abusive language. The only action Romania has taken thus far, under heavy international pressure, is the abrogation in 2001 of Article 200. The Chamber of Deputies has reduced the sentences for violating the other articles, but in the absence of agreement on the part of the Senate, the constitutional provisions themselves cannot be modified.

Under the Constitution, "a person's freedom and security are inviolable." Searches, detentions, and arrests are also very strictly regulated. For instance, the law says that a person cannot be held more than 24 hours without the issuance of a proper warrant by a prosecutor. The warrant's duration is between 5 and 30 days and can be prolonged only by a court. On occasion, though, abuses of these provisions are still reported. International human rights associations such as the Romanian Helsinki Committee have documented detentions without warrants and beatings of detainees.

Although human rights include property rights, these are only "protected," not guaranteed, under the Constitution. There is considerable evidence that the PSD and especially President Ion Iliescu do not wish to extend property rights any further. In fact, the president has repeatedly noted his disdain of private property. He even went so far in 2001 as to call it "a whim."

The state occasionally fails to enforce sentences in which owners receive their property back after a lawsuit. Another problem is associated with the recent passage of Law 10/2001 on the "restitution of property abusively confiscated by the Communists," which enshrines the sale of such property by the state to tenants in the early 1990s. The original owners can no longer sue the state for the improper sale but, instead, will have to accept compensation by the state, most likely in the form of shares in bankrupt state-owned enterprises.

Romania's Constitution guarantees freedom of religion. Yet property rights issues also weigh on the restitution of church property. The Communist Party had confiscated the belongings of the Greek Catholic Church as well as those of other religious groups, and such cases have not been resolved to this day.

Article 6 of the Constitution recognizes and guarantees minority rights, including those of religious minorities. Although this provision recognizes the rights of minorities "to develop a specific ethnic, cultural, linguistic, and religious identity," it also seeks to ensure equality and nondiscrimination among Romanian citizens, thereby introducing potential arbitrariness in the provision. In addition, since the European accession process demands better integration of the Roma minority, in 2001 the government passed an emergency ordinance on improving the group's situation. At year's end, the first steps had been taken to implement the ordinance, including the creation of a monitoring committee and the naming of Roma advisers in county prefectures. The government has also legislated the creation of a National Council for the Elimination of Discrimination. To date, though, the council remains a well-intentioned idea that has not yet materialized.

Romania has more than 3,000 judges. Of all these, 25 magistrates and 8 prosecutors are, as of this writing, being tried in criminal cases. In addition, although the justice minister has tried to distance herself from politics, the public still considers the justice system partisan and corrupt. Judges and policemen, for instance, are among the "most distrusted," according to public opinion polls. There have also been many recent allegations of judges and police officers being bribed; however, there is little evidence to confirm such charges.

The political independence and neutrality of the justice system is not always obvious. Since judges and prosecutors are considered magistrates, it is difficult to establish a clear dividing line between judicial and executive powers. As a result, there are several ways in which political interference can creep into the system, including in the very process of selecting magistrates, who are named by the Justice Ministry and by the Magistrates' Council rather than by a completely independent body. Political interference also occurs through political discourse. That is, politicians make public statements that have a tendency to get implemented as court decisions. Such was the case with a recent political statement about the desirability of favoring tenants in cases of property restitution. Once mentioned, the idea quickly became quasi court policy.

Another famous case of interference was the decision at the beginning of 2001 to reopen the trial of two generals who were involved in the December 1989 shootings of civilians during the Romanian revolution. The two had been tried and found guilty in 2000 under the previous administration yet were freed for the duration of an extraordinary appeals procedure that the new prosecutor-general initiated after the 2000 elections. The prosecutor

reopened the case just after both the president and the prime minister publicly described the original sentencing as “unfair.” Even more simply, interference in the justice system can be overt, such as the case of the recent letter sent to the minister of justice in which a prefect recommended a certain candidate for the presidency of a county tribunal. The minister did not follow suit.

The state does provide public defenders and free interpreting services when needed. In 2001, a new system was set up that in effect privatizes the judicial enforcement function. With the adoption of a new law in May 2001, 351 former state employees became independent judicial executors. It is unclear whether these new private entities will be able to hold the state accountable for the enforcement of judicial decisions.

Corruption

1999-2000	2001	2002
4.25	4.50	4.75

The Romanian Constitution states that membership in the government is incompatible with membership in any other state office except Parliament. Likewise, the 2001 Law on Reorganizing the Government also prevents cabinet members from holding positions in the private sector. Nevertheless, such provisions are rarely enforced.

The political system’s endemic lack of transparency makes it difficult to ascertain whether public officials have improper ties to private business. However, the press has recently exposed several high-ranking government officials as having personally benefited from the public policies they implement. For example, the secretary of state in the Transportation Ministry has ties to a construction company that has received important procurement contracts from the city in which his brother serves as mayor. Also, several business and corruption scandals shroud the current president of the Senate—a former prime minister, whose involvement in private business remains. More generally, concomitant involvement in public as well as in private business remains a thorny issue. One statistic is telling: In 2001, Romania’s parliamentarians collectively held more private corporations than there were actual members of the legislature. Many of these firms receive preferential treatment in bidding for public contracts.

One of the difficulties with prosecuting corruption stems from legal ambiguity. Legally, “conflict of interest” remains an elusive offense. “Conflict of interest” is not clearly regulated in a single law but, rather, is the subject of multiple pieces of legislation. Also, terms and legal concepts differ between Western countries and a country like Romania, where the notion of “conflict of interest” does not exist *per se* and is often replaced with the much narrower notion of “incompatibility.” Unfortunately, “incompatibility” has a much narrower mean-

ing and doesn’t address obvious problems such as nepotism and cronyism.

This, however, points to a larger problem of political culture. In a country where, before 1989, allegedly everyone held only one common interest, it was unconceivable to regulate conflict between public and private interests, since the latter, in theory, did not exist. As a consequence, Romania’s political culture still suffers from a lack of realism. For instance, at the University of Pitesti, no student in a recent graduating class of the School of Public Administration could give a clear, crisp definition of “corruption.” Everyone knew that “corruption means doing something wrong or against the law,” but not a single one could articulate the idea that it involves using public office for personal gain. This is partly explained by the Communist-era mind-set, which found it acceptable for public officials to use their positions for private ends.

Romanian law sanctions corruption with imprisonment. It also asks public officials, including the managers of state-owned enterprises and public utilities, to file statements about their financial situation at the beginning and at the end of their mandates. But since these statements are not made public they have practically no effect. In addition, no case has been prosecuted based on these declarations.

On paper, there are conflict of interest (“incompatibility”) rules for the following categories of officials: the president of Romania, members of Parliament, magistrates (judges and prosecutors), government ministers, secretaries of state (deputy ministers), and elected local officials. The financial disclosure requirements apply to these categories as well as to persons who hold management positions in the central bank, public utilities, and state-owned enterprises and to appointed public officials at central and local levels.

According to Transparency International, “the overwhelming part of corruption cases brought into the Romanian courts of law in the last ten years have concerned low-level civil servants.” Cases of racketeering are, in theory, judged according to the criminal code, yet the offense is not spelled out as a distinct crime. Even the term is not translatable in Romanian—though the practice clearly exists. A new National Department for Combating Corruption and Organized Crime (DCCOC) in the General Prosecutor’s Office was established in 2000 at the initiative of former President Emil Constantinescu. This office is attached directly to the Supreme Court of Justice. Its aim is to centralize the information received from institutions involved in anticorruption cases. Regional Departments for Combating Corruption and Organized Crime are attached at the local level to county appeals courts. There are opposing opinions on the adequacy of the existing legal framework: one deems it sufficient but considers lack of enforcement as the main problem, the other claims that the legal framework is obsolete and should be changed.

The Romanian Court of Audit (CAR) is the highest audit authority. It performs public sector external audits, including reviews of the legislative and executive branches of government. The CAR is mandated by Parliament and consists of 25 auditors who are appointed for six years. A special government ordinance establishes that in public institutions there should be 1 internal auditor for every 25 staffers. Even though Romania has taken key steps to comply with international standards, the legislation is not yet entirely compatible with that of Western countries.

Recently, the Romanian government adopted the country's first comprehensive anticorruption strategy that addresses both prevention and law enforcement. The program is being coordinated by the National Committee for the Prevention of Criminality, which was established in July 2001. However, this committee is an ad hoc interministerial body and has no independent institutional authority. Since the committee has failed to meet regularly thus far, its effectiveness is still unclear.

According to Transparency International, "No leading government official at the national level has been investigated and prosecuted in the past year. Only a small number of officials at the local level have been prosecuted." However, in 2001, an unusual number of cases were brought against magistrates. Even though there is considerable distrust about the motives behind this increase in prosecutions, the government has pledged that the fight against corruption will not be used as a political instrument. However, at least one recent case appears to be a political act of retaliation. The head of the Central Anticorruption Agency who investigated President Iliescu in 1992 was removed from office and expelled by the Justice Ministry in 2001.

Romania is plagued by an extremely heavy and cumbersome bureaucracy, and this in part explains the high incidence of corruption. In addition to increasing opportunities for bribe taking, bureaucratic complexity is responsible for a high level of arbitrariness in administrative decision making, which sometimes gets mistaken for petty corruption. Also, excessive regulations, administrative controls, and inspections are stifling the activities of the private sector. Even though the registration procedures were simplified in 2001, small and medium-size enterprises (SMEs) still have to comply with numerous registration and approval procedures. The cost of compliance is enormous. According to a May 2000 report by the U.S. Agency for International Development and the Center for Institutional Reform and the Informal Sector, during 1999, "a typical firm in Romania was required to obtain between 23 and 29 different approvals, authorizations, licenses, permits, etc. These approvals cost between 49 and 102 employee days. After completing each application, the typical firm waited between 34 and 101 days for the relevant approval. Once established, a typical firm was inspected between 11 and 23 times. Time spent preparing the documents requested by inspectors

amounted to between 14 and 39 days. Time spent waiting for relevant certifications after inspections were complete amounted to between 13 and 20 days."

In 2001, the government issued an emergency ordinance on consolidating the registration process for businesses within a single bureau. However, the effectiveness of the measure remains unclear since it only merges the locations for obtaining permits rather than reducing the actual number of authorizations needed. On the positive side, the time frame for receiving replies to applications is now set at a maximum of 20 days.

In 2000, the World Bank completed a survey about practices and corruption perceptions that showed that 42 percent of all households and 28 percent of all companies had to pay bribes or gifts to public officials; 38 percent of the public officials interviewed reported that they had received gifts or bribes. Most households pay bribes to health care officials and public utilities representatives, while corporations primarily bribe customs officials and export/import licensing authorities.

According to Transparency International (TI), "In comparison with other Stability Pact Anti-Corruption Initiative (SPAI) countries, the Romanian public tends to be less accepting of the existence of corruption in society. Romanian involvement in corrupt practices, on the other hand, is viewed as higher than average in comparison to other SPAI countries, while the public is generally more pessimistic than most of its neighbors." TI also deems Romanian public education efforts on corruption as insufficient. A handful of NGOs currently fill the gap by initiating civic education programs about integrity and corruption issues. Transparency International is also making available to the public its *Legal Anti-Corruption Measures in the Romanian Public Sector* report.

Transparency International ranked Romania 69th out of 91 countries in its 2001 Corruption Perception Index. Romania was ranked 68th in 2000, 63rd in 1999, and 61st in 1998. This downward trend shows that despite attempts to create and apply effective anticorruption programs, little progress has been reported. The 2001 scores of Romania's neighbors are: Hungary 31, Bulgaria 47, Moldova 63, and Ukraine 83 (out of 91 countries).

Corruption is probably the most significant political issue currently under active public debate. The American ambassador to Romania has stated that the Romanian government's failure to embark on a real and politically neutral anticorruption campaign may seriously harm the country's chances of joining NATO at the end of 2002. Officials of the European Union have sent the same kinds of signals.

ECONOMIC LIBERALIZATION & SOCIAL INDICATORS

Privatization				
1997	1998	1999-2000	2001	2002
4.50	4.50	4.00	3.75	3.75
Macroeconomic Policy				
1998	1999-2000	2001	2002	
4.50	4.00	3.75	3.75	
Microeconomic Policy				
1998	1999-2000	2001	2002	
4.50	4.50	4.50	4.25	

The Romanian transition has been at its most erratic in the economic domain. Eleven years of zigzagging policies and a general reluctance to implement reforms out of a fear of their political costs have not been without consequence: in spite of some hopeful signs, Romania is last in line for accession to the European Union. The year 2001, though, was marked by substantial growth—4.9 percent—possibly the highest in the region. This economic upturn began in 2000 after the previous government paid over \$2 billion in debt and started encouraging exports. The increase in exports (9.8 percent year-on-year) was also responsible for much of the growth in 2001. Nevertheless, Romania has a persistent trade deficit, which in 2001 reached \$4.166 billion owing to an even more rapid increase in imports to \$15.552 billion.

During the period covered by this report, inflation dropped from a high of 44.9 percent in 2000 to 30.3 percent. In mid-2001, the external debt was \$10.7 billion, \$1.8 billion higher than a year ago. At the same time, foreign exchange reserves increased from \$2.1 billion in 2000 to \$3.6 billion in August 2001.

Much of the economic improvement since 2000 has been based on increased exports and progress in restructuring and privatization. These changes will increase medium- and long-term economic competitiveness. Confidence in the economic upturn even led Standard & Poor's to upgrade its ratings for Romania and change its outlook to "positive."

A total of 7,485 state companies have been privatized in the last 11 years, and only 600 remain on the lists of the Authority for the Administration of State Assets. However, the remaining companies are the least profitable of the lot. They persistently produce large arrears and create the biggest drain on the state budget. In 2001, 127 companies were privatized, netting 9,822 billion lei (approximately \$337,897), which represents one-third of the social capital available at the beginning of the year and a 1.56 percent increase vis-à-vis the previous year. Among the privatizations

in 2001 were Banca Agricola, SIDEX Galti, Rafo Onesti, Hidromecanica Brasov, Argesana Pitesti, and Navigatia Fluviala Romana. At the end of 2001, the privatization agency was left with 19,927 billion lei in assets (\$685,530). The last "crown jewels" are Banca Comerciala Romana (BCR), ALRO Slatina, and ALPROM Slatina.

International organizations and the European Union have considerably helped the government pursue an accelerated pace in privatization and economic restructuring. The EU has initiated the RICOP program for the preparedness of companies in view of privatization. Likewise, the World Bank's Private Sector Adjustment Loan Agreement has helped the government restructure 62 large state-owned companies and 1,500 small and medium ones. PSAL also helped the government liquidate the bankrupt Bancorex, which had made numerous unprofitable loans based on political rather than economic criteria. A PSAL II Agreement is under negotiation. Although a second IMF line of credit has been postponed, one hopes this will not affect the signing of PSAL II, which reaches 300 million euro and includes the privatization of 20 companies.

Over the years, some privatization deals have been suspected of involving corruption, primarily because of their lack of transparency. These allegations have also been used as opportunities to score political points on both sides of the political aisle. More worrisome, however, is the fact that in 2001 the government canceled a privatization deal for TEPRO Iasi, which had been bought by a Czech company. The government is also in arbitration court over the privatization of the Resita Steel factory, which was bought by Noble Ventures, an American concern. The government has justified its decisions to rescind privatization contracts on the basis of the alleged failure of foreign investors to honor contractual obligations. To address the problem, the state authority in charge of privatizations has added a new monitoring department to ensure compliance with contractual obligations.

For the last 11 years, the Romanian economy has followed a boom-bust pattern. Interestingly, it has been an anticyclical pattern, so that when the world economy has been in recession, the Romanian economy has followed an upward trend. For the moment, Romania has retained a growth trend that began in 2000. With a 4.9 percent increase in GDP, the economy shows one of the highest growth rates in the region.

Bank assets represent only 29 percent of Romania's GDP, compared with an average of 68 percent in the rest of Eastern Europe. Although only 50 percent of bank assets are in private hands, this rate is expected to reach 80 percent after the privatization of the Commercial Bank of Romania (BCR). The bank, Romania's largest, will be privatized in 2002. The state owns 70 percent of BCR, and the rest belongs to the five state-owned, but theoretically independent, investment funds. BCR's profits were \$146 million in 2001. The state intends to sell only a 51 percent share.

In 2001, a set of new laws was adopted to modify the statutes of both the National Bank of Romania (BNR) and the country's commercial banks. In addition, a Law on the Bankruptcy of Banks was adopted. Together, these laws will help BNR more effectively control banking activity and make it much more difficult for banks to avoid bankruptcy. Among other things, the laws provide a workable definition of default: the impossibility to pay a liquid debt in a maximum of 7 working days.

After almost a year of negotiations, the government signed a new standby agreement with the IMF in October 2001. The agreement, for \$380 million, is valid for 18 months. As part of the agreement, the government pledged to continue privatizations (including that of the BCR), to eliminate subsidies for electricity (which will increase by 3.6 percent each month in the winter), to reduce the number of civil servants and other public administration staff, and to establish a 3.5 percent ceiling on the budget deficit. The IMF agreement will help the government obtain almost \$1 billion in loans, a considerably larger amount than the approximately \$600 million it received between 1998 and 2000. Predictions for 2002 are for growth of around 5 percent, inflation of 22 percent, and a deficit of 3 percent.

In spite of the current economic growth, there are a few areas of concern, such as growing arrears. The unpaid debts of public companies now amount to a staggering 50 percent of GDP. Also, at a 30.3 percent annual rate, inflation remains exceptionally high. Finally, the current account deficit is growing and is expected to reach \$4.4 billion—an amount that will put pressure on the national currency, the leu, and provoke an increase in inflation. Last but not least, foreign direct investment in Romania remains low, in spite of FDI growth in 2001 of 21 percent. The leu itself remains relatively steady owing to the influx of \$600 million per year from the EU and to the contribution of almost \$1 billion a year from Romanians working abroad.

The Romanian Constitution “protects” but does not guarantee property rights. This ambiguity has resulted in considerable political debate over the last decade. Romania's new restitution law, adopted in 2001, is probably the latest example. Rather than returning property to former owners, the law in effect enshrines the state's illicit sale of property to tenants in the early 1990s. In fact, the law essentially makes it legal for the people now in power to have sold property to themselves when they were in power the first time. In addition, the compensation the law provides when property cannot be given back in kind is at the mercy of local administrations that are cash poor and cannot afford to pay market rates. Thus, the law allows the state to offer shares in state-owned properties as compensation. The problem is that the only properties left are bankrupt. To make matters worse, in Bucharest, the mayor (elected) and the prefect (named by the government) are at odds on matters of restitution. The mayor applies the law and restitutes available buildings, while the prefect suspends the mayor's decisions.

On the other hand, an encouraging sign of economic

liberalization has been the suspension of subsidies for heat, electricity, and other utilities. That's the good news. The bad news is that the 3.5 percent increase per month is more than many Romanians can afford.

An increase in FDI is the panacea everyone hopes for. Fluctuations in FDI are the result of an unsettled macroeconomic climate, an unstable legislative environment, and relatively high inflation. But a large share of responsibility for the low level of investment in general—and FDI in particular—is borne by Romania's all too controlling state. For a business to open, it must complete 83 pages of forms. As mentioned in a previous section of this report, the consolidated registration office set up by the SME Ministry is a step in the right direction. However, the quantity of paperwork is not affected by this measure. Another measure destined for SMEs is the newly introduced turnover tax, which simplifies matters on the one hand but, on the other, penalizes enterprises that are operating at a loss.

To improve Romania's attractiveness to foreign investors, the government opened a new department in 2001 to deal with those planning to invest \$10 million or more. Some have criticized the move as increasing arbitrariness. Other measures meant to draw investment are more closely related to the newly signed IMF memorandum, which among other things demands uniformity in dealing with tax and customs duties and suggests a limit on items that are exempt from VAT. Excise taxes will be brought in line with European Union levels. To further reduce the pressure on the current account deficit, some of the privileges recently granted to SMEs may be taken back. Remaining subsidies, especially on energy prices, will also be liberalized. The EU accession negotiations include the privatization of utilities. Thermal power production units will be privatized in an accelerated rhythm of two per year so that by 2004, 25–30 percent will have been privatized. At the same time, the state-owned oil company PETROM has been listed on the stock exchange in an attempt to inject market discipline and transfer shares into private hands.

In addition to focusing on attracting investments, the government is keen on preventing the brain drain of Romania's youth—a problem that is especially manifest in the high-tech industry. Along with a new legislative package on the regulation of e-commerce, the government decreed a tax exemption on wages for programmers in the information technology and communications sector, as well as for some other occupations.

Romania's economic hardships have primarily affected the working class and pensioners. Average wages remain among the lowest in Europe, at \$151 per month. The net average is \$104 per month, which represents an increase of \$10 over 2000. GDP per capita is \$1,633, or \$5,928 at purchasing power parity. This represents 26 percent of the purchasing power parity in Germany and about half that in neighboring Hungary and the Czech Republic. In Romania, a country that was once known for its resources, real poverty (defined by the World Bank as “people living on

less than 1 dollar a day”) has become a serious problem that affects 41 percent of the population. This has natural repercussions on health and other human development indicators. Life expectancy is only 67.03 years for men and 74.20 for women, and infant mortality is among the highest in Europe at 18.6 per 1,000. The birthrate is equally low, reaching 10.4 per 1,000 in 2000. General mortality has improved slightly, going from 11.8 per 1,000 in 1999 to 11.4 per 1,000 in 2000 and 2001. These factors, including a high rate of emigration, have led to a decrease in the total population from 23 million in 1989 to 22.4 million in 2001.

Reforms in the health care field began several years ago with the Law on Health Insurance. Every employee now pays 7 percent and every employer matches with another 7 percent contribution for health benefits. This law, in effect since 1998, has raised available funds for health care to a total of 5 percent of GDP (4 percent public expenditures and 1 percent private). However, the implementation of the law remains problematic: hospitals cannot pay their bills, and pharmacies are having difficulty honoring prescriptions for medications for which they should be reimbursed. The financial flows from the Ministry of Finance, which collects the funds, to the county insurance company offices, which distribute them, are not yet functioning efficiently and are creating blockages in the system.

Romania’s pension system is also awaiting thorough reform, and experts consider the pay-as-you-go formula a “time bomb.” Romania has more pensioners than working

people at a ratio of roughly six to four. A low retirement age, early retirement, and abuses of disability pensions are but some of the reasons for the current problem. Although the last administration contemplated the introduction of a new private pension system, those plans were tabled after the 2000 elections. Since then, the new administration has been unwilling to tackle the issue in light of the disastrous crash of the FNI investment fund. However, on April 1, 2001, a new Law on Pensions was adopted. It raises the retirement age from 57 to 60 for women and from 60 to 65 for men and tries to curb many of the abuses.

A number of observers believe the new pension law is too timid. In contrast, workers did not welcome the move at all, and tensions finally erupted in protest in November 2001. The public sector’s health care and education personnel led demonstrations that were impressive not so much for their intensity as for their broad base of support. Protest organizers charged that the government had broken pledges it made to trade unions at the beginning of its mandate. Indeed, the submitted state budget was austere and, together with reform of the pension system, contributed to restricting extra benefits that had been lavishly available in the past.

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EXHIBIT E

[Go To Best Hit]

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Region: East Europe**Sub-Region: Balkan States****Country: Romania****Topic: INTERNATIONAL ECONOMIC, INTERNATIONAL POLITICAL, LEADER****Source-Date: 10/09/2002****PNL's Stolojan Says Romania Only EU Candidate Without Functional Market Economy***EUP20021009000488 Bucharest Rompres in English 1810 GMT 09 Oct 02***Reference:**

1. PM Nastase Sees EC Country Report as Balanced Assessment of Romania's Situation
EUP20021009000489 Bucharest Rompres English 1810 GMT 09 Oct 02

[FBIS Transcribed Text]

Bucharest, Oct 9 [Rompres] -- President of the National Liberal Party Theodor Stolojan said on Wednesday, 9 October, that although a report of the European Commission referred to progress in Romania, it was the only one of the 12 countries seeking integration into the European Union, which continued to have a non-functional market economy, with Bulgaria ranking before it. Stolojan said that the year 2007 for Romanian accession to the EU had no relation with the precise date when Romania would be admitted, it was only a legitimate wish of Romania and Bulgaria. "If Romanian will not go on with the reforms, the year 2007 will be irrelevant. Our country will be admitted when it demonstrates that it is ready to," said Theodor Stolojan an ex-prime minister. According to Theodor Stolojan, from the 12 Eu candidate countries, Romania is the only country with inflation higher than 20 percent, as its monetary and fiscal policies were an incentive for financial lack of discipline, and the fact that many companies and national companies were not restructured and made losses facilitated their access to resources created by others. After two years of ruling of the Social Democratic Party, Romania consolidated its last position among the 12 Eu candidate states, said Theodor Stolojan. The European Commission's report is an analysis of Romania's trends over 1997-2002, with the PSD [Social Democratic Party] at rule during two years of this span of time. [Description of Source: Bucharest Rompres in English -- government press agency]

EXHIBIT F



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Romania

Country Reports on Human Rights Practices - 2001

Released by the Bureau of Democracy, Human Rights, and Labor

March 4, 2002

Romania is a constitutional democracy with a multiparty, bicameral parliamentary system. Prime Minister Adrian Nastase is the Head of Government and President Ion Iliescu is the Head of State; they won elections in November and December 2000 that were judged to be generally free and fair. The judiciary is a separate branch of the Government; however, in practice the executive branch exercises influence over the judiciary.

The National Police are primarily responsible for law enforcement, the Gendarmerie for preserving public order, and the Border Police for maintaining border security. The Ministry of the Interior supervises these organizations. Protection against external threats is the primary responsibility of the military. An internal intelligence service assesses threats to national security but has no law enforcement powers. All security and intelligence organizations operate under the authority of civilian leadership. Some police officers committed serious human rights abuses.

Romania is a middle-income, developing country in transition from a centrally planned economy to a market economy. Its population is approximately 22.4 million. The private sector accounted for 64.5 percent of gross domestic product (GDP) and employed 62.8 percent of the work force, primarily in agriculture, commerce, and services. Although privatization is under way, government ownership remains dominant in the industrial sector. During the year, 183 firms were privatized. Approximately 1,200 firms are left in the State Privatization Fund's portfolio, including several of the country's largest firms. The GDP grew 1.6 percent during 2000, and estimated GDP growth during the year was 4.5 percent. Per capita GDP in 2000 was approximately \$1,639. Exports increased 21 percent in 2000 and rose 16 percent in the first half of the year compared to the same period of 2000. Inflation decreased from 54.8 percent in 1999 to 40.7 percent in 2000 and was estimated at 32 percent for the year. Official statistics significantly understate economic activity because of the size of the informal economy.

The Government generally respected the rights of its citizens; however, its human rights record was poor in some areas. Police use of excessive force resulted in four deaths. Police officers continued to beat detainees and reportedly used excessive force and harassed Roma. The Government investigated some police officers suspected of abuse and in some cases indicted those accused of criminal activities in military courts. However, investigations of police abuses generally are lengthy and inconclusive and rarely result in prosecution or punishment. While some progress was made in reforming the police, cases of inhuman and degrading treatment continued to be reported. Prison conditions, although somewhat improved, remained harsh, and overcrowding remained a serious problem. At times authorities violated the prohibition against arbitrary arrest and detention. The judiciary remained subject to executive branch influence. Authorities evicted a number of Roma from their homes as part of a program to return illegal squatters on public land to their places of origin. Religious groups not officially recognized by the Government complained that they received discriminatory treatment from the authorities. Violence and discrimination against women remained serious problems. There was a large number of impoverished homeless children in large cities. Societal harassment of religious minorities remained a problem, and discrimination and instances of societal violence against Roma continued. Child labor was a problem. There were reports of government interference in trade union activity. Trafficking in women and girls for the purpose of prostitution was a problem.

RESPECT FOR HUMAN RIGHTS

Section 1 Respect for the Integrity of the Person, Including Freedom From:

a. Arbitrary or Unlawful Deprivation of Life

There were no reports of political killings; however, in three instances police used excessive lethal force which led to the deaths of citizens.

Under a 1994 law, police may shoot in order to stop persons who are fleeing from attempts to take them into custody. The law also allows the use of firearms against persons who have escaped detention or run away from an escort, and allows other law enforcement bodies to use force under similar circumstances. On April 26, police shot and killed Mihail Dombi in Oradea, in Bihor County. Dombi had been issued a warrant to serve an additional year of a 3-year sentence for fraudulent insurance schemes. Police reported that Dombi fled from the police, refused to stop after they fired warning shots, and they reportedly shot him in the head when they tried to shoot him in the legs. Eyewitnesses claim that police fired at Dombi even though he had halted after a verbal warning, and that they did not fire warning shots or shoot only to injure him. No further information was available on the case at year's end.

On July 6, in the village of Buda in Bacau County, police beat Dumitru Grigoras to death while in custody. Police took Grigoras into custody after his wife asked police to calm him down after a fight. Police beat Grigoras; family members saw signs of beating, and a witness near the police station reported hearing Grigoras scream. Villagers told APADOR-CH, a nongovernmental organization (NGO) affiliated with the International Helsinki Federation, that the police chief in Buda had a reputation for brutality and violence. No further information was available on the case at year's end.

In July two policemen beat a suspect to death while attempting to obtain a confession. The victim, a worker at the Mechanical Plant in Cugir, was suspected of stealing construction materials. His body was found the next day on the outskirts of the city, and an autopsy showed that the victim had several injuries and fractures caused by blows. On July 7, two police officers from the Cugir police in Alba County were arrested and charged with the use of lethal force and abusive investigation. Several other officers in the leadership of the Alba County Police and Cugir City Police were dismissed or demoted.

On December 26, 2000, police found Mircea Chifan of the village of Vicovul de Jos dead in his cell in the Suceava County police jail. Chifan, who had a record of psychiatric problems, was in custody for beating his wife and had tried to escape from his cell. While the forensic report indicated that cirrhosis of the liver was the cause of death, it also noted that Chifan had been struck earlier, and police had not allowed him access to medical care. Chifan's relatives said that they had not been allowed to see him while he was in custody. No further information was available on the case at year's end.

Prosecutors ruled during the year that the shooting death of Petrea Letea while fleeing police in May 2000 was a legitimate use of deadly force by police officers under the law.

In several cases of deaths in custody or deaths reportedly due to police brutality during 1999, investigations and trials continued to drag on. There was no further information on the progress of investigation into the following 1999 cases: the death in police custody of Aurel Uluteanu in Barcanesti; the death of Cristian-Venus Dumitrescu, who allegedly was beaten by police in September 1999 and died after he "threw" himself out of a third floor window en route to a police station; the death of Sevastian Apostol, a Rom killed by police while trying to flee a bar where he had a serious conflict with the owner and other clients; the death of Elinoiu Toader, who died after being beaten by police; and the killing of Radu Marian, an unarmed Rom who was killed during a police raid on a group of cigarette smugglers.

According to the Government, the chief of police in Valcele was indicted in June 1999 for the illegal use of his weapon in the 1996 killing of Mircea-Muresul Mosor, a Rom from Comani who was shot in the back and killed while in police custody. A lower court found the police officer not guilty, but the prosecutor's office appealed the verdict in May 1999; the superior court's decision remained pending at year's end.

There was no further information in the November 2000 killing of Sorin Moldovan, deputy chairman of the Hunedoara County branch of the Party of Social Democracy (PSD), who was killed by an unknown assailant.

b. Disappearance

There were no reports of politically motivated disappearances.

c. Torture and Other Cruel, Inhuman, or Degrading Treatment or Punishment

The Constitution prohibits torture and inhuman or degrading punishment or treatment; however, there were credible reports that police beat detainees and used excessive force. Human rights organizations cited numerous reports of torture and mistreatment by police. On at least two occasions police beat detainees to death (see Section 1.a.).

On March 26, Arges county police detained Vasile Danut Moise, 14-year-old boy, for allegedly stealing a cow. Police beat Moise with a nightstick and a bat on his arms and back in order to obtain a confession from him. A subsequent medical evaluation by a hospital indicated that his injuries were consistent with being beaten. At year's end, prosecutors were investigating several officers for abusive investigation and illegal detention.

On April 5, a railroad police officer beat Ioana Silaghi, a 15-year-old girl, in Oradea in Bihor County. The police officer claimed that Silaghi had stolen his cell phone, and hit and kicked her in the police station in the Oradea railroad station. A forensic report indicated that Silaghi had been beaten. At year's end, the officer was under investigation for abusive use of force.

On July 3, the intervention squad of the Brasov police arrested and beat Italian citizen Massimo Lucarelli. The police mistakenly

identified Lucarelli as Cornel Racoare, a wanted criminal who had threatened to kill several law enforcement officers. In July following the complaint filed by Lucarelli and an investigation conducted by military prosecutors, the chief of Brasov County Police received a verbal reprimand and his promotion was delayed for 2 years.

Romani NGO's claimed that police used excessive force against Roma and also subjected Roma to brutal treatment and harassment (see Section 5). A human rights NGO alleged that prosecutors commonly refused to open criminal investigation into allegations of police abuse against Roma. When investigations are initiated, they often proceed slowly, and cases often close without indictment decisions. Police apathy regarding crimes against Roma is a problem (see Section 5).

In January police reportedly beat Roma in Zizin, a settlement near the town of Brasov, while searching for a group of Romani men who were collecting scrap metal. Police forcibly entered and used a spray irritant in Romani homes. NGO's reported police intimidation of Roma on February 1 and 9, when masked police officers with dogs boarded trains from Tohanul Vechi to Brasov, forced over 100 Roma to exit the train and board police vans, and drove them to the police station to be fingerprinted. The police reportedly threatened the Roma not to travel to Brasov. The Railway Transportation Police of Brasov told the NGO Romani CRISS that they were taking action to curb begging in Brasov (see Section 5). Romani CRISS filed criminal complaints over the incidents. In August military prosecutors declined to prosecute the police, claiming that there was insufficient evidence of police abuse.

On April 3, in Suceava County, NGO's reported that the Deputy Mayor of Dolhasca, four police officers, and four members of the police intervention squad harassed and beat Roma in the village of Gulia. They reportedly assaulted Roma residents, including a 14-year-old boy, who subsequently was hospitalized. In addition a police sergeant reportedly hit a Romani man when he did not move his horse cart out of the way of police vehicles. In response Romani CRISS filed a complaint against the police officer who beat the boy with the Military Prosecutor's Office in Bacau; the Military Prosecutor initiated a formal investigation into the complaint but in October declined to prosecute the police officer, claiming that there was no evidence of police abuse.

Gays and lesbians continued to face police harassment. For example, in December 2000, Adrian Georgescu was taken into custody by police and was questioned about his sexuality by police officers. In January, a police officer admitted on Romanian television that Georgescu had been detained solely because of his sexual orientation. Georgescu filed a complaint against the police officer; however, a lower court dismissed the case. Georgescu's appeal was ongoing at year's end.

In several cases of police beatings from past years, investigations continued without resolution, and, in some cases, charges were dropped by prosecutors. On August 28, 2000, policemen from the Bacau County police intervention squad arrested Vasile Anghel from the Don Vito bar in Bacau City and beat him. Anghel was hospitalized and subsequently was given a medical certificate testifying to his injuries. Anghel then pressed charges against a Bacau County police officer. On September 9, Bacau County police raided Anghel's house in Luizi Calugara village in Bacau County, searching for fugitive Luca Mihai, who was reportedly at Anghel's house, detained Anghel, took him to Bacau police headquarters, and seized his medical certificate and his complaint against the Bacau County police officer. Police investigators concluded that Anghel refused to cooperate with the police in the initial incident at the Don Vito bar, was disorderly, and tried to injure himself by hitting his head against the door of the police car, and therefore police acted properly. Police investigators said that they did not seize Anghel's certificate or complaint in the September raid and that Anghel was uncooperative in the search for the fugitive Mihai. At year's end, Anghel's complaint to the Bacau Military Prosecutors office over the second raid remained under investigation.

There was no further information available in the case of Mugurel Soare, a Romani man, who was shot and severely injured by police in May 2000. In August 2000, prosecutors dropped charges against police officers who were accused of beating Alexandru Botu in Prunaru village in Teleorman County in February 2000. Prosecutors continued to investigate the claims of Constantin Vrabie, who was beaten by police after being taken from a disco in Candesti in Buzau County in January 2000. Prosecutors dropped charges against police officers who beat Silviu Rosioru, also in Buzau County in January 2000. Buzau County police subsequently reprimanded and transferred to another unit the chief of the Buzau County police intervention squad--the unit involved in these cases. They demoted several other officers in the squad and transferred an additional officer to another unit. Investigations into the 1998 police beating of Nicolae Iloaie of Tandareni and the police shooting of Marian Ciulei from Brasov were ongoing at year's end.

Judicial cases involving military personnel and the police are tried in military courts (see Section 1.e.). At times some military prosecutors blocked proper investigation of alleged police abuses, or courts passed extremely light sentences. For example, sentences of between 1 and 11/2 years were handed down during the year for the beating of a girl in 1997; ultimately, the sentences were suspended.

Prison conditions are harsh; however, efforts to improve the prison system have led to some gradual but positive changes. The prison budget increased by \$71 million over the 2000 budget. There are a total of 43 penal units (an increase from 41 in 2000), 34 prisons, 5 prison hospitals, and 3 juvenile detention facilities (an increase from 2 in 2000). Nevertheless overcrowding remained a serious problem, although it improved slightly from 2000. On January 9, 50,370 persons, including 800 minors (down from 1,571 in 2000--see Section 5), were in detention. The legal capacity of the system was 35,246. The law provides for alternative sentences for minor offenses. Specifically the law, which has been moderately successful, provides for community service instead of a prison sentence and is aimed at reducing the prison population. Men and women, adults and juveniles, and pretrial detainees and convicted criminals are housed separately in the prison system.

Human rights organizations continued to report that the abuse of prisoners by other prisoners and prison authorities was a problem. Prisons continued to use the "cell boss" system, in which some prisoners are designated to be in semiofficial charge of other prisoners in places where there were 10 or more prisoners in the same room. There were attempts to ameliorate this

system by giving the inmates the right to select these "cell bosses" by vote, which has improved the situation slightly. Prison authorities introduced some vocational training programs to assist inmates' future integration into society, which also led to some improvement.

The Government permitted prison visits by human rights monitors; however, the Ministry has tightened conditions for prison visits. The new regulations, which are authorized by internal regulations that the Ministry does not release to the public, require that the visit be requested by a prisoner, and be announced 3 to 4 days in advance. Several domestic and international NGO's made such visits during the year.

d. Arbitrary Arrest, Detention, or Exile

The Constitution prohibits arbitrary arrest and detention; however, at times the authorities did not respect this right in practice. The law forbids the detention of anyone for more than 24 hours without an arrest warrant from a prosecutor, who may order detention for up to 30 days, and authorities generally respected this provision in practice. Detention can be extended past the 30-day limit only by a court ruling; however, courts and prosecutors often extend pretrial detention, to several years in some cases. Pretrial detention counts towards sentence time if a detainee is convicted. The use of pretrial detention decreased; one out of every three individuals in the prison system in 1995 was a pretrial detainee, compared with one in five in 2000. Detainees have the right to apply for bail, but in practice bail rarely is granted. Detainees may also ask for a hearing before a judge. Such a request must be granted within 24 hours.

Police often appear to take advantage of Article 16, Section b in the Police Organization Law 26 of 1994, which states that persons endangering the public, other persons, or social order and whose identity cannot be established, can be taken to a police station. Police often use this provision of the law to detain persons for up to 24 hours at a police station. Roma are disproportionately affected by this detention provision and often are viewed suspiciously by police. Roma often lack appropriate identity documents, which makes it easier for police to apply this article.

The law requires the authorities to inform those arrested of the charges against them and of their right to an attorney at all stages of the legal process. Police must notify defendants of this right in a language they understand before obtaining a statement; however, police often do not inform citizens of their rights. In addition the prosecutor's office may delay action on a request for a lawyer for up to 5 days from the date of arrest.

Under the law, minors detained by police and placed under guard in a center for the protection of minors are considered by judicial authorities to be in detention or under arrest if their age is more than 16, or, if between the ages of 14 and 16, if they have consciously committed a crime. However, since the Penal Code does not apply to minors in these centers until their cases are referred to a prosecutor, police are permitted to question them without restriction and may hold those suspected of criminal offenses for up to 30 days in such centers. This law appears to be in conflict with the Constitution, and local and international human rights groups have called on the Government to change it.

According to APADOR-CH, the Interior Ministry issued new instructions on detention in 1999 that provide for the confidentiality of discussions between detainees and their lawyers; this law was respected in practice.

At year's end, prosecutors were investigating several officers for the illegal detention of Vasile Moise (see Section 1.c.). The Government detained asylum seekers indefinitely in some cases (see Section 2.d.).

In May NGO's reported that the mayor of Tarry Murex issued an order to the city's public guardians (civilians deputized by the mayor to conduct rudimentary police duties) to take all of the city's beggars into custody. Approximately 70 to 80 Roma were detained in a castle for identification purposes; those who were not legal residents of the city were expelled. NGO's reported that there was no evidence that the Roma detained were begging.

The law prohibits forced exile, and the Government does not employ it.

e. Denial of Fair Public Trial

Under the law, the judicial branch is independent of other government branches; however, it remains subject to influence by the executive branch. Although members of the Senior Council of Magistrates, which controls the selection, promotion, transfer, and sanctioning of judges, are appointed by Parliament from a list provided by the courts and prosecutorial offices represented on the council, the Justice Minister may avoid the appointment of unwanted members by simply keeping them off the agenda. The judicial system widely is regarded as weak, inefficient, and suffering from systemic corruption, although the Ministry of Justice is investigating and bringing prosecutions against corrupt judges and officers.

The law establishes a four-tier legal system, including appellate courts. Defendants have final recourse to the Supreme Court or, for constitutional matters, to the Constitutional Court. The judicial system divides the Prosecutor General's Office into 16 local offices (paralleling the appeals court structure) and establishes an office at the Supreme Court.

Judicial cases involving military personnel and the police are tried in military courts. Local and international human rights groups criticize this system, claiming that the military prosecutor's investigations are unnecessarily lengthy and often purposefully inconclusive (see Section 1.c.).

The law provides for the right to a fair trial; however, the judiciary suffers from systemic corruption. Defendants are presumed innocent. The Penal Code requires that an attorney be appointed for a defendant who cannot afford legal representation or is otherwise unable to select counsel. In practice the local bar association provides attorneys to the indigent and is compensated by the Ministry of Justice. Either a plaintiff or a defendant may appeal. The law provides that confessions extracted as a result of police brutality may be withdrawn by the accused when brought before the court; the practice of extracting confessions through beating occurs occasionally. Due to a lack of a plea bargaining, the judicial system tends to be inefficient and slow. An average case takes 4 1/2 years before it is finished.

There were no reports of political prisoners.

f. Arbitrary Interference with Privacy, Family, Home, or Correspondence

The law prohibits such actions; however, there were some restrictions. The Constitution provides for protection against the search of a residence without a warrant; however, this protection is subordinate to "national security or public order." The law defines national security very broadly and lists as threats not only crimes such as terrorism, treason, espionage, assassination, and armed insurrection but also totalitarian, racist, and anti-Semitic actions or attempts to change the existing national borders. Security officials may enter residences without proper authorization from a prosecutor if they deem a threat to national security to be "imminent;" however, such actions are rare.

The Constitution states that the privacy of legal means of communication is inviolable; thus, the Romanian Internal Intelligence Service (SRI) is prohibited legally from engaging in political acts (for example, wiretapping on behalf of the Government for political reasons). However, the law allows the security services to monitor communications on national security grounds after obtaining authorization. The law requires the SRI to obtain a warrant from the "public prosecutor specially appointed by the General Public Prosecutor" in order to carry out intelligence activities involving "threats to national security." It may engage legally in a wide variety of operations such as surveillance, requesting official documents or information, or consulting with technical experts, to determine if a situation meets the legal definition of a threat to national security, or to prevent a crime.

The law permits citizens access to secret police files kept by the Communist government. Under the law, any Romanian or foreign citizen who had Romanian citizenship after 1945 is entitled to have access to his file; a council approved by Parliament reviews the files and releases the information unless it was a state secret or could threaten national security. The files remain in the custody of the intelligence services. This law has been criticized for exempting files of current employees of the intelligence services from review and changing the definition of an informer to require actual payment.

In March the Parliament passed legislation requiring individual citizens to report foreign guests to the police if the guest remained in the country for more than 2 weeks; this legislation has been criticized by human rights groups as infringing on privacy rights. Some minority groups, including ethnic Hungarians and Germans, also expressed concern over the law, since they often have family visitors for extended periods of time.

During the year, the Parliament passed legislation that would have imposed stiff penalties on private citizens who failed to protect state secrets and would have allowed the Romanian Internal Intelligence Service to place its agents in areas considered sensitive, such as factories working for the defense industry and private companies producing maps. Both domestic and international groups expressed concern that the bill would limit citizen's rights, and in April the Constitutional Court declared the bill unconstitutional.

A Government-sponsored program called "Back Home," aimed at returning persons who were illegally squatting in Bucharest (largely on public land) to their places of origin has been criticized strongly by human rights NGO's as forcing Roma out of their homes. For example, in April authorities evicted 10 Romani families who were squatting in 2 apartment blocks in the village of 1 Decembrie, in Ilfov County (which surrounds Bucharest). In May the authorities evicted several Romani families from the Vacaresti Lake area in Bucharest and evicted approximately 100 Roma from the Militari district of Bucharest and escorted them out of the city. In June authorities evicted five Romani families from the vicinity of Tineretului Park in Bucharest and returned them to their places of origin in Teleorman County. Also in June, authorities returned to their countries of origin 55 Roma who were squatting on public property in Sector 2 in Bucharest. Authorities also evicted over 60 Roma from Sector 6 in Bucharest. On July 5, representatives of the Sector 5 mayor's office of Bucharest evicted 200 Roma and escorted them out of the city.

Section 2 Respect for Civil Liberties, Including:

a. Freedom of Speech and Press

Although the Constitution provides for freedom of expression and prohibits censorship, it limits free expression by prohibiting "defamation of the country" and "offense to authority;" the Government generally respected the constitutional provisions in practice.

The Penal Code has been criticized by human rights organizations and professional journalists for retaining jail terms for those convicted of libel or slander, including journalists. Despite official promises that jail terms would be removed from the penalties for libel, calumny, "defamation of the nation," and "defamation of public officials," Parliament had not amended the relevant sections of the Penal Code by year's end. However, in June 2000, on the recommendation of the Council of Europe, the

Chamber of Deputies passed draft legislation that would reduce the sentence for libel to a fine instead of a prison term, and that would decrease the sentence for calumny to 3 to 12 months instead of the previous 2 to 6 years. This draft legislation had not been passed by the Senate or signed into law by the President by year's end.

Independent media continued to grow in an increasingly competitive market. Several hundred daily and weekly newspapers are published. Foreign news publications may be imported and distributed freely, but high costs, relative to domestic publications, limit their circulation.

Several private television stations broadcast nationwide, with the largest reaching approximately 45 percent of the rural and 85 percent of the urban market. There are 117 private television stations and 260 private radio stations. Approximately 3.4 million households were wired for cable, giving significant portions of the population access to both private and foreign broadcasts. Romanian State Television (RTV), Radio Romania, and the Europa FM radio network remained the only national broadcasters capable of reaching the bulk of the rural population at year's end. Independent stations continued to enlarge their coverage throughout the country by over-the-air, cable, and satellite transmissions.

Press and television coverage generally reflects the political viewpoints of owners, which cover most of the political spectrum. State-owned television and radio coverage tends to be biased in favor of the Government. In December, on a party line vote, the ruling party forced out the governing board of the state owned radio network, which had been appointed by a previous government. The new radio leadership is likely to reflect the ruling party's views in its new coverage. Media accuracy is not high but has been improving gradually. The Parliament failed to rescind the prohibitions on "defamation of the nation" and "defamation of public officials." Civil liberties advocates wanted these prohibitions rescinded to reduce the threat that they might be used to harass and punish journalists who report governmental or bureaucratic corruption. In the past, several journalists were arrested and tried for reporting on corruption by local government officials, and journalists who were investigating corruption cases also were targets of violence, mainly from those whose private interests were threatened. However, there were no reports that these provisions of the law were used to harass journalists during the year.

In the past, there were reports of police abuse of journalists; however, there were no such reports during the year. There were no further developments in the Interior Ministry's investigation of the case of journalist Valentin Dragan, who was beaten by police in May 2000. There also were no reports of other violence against journalists during the year.

Access to the Internet is not restricted.

Academic freedom is respected.

b. Freedom of Peaceful Assembly and Association

The Constitution provides for freedom of assembly, and the Government generally respected that right in practice. The law on public assembly provides for the right of citizens to assemble peacefully while unarmed but states that meetings must not interfere with other economic or social activities and may not be held near locations such as hospitals, airports, or military installations. Organizers of demonstrations must inform local authorities and police before the event. Authorities may forbid a public gathering by notifying the organizers in writing within 48 hours of receipt of the request. The law prohibits the organization of, or participation in, a counterdemonstration held at the same time as a scheduled public gathering. The law forbids public gatherings to espouse Communist, racist, or Fascist ideologies or to commit actions contrary to public order or national security. Unauthorized demonstrations or other violations are punished by imprisonment and fines.

The Constitution provides for freedom of association, and the Government generally respects this right in practice. Political parties gain legal status if they have at least 10,000 members. Associations may be granted legal status with proof of 20 founding members and at least 200 supporting members.

c. Freedom of Religion

The Constitution provides for freedom of religion and the Government generally respects this right in practice; however, there are some restrictions, and several minority religious groups continued to claim credibly that low-level government officials and Romanian Orthodox clergy impeded their efforts at proselytizing, as well as interfered with other religious activities (see Section 5). The press reported several instances when adherents of minority religions were prevented by others from practicing their faith, and local law enforcement authorities did not protect them. The Romanian Orthodox Church predominates; approximately 86 percent of the population nominally adheres to it.

The Government officially recognizes 15 religions; only the clergy of these 15 recognized religions are eligible to receive state financial support. Recognized religions have the right to establish schools, teach religion in public schools, receive funds to build churches, pay clergy salaries with state funds and subsidize clergy's housing expenses, broadcast religious programming on radio and television, apply for broadcasting licenses for denominational frequencies, and enjoy tax-exempt status. The number of adherents each religion had in the 1992 census--the last census taken--determines the proportion of the budget that each recognized religion receives. Representatives of minority religious groups dispute the 1992 census results, claiming that census takers in some cases argued with citizens over their religious affiliation or assigned an affiliation even without inquiring about religious affiliation.

The Government requires religious groups to register, and government registration and recognition requirements pose obstacles to minority religions. To be recognized as a religion, religious groups must register with the State Secretariat for Religious Denominations and present their statutes, organizational, leadership, and management diagrams, and the body of dogma and doctrines formally stated by a religion. Representatives of religious groups that sought recognition after 1990 allege that the registration process was arbitrary and unduly influenced by the Romanian Orthodox Church, that they did not receive clear instructions concerning the requirements, and that often the time frame in which a decision on their application has to be made was not respected by the State Secretary of Religions. The Government has not granted any religious group status as a religion since 1990. The Organization of the Orthodox Believers of Old Rite, Jehovah's Witnesses, the Adventist Movement for Reform, the Baha'i Faith, and the Church of Jesus Christ of Latter-Day Saints (Mormons) are some of the religious groups that have tried unsuccessfully to register as religions. The Baha'i Faith stated that it has never received any answer to its repeated requests to be registered as a religious denomination. Jehovah's Witnesses complained that the State Secretariat for Religious Denominations consistently had refused to grant it status as a religion, despite a March 2000 Supreme Court ruling that recognized the modified statutes of Jehovah's Witnesses as a Christian religious denomination. The court ruling asked the State Secretariat for Religious Denominations to issue an administrative document recognizing Jehovah's Witnesses, but the State Secretariat refused to do so. In response Jehovah's Witnesses asked for damages in court and, consequently, the court ruled that the Ministry of Culture and Religious Denominations will have to pay a symbolic \$.02 (500 lei) per day fine to the State as of May 9.

The Government registers religious groups that it does not recognize either as religious and charitable foundations or as cultural associations. A law enacted in May 2000 simplified this registration process in theory and also removed the minimum number of members required to set up religious associations and foundations.

In February the Government tried to revive a draft bill on religious denominations, which had been withdrawn by the previous government in February 2000, following domestic and international pressure. The bill would have increased state control over religious activity and made the Romanian Orthodox Church the national church. The Government put the draft bill on hold for revision after renewed objections from the international community and non-Orthodox religious denominations.

Although protected by law, several minority religious groups, which include both recognized and unrecognized religions, made credible complaints that low-level government officials and Romanian Orthodox clergy impeded their efforts to proselytize, interfered in religious activities, and otherwise discriminated against them during the year. The Government denied these allegations. In some instances, local police and administrative authorities tacitly supported, at times violent, societal campaigns against proselytizing (see Section 5). There appears to be no clear understanding by the authorities of what activities constitute proselytizing, but proselytizing that involves denigrating recognized churches is perceived as provocative.

The law does not prohibit or punish assembly for peaceful religious activities; however, several minority religious groups complained that on various occasions local authorities and Orthodox priests prevented religious activities from taking place, even when they had been issued permits (see Section 5). The Seventh-Day Adventist Church reported difficulties in obtaining approvals to use public halls for religious activities in the villages of Luna, Baiut, and Valenii de Maramures (Maramures County). The religious activities of the Baptist Church and the Evangelical Alliance often have been obstructed by the local authorities under the influence of the local Orthodox clergy in Crucea, Valul lui Traian (Constanta County), Isaccea (Tulcea County), Fratilesti, Savesti (Ialomita County), Vinatori, Tulucesti (Galati County), Sutesti, Gemenele (Braila County). According to Jehovah's Witnesses, in January the mayor of Tirgu Neamt (Neamt County) asked a school principal to resign because of his religious affiliation, allegedly following pressure by the local Orthodox priest.

In May the Israeli Ambassador expressed concern about a book published by a member of the extreme-right "Greater Romania" Party (PRM) which contained two jokes on the extermination of Jews by the Nazis. The Minister of Justice called for an investigation, the publishing house sent a letter of apology to the Israeli Ambassador, and the PRM leader apologized to the Jewish community. In August another PRM party representative published a book called "The Nationalist," which included xenophobic and chauvinistic ideas. The book was condemned widely by the national media and leadership, and the PRM leadership disowned the book.

New regulations regarding building permits for "places of worship," issued by the Government in May, no longer differentiate between recognized and unrecognized religions in terms of what they are allowed to build as places of worship. Prior to this, unrecognized religions received building permits for "halls of prayer" only and not for "places of worship." However, the new regulations could make it more difficult for minority religious groups to obtain such permits, since only the Orthodox Church is represented on the commission granting such permits. This commission is entitled to decide on the "opportuneness" of building the place of worship, and to judge whether the construction is in line with the specific dogma of the religion in question.

A small number of religious properties confiscated under past Communist regimes have been restituted under government decrees. A law passed in January on nationalized buildings specifies that a different law will address the restitution of religious communal property; however, such a law had not been passed by year's end. In many cases, religious minorities have not succeeded in regaining possession of the properties despite restitution by these decrees. Many properties returned by decree house state offices, schools, hospitals, or cultural institutions that would require relocation, and lawsuits and protests by possessors have delayed restitution of the property to the rightful owners. The Greek Catholic Church has made only limited progress in recovering its properties taken by the Romanian Orthodox Church after its forced merger in 1948. Of approximately 2,600 properties to which it has claim, only a handful have been returned. The Greek Catholics say they have received 137 churches, while the Government claims 200 churches had been returned by year's end. The Greek Catholic Church has very few places of worship. Many followers still are compelled to hold services in public places or parks (108 such cases, according to Greek Catholic reports) because most of the former Greek Catholic churches have not been returned. A joint Orthodox and

Greek Catholic committee formed by government decree in 1990 has failed to resolve the issue due to Orthodox resistance, despite the scaling back of the Greek Catholic requests from 2,600 properties to 300 churches. Restitution of the existing churches is important to both sides because local residents are likely to attend their local church whether it is Greek Catholic or Orthodox; thus the number of believers and share of the state budget allocation for religions is at stake. The historical Hungarian churches, including the Hungarian Roman Catholic and the Hungarian Protestant Reformed, Evangelical, and Unitarian churches, largely have received only a small number of their properties back from the Government. Out of 1,791 buildings claimed by the Hungarian churches, 110 were restituted by government decrees; however, the churches involved could take actual possession of less than 20. The Jewish community has received 42 buildings by government decree but could only obtain actual possession of less than half of them.

d. Freedom of Movement Within the Country, Foreign Travel, Emigration, and Repatriation

The law provides for these rights, and the Government generally respects them in practice. The Government places no restrictions on travel within the country, except for certain small areas reserved for military purposes.

The Government forcibly relocated hundreds of Roma illegally squatting in Bucharest (largely on public land) to their places of origin as part of a program called "Back Home" (see Section 1.f.). This program was criticized strongly by human rights NGO's.

The law provides for the granting of refugee and asylee status in accordance with the 1951 U.N. Convention Relating to the Status of Refugees and its 1967 Protocol. The Government cooperates with the U.N. High Commissioner for Refugees (UNHCR) and other humanitarian organizations. The Government provides first asylum. The Ministry received 1,981 applications for asylum from January through September. The law establishes a refugee office in the Interior Ministry to receive, process, and house asylum seekers. The Interior Ministry and the Labor Ministry fund programs to assist asylum seekers and refugees. Financial support provided by the Government (reimbursable loans for a period of 6 to 9 months) is minimal; it usually is not enough to cover basic needs. The Government provides temporary accommodation in only a few locations. Programs for integrating refugees into society are developing slowly. An increasing number of transiting illegal migrants regards the country as a springboard to other countries.

There were no reports during the year of the forced return of persons to a country where they feared persecution. The UNHCR expressed some concern over cases in which the Government reversed an initial acceptance of an asylum claim under undefined "national security" grounds. In one such case, an asylum seeker, whose claim was initially accepted by the Government and then was later rejected on these grounds, was detained indefinitely while his case went through the courts.

Section 3 Respect for Political Rights: The Right of Citizens to Change Their Government

The Constitution provides citizens with the right to change their government peacefully, and citizens exercise this right in practice through periodic free and fair elections held on the basis of universal suffrage.

In November and December 2000, in elections that were judged to be generally free and fair, the left-center Party of Social Democracy (PSD) won a near majority in the legislature and the PSD candidate, Ion Iliescu, won the Romanian presidency. The PSD governed as a minority government, with support from the Democratic Union of Hungarians in Romania (UDMR). The extremist, xenophobic Greater Romania Party (PRM) won the next largest share of parliamentary and presidential votes. Allegations of widespread voting fraud by the losing PRM candidate, Corneliu Vadim Tudor, were not judged to be credible.

The percentage of women in government or politics does not correspond to their percentage of the population; no legal restrictions hinder the participation of women in government or politics, but societal attitudes are a significant impediment. The Parliament is composed of 9.8 percent women, with 12 Senators and 37 Deputies. None of the 41 county prefects, an appointed position to represent the central Government at the county level, were women.

The Constitution and electoral legislation grant each recognized ethnic minority one representative in the Chamber of Deputies, provided that the minority's political organization obtains at least 5 percent of the average number of valid votes needed to elect a deputy outright. Organizations representing 18 minority groups elected deputies under this provision in 2000. Ethnic Hungarians, represented by the UDMR, obtained parliamentary representation through the normal electoral process. Roma are underrepresented in Parliament because of low Roma voter turnout and internal divisions that worked against the consolidation of votes for one candidate, organization, or party. There are two Romani parliamentarians; the former Romani minority representative joined the PSD and sits in the legislature, and there is one seat provided for Roma by the Constitution and electoral legislation.

Section 4 Governmental Attitude Regarding International and Nongovernmental Investigation of Alleged Violations of Human Rights

Domestic human rights monitoring groups include the Romanian Helsinki Committee (APADOR-CH), the independent Romanian Society for Human Rights (SIRDO), the League for the Defense of Human Rights (LADO), the Romanian Institute for Human Rights, and several issue-specific groups such as the Young Generation of Roma and the Center for Crisis Intervention and Study, also a Romani NGO. Other groups, such as political parties and trade unions, continued to maintain sections to monitor the observance of human rights. These groups, as well as international human rights organizations, functioned freely without government interference.

The Government generally cooperates with local and international monitoring groups, although some offices are slow to respond to inquiries. Local human rights monitoring agencies have found it difficult to obtain statistics concerning police abuses. The Ministry of the Interior, which is responsible for investigating such abuses, responds unevenly to inquiries from monitors. Often victims are reluctant to come forward, and the Government does not promote transparency in this regard.

In February 2000, the Ministry of the Interior tightened conditions for prison visits by human rights organizations (see Section 1.c.).

An Ombudsman's Office works to protect citizens against abuses or random acts by public officers. In 2000 there were 4,556 cases filed with the office. By year's end, it had received 6,871 complaints; of these, only 1,671 were accepted as falling under the Ombudsman's jurisdiction. The office registers these complaints and is obliged by law to provide an initial response within a year of the date that they were recorded. The Ombudsman has been moderately effective; however, the lack of executive powers limits the Ombudsman's authority. The office deals not just with human rights but with all facets of citizens' interaction with the Government. The Ombudsman's role still is not fully clear to the public. Many complaints were rejected because they related to problems with the judiciary and not the administration.

Section 5 Discrimination Based on Race, Sex, Religion, Disability, Language, or Social Status

The Constitution forbids discrimination based on race, nationality, ethnic origin, language, religion, sex, opinion and political allegiance, wealth, or social background; however, in practice the Government does not enforce these provisions effectively, and women, Roma, and other minorities are subject to various forms of discrimination.

In September 2000, the Government issued an emergency ordinance that outlaws discrimination based on a number of factors and introduces the ability to sue on the grounds of discrimination; however, implementation of the decree, primarily through the creation of a National Council on Combating Discrimination, had not occurred by year's end. An emergency ordinance has the effect of law unless it is nullified by the Parliament. The Senate and the Chamber of Deputies passed the ordinance during the year, but the Chamber amended it to exclude sexual orientation as a basis for discrimination, while the Senate passed it unchanged. The two houses had not reconciled their versions by year's end.

Women

Violence against women, including rape, continued to be a serious problem. Both human and women's rights groups credibly reported that domestic violence is common, and a 1999 report by the U.N. Children's Fund (UNICEF) emphasized that violence against women in the workplace is not uncommon since their subordinate position exposes them to greater risk. A survey conducted by the U.S. Centers for Disease Control reported that in 2000, 23.4 percent of women had experienced verbal abuse from their partners, 10 percent had experienced physical abuse, and 1.8 percent sexual abuse. The same survey reported that 22.5 percent of women experienced moderate to severe physical abuse over their lifetimes. A complicated criminal process discouraged domestic violence victims from pressing charges against perpetrators. Police often are reluctant to intervene in instances of domestic violence. There is no specific legislation dealing with spousal abuse or spousal rape. The prosecution of rape is difficult because it requires both a medical certificate and a witness, and a rapist can avoid punishment if he marries the victim. The successful prosecution of spousal rape is almost impossible. An emergency ordinance passed in June made laws on rape and sexual abuse gender neutral. The Senate and the Chamber of Deputies passed this ordinance during the year, but they had not reconciled their versions by year's end.

A pilot project opened a shelter for victims of domestic violence in Constanta in December 2000. The shelter opened with the cooperation of the police and the Constanta mayor's office and helped in 246 cases from January to November.

Trafficking in women for the purpose of prostitution continued to be a growing problem (see Sections 6.c. and 6.f.).

The Constitution grants women and men equal rights; however, in practice the Government does not enforce these provisions, nor do the authorities focus attention or resources on women's issues. In November the Senate approved a law prohibiting sexual harassment and any form of gender discrimination; however, the law was not passed at year's end.

Few resources are available for women who experience economic discrimination. Despite existing laws and educational equality, women have a higher rate of unemployment than men, occupy few influential positions in the private sector, and earn lower than average wages. A department in the Ministry of Labor and Social Protection advances women's concerns and family policies. This department organizes programs for women, proposes new laws, monitors legislation for sexual bias, targets resources to train women for skilled professions, and addresses the problems of single mothers, especially in rural areas. There is an Ombudsman within the department for child, woman, and family protection to resolve complaints of discrimination.

Children

The Government administers health care and public education programs for children, despite scarce domestic resources. International agencies and NGO's supplement government programs in these areas.

Education is free and compulsory through the eighth grade. After the eighth grade, schools charge fees for schoolbooks, which discourages attendance for lower income children, particularly Romani children. In the 2000-01 school year, 4,053,328 children

attended school, including kindergartens. Approximately 96 percent of primary school-age children attend school. Boys and girls generally receive the same treatment in schools. The Ministry of Education reported that 500,000 children under the age of 15 left school in 1997-98, which is approximately 20 percent of the school-age population.

Living conditions in all child care institutions very seriously deteriorated in 1999 for financial and administrative reasons and have not improved substantially. Inspectors who visited institutions and identified humanitarian needs at the request of the European Union Commission reported that while conditions were not equally poor in all institutions, the general situation was unacceptable in terms of basic infrastructure as well as hygiene, medical care, nutrition, and general assistance. According to official statistics, there were approximately 60,000 orphans in state institutions.

There was no perceptible societal pattern of abuse against children; however, a survey by a local polling firm conducted during the year found that 41 percent of women and 59 percent of men reported that they had experienced physical or verbal abuse as children. In addition large numbers of impoverished and apparently homeless, but not necessarily orphaned, children were seen on the streets of the larger cities. The Government does not have statistics defining the scope of the problem.

NGO's working with children remained particularly concerned about the number of minors detained in jail and prison (see Section 1.c.). These NGO's continued to seek alternative solutions to sending juveniles to prison, such as parole. Because time served while awaiting trial counts as part of the prison sentence but does not count towards the time to be served in a juvenile detention center, some minors actually requested prison sentences.

The prevalence of child labor in the Roma community was widespread (see Section 6.d.).

The sexual exploitation of children continued to attract press attention, and the police continued to stage a few high-publicity arrests of foreign pedophiles. Other issues, such as adequate legislation to protect children, received less attention. The law does not outlaw pedophilia expressly; instead pedophiles are charged with rape, corporal harm, and sexual corruption. Trafficking in girls for the purpose of prostitution is a problem (see Sections 6.c. and 6.f.).

Persons with Disabilities

Difficult economic conditions and serious budgetary constraints contributed to very difficult living conditions for those with physical or mental disabilities. Outside of large institutions, social services for persons with disabilities are almost nonexistent. Many persons with disabilities cannot make use of government-provided transportation discounts because public transport does not have facilitated access. The law does not mandate accessibility for persons with disabilities to buildings and public transportation. According to official statistics, there were 3,500 disabled children living in state institutions; conditions in these institutions ranged from adequate to harsh.

Religious Minorities

The centuries-long domination of the Orthodox Church, and its status as the majority religion, has resulted in the Orthodox Church's reluctance (in particular at the local level and with the support of low-level officials) to accept the existence of other religions. Consequently, actions by other religious groups to attract members are perceived by the Orthodox Church as attempts to diminish the number of its members. Due to its substantial influence, few politicians dare to sponsor bills and measures that would oppose the Orthodox Church. According to minority religious groups, the population is receptive to minority Christian confessions, and local officials tend to be tolerant but often are pressured and intimidated by the Orthodox clergy. Minority religious groups allege that the Orthodox clergy have provoked isolated mob incidents. The Romanian Orthodox Church has attacked the "aggressive proselytizing" of Protestant, neo-Protestant, and other religious groups, which the Church repeatedly has described as "sects." There is no law against proselytizing, or clear understanding of what activities consist of proselytizing; however, proselytizing that involves denigrating established churches is perceived as provocative. This has led to conflicts in some cases. For example, in May an Orthodox priest beat a Mormon missionary in the streets of Pitesti. The police, although not very cooperative initially, eventually contributed to resolving this conflict. On June 20, members of the "New Right" (Noua Drapta) organization (a small, right-extreme group with nationalistic, xenophobic views) beat four Mormon missionaries who were riding on a streetcar in Bucharest.

Representatives of minority religions credibly complain that only Orthodox priests are permitted to grant religious assistance in hospitals, children's homes, and shelters for the elderly. Charitable activities carried out by other churches in children's homes and shelters often have been interpreted as proselytizing. According to the Seventh-Day Adventist Church, Orthodox priests have not allowed Adventist ministers to conduct burial rituals in localities, mainly in rural areas, where the number of Adventist members was small. Such cases occurred in Costesti and Armasu (Bacau County), Cuparu and Doicesti (Dambovita County), Busteni and Cojasca (Prahova County), Scinteia and Progresu (Ialomita County), Malu (Giurgiu County), as well as in some localities in Galati, Bacau, and Iasi Counties. However, in most cases, the problems were resolved with the intervention of the local authorities. The Greek Catholic, Baptist, and Pentecostal Churches also have reported similar refusals by Orthodox clergy to allow the burial of the believers of these churches in Orthodox cemeteries. Such cases have occurred in Negresti Oas (Satu Mare County), according to Greek Catholic reports, and in Bihor County, according to Baptist reports.

The Seventh-Day Adventist Church also reported that a series of peaceful assemblies were disrupted by noisy groups, allegedly incited by Orthodox clergy, including in Ciudanovita and Glimoca (Caras Severin County). According to Adventists, Orthodox priests beat school children for having participated in Adventist meetings and Orthodox priests insulted Adventist members,

including in Perieni (Ias County).

In some areas, Orthodox clergy threatened Baptists ministers in order to make them leave the localities.

Three textbooks on sects and ecumenism, authored by an Orthodox deacon for use in state-funded theological institutions, art high schools, teacher, and vocational schools, contained anti-Semitic, pro-Fascist, and antiecumenical ideas.

The disputes between Greek Catholics and Orthodox believers over church possession decreased in number, due mostly to the Greek Catholics' decision in many cases to build new churches, following lack of progress made in obtaining the return of their properties (see Section 1.c.). Tensions continue to exist in Prunis (Cluj County) where most of the residents belong to the Greek Catholic Church and are forced to hold religious services in the open because the Orthodox priest does not allow them to use the church. In Decea (Alba County) tensions increased when the Orthodox priest locked the church so that the Greek Catholics could not use it. In Bicsad (Satu Mare County), where the Greek Catholics obtained a government decision restituting a former Greek Catholic monastery, the Greek Catholic Church still could not take possession of the monastery because of the opposition of the local Orthodox clergy. Local authorities have not supported the enforcement of the Government's decision. In Dumbraveni the Orthodox Church's opposition to a court-ordered resolution to share the local church has forced the Greek Catholics to hold their religious services in a high school. The Orthodox Church decided to build a new church and to restitute the old one to the Greek Catholics after it is completed. Until that time, the Greek Catholics continued to hold the religious service in the school building.

Harassment of Jehovah's Witnesses in Mizil and other areas continued during the year.

The fringe press continued to publish anti-Semitic articles. Legionnaire (an extreme nationalist, anti-Semitic, pro-Nazi group) books from the interwar period continued to be published. There have been repeated attempts to deny the Holocaust in the country (through symposiums and press articles). Most mainstream politicians publicly have criticized anti-Semitism, racism, and xenophobia.

Jewish cemeteries were desecrated in nine localities during the year. The perpetrator was identified in only one case. The perpetrators in the other five cases could not be identified but are believed to have been local youths, rather than members of an organized anti-Semitic movement. Four synagogues were also desecrated during the year. In December 2000, the Museum of Jewish History in Bucharest was ransacked. President Ilescu and other prominent figures expressed concern about this act of vandalism. The perpetrators remained unidentified. No progress was made on investigations into the desecration of Jewish synagogues and cemeteries in 2000 and 1999.

According to the Baha'i Faith, a show and an exhibit sponsored by their association in Herestrau Park in Bucharest in July 2000 were disrupted by a group of youths, who called them a "sect," used a Nazi greeting, shouted "long live the Orthodox Church," and destroyed all the exhibit materials. The police cooperated with the Baha'is in investigating the incident, but it had not been resolved by year's end.

National/Racial/Ethnic Minorities

After the 2000 election, the Government reorganized the Department for the Protection of Minorities into an Office for Interethnic Relations and a National Office for Roma, and placed them under the Ministry of Public Information. These offices have the responsibility to monitor the specific problems of persons belonging to ethnic minorities, to maintain contacts with minority groups, to submit proposals for draft legislation and administrative measures, to maintain permanent links with local authorities, and to investigate complaints.

Ethnic Hungarians, officially numbering more than 1.6 million, constitute the largest and most vocal minority, and their UDMR party was the leading political partner for the ruling minority PSD Government during the year. UDMR-PSD cooperation helped facilitate the passage by Parliament of a law on local public administration in March; the law provides for the use of the maternal language in administration in areas where a national minority represents over 20 percent of the local population, which applies almost exclusively to Hungarian communities. These provisions met with resistance in some areas; for example, in Cluj, the mayor, Gheorghe Funar, resisted implementation of provisions to allow bilingual street signs in the town, claiming that the population of ethnic Hungarians in the town falls below the 20 percent threshold required by law. On June 2, approximately 200 persons demonstrated outside of the Hungarian Consulate in Cluj, calling for ethnic Hungarians to leave the city. Bilingual street signs were not erected in Cluj by year's end; bilingual signs have been erected in small localities around Cluj.

A government decree permits students in state-funded primary and secondary schools to be taught in their own language, with the exception of secondary school courses on the history and geography of Romania. However, in Moldavia the Csango community, an ethnic group who speak a form of Hungarian and are Roman Catholic, have complained that there is no schooling available in their language. In November an NGO reported that the deputy school inspector in Bacau County harassed Csango families who were teaching Csango language classes in their homes.

The Romani population, officially estimated by the Government at approximately 400,000, is estimated by the European Commission to number between 1.1 and 1.5 million. Romani groups complained of routine police brutality--including beatings--prejudice, and racial harassment at the local level (see Section 1.c.). Under a government program, Roma living in Bucharest on public lands were forced to relocate to their counties of origin (see Section 1.f.). According to the Government, only 27

percent of Roma have steady jobs, and only half of those jobs are considered skilled. Illiteracy among Roma over 45 years of age approaches 30 percent. In April a national strategy for improving the condition of the Romani community was announced, with the support of the Prime Minister; a commission to implement the plan was established and held meetings during the year. A number of Roma experts were hired in the Ministries, at the county prefect's office, and in many local mayoral and county offices. Nevertheless the Roma office within the Government is understaffed, with only three civil servants, and longterm funding for the National Roma strategy has not yet been resolved.

The Romani population continued to be subject to societal discrimination. Roma often are denied access to shops, restaurants, and other places. For example, on February 6, Romani CRISS, an NGO monitoring Roma rights, filed a complaint with the Supreme Court against the owner of a bar in Pitesti (Arges County) after the bar's bodyguards denied access to two Romani men in January. The lawsuit was in progress at year's end. There was no further information on the ban on Roma in the Iasi County hospital, where Roma who cannot afford to pay for medical treatment and cannot prove that they have medical insurance provided by the State are banned from the hospital. However, a partnership protocol, signed by the Minister of Health and the representative for Roma in the Parliament in April, lays out cooperative measures between the Health Ministry and the Romani Party in order to ensure that Roma have access to health care. This protocol helped resolve most complaints of discrimination against Roma in the health system and sponsored several vaccination campaigns for Roma children.

In March a Tirgu Mures-based NGO, Liga Pro Europa, took legal action against a local weekly that carried an interview with two persons using pseudonyms who proposed to "clean the town of Roma." The local prosecutor's office answered in a letter that no crime had been committed and refused to answer a second letter by the NGO asking for the legal grounds of that answer. There was no further information regarding the status of charges filed in 2000 by Bucharest-based Roma organizations against Marcel Fluerau, a journalist for the National, for using racist language in an article.

On May 7, Romani CRISS filed a complaint against a Bucharest-based advertising newspaper, which in March had published an advertisement for security guards that overtly excluded Roma. The Bucharest Mayor's office replied that job announcements did not fall under the law on publicity, which forbids discriminatory publicity. The Bucharest Mayor's office told the NGO to redirect its complaint to the National Council for Combating Discrimination, a body which has not yet been established. In 2000 the NGO Romani CRISS filed a complaint with the Ombudsman's Office regarding a job announcement, posted in Bucharest's Third Sector Labor Force Office by a private firm called S.C. Guard, which stated, "no Roma accepted." The Labor Force Office offered public apologies, and no further such announcements have been posted there.

In October in Transylvania the New Right political party distributed anti-Romani leaflets in Sighisoara and Deva. In July police arrested two members of the New Right party who were suspected to have painted anti-Romani slogans in Sibiu; the two reportedly were foreigners.

In January the European Roma Rights Center (ERRC) reported two incidents in which private security guards beat Roma; in one of the cases, a Roma man was shot in the leg. There was no further information regarding the 2000 beating of Vasile Florica, a Rom, by villagers in Palos.

Four persons who were arrested, tried, and convicted in a 1993 incident in Hadareni, in which three Roma died in a house burning, were released in 2000 after serving their sentences. The victims appealed to the European Court of Justice, arguing that the sentences were too light at 2 to 6 years. The case was pending before the European Court at year's end. According to Human Rights Watch, the ERRC lodged applications against the country with the European Court of Human Rights regarding cases of violence against Roma and destruction of Romani property in Casinul Nou (1990) and Plaiesii de Sus (1991). These cases had been rejected in Romanian courts in part because the statute of limitations had expired before the ERRC could initiate final appeals. Police in both cases failed to conduct onsite investigations. These cases were pending with the European Court of Human Rights at year's end.

Section 6 Worker Rights

a. The Right of Association

All workers except certain public employees have the legal right to associate freely and to form and join labor unions without previous authorization; however, there were reports that the Government restricted this right. Intelligence, Ministry of Defense, and Ministry of Interior personnel are not allowed to unionize. The majority of workers are members of approximately 18 nationwide trade union confederations and smaller independent trade unions. Trade unions may acquire property, support their member's exercise of their profession, establish mutual insurance funds, print publications, set up cultural, teaching, and research bodies, establish commercial enterprises and banks, and borrow money. No workers may be forced to join or withdraw from a union, and union officials who resign from elected positions and return to the regular work force are protected against employer retaliation. However, the International Confederation of Free Trade Unions (ICFTU) 2000 "Annual Survey of Violations of Trade Union Rights" reported that violations of trade union rights continued in practice. In September 2000, a trade union leader, Virgil Sahleanu of the Tepro steel mill in Iasi, was killed, allegedly because of a dispute with a new private owner. Also in 2000, Sabina Nicolescu, a trade union leader in a wool company, was beaten after receiving threats from the company owner. No new violations were reported during the year. The unions reported that the Government interfered in trade union activities, collective bargaining, and strikes. The requirements to register a union were excessive.

Past studies indicated that the labor legislation adopted in 1991 falls short of International Labor Organization (ILO) standards in several areas, including the free election of union representatives, binding arbitration, the financial liability of strike organizers,

the restriction of eligibility for trade unions, and the restriction of eligibility for trade union membership and offices to "employees." Amendments in 1999 to the law on labor disputes brought some improvements and eliminated many restrictions, including widening the scope of the right to strike.

The collective labor dispute law defines the conciliation, mediation, and arbitration procedures under which strikes can be conducted. The law established tripartite arbitration panels, and the list of arbitrators must be approved by the economic and social council where trade unions and employers associations each have one-third of the membership; however, mediation capability has not developed fully. Local panels are poorly trained, and unions continued to take their cases directly to the Government for dispute resolution. Amendments to the labor law in 1999 widened the scope of the right to strike, although it continues to be difficult to hold a legal strike because of lengthy and cumbersome procedures. Union members complained that unions must submit their grievances to government-sponsored conciliation before initiating a strike, and that the courts had a propensity to declare illegal the majority of strikes on which they had been asked to rule. Judges, prosecutors, and related Ministry of Justice staff are forbidden to strike, along with Ministry of Defense, Ministry of Interior, and intelligence service employees. The Government concluded a Social Pact early in the year with national union confederations and employer associations; in return for promises regarding wages, pensions, and new labor legislation, the unions agreed not to stage national strikes. Although at times fragile, the Social Pact remained in place at year's end, and the Government initiated talks on its renewal. At least one labor confederation has stated that it is unlikely to renew membership in the Pact. The Social Pact did not prevent local unions from staging protests and strikes. In September 2000, amendments to the labor code permitted companies to claim damages from strike initiators if the strike is deemed illegal by a court.

The Government has promised to speed the privatization of state-owned companies; fearing loss of their jobs, some union workers held strikes protesting the potential sale of their companies, and others threatened strike actions if privatization occurs. Protest actions also were held demanding the cancellation of privatization contracts. The most significant of these were the Resita protests, which were accompanied by some instances of violence. Groups of union members protested against local authorities by damaging official buildings and harassing employees of the firm. The Resita steel company was purchased by a foreign company and has been the subject of major labor protests since January; the Government was attempting to mediate the labor dispute at year's end.

The Government occasionally interfered in strikes. For example, the Ministry of Transport attempted to intimidate the subway system union from striking during the year.

The law stipulates that labor unions should be free from government or political party control, a provision that the Government generally has respected in practice. Unions are free to engage in political activity and have done so; for example, during the 2000 elections, the National Confederation of Trade Unions (Fratia) and the National Union Bloc openly supported the PSD party.

Labor unions may form or join federations and affiliate with international bodies. The National Confederation of Trade Unions-Fratia and the National Union Bloc are affiliated with the International Confederation of Free Trade Unions and the European Trade Union Confederation. The Confederation of Democratic Trade Unions of Romania and Cartel Alfa are affiliated with the World Labor Confederation. Representatives of foreign and international organizations freely visit and advise domestic trade unionists.

b. The Right to Organize and Bargain Collectively

Workers have the legal right to bargain collectively, but collective bargaining efforts are complicated by continued state control of most industrial enterprises and the absence of independent management representatives. Although the law supports collective bargaining as an institution, the contracts that result are not always enforceable in a consistent manner. Basic wage scales for employees of state-owned enterprises are established through collective bargaining with the Government. Public employees may bargain for everything except salaries, which are set by the Government. Unions claimed that downsizing decisions resulting from agreements with international financial institutions have violated labor agreements. In one case, gas and oil unions claimed that a budget approved by the Government for state-owned gas and oil companies violated its labor agreement and filed a court claim against the Government.

Antiunion discrimination is prohibited by law, and the Government generally respected this prohibition in practice.

Labor legislation is applied uniformly throughout the country, including in the five free trade zones.

c. Prohibition of Forced or Compulsory Labor

The Constitution prohibits forced or compulsory labor; however, trafficking in women for sexual exploitation is a problem (see Section 6.f.). The Ministry of Labor and Social Protection is responsible for enforcing the prohibition against forced labor.

The Constitution prohibits forced and bonded labor by children; however, trafficking in girls for prostitution is a problem (see Section 6.f.).

d. Status of Child Labor Practices and Minimum Age for Employment

The minimum age for employment is 16 years, but children as young as the age of 15 may work with the consent of their parents or guardians, although only "according to their physical development, aptitude, and knowledge." Minors are prohibited from working in dangerous or hazardous conditions. Violations of the child labor laws are punishable by imprisonment for periods of 2 months to 3 years; however, there is no recent evidence of anyone being charged or convicted under this law. Working children under the age of 16 have the right to continue their education, and the law obliges employers to assist in this regard. The Ministry of Labor and Social Protection has the authority to impose fines and close sections of factories to ensure compliance with the law. There is no recent evidence of anyone being charged or convicted under this law.

A department in the Office of the Prime Minister is responsible for child protection. Local organizations were established in the counties and the city of Bucharest to enforce child welfare legislation. The roles and responsibilities of the several agencies that enforce child labor laws remain ill defined, and these laws often have not been enforced.

There are no accurate statistics of the number of illegally employed children; however, there is recognition of the problem. The prevalence of child labor, including begging, selling trinkets on the streets, or offering to wash car windshields, is widespread in the Roma community; these children range from 1 to 18 years of age. In March 2000, the ILO and the Ministry of Labor and Social Protection agreed to establish an International Program for the Elimination of Child Labor. A national steering committee was formed, and several ILO-funded programs began to raise public awareness, identify the nature and extent of the problem, train officials to monitor and investigate child labor, build the capacity of governmental and nongovernmental agencies, and prevent increases in child labor; however, no concrete steps were taken by year's end.

The Constitution prohibits forced and bonded child labor; however, trafficking in girls for prostitution is a problem (see Section 6.f.).

e. Acceptable Conditions of Work

Most wage rates are established through collective bargaining at the enterprise level; however, they are based on minimum wages for specific economic sectors and categories of workers that the Government sets after negotiations with industry representatives and the labor confederations. Minimum wage rates generally are observed and enforced. During the year, the minimum monthly wage was raised from approximately \$30 (700,000 lei) to approximately \$48 (1.4 million lei); the minimum monthly wage does not provide a decent standard of living for a worker and family. Prices for utility services such as water and heating continued to rise; however, basic food and pharmaceutical products still were subject to price ceilings. Housing is no longer subsidized.

The Labor Code provides for a standard workweek of 40 hours or 5 days, with overtime to be paid for weekend or holiday work or work in excess of 40 hours. It also includes a requirement for a 24-hour rest period in the workweek, although most workers receive 2 days off per week. Paid holidays range from 18 to 24 days annually, depending on the employee's length of service. The law requires employers to pay additional benefits and allowances to workers engaged in particularly dangerous or difficult occupations. The Labor Code was scheduled to be revised in 2000; however, trade unions and business associations were not included in the drafting discussion, and no agreement could be reached on changes. New discussions, which included the unions and employers, commenced during the year; however, no new legislation was presented to Parliament by year's end.

Some labor organizations lobby for healthier, safer, working conditions on behalf of their members. However, neither the Government nor industry, which is still mostly state owned, has the resources necessary to improve significantly health and safety conditions in the workplace. The Ministry of Labor and Social Protection has established safety standards for most industries and is responsible for enforcing them; however, it lacks sufficient trained personnel for inspection and enforcement, and employers often ignore its recommendations. In 1999 a department was established within the Ministry to conduct comprehensive safety inspections. European Union funds have assisted in building capacity within the new department. Although they have the right to refuse dangerous work assignments, workers seldom invoke it in practice.

After an explosion killed 10 workers in the port of Constanta on June 5, workers at the shipyard protested against the lack of safety equipment and violations of safety procedures by management. A government delegation led by Privatization Minister Ovidiu Musatescu was sent to mediate talks between workers and management.

f. Trafficking in Persons

A law passed in November prohibits trafficking; however, trafficking in women is an underreported but serious problem. The law defines trafficking as the use of coercion to recruit, transport, harbor, or receive humans for exploitation. Coercion includes fraud or misrepresentation. Exploitation includes slavery, forced labor, prostitution, performance in pornographic films, organ theft, or other conditions that violate human rights. For minors under the age of 18, it is not necessary to prove coercion.

Romania is both a country of origin and a transit country for trafficked women and girls. The full extent of the problem is not known, since neither the Government nor NGO's maintain statistics on this problem; however, there is evidence that the problem is growing. The International Organization for Migration (IOM) reported that from January 2000 to June 2001, they assisted 279 victims of trafficking. Of these victims, 6 were 14 years of age or younger, and 57 were between the ages of 15 and 17. Figures for 1999 were less than 10 victims. The IOM office in the country estimated that as many as 20,000 women are trafficked from Romania each year. Romania is a country of origin; women reportedly were trafficked for prostitution to Yugoslavia (including Kosovo), Macedonia, Turkey, Albania, Bosnia and Herzegovina, Greece, Cyprus, Italy, France, Germany, Hungary, the Netherlands, Poland, the United Arab Emirates, Japan, and Cambodia. Women were trafficked through

Macedonia and Bulgaria to reach Greece and other countries. Romania remains a popular transit country for persons, especially women, being trafficked from Moldova, Ukraine, and other parts of the former Soviet Union. Iasi and Timisoara are major transit centers in the country. Trafficking patterns within the country generally go from its border with Moldova to the countries bordering Serbia, and there is anecdotal evidence of some internal victims of trafficking as well. There also is anecdotal evidence that the country is a minor destination country. Victims are primarily women and girls trafficked for prostitution; however, there are reports that men also are trafficked to Greece for agricultural labor.

Women often are recruited to work abroad by friends, relatives, or newspaper advertisements. Many times a friend or relative makes the initial offer, usually telling the victim that she will obtain a job such as babysitting or waitressing. According to the IOM, most women were unaware that they would be forced into prostitution. A minority of trafficked women are sold into prostitution by their parents or husbands or are kidnaped by trafficking rings. Ministry of Interior officials reported that trafficking rings appear to be operated primarily by Romanians; several domestic prostitution rings are active.

No separate Government or IOM statistics exist for children trafficked to other countries. The Romanian NGO Sanse Egale Pentru Femei (Equal Opportunities for Women) reported that cases of trafficking in children that it dealt with rose from 8 in 1997 to 43 in 1999. In 1998 the NGO Save the Children dealt with 101 cases of children, mostly Roma, being taken to Germany and Italy and being forced to work as beggars or petty thieves; however, there were no new reports of the problem available during the year. Trafficking of girls for prostitution is also a problem. The country has an extensive system of orphanages with approximately 60,000 dependents, and many orphanages are complicit in letting girls escape into prostitution. Children forced out of orphanages between the ages of 16 and 18 often have no identity documents, very little education, and few, if any job skills. NGO's believe that many girls from these orphanages fall victim to trafficking networks. A study by the IOM's Romania office found that 38 percent of girls between 15 and 18 years of age in orphanages were ready to "emigrate to a foreign job," putting them at risk of being trafficked. The same study found that 38 percent of single women and girls aged 15 to 25 and 20 percent of women and girls who lived with their parents were ready to emigrate to a foreign job.

While the Government is beginning to recognize trafficking as a problem, it has only begun to mount an effective effort to combat it. Corruption in the police force, particularly in local forces, also may contribute to the problem. Due to personnel changes within the police and training, police largely acknowledged that Romania is a country of origin for trafficked victims and have become more aware of the problem.

In late 2000, the Government promised that a dedicated unit of seven officers would be established to combat human trafficking as part of an effort to lead a regional antitrafficking law enforcement program under the Southeastern European Cooperative Initiative. However, only two officers from the Romanian Police had been assigned to this unit by April. In April the Government assigned a senior police general to coordinate the antitrafficking unit, significantly increased personnel assigned to the unit, and began to expand interagency and local resources assigned to human trafficking. The unit had conducted a series of human trafficking arrests by the end of the year. During the year, the unit arrested 77 human traffickers for pimping and kidnaping offenses and continued to investigate another 90 individuals suspected of human trafficking at year's end. Police also began a comprehensive investigation of agencies that advertised jobs abroad for possible human trafficking connections and exposed one ring of traffickers.

At the beginning of the year, only one prosecutor was assigned, on a part-time basis, to the Human Trafficking Task Force to carry arrests through to prosecution and conviction. In November another prosecutor was assigned to assist the task force. A handful of prosecutions have occurred for pimping offenses; prosecutions based on indictments under the new trafficking law are not scheduled to begin until 2002.

The law passed in November provides for sentences for traffickers of 3 to 12 years imprisonment. Trafficking in minors between 15 and 18 years of age also carries sentences of 3 to 12 years. Sentences are increased to 5 to 15 years for trafficking in minors under age 15, if there are two or more victims, or if a victim suffers serious bodily harm or health problems. The sentence for trafficking that leads to the death or suicide of the victim is 5 to 25 years. There are increased penalties of 3 years if the trafficker is a member of an organized crime group and 2 years in the case of minors if the trafficker uses coercion. Consent of a trafficked person does not exempt the trafficker from liability.

In the past, victims returned to Romania have been prosecuted for the crime of leaving the country illegally, which has reduced their willingness to return to the country or to cooperate with law enforcement authorities. For most of the year, because there was no legislation that directly addressed trafficking, victims had no way to press charges against traffickers. The law passed in November empowers the Ministry of the Interior to provide protection for victims of trafficking, and undercover operations and electronic surveillance are authorized against traffickers. The new law also eliminates criminal penalties for prostitution if the victim turns in traffickers, or cooperates in investigations against traffickers. However, trafficking victims who cooperated with authorities nonetheless were sentenced for crimes such as illegal emigration. The Government provided little aid to repatriated victims. In October the Government opened a short-term shelter for victims in Bucharest in cooperation with IOM and an NGO. The Ministry of Interior provides law enforcement personnel to investigate trafficking. The Border Police, who report to the Ministry of Interior, process repatriated victims when they return from abroad. The Ministry of Foreign Affairs provides documentation for victim repatriation.

A very small number of local NGO's dealt with trafficking issues. There are two shelters for victims of sexual abuse, and besides the Bucharest center, there is another shelter for trafficking victims in Pitesti. A very small number of other shelters operate in Transylvania. Some NGO's stated that fear of reprisal from organized crime groups deters them from taking aggressive action against traffickers. NGO's have had some success in providing training for and working with local police forces on trafficking. Nevertheless awareness of human trafficking is low, and while victims are not treated as criminals, they

are seen as social outcasts. However, numerous media stories have begun to report on the problem, and during the year, the IOM started a campaign to increase awareness of the problem with the public, using plays in summer camps for children, leaflets and brochures, and press conferences for local media.

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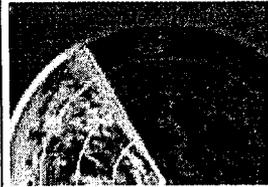
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Survey 2002

2002 Romania: Annual Survey of Violations of Trade Union Rights (2002)

- Cases before the ILO's Committee on Freedom of Association
- ILO core conventions ratified

Trade union rights are fairly well protected in law, but an increasing number of private sector – mainly foreign – employers seek to prevent any trade union activity.

The legislation

Under the 1991 Trade Union Law workers can establish and join the trade union of their choice. There must be at least 15 members, who must all be employees of the same enterprise. This right applies to all except high level government and civil service staff, public prosecutors, judges, military and intelligence personnel. No worker may be forced to withdraw from or join a union.

Restrictions on choice of union officials

To be elected to trade union office a person must be a Romanian citizen, a member of the trade union and employed at the workplace, restricting the freedom of unions to elect the representative of their choice.

Strike limitations

The right to strike is recognised. Employees in sanitary services, pharmacies, schools, communications, radio and television, transport, and the supply of essential services (gas, electricity) etc. must provide a minimum service of one third of normal activity in the event of a strike.

Strikes may be held only if all means of possible conciliation have failed. The employer must be given 48 hours warning. Strikes can only be held to defend the economic interest of the workers and must not be used for political reasons. The same people who are prohibited from joining and forming trade unions may not strike.

Developments in Romania

Romania: Annual Survey of Violations of Trade Union Rights (2001)
(1/10/2001)
Discreet, docile and invisible (2/3/2001)
Romania: Annual Survey of Violations of Trade Union Rights (2000)
(1/9/2000)
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Collective bargaining

Collective bargaining is a recognised right under a 1996 law which stipulates that collective agreements are to be renewed every year. The state may not interfere in the collective bargaining process. No sector is excluded by law from collective bargaining. Public employees may bargain for everything except salaries, which are set by the government.

Anti-union discrimination is prohibited by law, but the unions would like to see more specific protection for trade union leaders.

Rights in practice

Yellow unions

The right to form trade unions is generally respected in practice. However, some employers create "yellow unions" to counteract the activities of independent trade unions. In some cases the employer seeks to destroy independent trade unions, which is punishable by law but difficult to prove.

It is reported that the most anti-union employers – usually foreign companies – make employment conditional upon the worker agreeing not to create or join a union.

Collective bargaining is complicated by the fact that the state still controls most industrial enterprises and there are no independent management representatives. Collective agreements have not always been effectively enforced.

Events in 2001

The government announced it was stepping up its privatisation programme. Workers feared the loss of rights, and particularly the loss of their jobs. There were a series of protests at the Resita steel company following privatisation.

Refusal to recognise union

The Village Museum of Bucharest refused to recognise the trade union, despite the fact that it had been recognised as a legal entity

Romania: Annual Survey of Violations of Trade Union Rights (2002) (ICFTU Website)

by the court. The employer also refused to provide the union with premises, or access to a telephone, fax machine, computer, etc. The Director made verbal threats against the union, and withheld its correspondence, including the notification that it had been granted legal status. The union leaders have faced constant pressure, including the removal of personal effects. The Director asked for a list of names of union members, while all those suspected of being members have been harassed.

Unpaid wages

Several unions reported their members had faced problems of unpaid wages, although only for short periods, of between two to five days.

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Romania - Economic Overview

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The Romanian economic system at the end of the 1980s was one of the most tightly controlled and centralized in all the former communist countries. All sectors of the economy were planned and supervised centrally. Unlike some other Eastern European countries, hardly any economic activity was in the hands of the private sector. As regards company private ownership, only the co-operatives (agricultural and craftsmanship type) were legally accepted, but they were entirely under the control of the Government.

From the early 1980s the communist dictator Ceau^oescu pursued an aggressive foreign debt repayment policy in order to reduce dependence on the West. The rapid pace of debt repayment resulted in a severe capital shortage within the country. Imports of new machinery and capital equipment were stopped, rendering the existing assets increasingly obsolescent and inefficient. Additionally, imports of spare parts and raw materials were drastically curtailed and exposure to modern products and production methods declined. The population also suffered, since much of the domestic agricultural production was exported and draconian restrictions were imposed on household use of energy to ensure an adequate supply for the industry.

[Economic Policy](#)[top](#)

Progress in the transition to a market economy has been substantially slower in Romania than in the majority of Central and East European economies. Structural change has been resisted by the state bureaucracy, managers of large state enterprises and labour unions. Government subsidies to loss-making industries have contributed to large fiscal deficits that have been partly financed by inflationary monetary emissions. The failure to restructure industry has contributed to the poor competitiveness of exports, which, in turn, has resulted in large current-account deficits. These deficits have been largely financed by credits from multilateral agencies.

By the end of 1999 some structural reforms had been introduced. Controls over prices have been progressively removed, the foreign-exchange market has been liberalised, the exchange rate has been unified and virtually full convertibility has been introduced, although some controls remain over capital exports. Loss-making coal mines and enterprises in the heavy industry sector have been restructured and closed. Public utilities have been restructured as public corporations and have been partly privatised. Nevertheless, monopolies remain in many critical sectors. The restructuring and privatisation of State-owned banks is fairly advanced and legislation to improve corporate governance and to strengthen the rights of shareholders over managers has been introduced. However, the need to attract foreign capital for restructuring industry, public utilities and the financial sector remains a major priority before sustained economic recovery can take place.

[Trends in Gross Domestic Product](#)[top](#)

Under the former communist regime economic statistics were regularly misstated. Since the December 1989 revolution Romania has improved its reporting of economic statistics and data.

By 2001 GDP was still at just 81% of its 1989 level, while GDP per head was around 87% of 1989 levels in

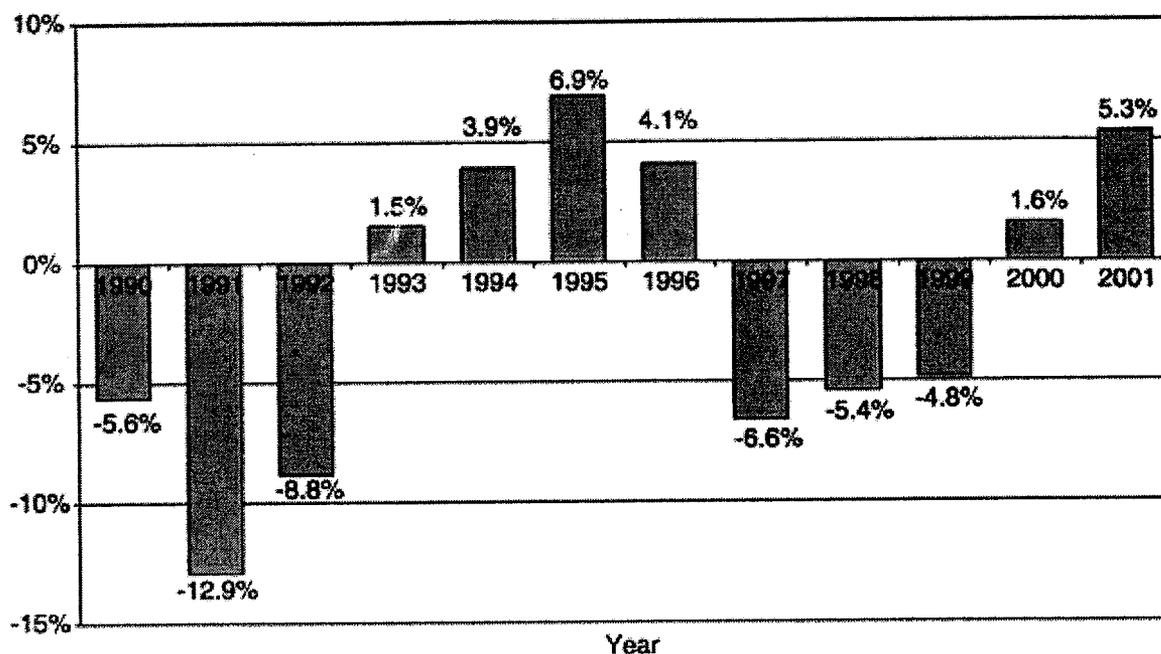
dollar terms. Since the beginning of the transition in 1989, industry and agriculture have contracted in real terms and as a percentage of GDP. Industry's share of GDP fell from 57% in 1989 to 34% in 2001, while the share of agriculture and forestry, which accounted for 13% in 2001 also declined in the second half of 1990s. The share of services, with 52% of the GDP in 2001 are expected to grow over the long term, not least because the prices grow faster than the rate of inflation, as they align with world market prices. Romania, with a population of 22,3 million is the second largest of ten east European EU applicants, but the country ranks only sixth in terms of dollar GDP.

The main internal causes for Romania's collapse in GDP after 1989 were: the disorganization of the economic system, the continuous erosion of domestic purchasing power due to inflation and the removal of state subsidies; the lack of effective stimuli for the Romanian capital, leading small and medium-sized enterprises into difficulties; delays in the privatization program and associated restructuring of the industrial sector; and the lack of correlation between the macro-stabilization policy and the structural transformation of the economy.

Among the external factors affecting the GDP one can cite: the decline of exports to the former USSR and other Eastern European countries in the early 1990s; energy supply problems, associated with the imposition of world prices by the former USSR for oil and natural gas, coupled with declining domestic production; the adverse impact on exports caused by the implementation of UN sanctions against Iraq and Yugoslavia (the 1992-1995 economic embargo on Yugoslavia decreased Romania's exports by USD 6 billions according to the Romanian Government).

As shown in Graph 1, the real annual rate of GDP growth was negative from 1990 through 1992. The compounded annual decline in GDP over these three years was 9.2% per annum with a cumulative contraction over the period of 25%.

Graph 1 Real Change in GDP - in % over previous year



Source: National Commission for Statistics

However, starting with a small but positive growth of 1.5% in 1993, Romania continued with 3.9% in 1994, 6.9% in 1995 and 4.1% in 1996; this growth was fueled by a pro growth economic policy of the Văcăroiu administration that included fuel and power subsidies.

Due to the slow pace of privatization and delay of structural reforms, the initial macro-stabilization of the economy achieved in 1994 could not be maintained and fully taken advantage of. Real GDP growth in 1997 was -6.6% as against the previous year, and it dropped by 5.4% more in 1998, while in 1999 was registered a further drop of 4.8%.

In 2000 the economy registered an upturn with a real GDP growth of 1.6% in 2000. The main drivers for growth were the industry recovery, which reported a 6.1% growth in 2000, combined with strong exports, which

registered a 23.9% increase in the same period. A faster recovery for the year as a whole was held back by the prolonged drought, which resulted in a fall in gross value added in agriculture, forestry and fisheries of 15.8% in real terms and pushed the share of agriculture in GDP from 13.9% in 1999 to 11.4% in 2000. In 2001 Romania registered an increase in GDP of 5.3%

Inflation and Consumer prices

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As in other centrally planned economies, most consumer prices were fixed in Romania before the 1989 revolution. However, with the liberalization of economic policy dramatic changes occurred and high inflation was, and still is, expected to remain one of Romania's key short-term economic concerns.

The evolution of Romania's annual inflation rate (year-end to year-end or one year inflation) after 1989 started with a relatively moderate figure in 1990 (37.6%), but was very high during 1991 to 1993 (205.5% in 1991, 199.5% in 1992 and 295.5% in 1993).

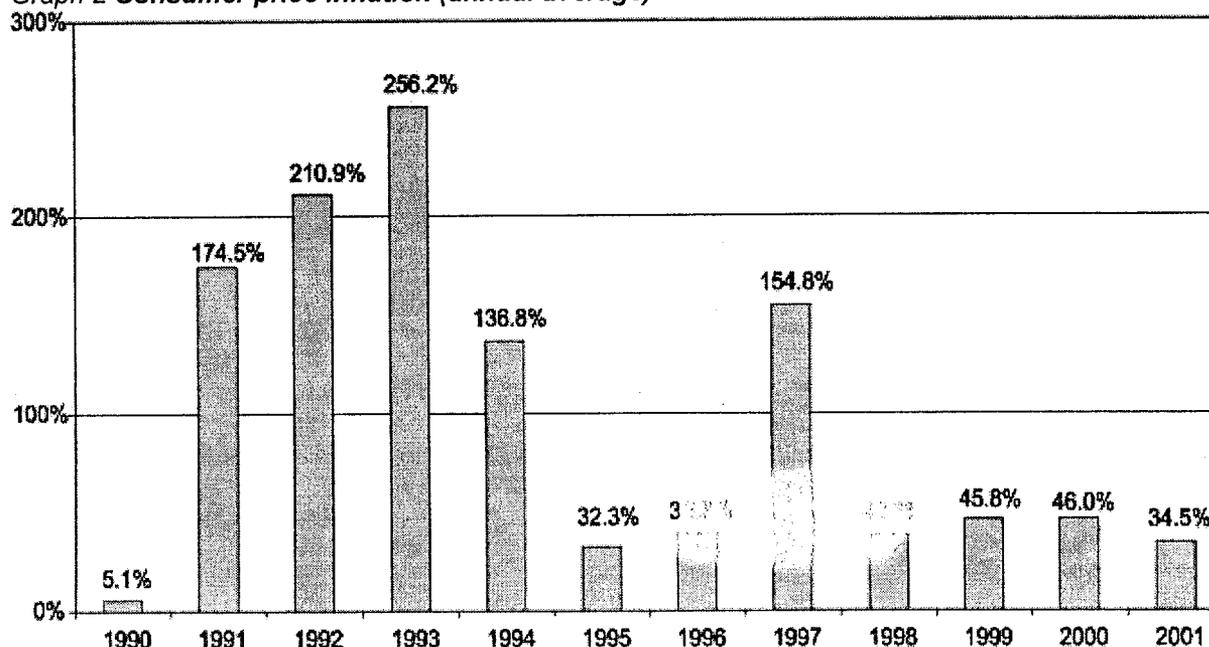
The reduction in inflation from 1991-1993 annual triple-digit rates to less than 33% in 1995 was the main achievement of the stabilization program of 1993-1994. However, the expansionary macro-economic policy pursued in 1995 led to a resurgence of inflationary pressures in the middle of 1996, which resulted in year-end inflation of 56.9% in 1996.

From 1994 to 1997 there was a period of repressed inflation. Many of the prices (energy, gas, fuel, etc.) were not true, in the sense that consumers were paying less than the related costs to producers. The difference was found in the growth of the deficit in the balance of payments, in the budgetary deficit and in the huge losses reported by large State-owned companies.

The exchange rate liberalization and the energy price adjustments of the first half of 1997 resulted in a steep increase (100%) of the price level. After this price explosion, under the effect of budgetary constraints and tight monetary policy, inflation seemed to calm down, but not at reassuring levels. The initial forecast of 90% inflation for the whole year was exceeded by June 30, 1997, and the resulting year-end rate of inflation was 151.4%.

The impact of restrictive monetary and fiscal policies throughout 1998 brought the year-end inflation to 40.6%, in line with expectations. In 1999 the year-end inflation was 45.8%. This evolution corresponds to the consumer price inflation (annual average) evolution depicted in Graph 2 below:

Graph 2 Consumer price inflation (annual average)



Source: National Commission for Statistics

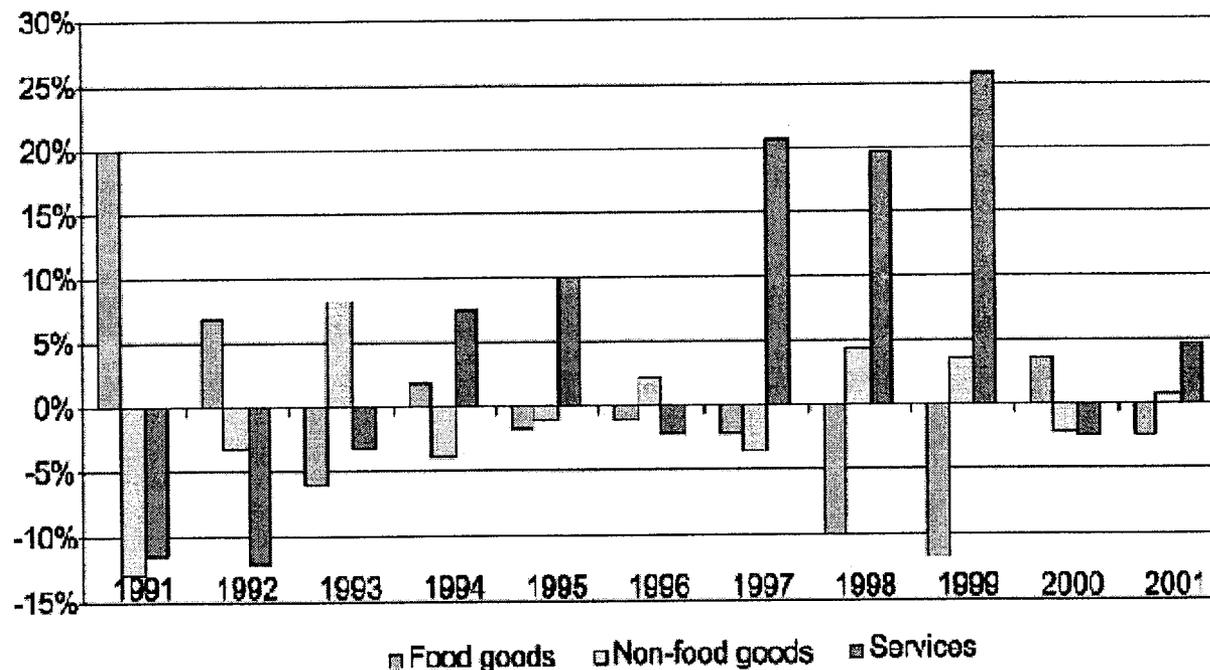
It should be noted that the consumer price inflation (or annual average) presented in Graph 2 is computed as an increase in the average monthly price index for each year compared to the average monthly price index of the previous year (trying to take into account not only the year-end to year-end price index increase, but also the

pattern of variation during the entire year).

The fight against inflation was lost for the Government in 2000 and even IMF agreed that most of the inflation drivers were outside the control of policy makers. Higher international energy prices, the harsh drought and the depreciation of EUR against USD are the uncontrolled factors to blame. The initial y-o-y inflation target of 27% has been revised to 40% at year-end.

Since 1990, service companies were able to price their products well above the inflation rate - a 91% increase in real terms, while both food and non-food goods' prices decreased in real terms with around 10%. The evolution of the price in real terms is depicted in Graph 3:

Graph 3 Real Price Change

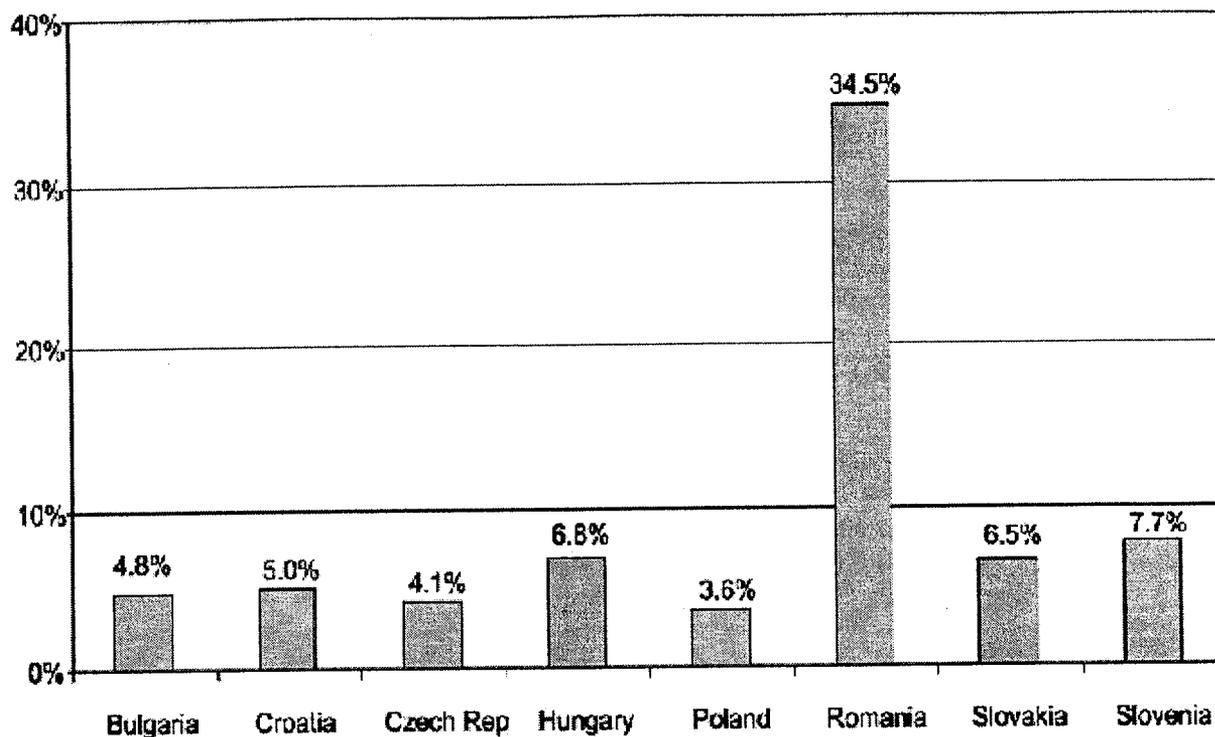


Source: National Commission for Statistics

The improvement in medium term prospects is primarily related to the implementation of the international financial agreements and associated macro stabilization measures. Romania's persistent high inflation rate is strongly related to Government decisions. The real economy must be the battlefield against inflation and not just the monetary policies as has been the case until recently.

The cause of the accelerated inflation is the general inefficiency of the economy: many large, State-owned firms spend resources in non-performing activities and in producing goods without a market, consequently they are unable to pay their debts to both other businesses or to the State. In 1998, fewer than 150 enterprises accounted for 90% of the losses produced in the Romanian economy. The situation changed for the better as several money-losing firms (especially in the metallurgy sector, and oil processing) were closed in recent years. At the same time many large State-owned monopolies are allowed by law to increase the prices whenever the cumulated inflation is higher than 5%, which consequently leads to new inflation waves. As Graph 4 shows, this approach resulted in Romania having at present the highest annual inflation rates in the region.

Graph 4 2001 Inflation Rates



Source: *Business Central Europe*

Unemployment and Wages

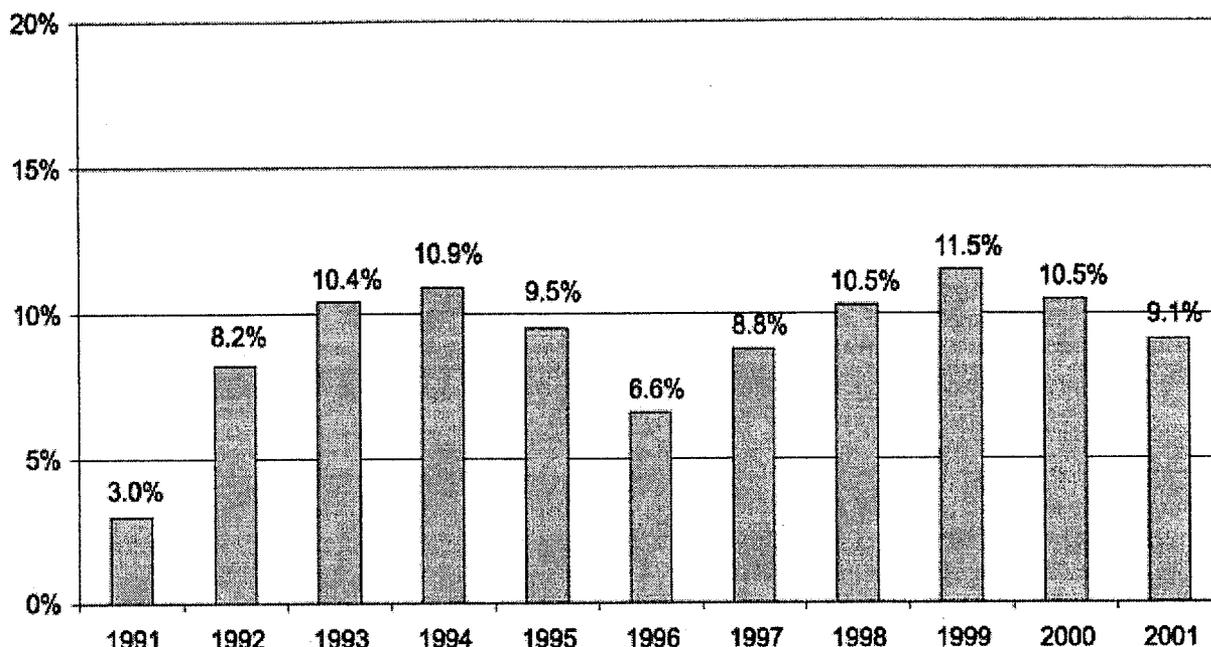
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The workforce is adjusting to the changes in the economy. No longer does the State guarantee a job and housing and no longer are rents and prices frozen. In 1989, before the Ceau^oescu regime was replaced, there was officially no unemployment. Throughout 1990 this remained the case as the interim Government issued a decree requiring State-owned companies to hire all job applicants. This decree was rescinded in 1991 and by the end of that year unemployment had reached 3.0%.

Graph 5 shows that since 1991 unemployment has steadily increased through 1994 (8.2 % in 1992, 10.4% in 1993, 10.9% in 1994). By the end of 1995, the unemployment rate reported by the National Commission for Statistics, decreased to 9.5 % and continued to decrease in 1996 (election year) to 6.6%, whereas the 1997 year-end rate reached 8.8 % after restructuring and liquidation of some of the loss makers (mining sector included).

The industrial production went down in 1998 (a 10.5 % decrease was recorded over the previous year based on the data from the National Commission for Statistics); nonetheless unemployment fell slightly in the same period. This paradox can be traced to two factors: first, managers have not felt the pressure to cut costs; second, the persons who do not qualify for unemployment benefits are no longer registered as "unemployed".

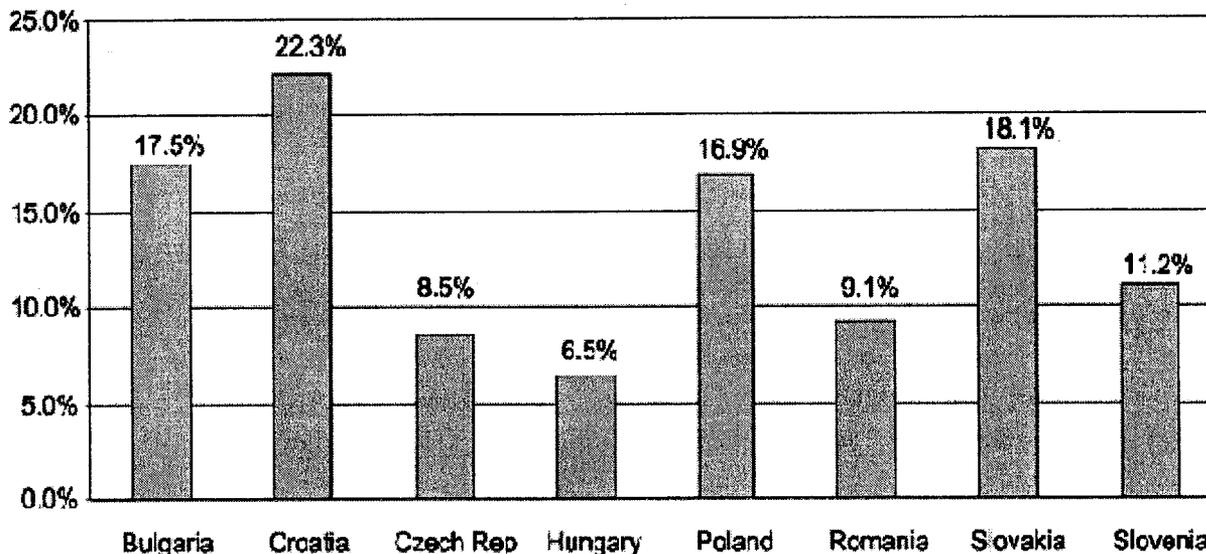
Graph 5 Unemployment



Source: Romanian National Commission for Statistics

Graph 6 illustrates that according to the latest official unemployment figures, Romania still compares favorably to other countries in the region.

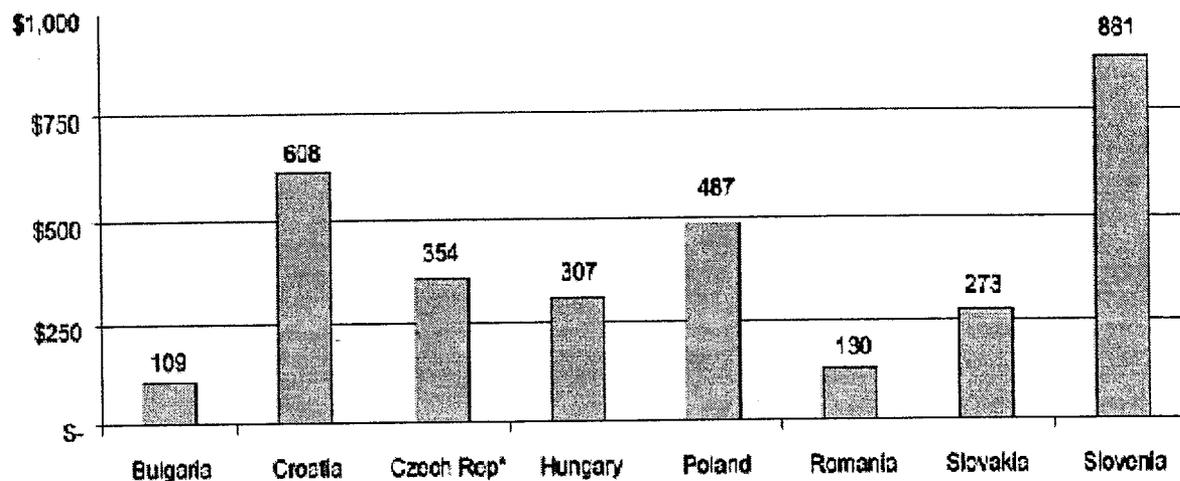
Graph 6 *EE unemployment in 2001*



Source: Business Central Europe

Graph 7 shows the average gross wages, as of May 2000, for various Eastern European countries. Romania, with an average gross monthly wage of USD 130, is at the lower end. Due to anticipated increases in unemployment associated with privatization and restructuring of State-owned enterprises, Romania is expected to remain one of the lowest wage earning countries in the region.

Graph 7 *Average Gross Wage Comparison - Eastern Europe (February 2000)*



Source: Business Central Europe; * February 2000

The average monthly wage in Romania reported by Romanian National Commission for Statistics is presented in Table 1.

Table 1 Average monthly wage in Romania (USD)

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000*	2001*
138.6	97.6	82.6	103.1	109.8	138.3	138.4	121.8	153.0	127	127	130

Source: Business Central Europe; * - D&T estimates

Foreign Trade and Payments

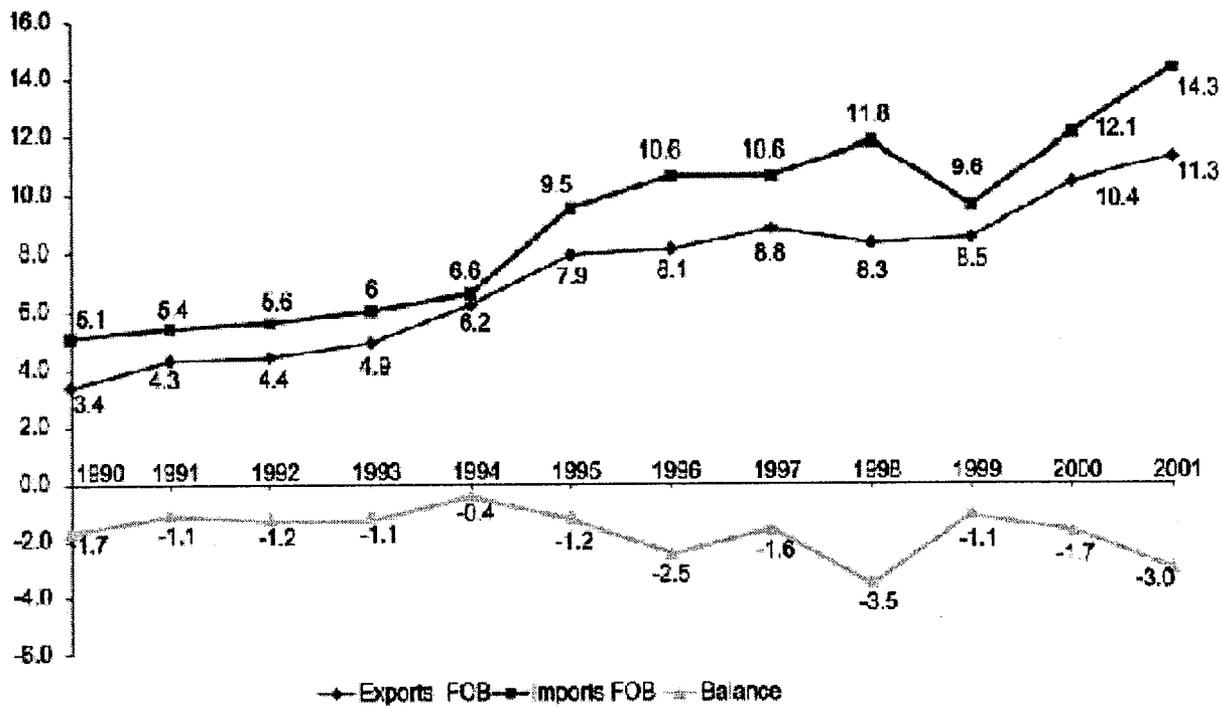
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By the late 1980s the trading block of communist countries (COMECON) had started to break down and by 1991 it had ceased to operate. Trade between former member countries is now settled in hard currency at world market prices. This has stressed the need to maintain a balanced trading position. In 1990, the first year after the revolution, imports rose by 50% while exports decreased by 77% in an attempt to immediately improve the living standards of the population. Over the next 4 years, Romania's trade deficit was around USD 1 billion, with both imports and exports increasing slightly each year.

In 1994, Romania finally experienced a major upturn in exports. The restoration of the Most Favoured Nation trading status by USA, the European Union (EU) and the CEFTA trade concessions, the recovery in the West, as well as discontinuing of the embargo against Yugoslavia, contributed to a great extent to set an upward trend for Romanian exports. Export growth has been concentrated on items in which Romania can be expected to be competitive in the long run, such as textiles, clothing, shoes and furniture.

This imbalance of Romania's foreign trade increased in the following years as shown in Graph 8 below

Graph 8 Exports

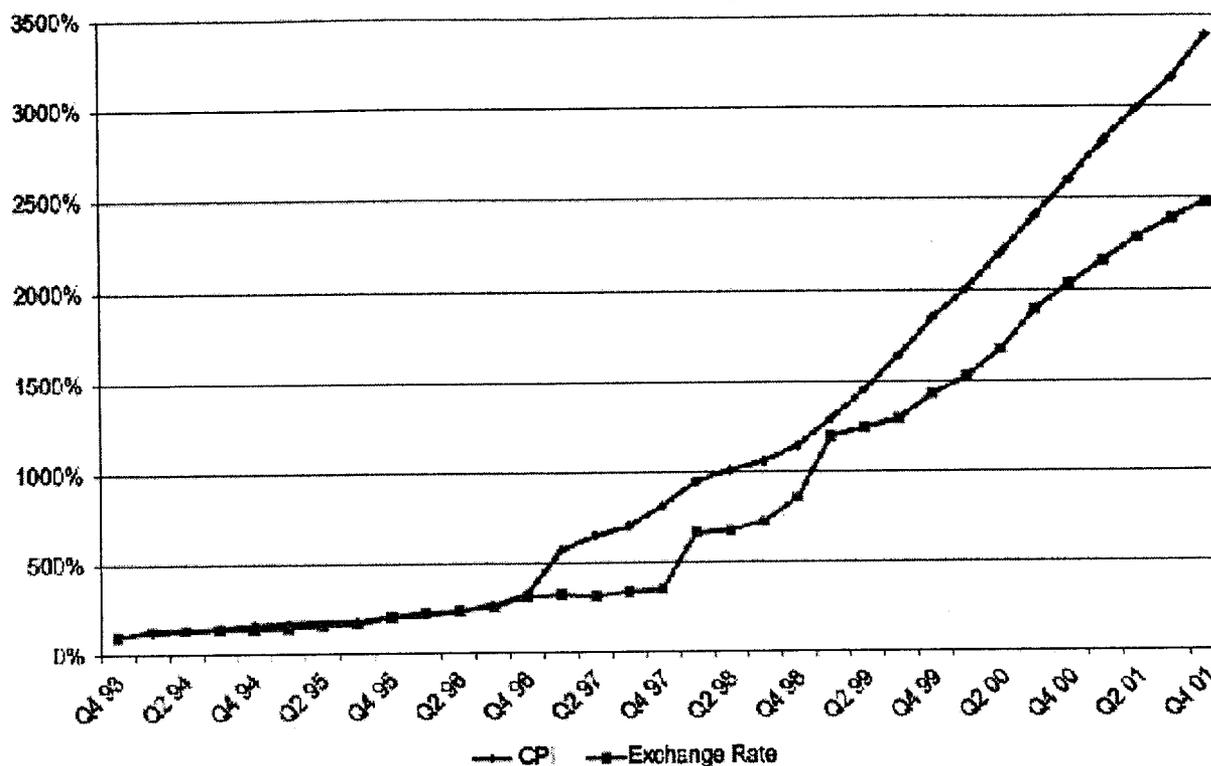


Source: National Commission for Statistics

Some of the most important factors affecting the trade balance were:

- Continued shortages of hard currency before 1994. Supply generally covered 2% to 5% of demand at the inter-bank currency auctions. This restricted imports. The situation has improved since 1994.
- The removal of most import control quotas. There are now few controls on trade, other than customs and excise systems. This has increasingly exposed domestic producers to Western quality goods and products. In 1993, Romania was accepted as an associate of the European Union, and since 1997 it has become a full member of the Central European Free Trade Association (CEFTA).
- Continued official devaluation of the ROL, as depicted in Graph 9.

Graph 9 Inflation Index vs Exchange Rate Index



Source: National Commission for Statistics, and the National Bank of Romania

Note: In the Graph 9 above is presented the Inflation index (assumed 100% in Q4 1993) compared to the Exchange rate index (assumed 100% in Q4 for 1993).

International Finance Agreements

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Future growth prospects are affected by the availability of foreign financing. The initial IMF Stand-by Agreement (approved by the Parliament in early 1994) was subsequently frozen due to the failure of the previous Government to fulfil its commitments. The IMF assistance resumed with the new Government after the November 1996 elections. The agreement had an important role in restoring the confidence in Romania (which was badly shaken by ROL's slide and the widening external deficit). The targets agreed with the IMF for 1997 included GDP current account deficit cut to 4.5% and a monthly inflation decrease to 2% by the end of 1997. These targets were not met.

The agreement required Romania to pursue tight fiscal and budgetary policies and, at the same time, to implement a package of structural reforms. Key requirements included: limits on growth in net domestic assets; minimum limits of net international reserves; limits on credits of the banking system to the Government and on external debt increases; no exchange restrictions and no build-up of arrears; an income policy which retains a link between permissible wage increases and labour productivity growth; progress in bank restructuring and privatization of the Romanian State-owned Banking Sector; and a budget deficit within certain specified target limits.

In 1997, Romania won pledges of some USD 1.5 billion in credits from international lenders. The IMF then resumed its financial assistance and approved a 13-month USD 430 million stand-by loan, of which two drawings of USD 86 million were disbursed.

Also in 1997, the World Bank approved USD 625 million in funding including the long-awaited USD 280 million Financial and Enterprise Sector Adjustment Loan (FESAL) and a USD 120 million loan for railway modernization. The FESAL funds were to be disbursed in drawings in order to ensure that certain conditions are met. The conditions included completion of privatization of a specified number of companies (including targets for the number of medium sized and large companies) for each drawing, and enterprise restructuring progress. The State Ownership Fund (SOF) privatized 1,304 enterprises in 1997, half of the objective established in January 1997.

On December 9, 1997, the World Bank approved a loan of USD 25.5 million for the support and implementation of the project of Real Estate Registry and Publicity. On June 2, 1997 IBRD approved 3 credits totalling USD 550

million for restructuring agriculture and industry and for social programs.

In the early 1998, the IMF rejected Romanian Government's 1998 evaluation of income from privatization included in the annual budget as too optimistic and the "transformation costs" of the Romanian economy as much higher than the Government's prospects. Consequently, the IMF decided to postpone the payment of the further drawings of this loan, because of the Government's lack of decisive actions with respect to economic restructuring.

In 1999, Romania had to pay USD 2.8 billion in debt servicing, with USD 1.6 billion due in the first 6 months. With around USD 1.66 billion in hard currency reserves, and with a trade deficit of USD 2 billion at the end of 1998, only a concentrated effort from the Government was likely to meet this challenge. To add to the hardship, the international lending agencies were not eager to issue new loans to support debt servicing, given the fact that Romania has been unable to successfully implement previous structural initiatives. An agreement with the IMF was one thing the Government could do to ease the investment community's anxiety about Romania. And this is what the Vasile Cabinet did.

After discussions that started before 1999, the World Bank and the Romanian Government agreed on a new USD 300 million loan (Private Sector Adjustment Loan or PSAL), and a USD 25 million loan meant for institutional development of the private sector, on March 26, 1999.

In late April 1999, the Government of Romania signed a letter of intent for a new stand-by agreement with the IMF for a new one-year loan of USD 475 million. The IMF conditioned the arrangement to the Romanian Government being able to secure USD 250 million from private sources. Under these conditions, interest rates charged by different banks increased dramatically to as high as 30%, and the Government decided to postpone obtaining the private loan.

In August 1999, the Board of Directors of the IMF approved an eight-month stand-by credit for Romania worth USD 547 million to be released in four tranches. The first tranche was disbursed immediately, with the second one being conditioned on Romania complying with a strict reform program and borrowing some USD 470 million on the international private capital markets. The last issue was impossible to observe, as the Romanian authorities were unable to borrow this sum of money even after several banks (Credit Suisse First Boston, Deutsche Bank, and Merrill Lynch) were asked for help. Given the improved reserves and the lower current-account deficit, in June 2000 the IMF Board approved the extension of the stand-by agreement till February 2001 and released the USD 116 million second tranche. However, in February the new Government was not successful in prolonging the agreement.

The settlement with the IMF unlocked other financing sources, such as USD 325 million from the World Bank secured under the PSAL program, USD 191 million from the European Union and USD 100 million non-refundable PHARE funds.

The Government signaled its commitment to macroeconomic stabilisation and structural reform, by securing a new stand-by arrangement with the IMF at the end of October 2001 (the 18-month stand-by credit for SDR300m, or USD 383m, is to be made available in seven purchases between end-September 2001 and end-March 2003). The main aims of the program are to achieve gradual disinflation (a rate of 22% at by the end of 2002) and to contain the current-account deficit (to 5.6% of GDP), at the same time as accelerating structural reforms and strengthening growth prospects. In order to fulfil these aims, the program envisages a fiscal adjustment equivalent to 0.5 percentage points of GDP in 2002; a reduction in energy sector losses equal to about 1.5 percentage points of GDP; a public-sector wage policy that is consistent with the disinflation target; a monetary program consistent with the inflation target and balance-of-payments developments; structural reforms that include an ambitious privatisation agenda to downsize the public sector and measures to improve the business climate; and strengthening of the regulatory framework and supervision in the financial system. However Romania had difficulties in fulfilling the targets included in the letter of intent and the board of IMF decided to postpone the decision regarding the disbursement of the second and third tranches of the stand-by loan.

Following Romania's acceptance to accession negotiations with the European Union new loans became available. The World Bank committed USD 500 million to assist with the cost of integration, the EU pledged Euro 120 million under the Instrument for Structural Policies for Pre-accession program, and some Euro 600 million per year, as support for the accession process. The European Bank for Reconstruction and Development will grant Euro 273 million for the development of the Trans European Corridor IV.

Foreign Reserves

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Romania's exchange rate was officially unified in November 1991, but the interbank market was heavily controlled leading to big differences between the official exchange rate and the boutique market exchange

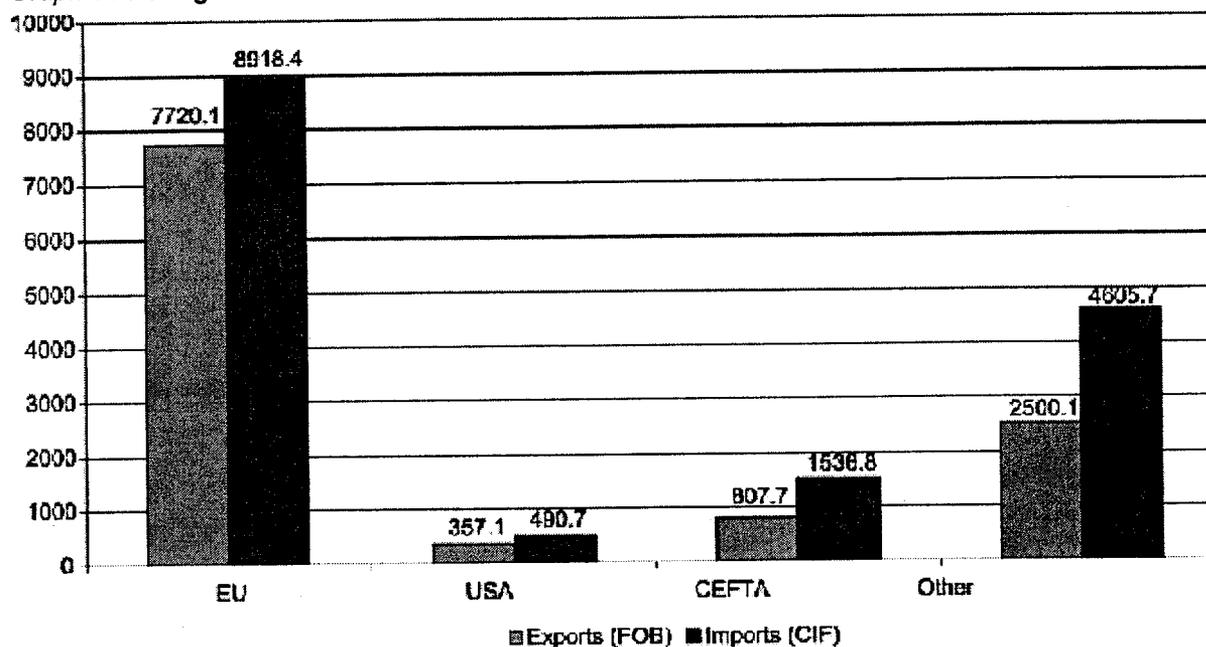
rates. Expansionary macroeconomic policies from 1993 to 1996 contributed to the increase of the current-account deficits and the run-down of the foreign-exchange reserves, requiring the Government to impose the suspension of multilateral credits in April 1996. The exchange rate was reunified in January 1997 and full internal convertibility was introduced on 30 January 1998.

The National Bank of Romania ("NBR") has attempted to liberalize the foreign-exchange regime and to restore foreign-exchange reserves to more prudent levels against a difficult background of continuing current-account deficits, pressure on the ROL and high levels of debt repayments. Improved inflows of portfolio investment and debt securities facilitated the build-up of total foreign-exchange reserves in the banking system to USD 3.8 billion by the end of 1997. The NBR built up its own reserves from USD 812 million at the end of 1996 to USD 2.52 billion at the end of 1997. This reduced the immediate prospect of a financial crisis in 1998 as Romania financed its current-account deficit in part, by reducing its gold and foreign-currency reserves. Total foreign-exchange reserves in the banking system (excluding gold) had fallen to USD 2.9 billion at the end of 1998, with the NBR's holdings reduced to USD 1.3 billion.

The NBR successfully financed high foreign debt service of USD 2.8 billion in 1999, despite a severe bunching of repayments in the first half of the year and continued disputes with the IMF over the disbursement of the second tranche of a stand-by agreement reached in August. The NBR built up its own foreign-exchange reserves to USD 1.5 billion by the end of 1999, partly by acquiring foreign exchange from domestic banks. As of August 2000, international reserves reached USD 2.1 billion. The increase in the NBR's foreign-exchange reserves broadly corresponds to borrowing from the IMF, the World Bank and the EU over the period.

Graphs 10 summarize Romania's main destinations for exports (FOB) and the main origins of imports (CIF) for 2001.

Graph 10 Foreign Trade 2001



Source: National Commission for Statistics

Starting with 1994, more than 50% of Romania's trade was conducted with the EU. In 2000, 63,8% of exports and 56,6% of imports involved EU countries.

Romania's main export products are clothing, followed by iron and steel, footwear, fuels and mineral oils, electrical equipment and appliances.

Foreign Debt

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Table 2 below shows the historical foreign debt of Romania since 1990.

Table 2 Evolution of Gross External Debt

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001*

Gross External Debt (USD billions)	1.2	2.2	3.2	4.2	5.5	6.7	9.2	10.4	9.7	9.4	9.8	11.6
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Source: National Commission for Statistics; * EIU estimates

External debt increased from USD 1.2 billion in 1990, by USD 1- 1.3 billion a year to USD 6.7 billion as of the end of 1995. Until then, most of the additional debt arose from multilateral and bilateral sources. In March 1996 Romania won its first credit ratings from major international agencies (BB-minus by Standard and Poor's, and Ba3 from Moody's Investors Service). As a result, Romania started tapping the commercial loan markets with NBR successfully raising funds through bond issues. After the highest annual increase of USD 2.5 billion in debt was recorded in 1996, the annual increase was tempered in subsequent year and Romania was able to pay down some of its debt in 1998 and 1999.

In the first quarter of 1999 Romania's political turmoil and increasing indebtedness, coupled with a debt service of 2.8 billion in 1999 and previous year's international currency crisis, led to a decrease of Romania's Sovereign Ratings. The rating agencies still maintain these low ratings, as one can see from the table below:

Table 3 Romania's Sovereign Ratings

	Local Currency		Foreign Currency	
	Long-term	Short-term	Long-term	Short-term
Standard & Poor's	BB-	B	B+	B
Moody's	B2	-	B3	-
Fitch IBCA	BB-	B	B+	B

Debt servicing will remain at manageable levels due to the low initial size of external debt and to generally favourable borrowing terms. The debt-service ratio was relatively low at 12.6 % at the end of 1996, it gradually increased to 15.6% in 1997, 21.5% in 1998 and some 28.4% in 1999. In 2001, the debt-service ratio decreased to 20.8%. In 2001 Romania repaid USD 3.2 billion of its debts and has to repay USD 2.7 billion in 2002.

In September, after a three-year absence, 2000 Romania returned to international capital markets, with a three-year Euro 150 million Eurobond and a five-year Euro 150 million Eurobond, and in November 2000 to the syndicated loan market, with a two-year syndicated loan for USD 138 million, facilitated by Citibank.

Foreign Investment

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Romania's foreign investment laws are quite liberal even when compared to other Eastern European countries. However, foreign capital inflows have been small.

During 1993, foreign companies in Romania invested only USD 380 million. The situation improved during 1994, with USD 995 million foreign direct investment being recorded. However, 1995 did not meet expectations with approximately USD 300 million on record.

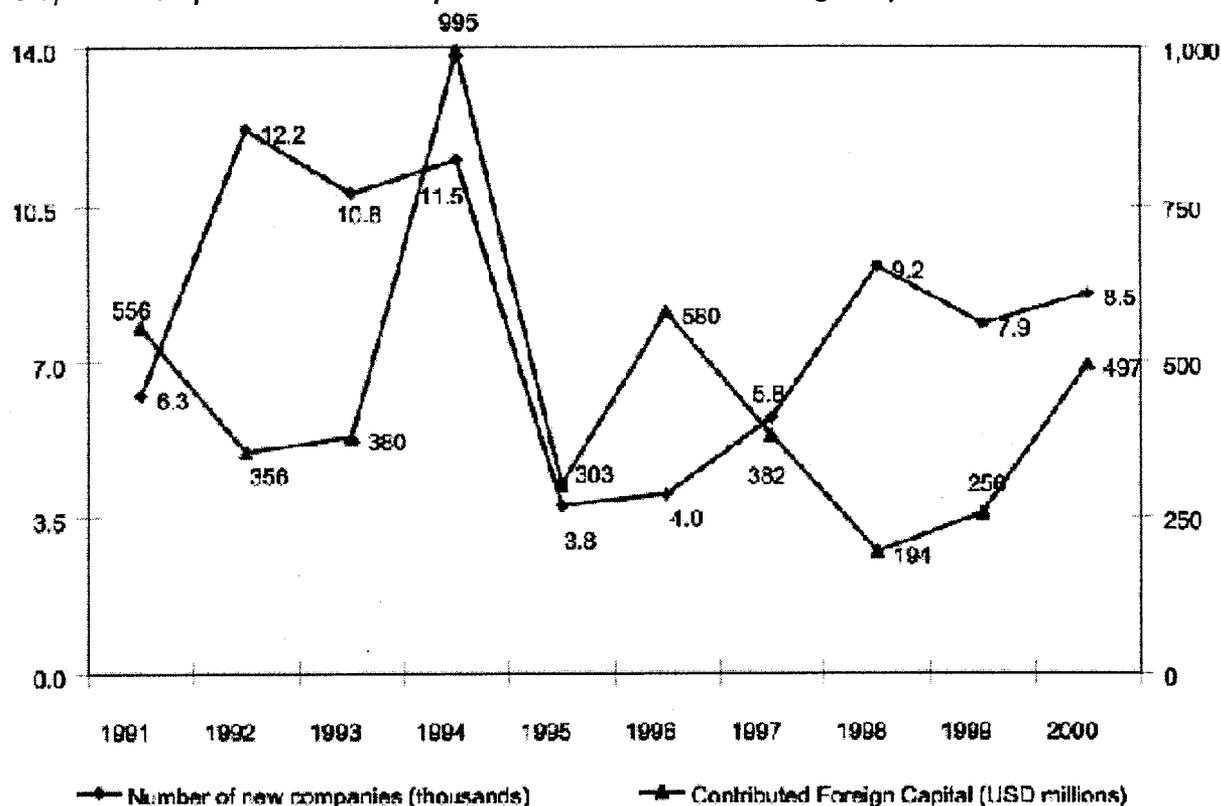
In 1994, the inflow represented just 1% of GDP (compared to 0.4% of GDP in 1992 and 1993) whereas the corresponding average for Visegrad countries (Hungary, Poland, the Czech Republic and Slovakia) was 4% in 1995 (from 2.2% in 1992 and 2.9% in 1993).

The main obstacles to foreign investment during these years were: severe shortages of hard currency, continued economic instability, poor infrastructure and the lack of political will to implement required fiscal and economic reforms. Nonetheless, many multinational companies attracted by the size of the country, its natural resources and location, set up representative offices in Romania. These companies were well positioned to respond quickly when the business climate improves. Total foreign investment inflows amounted to USD 2.2 billion by the end of 1996.

By the end of 1997, the gap between the Visegrad countries and Romania widened further: the cumulative inflow of foreign funds for Romania was 8% of its GDP, while the Visegrad average was 22.8%.

Graph 11 presents the number of firms with contributed foreign share capital (in thousands) and the value of foreign share capital (in USD millions), for the last 9 years. Data includes privatization revenue:

Graph 11 Incorporated name companies with Contributed Foreign Capital



Source: National Commission for Statistics

From December 1990 to date, Romania has drawn more than USD 7 billion in foreign investments – a figure including both the amount of direct capital investments and that of currency capital resulting from privatizations carried out by the State Ownership Fund (SOF).

Western firms have shown particular interest in oil and gas, tourism, steel, consumer goods, textiles and food processing. According to the statistics (Registry of Trade), firms and individuals from more than 130 countries have invested in Romania.

Public and Private Sector Finance

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Romanian firms use locally denominated loans mainly for short term, working capital related needs, because the high interest rates charged by the banks, when combined with the low profitability of many Romanian firms, make long term borrowing on a local basis commercially prohibitive.

There are no restrictions on foreign investment in Romania, but the legislation on venture capital is somewhat unsatisfactory because the laws are not consistently applied; VAT is payable shortly after the invoice is issued (which, given the significant inflation, reduces the willingness of suppliers to provide credit to their customers); and because of burdensome administrative requirements.

The Romanian Government approved several tax rules and reporting requirements meant to align the local tax and accounting systems with international practices. Among them there are: semiannual submissions of financial statements (as opposed to the monthly submissions); free repatriation of profits derived from activities in Romania; full tax deductions for advertising and promotion as well as for losses resulting from exchange rate differences.

There are several investment funds in Romania with more than USD 50 million invested (Central European Growth, Advent Central European Fund II, AIG - New Europe Fund, First Russian Frontiers Trust, DB Osteuropa Fund, Coop Central Europe Fund, and Romanian American Enterprise Fund). There are also present regional/ Romanian-dedicated funds like Société Générale Romania Fund, Baring Central European Fund, Broadhurst Investment Ltd., Romania Investment Fund, Danube Fund, and Romania Post Privatization

Fund.

The financial market in Romania lost almost half of its value in 1998, and decreased further in USD terms in 1999. Nonetheless, the number of international investors in the country is increasing. This trend may be related to the funds' search for diversification, and to the competitive pricing of Romanian companies' shares.

The Private Sector and Privatization

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By the end of 1999, the contribution of the private sector was estimated at 61.5% of GDP. The contribution of the private sector is already dominant in agriculture, construction and services. As regards industrial production, the private sector's share is still minor (around 30%). As more State-owned firms are privatized, the stake of the private sector is expected to grow to 80%.

Agriculture: the first step in privatization after 1989 was taken by the Land Reform Law issued in 1991 whereby some 9.2 million hectares of agricultural land were the subject of restitution to former owners (or legal heirs). The process of distribution of full legal titles for the land was slow and after 9 years there are still farmers that have only temporary property certificates. The private agricultural producers possess less than 20% of the country's stock of agricultural equipment. The small land areas owned by farming families after the limited restitution of former owned land (up to a maximum of 10 hectares per family) and the lack of farming equipment make farming outside of associations very difficult.

Under pressure from the World Bank, on April 8, 1999 the Government issued a draft law enabling the State Ownership Fund (SOF) to privatize the agricultural companies with majority State-owned capital (former State Agricultural Enterprises – IASs) by either public offering or direct negotiation. This law also sets up the Agency of State Domains, which will manage the farming lands that will stay in the State's property.

Non-agricultural sectors: the pace of privatization has been slow. The privatization process began with a pilot program involving some 30 commercial companies in 1992 - 1993. The second stage of the privatization (based on Law no. 55, a voucher scheme similar to that implemented in the Czech Republic) involved the transfer to entitled citizens of up to 60% of the shares in some 3,905 State-owned firms and the subscription process was closed (after repeated delays) on 30 April 1996. The remaining shares were offered to strategic investors or to the public exclusively for cash. A law on the privatization of banks was issued in September 1997.

The year 1997 signaled the real take off in privatization. The hard currency cash payments in the contracts signed by the SOF with foreign investors were USD 385 million in 1997 compared to USD 16 million in 1996. The hard currency investments committed through the sale contracts signed by foreign investors with the SOF during the whole period 1992-1996 were USD 250 million whereas the same figure for 1997 alone was USD 465 million.

A law of privatization (Government Emergency Ordinance 88/23.12.97 approved by Law no. 44/20.02.98) has been in place since December 1997 replacing the regulations applicable for different situations (which seemed to confuse foreign investors). This Government ordinance was seriously amended and completed by Law no. 99/1999 regarding certain measures for the acceleration of the economic reform. The new rules, outlined in the text of the law, were meant to clarify procedures, cut bureaucracy and simplify privatization by reducing to a minimum the number of approvals needed from shareholders to sell a State-owned controlling stake in a company.

In 1997, SOF privatized a total of 1,304 companies (50 large, 170 medium sized and 1,084 small companies). In 1998, 1,650 companies were privatized, with RomTelecom being the largest privatized firm to date. The Privatization Program for 1998 aimed to attract a higher amount of foreign capital by switching the privatization effort from the small and medium sized companies to the large ones.

The main successes of the 1998 privatization effort by the SOF were the privatization of Romanian Bank for Development and RomTelecom. With ROL 7,000 billion, the 1998 privatization raised the largest amount since the start of the process, but fell short of expectations as the Government wanted to realize ROL 30,365 billion. This outcome is due mainly to the inability of SOF to sell the big companies (less than 100 were sold, but 312 were proposed for sale).

In 1999 SOF privatized more than 1,600 companies, succeeding to transfer to the State budget some ROL 10,000 billion. The main privatizations were: Banc Post (a 45% stake was sold for USD 42.8 million to General Electric Capital and Banca Portugues de Investimento) and Dacia Pitești (a 51% stake was purchased by car maker Renault with USD 50 million for the shares and a USD 220 million investment commitment over the next 5 years).

Unfortunately a deal of USD 725 million for a 65% stake in Petromidia refinery with Turkey's Akmaya went sour when the Government (under pressure from the IMF) decided to withdraw some fiscal incentives provided for in the law for major investors. The refinery subsequently was sold to Rompetrol at the end of 2000.

In line with the provisions of the Memorandum signed with the World Bank, the Government focused on the privatization of the State-owned banks and on the carrying through of the PSAL and ASAL programs.

In 1999, the Government of Romania obtained a Public Institution Building Loan from the International Bank for Reconstruction and Development which provided financing for the services of sales agents for privatization. As a result 64 companies were put out for privatization.

From the companies included in this program, the largest steel mill from Central and Eastern Europe – Sidex Galapi, was sold in July 2001 to the fourth largest steel producer in the world ISPAT, which jumped on the second place in the world hierarchy after this acquisition. Other large State-owned companies included in the program, such as Alro Slatina, Electroputere Craiova, Roman Bra^oov, Tractorul Bra^oov, etc., are scheduled to be privatized in 2002.

As regards the privatization of the banking sector, the Government moved a step forward by selling its stock in Banca Agricolă to a consortium formed by the Austrian Raiffeisen Bank and Romanian American Investment Fund. This is the third bank to be privatized after Banca Română pentru Dezvoltare, now controlled by Société Générale, and Bank Post controlled by GE. Banca Comercială Română – the largest Romanian Bank, is also going through the privatization process, the official announcement being published in the beginning of March 2002. The privatization of State-owned banks is considered crucial to the success of the economic reform program and the development of the financial markets.

In an effort to achieve its goals, the Government started a restructuring process for the major public utilities: the Romanian oil company - Petrom, the national electricity company - Conel, the national gas company - Romgaz, Romanian railway operator - SNCFR, Romanian postal service company - Po^ota Română.

New methods of privatization have been made possible by the organization and development of capital markets. The Bucharest Stock Exchange reopened in November 1995 after the long communist era break. At the end of December 1998 it listed 123 companies. The Bucharest Stock Exchange Indexes rose 49% in 1997, as a result of the surge of inward investment that began in late 1996, but dropped around 50% in 1998, putting Romanian equities among the cheapest in Central and Eastern Europe.

At the same time, shares of some 5,495 companies (most of them the subject of the Mass Privatization Program) are regularly traded "over the counter" on the RASDAQ market. Initiation of both stock markets involved a significant regulating and organizational effort, but now they are fully operational and part of the Romanian economic environment.

Changes in the Business Environment

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Business environment in Romania improved gradually during the last years, but the country ranked on the 52nd place among the 60 countries included in EIU's global ranking for the 1997-2001 period. In the regional ranking, were EIU included 10 countries (Azerbaijan, Bulgaria, Czech Republic, Hungary, Kazakhstan, Poland, Romania, Russia, Slovakia and Ukraine), Romania took the 9th place for the same period.

At present, direct taxes represent a large part of State revenues. Steps are being taken to increase the proportion of revenue accruing from indirect taxation. The Government's Decision effective since January 1998 to lower the top rate of tax on wages from 60% to 45%, was one of the steps to change the balance between direct and indirect taxation. The Government introduced the tax on global income starting with the 1 January 2000. The highest rate on income is at 40% since 1 January 2000.

Starting with the spring of 1999, signs began to emerge that some Romanian banks were plagued by bad loans. Under pressure from the IMF to improve the banking environment, in May the NBR withdrew Bancoop's and Albina's license. Bancorex, Romania's largest bank just a couple of years ago, was about to follow Albina, but finally was absorbed by Banca Comercială Română, its bad debts being transferred to the Banking Asset Resolution Agency.

There are signs that the country will follow the right path:

1. Romania is an official EU candidate. Although it is likely that it will take more than ten years for Romania to

be accepted into the EU, the process will provide Romania with a path toward restructuring its economy, laws and institutions.

2. The agreements with IMF require Romania to pursue tight fiscal, monetary and income policies and, simultaneously, implement significant structural reforms. Once Romania implements these changes the economic situation will improve considerably. The transformation from a centrally directed economy to a market economy involves deep structural changes, which will not be realised without short and medium term production decreases, unemployment increases, inflation, insolvency and bankruptcy problems. These factors influence the actual economic situation as well as the general attitude of the organisations subject to the privatisation process.

The future business environment will be highly dependent on how and when new legislation is effectively implemented. Creating a competitive market economy is a long-term process and will certainly last several more years.

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EXHIBIT I

**Document of
The World Bank**

Report No. 22180-RO

**MEMORANDUM OF THE PRESIDENT
OF THE
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
AND THE
INTERNATIONAL FINANCE CORPORATION
TO THE
EXECUTIVE DIRECTORS
ON A
COUNTRY ASSISTANCE STRATEGY
OF THE WORLD BANK GROUP
FOR
ROMANIA**

May 22, 2001

**South Central Europe Country Unit
Europe and Central Asia Region**

**The International Finance Corporation
Southern Europe and Central Asia Department**

The last Country Assistance Strategy for Romania was discussed by the Executive Directors in May 1997 (Report No. 16559 RO).

CURRENCY EQUIVALENTS

(Exchange rate as of May 11, 2001)

Currency Unit = Romanian LEI (ROL)
US\$ = 28,412 ROL

GOVERNMENT'S FISCAL YEAR

January 1 – December 31

WEIGHTS AND MEASURES

Metric System

ACRONYMS AND ABBREVIATIONS

APL	Adaptable Program Loan	IMF	International Monetary Fund
BCR	Romanian Commercial Bank	ISPA	Instrument for Structural Policies for Pre-Accession
CAS	Country Assistance Strategy	JPR	Joint Portfolio Review
CDF	Comprehensive Development Framework	M&E	Monitoring and Evaluation
CEC	Romanian Savings Bank	MIGA	Multilateral Investment Guarantee Agency
CEFTA	Central European Free Trade Agreement	MTES	Medium-Term Economic Strategy
CEM	Country Economic Memorandum	NATO	North American Treaty Organization
CGAS	Government Anti-Poverty Commission	NGO	Non Governmental Organization
CONPET	Commercial Enterprise for Crude Oil Transmission	OECD	Organization for Economic Cooperation and Development
DOTS	Directly Observed Treatment Shortcourse	OED	Operations Evaluation Department
EBRD	European Bank for Reconstruction and Development	PAL	Programmatic Adjustment Loan
EC	European Commission	PAYG	"Pay-as-you-go" Pension System
ECA	Europe and Central Asia	PCF	Prototype Carbon Fund
EIB	European Investment Bank	PDSR	Social Democracy Party of Romania
EMS	Emergency Medical Services	PER	Public Expenditure Review
EU	European Union	P&PG	Public and Publicly Guaranteed
EUR	Euro	PSAL	Private Sector Adjustment Loan
FDI	Foreign Direct Investment	PSC	Pension Supervision Commission
FESAL	Financial and Enterprise Sector Adjustment Loan	SAPARD	Special Accession Program for Rural Development
FRY	Federal Republic of Yugoslavia	SBA	Stand-By Arrangement
GDP	Gross Domestic Product	SMEs	Small and Medium Enterprises
GEF	Global Environment Facility	SNIF	State Land Reclamation Company
GNP	Gross National Product	SOE	State-Owned Enterprise
IAS	International Accounting Standards	SOF	State Ownership Fund
IBRD	International Bank for Reconstruction and Development	STD	Sexually Transmitted Diseases
IFC	International Finance Corporation	TB	Tuberculosis
IFI	International Financial Institution	UK DFID	United Kingdom Department for International Development
		UNDP	United Nations Development Program
		USAID	United States Agency for International Development
		WBI	World Bank Institute

The World Bank Group Team

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ROMANIA: COUNTRY ASSISTANCE STRATEGY

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THE WORLD BANK GROUP'S COUNTRY ASSISTANCE STRATEGY FOR ROMANIA

EXECUTIVE SUMMARY

1. This document is presented to the Board at a time when Romania is turning away from its legacy of erratic macroeconomic management of the 1990s. After almost a decade of uneven reform efforts, the new Government that took office in December 2000 has begun laying plans for reforms needed for a successful economic transition, and eventual accession to the European Union (EU). The key challenge ahead is turning these plans into sustained actions.

Country Context

2. The starting point for the transition process in Romania was, in many respects, more difficult than in other countries in Central and Eastern Europe. Pre-transition policies emphasized self-reliance, which resulted in excessive focus on heavy industry and large infrastructure projects. During the 1980s, the rapid repayment of the US\$11 billion foreign debt (20 to 30 per cent of gross domestic product (GDP)) imposed severe strains on the population, with deep cuts in imports and a widening of the technological gap. Towards the end of the 1980s the Romanian economy was on the verge of collapse and no attempts to reform had yet been made.

3. Given this difficult legacy, and seeking to protect vested interests and minimize the social costs associated with the transformation to a market economy, during the 1990s the Romanian authorities took a gradualist and piecemeal approach to reform. The imposition of hard budget constraints and privatization of state-owned enterprises were significantly delayed. While social concerns were understandable, this strategy failed to produce sustainable gains in either economic or social conditions. Given the experiences of the last ten years, the costs of a hesitant reform path have been higher than if a bolder approach to structural transformation had been adopted at the outset. Poverty has increased sharply, with the share of the population living below the national poverty line doubling in the second half of the 1990s, from 20 to 41 percent.

4. Lack of political will to reform, and constrained institutional and governance capacity are at the root of Romania's less-than-satisfactory economic performance and worsened social conditions. These two issues are evidenced by Romania's very high levels of enterprise arrears, that reached, at end-1999, 42 percent of GDP; frequent changes in legislation, with a strong reliance on emergency measures and few efforts to build the institutional capacity to enforce the new legislation, or to carry out new responsibilities; and an unattractive business environment. The instability in the legal framework and the delays in building needed administrative capacity have an acute impact on the delivery of health care and social assistance, especially to the poor, and on the business environment needed to attract foreign direct investment and private sector development. Many of these problems were reported during consultations held in 1999-2000, as part of the Comprehensive Development Framework (CDF) initiative, for which Romania is a pilot country. These consultations revealed a clear consensus among Romanians around the development objectives of poverty reduction and EU accession, and widely held views that

meeting these objectives would, in turn, require economic growth, strengthening of public institutions, greater access to opportunity, a strong social safety net, and sustainable development and protection of environmental and natural resources.

5. Cognizant of these widely held views, the newly elected Government has identified its priorities along the same lines. The Government's program lays the basis for a pragmatic approach to reforming the economy and raising living standards by improving the quality of Government services and creating an attractive business environment. An important milestone will be reaching agreement with the International Monetary Fund (IMF) on a Stand-By Arrangement, which would facilitate Romania's access to international capital markets, progress toward EU accession, and ability to attract foreign direct investment. Accordingly, the Government is in active discussions with the IMF on a macroeconomic framework and a possible Stand-By Arrangement.

6. In addition, the Government has taken action in a number of structural reform areas, including: (i) termination of all directed credit programs and all Government financing of rural and agricultural credit; (ii) a signed share sale-purchase contract for Banca Agricola; (iii) establishment of an Anti-Poverty Commission in the Office of the Prime Minister; (iv) and initiation of a 30 percent reduction in public administration staffing levels. In addition, the Government has committed to take action on several other fronts, in particular further privatizations.

7. Other important development challenges still remain, however, particularly with regard to further enterprise privatization, reform of the banking and financial sector, restructuring and deregulation of the energy sector, fiscal decentralization, land privatization and continued reform of the agriculture sector, access to quality education in rural areas, and reform of the pension system to ensure sustainability in the context of an aging population.

8. The Government needs to demonstrate a sustained commitment to accelerated reform and avoid reverting to a stop-and-go pattern of reform implementation, to secure complementary external financing. Romania's recent developments place the country in a particularly advantageous position to pursue accelerated reforms. After three years of negative real GDP growth rates, the Romanian economy began growing again in 2000, and is projected to reach around 4 percent real GDP growth rate in 2001. The economic recovery has been driven partly by a strong growth in exports, primarily the re-export of processed inputs from EU countries. The sustainability of the current economic recovery will depend on the new Government's ability to implement a coherent set of economic reforms, but will also be vulnerable to external shocks.

Country Assistance Strategy

9. The Bank Group's country assistance strategy presents two very distinct lending scenarios. If Romania reverts to pursuing a hesitant pace of reforms, Bank Group assistance will be very limited, centered on a few poverty-focused interventions, and significantly reduced from the levels of Bank Group support over the past four years (the low case). If, on the other hand, Romania sustains accelerated reforms, Bank Group assistance will support a broad set of structural and sectoral reforms to accelerate growth and pave the way for Romania's eventual

accession to the EU, in addition to an enhanced program of poverty focused interventions (the high case).

10. Adjustment lending would be important to support the accelerated reform scenario. Because of the Government's heavy structural reform agenda, adjustment loans account for about one-half of planned lending volume during FY02-04. The first such operation would aim at supporting reforms encouraging private sector development. This would be achieved through the proposed Second Private Sector Adjustment Loan (PSAL 2) program -- a follow-up to the PSAL 1 program. As a second stage, and post-PSAL 2, the Bank would support the Government's program of reforms of the institutional, regulatory, and governance framework, as well as continued reforms in the enterprise, financial and energy sectors. The Bank is considering supporting this reform agenda through a series of programmatic adjustment loans (PALs). The programmatic instrument would provide greater adaptability for step-by-step institutional reforms, capacity building that involves significant policy content, and an economy-wide scope that goes beyond individual projects. The use of a programmatic approach would depend on the country's ability to strengthen its procurement and financial management frameworks. Programmatic lending will be grounded in clear country commitment and capacity to reform, structured in a series of operations supporting a medium-term reform program, and disbursed on the basis of completed actions. Their content will be underpinned by the results of the Bank's advisory services (e.g., the forthcoming Public Expenditure Review). To prepare the ground for the possible use of programmatic adjustment lending, the Bank is assisting Romania to strengthen its procurement and financial management frameworks. Following the completion of the FY00 procurement assessment, a Country Financial Accountability Assessment is planned for FY02-03.

11. **High-case lending scenario.** Under this scenario, Bank commitments would increase to a maximum of \$995 million during FY02-04, with three or four operations per year, in contrast to lending commitments totaling nearly \$600 million during FY98-00 (including adjustment lending). This increase would be mainly due to adjustment lending (up to \$550 million over the three-year period) to support the policy reform agenda associated with the accelerated reform scenario. Adjustment lending would be aimed at supporting private sector development and institutional and governance reforms, and would complement sector reforms under individual investment loans. Non-lending services in a high-case scenario would include at least four studies per year, plus several grants, technical assistance, and World Bank Institute (WBI) training in key areas of reform. IFC will complement the Bank's efforts in private sector development by focusing on four key areas: restructuring of municipal infrastructure, marshalling financing for post-privatization restructuring; supporting capital markets and SMEs development, and selected private sector investments in the forestry sector. Overall, the level of IFC activity will depend very much on the extent of improvements in the enabling environment for business in the country.

12. **Triggers.** The high-case lending scenario would be triggered by Romania's progress in establishing a macroeconomic environment conducive to lower inflation and sustainable growth, as well as moving forward in the following key policy areas: (i) conclusion of the privatizations and work-outs initiated under PSAL 1; (ii) initiation of the privatization and work-out process for a number of remaining large state-owned enterprises; (iii) an agreement on a plan and timetable for reducing energy arrears; (iv) an irrevocable agreement on the method and timetable for

privatization of Romanian Commercial Bank (BCR) and the Savings Bank (CEC); (v) improvements in the financial sector legal and supervisory framework; (vi) an agreement on the process for developing an anti-corruption strategy; and (vii) the approval of agreed social assistance legislation (minimum income guarantee and social assistance framework law).

13. **Low-case lending scenario.** In the low-case lending scenario, Bank lending would be significantly reduced to a total of \$60 million during FY02-FY04. The number of Bank operations would also be significantly reduced, to one or two per year. Lending instruments for FY02-04 would consist of one second-phase adaptable program loan, two technical assistance loans, and one investment loan. This minimal lending program would focus on reducing poverty and building capacity on a modest scale, and would be complemented by non-lending advisory services aimed at maintaining the policy dialogue with the authorities. This includes several fast turn-around policy notes (e.g., on energy sector issues), a Public Expenditure Review, and a Country Economic Memorandum focusing on EU accession.

Risks and Exposure Management

14. The Bank Group assistance strategy faces risks. The most important risk is political, and stems from potential divisions within the Government that would delay the articulation and implementation of a reform program. It took the previous Government nearly three years to put in place a reform program that could be supported by the international financial community, and this delay had an adverse impact on economic performance. If the new Government adopts a similar approach, it runs the risk of eroding the support of international financial institutions and access to credit markets, as well as triggering a steep deterioration in economic performance and, possibly, external financing difficulties. The new Government's room to maneuver is much more circumscribed than in the mid-1990s because of the external debt build-up and the depletion of the country's human and capital stock.

15. Political risk, while high, is mitigated by three factors. First, in contrast to the previous Government, the new Government is not a coalition and has shown signs of acting in a more disciplined and decisive fashion in some reform areas. Second, there is broad political consensus around the goal of Romania's joining the EU. This should create additional momentum for reforms. Third, the international community has shown a clear commitment to continue to engage Romania in an active dialogue, including contacts at very high levels and regular participation in international events. The Bank in particular has maintained, and will continue to maintain, a strong presence in the country, including the provision of analytical and advisory services, even in the low-case scenario.

16. A fragile fiscal position and relatively large external financing needs over the next three years pose interrelated economic risks. Without early and decisive action to limit public spending and lending by state-owned banks, there could be a loss of confidence in economic management. These economic risks are exacerbated by the slippage in fiscal consolidation in late 2000 and early 2001 that eased pressures on state enterprises to restructure, and are likely to put additional strain on the balance of payments. Over the next few months, therefore, the international financial community is likely to assess the new Government's commitment to reform by how well it manages its fiscal policy.

17. An important issue for the Bank Group is the composition of Romania's external debt, as the debt structure contains a high percentage of public and publicly guaranteed (P&PG) debt, particularly preferred creditors. Total debt outstanding (including short-term) was approximately \$10 billion at the end of 2000 (or about 27 percent of GDP), of which nearly 70 percent was P&PG debt, and P&PG debt service accounted for 58 percent of total debt service, for a debt service ratio of 11 percent. The share of P&PG debt service is expected to reach 70 percent by 2002 in both the high-case and low-case lending scenarios, due to the undisbursed pipeline (\$557 million as of January 2001).

18. The World Bank is the largest creditor, accounting for about 20 percent of the total debt outstanding and nearly 15 percent of P&PG debt service at end-2000. The Bank Group's CAS for Romania has been developed to ensure that further increases in exposure are closely matched by increases in overall creditworthiness as well as by proportionate burden sharing among the IFIs. The longer the high case is sustained, the more the Bank's relative exposure would be expected to decrease over time, as private sources of P&PG financing would be increasingly available under an accelerated reform program. In the low-case lending program, however, due to the undisbursed pipeline of \$557 million (as of January 2001), and the likelihood of Romania's difficulty in accessing private financing, the Bank's relative exposure would remain high, even in the medium term.

Conclusion

19. While the new Romanian Government has taken a number of actions that signal its intention to accelerate the pace of reform relative to that of its predecessors, it will be important for this Government to demonstrate during the remainder of 2001 a sustained commitment to accelerated reform. It could make significant and sustained progress in fiscal management and structural reforms – particularly in the area of privatization – and hence adopt a program that could receive support from the Bank and the IMF. This would usher Romania into the high-case scenario by the end of this calendar year. Alternatively, the new Government could take a more hesitant approach to reforms, or even reverse past progress in some areas. This would result in a significant decrease in Bank Group support for two reasons. In the policy environment implicit in the low-case scenario, the Romanian Government should not commit its citizens to additional debt obligations, not least because Bank Group financing would not generate the growth needed to service the debt. In addition, there would be exposure and creditworthiness concerns on the Bank's side.

20. The Government will need to weigh the political as well as economic implications of its chosen pace of reform. However, with poverty reduction and EU accession as the long-term outcomes for which Romanians are striving, the Government is likely to conclude that the political and economic considerations converge rather than conflict. Should the Government pursue this conclusion in a sustainable way, the World Bank Group stands ready to support the Government's efforts to break critical bottlenecks in the reform process by ensuring improvement in the delivery of key services to the poor, moving forward on critical and irreversible steps of the privatization program, and helping to lay the foundations of key public sector institutions.

Agenda for Board Consideration

21. The Executive Directors may wish to discuss the following issues:
- Is the proposed dual scenario approach appropriate, given Romania's track record on reforms?
 - Does the proposed World Bank Group strategy adequately support Romania's top priorities as identified during CDF consultations, namely, poverty reduction and EU accession?
 - Are the proposed scenario triggers appropriate?
 - Does the proposed World Bank Group strategy adequately address and mitigate against country and implementation risks?

**MEMORANDUM OF THE PRESIDENT OF THE
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
AND THE INTERNATIONAL FINANCE CORPORATION
TO THE EXECUTIVE DIRECTORS ON A
COUNTRY ASSISTANCE STRATEGY OF THE WORLD BANK GROUP
FOR ROMANIA**

I. COUNTRY CONTEXT

A. Introduction

1. The last Country Assistance Strategy (CAS) for Romania was presented to the Board on June 3, 1997. This CAS has been prepared jointly by the Bank and IFC with input from MIGA. The document was discussed in draft form with the Romanian Government, which endorsed the assistance strategy. The document also benefited from extensive in-country consultations with civil society (see Annex C).

B. Political Developments

2. The November 2000 elections brought back to power the center-left Romanian Party of Social Democracy (PDSR) that had governed the country from 1992 to 1996. The PDSR returned to power against the backdrop of worsening social and economic conditions for the Romanian population in the second half of the 1990s. The outcome of this election signaled expectations that a more cohesive and organized political grouping, such as the PDSR, would have greater success in achieving Romanians' broadly shared goals of poverty reduction and accession to the European Union (EU) (see paras. 14-15).

3. These objectives will need to be pursued, however, under significantly different political and economic circumstances than those that prevailed during PDSR's first tenure in office. The new Government can ill-afford to disregard the popular objective of EU accession. EU support of Romania's accession depends, in turn, on the Government's adopting reforms that will lead to Romania's becoming a functioning market economy – a condition it has not yet met, according to the latest EU regular report on Romania's accession (see Box 1).

Box 1: Relations with the European Union

The EU opened accession negotiations with Romania on seven of the 31 chapters of the *Acquis Communautaire* in early 2000. Six of these chapters have been successfully closed, and the new Government is now elaborating position papers on eight other chapters. The new Government is also preparing an Action Plan for the Medium-Term Economic Strategy (MTES). The Action Plan will identify economic and structural reform measures broadly in line with EU policies, that could be supported by IMF and World Bank programs. This Action Plan for the MTES will guide day-to-day decision making on economic reform to move the Romanian economy toward becoming a functioning market economy. Romania is receiving substantial EU assistance under EU PHARE programs, and two pre-accession facilities (the Special Accession Program for Agriculture and Rural Development (SAPARD) and the Instrument for Structural Policies for Pre-Accession (ISPA)). Total disbursements under these three programs in 2001 could amount to as much as Euro (EUR) 650 million, or around 0.5 percent of Romania's GDP (see Annex D).

C. Social and Economic Developments

4. The starting point for the transition process in Romania was, in many respects, more difficult than in other countries in Central and Eastern Europe. Pre-transition policies emphasized self-reliance, which resulted in excessive focus on heavy industry and large infrastructure projects. This strategy led to the depletion of domestic energy sources, and induced a costly dependence on imports of energy and raw materials. During the 1980s, the rapid repayment of the US\$11 billion foreign debt (20 to 30 per cent of GDP) imposed severe strains on the population. As there was no growth in exports (in dollar terms), imports from the west were cut roughly in half over the decade in order to repay the debt. The technological lag increased significantly as a result. Towards the end of the 1980s the Romanian economy was on the verge of collapse and no attempts to reform had yet been tried.

5. Given this difficult legacy, and seeking to protect vested interests and minimize the social costs associated with the transformation to a market economy, during the 1990s the Romanian authorities took a gradualist and piecemeal approach to reform. The imposition of hard budget constraints on the enterprise sector and privatization of state-owned enterprises (SOEs) were significantly delayed. While social concerns were understandable, this strategy failed to produce sustainable gains in either economic or social conditions. Given the experiences of the last ten years, the costs of a hesitant reform path have been higher than if a bolder approach to structural transformation had been adopted at the outset. Poverty has increased sharply, with the share of the population living below the national poverty line (defined as 60 percent of average adult equivalent consumption) doubling in the second half of the 1990s, from 20 to 41 percent (see Table 1 and Box 2).

6. The worsened economic and social conditions were the result of slow and at times erratic implementation of reforms. Only in mid-1999 did the previous coalition Government embark on an ambitious program of macroeconomic stabilization measures and structural reforms. The reform program was supported by the Bank (via the first Private Sector Adjustment Loan (PSAL 1)) and by the Fund (via a Stand-By Arrangement (SBA)). The centerpiece of the macroeconomic program was a strong fiscal correction, supported by tight monetary and incomes policies and an exchange rate policy designed to help restore external competitiveness. The Government's program also included improvements in the tax regime and to the legal

framework for financial transactions, the closure of Bancorex (the country's flagship state-owned bank, that at the time had 70 percent of its loans classified as doubtful or non-performing), and programs to mitigate the social impact of enterprise reforms.

Table 1: Poverty and Inequality in Romania

Year	1996	1997	1998	1999
GDP growth ^a	3.9	-6.1	-5.4	-3.2
Poverty (at national poverty line)				
Poverty headcount (percent)	19.8	30.8	33.8	41.2
Total number of the poor ('000)	4,488	6,945	7,609	9,252
Consumption shortfall as percent of poverty line	22.7	25.7	27	---
Extreme poverty headcount (percent)	5.1	9.5	11.7	16.6
Inequality (Gini Index, consumption)	0.30	0.28	0.30	---

^aAt market prices, calculated from 1993 prices

Source: National Statistical Institute and Romania Integrated Household Survey

7. The reform program resulted in an improved economic performance into the latter half of 2000. The large corrections in the fiscal deficit, the exchange rate and the tight monetary stance narrowed the current account deficit, and restored foreign exchange reserves to more comfortable levels. The banking system was stabilized and the privatization process was finally accelerated, which allowed the successful completion of the PSAL 1 program. Economic growth responded slowly to the program, but after three years of negative growth rates, the economy began to recover in 2000, with a 1.6 percent growth rate (that would have been higher, had it not been for a drought in the summer of 2000).

Box 2: Poverty Profile

The poverty profile that emerges from Romania is one where poverty is widespread but mostly shallow, with some deep pockets among households with many children and households headed by farmers, the unemployed, and ethnic Roma. The poverty incidence is also high in the Northeastern region of the country, where there is high concentration of farmers. Farmers account for 16 percent of the poor, with a poverty incidence of almost 60 percent. Households headed by unemployed account for about 11 percent of the poor, with a poverty incidence of almost 70 percent. Roma-headed households account for just under 7 percent of the poor, but their poverty incidence reaches almost 90 percent. Among pensioner-headed households, poverty is higher for those earning lower pensions (e.g., farmers, survivors) and pensioners who retired before 1997, when benefits were under-indexed to inflation. Among employee-headed households, the risk of poverty is highly correlated with the number of children in the household, although poverty is also high for households where the main income earner has a seasonal job, lower educational attainment, or a low paying job. The gender of the head of household does not appear as a determining factor in the poverty status.

8. Despite the initial promising results from the reform program, the coalition Government was unable to sustain progress on reforms past mid-2000 due to external factors (the drought and rising energy prices) and pre-election pressures. More importantly, the Government began to loosen fiscal policies and delayed structural reforms in the run-up to the elections. A higher-

than-programmed budget deficit resulted from excessive real wage growth in the public sector and from growth in arrears, and was a major reason for the cessation of the Government's agreement with the International Monetary Fund (IMF) late last year.

9. Stabilization remains a key challenge. Romania's annual inflation rate is still very high, at around 40 percent (see Table 2). This amounts to a very regressive tax on the poor and shortens the investment horizon of enterprises. While there were efforts to reduce the fiscal deficit in 1999, fiscal consolidation has been slower than required for macroeconomic stability, and many of the expenditure reduction measures introduced could be easily reversed, with adverse effects on the current account. The improvement in external competitiveness is due primarily to adjusting the exchange rate in lockstep with inflation.¹ This policy has allowed exports to recover and grow, and provided an opportunity to rebuild foreign exchange reserves.

Table 2: Main Macroeconomic Indicators

	1995	1996	1997	1998	1999	2000
GDP growth (%)	7.1	3.9	-6.1	-5.4	-3.2	1.6
GNP per capital (US\$-Atlas method)	1,400	1,450	1,420	1,430	1,520	1,640
Current Account Balance (US\$ million) ¹	-1,732	-2,611	-2,360	-3,112	-1,302	-1,200
Current Account Balance (% of GDP)	-4.9	-7.4	-6.7	-7.5	-3.8	-3.4
Consolidated Government Budget Balance (% of GDP)	-3.4	-4.8	-5.2	-5.5	-3.7	-3.8
Inflation (CPI, y-o-y % change)	32.3	38.8	154.8	59.1	45.8	40.7
Unemployment rate (%) ²	9.5	6.6	8.9	10.4	11.5	10.5

1) Excluding non-convertible currencies.

2) As percent of total active civil population.

Source: Romanian National Commission for Statistics, 1999.

10. Lack of political will to reform and constrained institutional and governance capacity are at the root of Romania's less-than-satisfactory economic performance and worsened social conditions. These two issues are evidenced by (i) Romania's very high levels of enterprise arrears to the banking sector and utilities, (ii) frequent changes in the legislative framework, and (iii) an unattractive business environment. The Government therefore needs to accelerate privatizations and strengthen the legal framework as well as enforcement capacity.

11. **Very high levels of enterprise arrears.** Enterprise arrears reflect the politicization of the allocation of credit as well as weak creditor rights and institutional capacity to enforce them. Banks and utilities have been used to subsidize enterprises. At end-1999, enterprise arrears reached the astounding figure of 42 percent of GDP. They were evenly distributed between state and private sector enterprises, and included arrears to the budget, the banking system, and suppliers. Arrears in tax payments and contributions to the social security system accounted for just over 8 percent of GDP, a significant subtraction of needed revenues from the budget. In addition to these indirect transfers, many enterprises receive direct budget transfers and preferential access to credit from state-owned banks. Enterprise arrears to the banking system, over two-thirds of which were arrears on principal repayments, accounted for just under 6.5 percent of GDP. The largest share of inter-enterprise arrears, however, was to suppliers (18

¹ Two other factors contributing to growth in exports were the recovery of growth in EU countries, and the reduction in Romania's tax on profits from 38% in 1999 to only 5% in 2000.

percent of GDP), primarily energy utility companies that were unable or unwilling to enforce payment discipline on industrial consumers. This happened despite the price of energy inputs (oil, gas, electricity and district heating) being set below either world market levels (oil and gas), or cost recovery levels (electricity and district heating).

12. **Frequent changes in legislation and weak institutional capacity.** Due to a lack of political consensus, previous governments have relied heavily on emergency measures. Legislation has often been unclear and frequently modified, and there is too much discretion in interpreting the law. In addition, there has been little consideration of the need to build the institutional capacity required either to enforce the new legislation or to carry out new responsibilities. This has hindered public agencies' ability to implement new laws and regulations effectively, and has compounded the problem of scarce financial resources for their operations. In this maze of laws, regulations and overlapping Government agencies, corruption is perceived as a serious problem (see Annex E).

13. The instability in the legal framework and the delays in building needed administrative capacity have an acute impact on the delivery of health care and social assistance, especially to the poor, and on the business environment needed to attract foreign direct investment (FDI) and private sector development, in turn to promote growth.

- The allocation of resources for **health care services** has been disrupted by the transition from a centrally managed system that has no checks and balances to an insurance-based system. While revenues are collected from employees in an insurance-based system, expenditures are defined in the annual budget and usually set at around 85 to 90 percent of revenues. This allows the short-term surplus of the Health Insurance Fund to go towards reducing the public sector's consolidated deficit. It also allows the Government to keep the formula for redistribution non-transparent, as it uses redistribution primarily as a tool for addressing collection compliance problems in lagging regions rather than for increasing equity. Not surprisingly, Romania ranks among one of the lowest spenders in health care in Central and Southern Europe, and has significantly worse basic health status indicators than its neighbors. Romania's infant mortality rate in 1998 was 20.5 per thousand live births, which is very high when measured against 9.5 in Poland and 14.4 in Bulgaria (see Box 3). The maternal mortality rate was 40.5 per hundred thousand live births in Romania, compared to 4.8 and 18.7 in Poland and Bulgaria, respectively. These indicators also varied considerably across the country, with the infant mortality rate ranging from 14 in Bucharest to 27 in Tulcea.
- The delivery and, until recently, the financing of **social assistance** (cash transfers) have been delegated to local Government without due consideration to their administrative capacity or their ability to fund these programs. This has led to inequalities in the provision of these services across regions and among certain socioeconomic groups, especially vulnerable groups such as children, women, and ethnic minorities (see Annex F). Because many of these expenditure responsibilities are mandated, many local Governments are coping with these mandates by not funding the full obligation -- something that is allowed because the legislation is vague and there is little incentive to monitor the implementation of these programs. Furthermore, in those instances where mandates were being fully funded, it was found that cash transfers were poorly targeted,

and coverage of the poor was modest, except for child allowances. Coverage is especially low in the case of the homeless and children at risk. An exception has been the provision of childcare services. Under socialism the Government placed an undue emphasis on institutional care. With the decentralization of these services there has been a shift toward community-based care.² The sustainability of this trend, however, will require strengthening the capacity of local Government to deliver social services, adequate financing, and greater involvement of communities and civil society.

Box 3: Gender Dynamics

While the figures on maternal mortality in Romania are appalling, there are many areas where the statistical data indicate a large degree of gender equality. For instance, in 1998 the enrollment rate across all education levels was 64.8% for females and 63.1% for males. The gross enrollment rate in higher education was 27.9% for women and 23.1% for men. The employment rate was 43.1% for women and 53.4% for men. The registered unemployment rate was 10.5% for women and 10.2% for men. There are other areas where more needs to be done to achieve greater equality, nevertheless. For example, the average wage differential (female workers earn about 80% of the average for male workers) leads to lower pension benefits for female pensioners, especially since women usually have shorter accumulation periods. This needs to be considered in the design of social protection policies. Also, more remains to be done to ensure equal opportunities in the work place by, for instance, increasing access to childcare (more readily available in the socialist era). The Romanian Government is aware of these problems, and recently adopted a National Plan of Action for Equal Opportunities for Women and Men. While many of the solutions to these problems require a long-term change process, this is amenable to acceleration under a high economic growth scenario and the resulting increased demand for skilled labor, especially in the service sectors.

- Weak institutional and governance capacities also undermine the *business environment*. Private entrepreneurs report having problems with enterprise, land and tax registration, as well as in their dealings with the customs administration and the courts. Excessive taxes and regulations reflect the instability in the legal framework mentioned above, and provide fertile ground for the high levels of perceived corruption, as documented by the recent surveys conducted by the Bank, and the growth of the informal economy. Indeed, over the last decade, the size of the informal economy as a share of GDP is estimated to have climbed steadily, from 6.7 percent in 1992 to 21 percent in 1999. While informal activities are most prevalent in industry (accounting for 8.6 percent of GDP in 1999, compared to 3.3 percent in 1992), their growth has been faster in services such as wholesale and retail trade, and hotels and restaurants, with a combined contribution to GDP of 6.5 percent of GDP in 1999, up from 1.4 percent in 1992. The most important contribution of the informal economy is, however, in employment in rural areas. Many displaced industrial workers have taken up informal jobs in rural area activities that are neither taxed nor burdened by high payroll taxes. (Payroll taxes account for just under 40 percent of gross wages.) As a result, subsistence farming has increasingly become an economic safety valve for households, with just over one half of all households in Romania reporting owning farmland, even though holdings are frequently too small to be commercially viable. The labor force surveys report that approximately two-fifths of those employed are in agriculture, and that over half of their income results from production for their own consumption.

² This has been supported by the Bank-financed Child Welfare Reform loan.

D. CDF Findings

14. The Comprehensive Development Framework (CDF) initiative launched in Romania in 1999 has helped to shape the new Government's development agenda. Recognizing the difficulties that Romania has faced since 1990 in reaching consensus within the country on its medium- and long-term development priorities, the Bank agreed to the Romanian authorities' request that Romania be included among the pilot group of countries for the CDF. Accordingly, the CDF initiative in Romania has been specifically aimed at building consensus for a development strategy.

15. Romania's being a CDF pilot country gave members of its public, private and civil sectors the opportunity to articulate a shared perception of the main priorities for achieving sustained development over the next ten years. Extensive consultation sessions were held in 1999 and 2000 (see Annex G). These consultations revealed a clear consensus around the goals of poverty reduction and EU accession. More specifically, they revealed the following development priorities and constraints: frustration with the ineffectiveness of the legal framework in particular, and public institutions in general (this was seen by many as the most urgent problem); a keen desire to become part of Western Europe via EU accession; an urgent need to improve Romanians' access to economic and social opportunities; frustration with Romania's poverty in the midst of "natural wealth"; a plea for knowledge transfer on how to adapt production to market demand, and how to organize a market economy more generally; a legacy of distrust that impedes partnerships and risk-taking behaviors; and a continued reliance on Government, despite distrust of it. The findings are consistent with the Bank's diagnosis and have informed the Government's Development Program.

E. The Government's Development Program and Recent Policy Actions

Development Program

16. Immediately after being sworn into office in late December 2000, the new Government obtained Parliamentary approval of its "Governing Program for 2001-2004." This program sets out what the new Government intends to accomplish during the next four years, and draws from both the Medium Term Economic Strategy presented in 1999 to the EU (which the PDSR endorsed when it was in opposition) and the findings of the CDF consultations (in which the PDSR participated). The major objectives of the program are to restore economic growth, reduce poverty and unemployment, fight corruption, and accelerate integration into the EU and the North American Treaty Organization (NATO). The program lays the basis for a pragmatic, rather than abstract, approach to reforming the economy and raising living standards by improving the quality of Government services, including the regulatory functions and the judiciary, and creating a business environment which attracts foreign and domestic investors, including in new small and medium enterprises and in privatizing state entities.

17. The new Government's immediate priority has been to ensure economic stability. The previous Government's program, agreed with the IMF in August 1999 under an SBA, went off track in late 2000. The SBA expired in February 2001. The new Government is now in active discussions with the IMF toward reaching an agreement on a new program. The policy agenda has therefore been dominated by short-term measures to limit the public sector deficit.

Recently Policy Actions

18. Cognizant of the importance of moving quickly with implementing its program, the new Government has made recent progress in the following specific areas:

- **Termination of all directed credit programs and all Government financing of rural and agricultural credit**, as agreed in the context of the World Bank –financed Rural Finance Project, approved on March 29, 2001.
- **Clarification of the ownership of the assets of the Commercial Enterprise for Crude Oil Transmission (CONPET, the national oil pipeline company)**. The new Government's decision on CONPET's assets, reached in the first days of its administration, made it clear that CONPET cannot be owned or operated by an enterprise involved in exploration, refining or supply of oil. This decision guarantees greater competition in the market. It is also consistent with Government plans to develop an action plan for the energy sector that identifies the closure of non-viable enterprises, the privatization of others, and the restructuring of enterprises that will remain in the state's hands.
- **Signing of a contract for the sale of Banca Agricola**. On April 13 the new Government signed a share sale-purchase contract to sell the agriculture bank, Banca Agricola, to a consortium including the Austrian bank, Reiffeisen Zentralbank Oesterreich, and the Romanian American Enterprise Fund. Banca Agricola is one of four remaining state-owned banks. It accounts for 4 percent of banking assets in the country. Its privatization is a major step forward in the Government's exit from the banking sector, and builds on the closure of Bancorex in 1999.
- **Confirmation that the Government will proceed with privatization agreements reached under the first Private Sector Adjustment Loan (PSAL I)**. After a slow start on the privatization front, the new Government has indicated that it will proceed with the privatization of at least 30 large state-owned enterprises from its current portfolio. These enterprises would be offered for privatization in pools of five enterprises to sales agents to be engaged using international tenders. The Government has also agreed on contracts for the technical closure and environmental work related to at least 10 coal mines and to the further reduction of losses incurred by six mining companies.
- **Recent establishment of a Government Anti-Poverty Commission (CGAS) subordinated to the Office of the Prime Minister**. The key function of the CGAS is to evaluate and monitor the poverty reduction impact of Government and development partner programs. Building on ex ante analysis of the poverty and income distribution, this new commission aims to promote coherent and sustainable poverty reduction initiatives. CGAS officials have already been closely involved in the final stages of preparing the Social Sector Development project and are expected to play an important role in the implementation of this project.
- **Trimming of public sector staffing levels across the board by 30% now under implementation, to reduce the fiscal burden of the public administration**. While such dramatic reductions in staff inevitably raise concerns, they signal the new Government's

intention to deal with the public sector wage bill by reducing staff rather than compressing wages. It is also consistent with the new Government's program, which identifies public administration reform as a central objective.

F. Romania's Unfinished Structural Reform Agenda

19. While the new Government is starting to take action on several fronts, a number of important development challenges remain, as discussed below.

20. *Enterprise privatization.* While many small enterprises were privatized in the early years of the transition, including all the shops and service outlets, almost all large industrial enterprises remain under state ownership. This includes the *Régies Autonomes*, so-called strategic enterprises and public utilities, which represent around 20 percent of employment in the economy. These enterprises have not yet been included in the privatization program, and remain largely unstructured. As a result, the state still holds shares in around 6,000 enterprises and accounts for about three-quarters of industrial output. While the private sector accounts for around 60 percent of GDP, most of its activities are in the service sector.

21. *Banking and financial sector reforms.* While there are 40 licensed commercial banks operating today in Romania, the four state-owned banks account for about one-half of all banking assets, with most loans being made to loss-making state-owned enterprises. The Government still needs to make an irrevocable decision regarding how, and in what timeframe, it intends to privatize the Romanian Commercial Bank (BCR), and the Savings Bank (CEC). This will be an important step toward ending the practice of channeling funds from the banking sector to loss-making enterprises. Otherwise, the perception that the Government will always step in to deal with bad assets problems will only serve to perpetuate the problem of weak corporate governance. Also, actions to raise the private sector's participation in the banking system will need to move in parallel with the strengthening of bank supervision, and improvements in the legal framework and incentive structure to resolve commercial disputes.

22. *Energy sector reforms.* Oil prices in Romania track world levels, albeit with a lag. Gas wellhead prices, which should be aligned with import prices, are by contrast one-fifth of the imported cost. Electricity and district heating prices are also heavily regulated, with prices to both household and industrial consumers significantly below cost recovery levels. The recent decision to postpone and scale down the adjustment in electricity prices and the announced decision to reduce natural gas prices raise concerns. An agreement reached with the previous Government had committed Romania to increase gas prices for domestic producers to world market parity by mid-2002. These continuing subsidies are one of the major factors contributing to Romania's fiscal imbalances. The fiscal situation and the weak financial position of Termoelectrica (Romania's SOE for thermal power plant operations) are exacerbated by the fact that the largest beneficiaries of these subsidies are state-owned enterprises which do not pay their energy bills, even at the subsidized prices. The new Government therefore needs to phase out energy subsidies (except district heating subsidies for the poor), improve tariff collection and enforce service cut-off for non-payment. The Bank is currently assessing the situation in more detail and working with the Government to develop a program of remedial actions.

23. **Fiscal decentralization.** Fiscal decentralization began in earnest in 1998. While legislation has given local authorities control over their own revenue collection, there has been limited progress in providing local governments with autonomy concerning expenditures. The new Government's program specifically calls for acceleration of decentralization, with further allocation of responsibilities for the delivery and financing of public services to local Governments. This will require more specific policy initiatives, including laws that deal with control of – and associated expenditure responsibilities for – public property, whether national or local, as well as expenditure responsibilities for social assistance. Accelerated decentralization will also call for a more effective system of transfers, a more appropriate degree of consolidation of local governments, measures to build a professional and meritocratic civil service, and steps to strengthen and simplify the legal and regulatory framework for locally provided public services.

24. **Land privatization and agriculture sector reforms.** While land privatization began early in the transition process (1991) through the restitution of land used by large cooperatives to the former owners, almost two-thirds of the land transferred through restitution went to elderly farmers, with the remainder to younger, generally poorer households. Most farms today are small semi-subsistence units of about two hectares, run by owners with limited farming skills and with weak integration into factor and commodity markets. The productivity of many households is further reduced by the limited physical capacity of elderly household heads. These structural problems will require public and private investment in rural marketing infrastructure, and increased research and extension aimed at integrating small households into commodity and input markets. Meanwhile, the privatization of state farms, which are chronic loss-makers, remains a critical unfinished task. These farms tie up substantial portions of arable land (17 percent in late 2000) that is the best in the country. While agricultural subsidy allocation was improved through the establishment of an input-voucher scheme, the new Government's decision to allocate most of the budget transfers to "advanced producers" with no ceiling on the transfer per beneficiary will benefit primarily large land holders. Allocations to state farms were also allowed, which may well have the result of slowing their privatization.

25. **Education reform.** Romania's basic education indicators are quite favorable. There is almost universal access (95 percent) to compulsory education (grades 1 through 8), although it is lower in rural areas and among some ethnic groups. Gross school enrollment at all levels is 64 percent. The management of the system is evolving from a highly centralized structure where national authorities have responsibility down to the level of instructional implementation, to a system that gives local administrations more autonomy. At the county (judet) level, School Inspectorates are acting as de-concentrated branches of the Ministry of Education and Research. Elected local authorities have been asked to assume responsibilities for most pre-university school functions, such as rehabilitation and maintenance of school buildings and, more recently, teachers salaries and text books. While decentralization has been accompanied by measures to maintain central monitoring of outcomes (e.g., there is a national learning assessment exam), the results suggest that there are still significant disparities in access to and quality of education in rural versus urban areas. While 46 percent of Romania's school-age population lives in rural areas, only 6 percent of its secondary school students and 1 percent of higher education students come from rural areas. The new Government will need to put in place a cost effective, more equitable distribution system for education services. This will call for investment in teacher training, curricula development, and resource materials, to upgrade the quality of education in rural areas.

26. **Pension reform.** Romania's old age insurance system is comprised of a publicly managed "pay-as-you-go" (PAYG) defined-benefit plan, including special regimes for certain categories of occupations, a contributory supplemental retirement plan, and a mostly non-contributory program for farmers. Participation in the old age insurance program is mandatory for all salaried workers. The self-employed and those with civil contracts are covered on a voluntary basis. Contributions currently average around 37.5 percent of gross wages, which are fully paid for by employers. The system absorbs 8 percent of GDP and faces three major problems: evasion, the abuse of early retirement and disability pensions which absorb eight percent of GDP, and preferential provisions for a large number of occupational categories. These factors have seriously compromised the financial viability of the pension system, with large deficits in the short term (particularly when the farmers' pensions are taken into consideration), and a doubtful long-term viability due to the imbalance between promised benefits and required contributions in the context of an aging population and a high dependency ratio. (For each pensioner in 1999 there were only 1.3 contributors.) Contribution rates would need to rise to 62 percent in 2050 to finance the current replacement rate (70 percent of average wages). To make Romania's pension system sustainable, the new Government will need to establish a multi-pillar system, i.e., one that includes privately managed pension funds. This, in turn, will require a significant reduction in inflation and development of capital markets, including a regulatory framework.

G. Economic Prospects, External Environment, and External Financing

Economic Prospects

27. After three years of negative real GDP growth rates, the Romanian economy began growing again in 2000, and is projected to reach, under accelerated reforms, around 4 percent real GDP growth rate in 2001. The economic recovery has been driven by a strong growth in exports, primarily the re-export of processed inputs from EU countries, and a moderate expansion of the economy in the run up to the elections and their aftermath. The setting of the real exchange rate at a competitive level, the achievement of some fiscal consolidation, and the initiation of bank and enterprise privatization have helped in this economic recovery.

28. The sustainability of the current economic recovery will depend on the new Government's ability to implement a coherent set of economic reforms. In the short run, such reforms would include implementing a sound fiscal policy that maintains primary surpluses, hardening the budget constraints for enterprises, and making visible progress on enterprise and bank privatization. This should spur growth by shifting resources – capital and labor – to the emerging private sector, and should lead to lower inflation, which in turn should improve the country's prospects for more equitable growth. Over the longer run, the sustained growth will depend on improving the environment for new investment, hence on implementing a governance reform program that would stress transparency and accountability in Government, improvements in public sector management, and strengthening of parliamentary and judicial oversight.

29. Under an *accelerated reform scenario*, real GDP growth could average at least 4.5 percent per annum during the 2001-03 period. (See Table 3 and Annex B6a.) This growth would be driven initially by the sustained growth in exports, followed by supporting policies consistent with achieving and maintaining lower inflation and the increase in investment

necessary to rebuild the country's productive capacity. These supporting policies would include a tight fiscal policy, wage moderation, and improvements in competitiveness and efficiency. Increased production would cause a surge in imports and lead to a widening of the current account deficit. Higher foreign investment and access to financing from official and private creditors would, however, finance this deficit and sustain the economic recovery. A sustained recovery would encourage employment creation and enhance support to fiscal discipline and policies fostering investment. This would lay the foundation for continued growth, with workers moving from underemployment in agriculture and state-owned enterprises to jobs in the emerging private sector.

30. The realization of this accelerated reform scenario hinges on three factors:

- ***Progress in moving ahead with the stabilization and structural agenda***, including short-term actions to ensure the achievement of agreed fiscal targets, and structural reforms that reduce sources of quasi-fiscal deficits and improve overall public expenditure management. The short-term actions include reducing arrears to the budget and state-owned utility companies, privatizing large commercial state-owned enterprises, and reforming the pension system that currently consists only of a "pay-as-you-go" defined benefit plan. The structural reforms include strengthening the Government's budget management capacity to improve prioritization and the efficient use of funds, as well as measures to improve the inter-governmental finance framework.
- ***Increasing the value added of Romania's exports to EU markets***. This in turn will depend on Romania's ability to attract foreign investment flows into industries with export potential, as well as its ability to reduce delays in customs procedures at various stages, caused by either cumbersome bureaucratic procedures or outright corruption. This is especially important since most of Romania's trade with the EU is based on processing of imported inputs for further export. Sustaining export growth will also depend on the country's ability to maintain external competitiveness in the face of larger capital inflows. This will require a sound fiscal policy, able to offset the aggregate demand impact of these inflows and a possible appreciation of the currency. This will require in turn an acceleration of the privatization program, especially of state-owned banks and large state-owned commercial enterprises. These enterprises continue to place large demands on fiscal resources either directly through budget transfers, or indirectly through the build-up of tax and inter-enterprise arrears.
- ***Raising private investment*** rapidly from the current very low levels, while gradually introducing measures to increase savings and ease private sector access to credit from the financial sector. To spur investment, the Government needs to take measures to improve the business environment by facilitating entry of new firms and eliminating barriers for the operation of existing ones. These measures include simplifying the tax system, streamlining procedures for enterprise registration, and discontinuing the current practice of channeling funds through the banking system to the state sector. Actions to increase domestic savings include moving forward with bank privatization, restricting the size of public sector deficits, and introducing a funded pillar (i.e., privately managed funds) in the pension system.

31. The *slow reform path* would result from the inability to carry out structural reforms to support macroeconomic stabilization, such as imposing hard budget constraints on large SOEs (e.g., in the energy sector) and eliminating politicized bank lending by divesting state banks. The Government's fiscal stance would significantly deteriorate, recovery would be choked off, and financial instability might ensue. This situation could manifest itself through a swift rise in inflation and/or a rapid worsening of the external current account. (See Table 3 and Annex B6b.) Access to international capital markets would be lost, and foreign direct investment flows would decline significantly from present levels. Without bilateral or international financial institution (IFI) support, the external financing gap would be bridged by dwindling external reserves. Even if a full-blown external crisis were avoided in the next three years, there would still be a sharp slowdown in economic growth.

Table 3: Macroeconomic Prospects

	Actual	Accelerated Reform			Slow Reform		
	2000	2001	2002	2003	2001	2002	2003
GDP at market prices, real growth (%)	1.6	4.0	5.0	5.0	3.4	0.5	-2.0
Current Account Balance as % of GDP	-3.8	-4.2	-4.8	-5.8	-4.9	-5.5	-6.1
Consolidated Budget Deficit (% of GDP)	-3.7	-3.7	-3.0	-2.5	-3.8	-4.3	-5.0
Consumer Price Index (% change)	45.7	30.0	22.0	15.0	33.0	32.0	38.0

Source: World Bank staff estimates.

External Environment

32. Romania's economic prospects will be strongly influenced by its external environment, given the importance of EU markets for the country's exports, its large external financing needs, and the contribution that external investors can make in bringing managerial and marketing expertise to new and existing enterprises. Four external factors stand out which would influence Romania's economic prospects over the next few years: (i) progress in integration with the EU; (ii) regional stability in the Balkans; (iii) possible terms of trade shocks; and (iv) access to international capital markets.

33. *Integration into the European Union.* Romania's integration into the EU would have strong positive effects on its economy. The EU is already its main trading partner, accounting for 70 percent of total exports. It is also Romania's most important source of foreign direct investment. An economic slowdown in Europe would weaken the demand for exports, reduce investment flows, and possibly slow down the accession process (e.g., EU grant program funding might be reduced). To mitigate this risks, Romania needs to deepen trade links with the EU by making investments to meet quality standards and improve the business environment (see Annex H).

34. *Regional stability.* Political instability and further escalation of conflicts in neighboring countries would have deleterious effects on Romania's growth prospects and disrupt the current economic recovery. These risks are mitigated, however, by recent events in the Federal Republic of Yugoslavia (FRY), which harbor the possibility of an improved environment for economic recovery. Romania will benefit from the enhanced opportunities for trade and from increased demand for economic services resulting from the end of sanctions, the potential reopening of

transport traffic along the Danube River, and the need for reconstructing FRY's infrastructure. An active role for the Stability Pact should also help lower these regional risks.

35. **External Shocks.** Romania's dependence on energy imports – the country imports three-quarters of its oil and natural gas consumption – makes it vulnerable to increases in energy prices. A sharp increase in energy prices from current levels could hurt its balance of payments position and limit its ability to import needed investment goods. To alleviate this risk, the country needs to take steps toward aligning domestic energy prices to world market levels, and manage its external reserves prudently.

36. **Access to international capital markets.** While Romania's foreign debt profile does not anticipate a concentration of repayments, there are still substantial financing needs over the next three years. A temporary loss in access to international capital markets, as in the first half of 1999, would lead to a slowdown in growth by forcing the country to use domestic savings to meet external obligations.

External Financing

37. Romania's **external position** has improved over the last two years. This is particularly true for the current account and the debt-servicing schedule. The former benefited from improved terms of trade following the sudden currency devaluation in March 1999. The Lei depreciated against the US dollar by 30 percent at that time (20 percent in 1999 vs. 1998), and has depreciated more or less in lockstep with inflation ever since and has kept its real value constant (see Annexes B6a and B6b). As a result, the current account deficit dropped from 7.0 percent of GDP in 1998 to 3.8 percent in 1999, and is estimated to have remained in that range for 2000.

38. The **debt-servicing** schedule has improved primarily because of the large repayment of external debt obligations in 1999 when, like other emerging market economies, Romania temporarily lost access to international capital markets in the aftermath of the Russia crisis. Increased access to grant funding from the EU has also reduced the country's external financing requirements. Since 1999, when Romania was invited to open accession negotiations, EU financial support to the country has followed an upward trend. Grants from the EU could reach as high as EUR 650 million yearly through 2006, to fund projects ranging from infrastructure and environment to agriculture and regional development. These grant funds are disbursed, however, only as eligible projects and programs are put forward to the EU (see Annex D).

39. Romania's external financing requirements are expected to remain high (see Table 4). Under an accelerated reform path, remaining external financing needs, including a build-up in reserves, would average US\$4.6 billion per year over the next three years. Assuming increased access to private capital markets, and a doubling of foreign direct investment flow by 2003, official creditors would meet just over 12 percent of Romania's external financing needs, net of principal repayments. Under the sustained growth scenario, a rapid increase in FDI, which in turn would depend on significant progress in structural reforms, would contribute significantly to financing the current account deficit. Hence structural reforms and macroeconomic performance are closely linked.

Table 4: Romania's External Financing Requirements and Sources (2001-2003)

(US\$ million)	Actual	Accelerated Reform			Slow Reform		
		2000	2001	2002	2003	2001	2002	2003
Overall External Financing Requirements	-3,287	-4,187	-4,382	-4,658	-3,406	-2,100	-1,545
Current Account Deficit	-1,400	-1,622	-1,926	-2,472	-1,830	-2,018	-2,210
Principal Repayments, of which:	-959	-1,564	-1,494	-1,351	-1,564	-1,494	-1,351
IBRD	-91	-101	-119	-136	-101	-119	-136
Increase in Reserves	-928	-1,002	-962	-835	-13	1,412	2,016
Overall Financing Sources	3,287	4,187	4,382	4,658	3,406	2,100	1,545
Foreign Direct Investment	1,009	1,350	1,700	2,000	900	650	400
Disbursement of Long-Term Loans, of which:	1,744	2,037	1,983	1,658	1,807	1,150	745
IBRD	384	297	394	244	145	134	133
EU Capital Grants	40	350	400	450	350	250	250
Other Financing Flows	494	450	300	550	350	50	151

Source: World Bank staff estimates.

40. Under a slow reform approach, foreign direct investment and official creditors' financing flows would be much lower and lead to a sharp drop in external reserves, which would be almost completely depleted by the end of the projection period. (See paras. 88 - 94 for discussion of risks, which would have a direct impact on external financing).

II. WORLD BANK GROUP ASSISTANCE STRATEGY

A. Lessons of Experience

41. The 1997 CAS outlined four priorities for the World Bank Group's assistance strategy during the period FY98-01: (i) promoting structural reform and private sector development; (ii) fighting poverty and developing human capital; (iii) strengthening and rationalizing the role of the state; and (iv) protecting and enhancing the environment. While these priorities were shared by the Government, implementation of the CAS was constrained by the slow pace of economic reforms.

42. There was, however, some progress in specific areas. Under the Bank-financed PSAL 1 program, the largest state-owned bank (Bancorex) was closed, privatization was initiated for some of the largest SOEs, and a number of important reforms in agriculture were implemented. A social fund for community development was established and is proving to be an effective tool for poverty reduction in rural areas. Global Environment Facility (GEF) - supported efforts to establish a biodiversity conservation and management program with local participation have successfully introduced practices to ensure sustainability of natural resources.

43. This CAS takes into account two important lessons learned during the implementation of the 1997 CAS:

- *Engage in meaningful participation and consultation in project preparation and overall policy dialogue.* This reflects the finding that more was accomplished when

ownership of project objectives and the underlying reforms was strong. Engaging in dialogue with the Government, other interested parties, and society at large carries a high pay-off. Whether connected to specific lending operations (e.g., new privatization methods, bank restructuring) or to the design of overall reforms (the October 1999 Conference on Romania's ten years of transition), these investments to increase understanding on all sides have proven to help build broader consensus for reform.

- **Take active role to support strengthening institutions for a market economy (governance, anti-corruption, and business environment).** The activities of IFC and MIGA as well as the Bank have been constrained by an environment that is perceived by the private sector as being over-regulated, and where there are still unresolved property rights issues, and red tape and the perception of corruption are pervasive.

44. **IFC.** At the time of the 1997 CAS, IFC indicated that it would support the development agenda in Romania through investment in (i) small and medium enterprise (SME) development with loan facilities, credit lines and leasing company investments; (ii) other capital market development via potential joint venture projects in bank and non-bank institutions; (iii) infrastructure development via innovative private sector investments and advisory work in privatization planning and specific privatization transactions; and (iv) investments in other private sector industries via equity and debt support. Most of the progress in these objectives was achieved during 1997-1998, however. After 1998 IFC activity in Romania slowed, limited by the pace of reform in the country. While developmentally beneficial private sector investments can be made even in a difficult environment, the pace of investment is constrained by the slow pace of reforms, particularly with respect to infrastructure investments and investments in the privatization of state-owned enterprises. A significant increase in investments will require substantial strengthening of the environment for private sector activities.

45. **MIGA.** At the time of the 1997 CAS, MIGA had not yet issued any guarantees to foreign investors in Romania. Since then, MIGA has insured three projects in the financial, manufacturing, and services sectors, which together bring its total gross exposure to the country to only \$54 million. While investors registered preliminary application for a total investment amount of about \$500 million (\$55 million in manufacturing, \$200 million in services, US\$45 million in finance, \$100 million in infrastructure, and \$100 million in oil and gas) since 1998, this significant amount of preliminary applications has never been realized, in part due to the poor business environment.

B. Country Assistance Strategy FY02-04

Strategic Focus and Programmatic Context

46. The Bank Group's assistance strategy for FY02-04 is built on the premise that while Romania is turning away from its legacy of erratic macroeconomic management of the 1990s, the new Government needs to demonstrate a sustained commitment to accelerated reform, in order to secure complementary external financing and to pave the way for eventual EU accession. If Romania reverts to pursuing a hesitant pace of reforms (see para. 31), Bank Group assistance will be very limited, and significantly reduced from the levels of Bank Group support over the past four years. Under these circumstances, Bank support would be limited to a few

targeted poverty interventions aimed at improving the delivery of key social services and revitalizing the rural economy. If, on the other hand, Romania sustains an accelerated pace of reform (see paras. 29-30), Bank Group assistance will be broader in scope, and support a sustained reduction in poverty; that is, not only targeted poverty interventions, but also bold structural and sectoral reforms to accelerate growth through private sector development and the strengthening of public sector institutional capacity, and to pave the way for Romania's eventual accession to the EU. In light of uncertainties about whether accelerated reforms will be sustained in Romania, Bank assistance is organized around two lending scenarios (high and low), one of which would be triggered by the end of 2001 (see Table 5 and Annexes B3a and B3b). Complementing the Bank's assistance for private sector development, IFC would focus on cutting edge areas of privatization, such as health care and the delivery of municipal services, and support private sector development by marshalling financing for post-privatization restructuring, assisting in capital markets development, and making selected private sector investments.

47. The Bank's non-lending services (see Annex B4) would be an important component under either assistance scenario. Both would include fast turn-around policy notes on relevant issues for economic management, as well as in-depth studies on long-term development issues. Topics that would receive in-depth attention include an assessment of poverty developments, a review of public expenditures, and an analysis of the reforms needed in Romania's accession to the EU. Other planned non-lending services include the program for monitoring and evaluation (M&E) capacity building, a country financial accountability assessment, and several WBI activities (see Annex I).

Lending Scenarios and Triggers

48. **High-case lending scenario.** Under this scenario, Bank commitments could increase to a maximum of \$995 million during FY02-04, with three or four operations per year, in contrast to lending commitments totaling nearly \$600 million during FY98-FY00. (See Table 5 and Annex B3a). Adjustment lending would be important (up to US\$550 million) to support the policy reform agenda as outlined in the accelerated reform scenario. The first adjustment operation (PSAL 2) would aim at finishing the private sector development agenda, begun under PSAL 1, in the areas of privatization, banking, business environment, energy pricing, and social mitigation measures. The main constraint to completing this agenda is the political will to implement these reforms. A speedy implementation of the reforms supported by the PSAL 2 program would send a signal to the domestic and external investment communities that the new Government is committed to accelerating the pace of reforms.

49. As a second stage, and post-PSAL 2, the Bank would continue supporting the completion of the privatization agenda (including utilities), as well as reforms of the Government's institutional, regulatory and governance framework. This set of reforms requires careful sequencing and a step-by-step approach. The Bank would therefore consider supporting this component of the reform agenda through a series of programmatic adjustment loans (PALs). These could amount to up to \$400 million through FY06 or FY07, focusing on institutional and governance reforms, completion of the privatization agenda, full transition to market-based mechanisms in the utilities, infrastructure, and other network industries, and environmental

policy reforms, structured in a series of three or four operations, the first two of which could be prepared during this CAS period.

Table 5: IBRD Lending Program: FY02-FY04 (US\$m)

	FY02	FY03	FY04 ¹	Total FY02-04
High Case	Private Sector Adjustment 2 (SAL)/ Private Sector Institution Building 2 (TA) 300.0 40.0	Irrigation Rehabilitation 75.0	Hazards Mitigation 150.0	
	Rural Development 40.0	Rural Education 60.0	Health Sector Reform 2 (APL) 20.0	
	Social Development Fund 2 (APL) 10.0	Programmatic Adjustment 1 (PAL) 100.0	Programmatic Adjustment 2 (PAL)/ Public Institution Building (TA) 150.0 25.0	
	Forestry Development 25.0			
Total	415.0	235.0	Total FY04 345.0	995.0
Low Case	Social Development Fund 2 (APL) 10.0	Rural Education 25.0	Environment (TA) 10.0	
	Forestry Development (TA) 10.0		Hazards Mitigation (TA) 5.0	
Total	20.0	25.0	15.0	60.0

¹ FY04 program also includes a possible stand-by operation (Regional Development) for \$50 million.

50. The programmatic approach would provide greater adaptability for step-by-step institutional reforms, capacity building that involves significant policy content, and an economy-wide scope that goes beyond individual projects. Programmatic lending will be grounded in clear country commitment and capacity to reform, structured in a series of operations supporting a medium-term reform program, and disbursed on the basis of completed actions rather than future commitments.³ The use of a programmatic approach would depend on the country's ability to strengthen its procurement and fiduciary frameworks. Each operation will be calibrated in line with evolving reform progress, and subsequent operations will build upon each other to support the medium-term reform objectives. Their content will be underpinned by the results of the Bank's advisory services (e.g., the forthcoming Public Expenditure Review). To prepare the ground for the possible use of programmatic adjustment lending, the Bank is assisting Romania to strengthen its procurement and financial management frameworks. Following the completion of the FY00 procurement assessment, a Country Financial Accountability Assessment is planned for FY02-03.

51. The above support would complement other sector reforms under individual investment operations. For example, public institution building and governance reform would (i) reinforce and facilitate reforms to be implemented under the proposed Rural Education Loan, and (ii) assist in capacity building to be supported by investment operations in the forestry and health

³ See Task Force on the World Bank Group and the Middle Income Countries March 27, 2001 (SecM2001-0204).

sectors, as well as in hazards mitigation. Also, financial and energy sector reforms to be supported by the proposed PSAL 2 and the subsequent PALs would create the enabling environment needed for the successful implementation of the Regional Development loan, and the privatization component supported by the same adjustment operations would similarly create an enabling environment conducive to irrigation sector reforms. Other investment operations would be targeted poverty interventions, particularly in rural areas. Non-lending services in a high-case scenario would include at least four reform studies per year, plus several grants, technical assistance, and WBI training in key areas of reform (see Annexes B4 and I).

52. *Triggers.* The high-case lending scenario would be associated with a path of accelerated reform (see paras. 29 - 30). This scenario is predicated on the adoption and maintenance of a macroeconomic framework and financing plan agreeable to the Bank. It also includes significant progress in three key areas of the structural reform agenda: (i) enterprise and energy sector reform; (ii) financial sector reform; and (iii) governance and institutional reform. Actions across these three areas would constitute the structural reform program, and would be monitored as a program, rather than a series of actions identified under separate lending operations. This implies that performance throughout the CAS period will be measured broadly across all three areas. For example, in the pre-PSAL 2 phase of the program, moving to the high case would require progress in financial sector reform and governance and institutional reform, as well as in enterprise and energy sector reform. As some of the specific triggers listed in Table 6 are expected to be met only in the latter part of the CAS period, decisions on whether the triggers for the high case are met at any particular point in time will require a judgment on the extent of progress across all three areas. However, under the high-case scenario, the Bank would expect all of the specific triggers listed in Table 6 to be met by the end of the CAS period.

53. Progress on structural reforms will be measured initially by actions indicating that the country is moving toward the high-case lending scenario, and later by actions aimed at sustaining the high-case lending scenario (see Table 6). The precise actions indicating that the country is moving toward the high-case lending scenario include: (i) moving forward on the enterprise privatization agenda agreed under PSAL 1; (ii) making visible progress on tackling the problem of arrears in the energy sector; (iii) adopting social sector legislation aimed at mitigating some of the distributional impact of enterprise privatization and the increases in energy tariffs; and (iv) agreeing on the process for developing an anti-corruption strategy. Actions designed to sustain the high-case lending scenario would, inter alia, include: (i) making further progress on enterprise privatization, including the implementation of banking and energy sector privatization plans; (ii) ensuring that most large SOEs and all banks are compliant with international accounting standards for financial reporting; (iii) adopting and implementing an agreed anti-corruption strategy; and (iv) developing rule-based equalization formulae for the allocation of federal revenue grants to local councils.

Table 6: Lending Scenario and Triggers**High Case**

Lending to include adjustment lending (PSAL 2, then PALs) to support transitional budget expenditures, and investment lending in reforming sectors. FY02-04 lending to total up to US\$995 million.

The core conditions for moving to and sustaining the high case lending scenario are a macroeconomic framework and financing plan agreeable to the Bank. In addition, the high case would require specific actions on (i) enterprise and energy sector reform; (ii) financial sector reforms; and (iii) governance and institutional reform.

Actions for moving to the high case (pre-PSAL2) include visible progress in the following areas:

Enterprise and energy sector reform

- Privatization plan for large commercial SOEs identified under PSAL 1 (9 case-by-case, 5 work-outs, and at least 30 pooled);
- Initiation of privatization/work-out process for large commercial SOEs (4 case-by-case, including PETROM, and 30 pooled);
- Agreement on a plan and timetable for reducing the flow of energy arrears;
- Cost reduction and energy tariff increases for electric power plants; and
- Unbundling of electricity and gas industry SOEs and the adoption of acceptable regulatory legislation.

Financial sector reform

- Elimination of directed credit and rural/agricultural credit programs;
- Divestiture of Banca Agricola, and an irrevocable agreement on method and timetable for divestiture of BCR and CEC; and
- Improvements in financial sector legal and supervisory framework, including NBR supervision of credit co-ops. and plan for development of equity and capital markets.

Governance and institutional reform

- Adoption of agreed social assistance legislation (Social Assistance Framework Law and Minimum Income Guarantee Law); and
- An agreement on the process for development of an anti-corruption strategy.

Actions for sustaining the high-case lending scenario (post-PSAL2) include visible progress on the above and in the following areas:

Enterprise and energy sector reform

- Offering for sale the SOEs noted above;
- Timely implementation of plan to reduce energy sector arrears, and agreement on, and subsequent implementation of, a plan to eliminate the overall stock of arrears;
- Ensuring that most large SOEs and recently privatized SOEs are compliant with IAS for financial reporting;
- Privatization of at least 25% of gas distribution sector;
- Adoption of agreed privatization plan for electricity generation and distribution; and
- Offering for sale the remaining state-owned utilities/network companies.

Financial sector reform

- Satisfactory implementation of a privatization plan for CEC Bank;
- All banks compliant with IAS for financial reporting; and
- Implementation of agreed tax legislation for banks.

Governance and institutional reform

- Adoption and subsequent implementation of agreed anti-corruption strategy;
- Development of rule-based equalization formulae for allocation of federal revenue grants to local councils; and
- Establishment of a Code of Ethics for civil servants.

Low Case Loans limited to targeted poverty interventions and technical assistance for institution building. FY02-04 lending to total up to \$60 million.

Any one or more of high-case triggers not met

54. In the remainder of this calendar year, the Bank is prepared to assist the Government in meeting the triggers for moving to the high case scenario and the specific policy conditions for PSAL 2. This will require continuation of the Government's ongoing dialogue with the IMF and formulation of a macroeconomic program acceptable to the Bank. The Bank will continue to support Romania's efforts to move to the high case through several reform-oriented investment operations, in particular the Rural Finance loan (approved by the Bank's Board on March 29, 2001), the Social Sector Development loan (scheduled for Board consideration in June 2001), and the Rural Development loan (for which Board consideration is planned in the first half of FY02). The Social Sector Development loan supports pension reform, labor market adjustment, more targeted and cost effective social assistance programs, and capacity building for policy development and monitoring and evaluation. The Rural Development loan (see para. 63) supports decentralization and complements EU assistance for local infrastructure investment. By being actively engaged with the new Government in the context of these investment operations during this transition period, the Bank can more effectively support the Government's early momentum, which will, in turn, increase the likelihood of Romania's moving into the high case.

55. It should be noted that the investment loans made during this transition period would be self-regulated, so as to ensure their viability even if Romania were to fall into the low case after their being committed. For example, both the Rural Finance loan and the Rural Development loan are two-part adaptable program loans (APLs), with their own set of clearly delineated triggers for the second phase. If Romania were to move to the low case during the transition period in the remainder of this calendar year, these loans would be limited to their respective first-phase operation only. The proposed Social Sector Development loan would also be limited to activities that do not depend on policy reforms, such as capacity building for poverty monitoring and evaluation.

56. **Low-case lending scenario.** In the low-case lending scenario, Bank lending would be significantly reduced (see Table 5 and Annex B3b) to a total of \$60 million during FY02-04. The number of Bank operations would also be significantly reduced, to one or two per year. Lending instruments for FY02-04 would consist of one second-phase adaptable program loan, two technical assistance loans, and one investment loan. This minimal lending program would focus on reducing poverty and building capacity on a modest scale, and would be complemented by non-lending advisory services aimed at maintaining the policy dialogue with the authorities. This includes several fast turn-around policy notes (e.g., on energy sector issues), a Public Expenditure Review, and a Country Economic Memorandum focusing on EU accession.

High-Case Program Instruments

57. The Bank Group's high-case program would focus on targeted poverty interventions, promotion of growth through private sector development, and governance and institutional reform.

(i) Targeted Poverty Interventions

58. The targeted poverty interventions would emphasize improvements in the delivery of key social and infrastructure services, especially in rural areas. This should address problems of inequitable access to education and primary health care services, as well as other community

services, across regions and among the most vulnerable groups -- children, women, and ethnic minorities. The planned instruments to achieve these goals include the Social Sector Development loan, a Health Sector Reform loan, a Second Social Development Fund loan, and four operations aimed at revitalizing the economy in rural areas. More specifically:

59. **Strengthening of the social safety net.** The Social Sector Development loan would support improvements in social protection policy, poverty monitoring and evaluation, the transition to a multi-pillar pension reform (i.e., privately managed funds in addition to a "pay-as-you-go" defined-benefit plan), and retraining programs to facilitate labor market adjustment (also supported under the proposed PSAL 2 – see para. 64). It would also aim at strengthening the social assistance system through better targeting of cash benefits, including heating subsidies as the country moves toward aligning energy prices to world market levels under PSAL 2. Non-lending services would include a poverty assessment, poverty policy capacity building, and a pension reform study. Complementing the Bank's support for pension reform, IFC is assisting the Government with technical assistance to establish proper supervision and licensing for private pension funds, and is also exploring possibilities to invest in private pension funds, to support the reforms as they develop in this area.

60. **Improving the delivery of health services.** The planned Health Sector Reform loan (a second phase of an adaptable program loan in FY04) seeks to support the transition to a decentralized, market-oriented health system. The operation would aim to improve capacity in the health sector for policymaking, finance, and management, to ensure efficient and equitable allocation of resources, and to address the problem of informal payments for health care services (common according to the recently completed Diagnostic Surveys on Corruption – see Annex E). It will also support quality and efficiency improvements for primary health care in selected poor and remote areas, beyond those targeted in the first phase of the project currently under way. Finally, the operation would support, in collaboration with other donors, the modernization of public health services in areas such as tuberculosis and AIDS/HIV prevention.

61. In addition, IFC is looking at the possibility of assisting the Ministry of Health in developing a national strategy for private sector participation in the country's hospitals, and implementing the strategy for metropolitan Bucharest. The objective is to introduce private sector participation in the country's public health care facilities by improving management and quality of care in public hospitals, and by attracting private sector capital in the construction, renovation and rehabilitation of public hospitals and clinics. MIGA is currently underwriting a project for the rehabilitation and expansion of a Bucharest hospital.

62. **Strengthening community-based development.** Romania is one of the first countries in the Europe and Central Asia (ECA) Region to operationalize community-driven development concepts in Bank projects. The most prominent initiative has been the Bank-financed Romanian Social Development Fund, which is enabling the building of organizational capacity at community levels. Many community organizations have been formed and received RSDF grants for financing small rural infrastructure and income-generating activities. In light of the success of this first-phase APL, a second phase of support for the Social Development Fund is planned for FY02. (See para. 79 below regarding the low-case.) In addition, through its ongoing Child Welfare Reform loan, the Bank will continue its support for phasing out the institutionalized system of child care with an integrated program aimed at preventing child abandonment,

supporting family reintegration, and promoting local adoption, foster care, and community-based group homes. Lessons from these operations would be reflected in the proposed Community Networks Study and would provide insights into how to improve community-based development initiatives that could be supported by future operations.

63. **Revitalizing the economy in rural areas.** Poverty in Romania is deeper and more prevalent in rural areas. This reflects the collapse of agricultural production and the absorption of displaced industrial workers in small farming production. A large share of Bank-financed targeted poverty interventions over the coming years therefore focus on rural areas. These include:

- the **Rural Finance** loan (approved by the Bank's Board on March 29, 2001), which aims at facilitating income-generating activities, on and off-farm. This operation will be complemented by IFC activities supporting the financing of agriculture through investments in networks of processing facilities. Several potential opportunities have been identified. These projects would have strong linkages to local farmers and suppliers and would help upgrade the farm production base. Work under these activities would be complemented by the planned Rural/Urban Growth Study that would focus on the economic interaction between urban and rural areas through commodities, labor, and credit markets. This study aims at improving our understanding of the ways in which rural-urban interactions facilitate or hinder regional economic integration and poverty reduction, in particular for female-headed households. The findings would be factored into possible second phase Rural Finance and Rural Development operations (both planned for post-FY04).
- the **Rural Development** loan, which would build an initial capacity for rural development and provide funds for infrastructure activities in five judets (counties). Technical assistance would be targeted to poor communes, which should result in their accessing infrastructure financing. This loan will complement the EU's Special Accession Program for Agriculture and Rural Development (SAPARD) to maximize funding for rural infrastructure investments. It should also contribute to improved governance and more participatory rural development planning in poor communities.
- the **Irrigation Rehabilitation** loan, which would aim at increasing small farmers' competitiveness by financing physical rehabilitation of deteriorated irrigation schemes, as well as institutional reforms (such as development of water user associations, which in turn would enhance social capital and community-based development). This operation would also include property reforms to allow the transfer of management of on-farm irrigation facilities to users.
- the **Rural Education** loan, which would aim at reducing sharp disparities in quality of and access to rural compulsory education (currently grades one through eight, and as of 2003 to extend through grade nine). In the high-case program, this would be achieved through investment in the provision of teaching materials, equipment (including information technology), teacher training in reformed curricula, and monitoring and evaluation. The potential impact of this project is enormous, since forty percent of Romania's school-age population lives in rural areas, and yet only six percent of

secondary school students and one percent of higher education students come from rural areas. The loan would also assist the Government in its outreach to ethnic minorities in rural areas. Work under this operation would be supported by the planned Education Sector Review, which would take stock of lessons learned from the Bank's three ongoing education projects and define the remaining sector reform agenda. (See para. 79 below regarding the low case.)

(ii) *Private Sector Development*

64. The Bank Group's support to private sector development in the high case aims at laying the foundations for the private sector-led growth necessary to sustain the poverty reduction efforts. Higher growth will accelerate job creation and lift households living on incomes close to the poverty line. It would also place the Government's fiscal position on a more sustainable basis by reducing the burden of loss-making state-owned enterprises on the budget, and by broadening the tax revenue base. This additional fiscal space will help to sustain the targeted poverty interventions discussed above (see paras. 58 – 63). The program will focus on:

- *privatization* of the remaining state-owned enterprises, with emphasis on the unbundling and eventual privatization of *infrastructure* and *energy* enterprises, as well as on improvements in privatization procedures;
- adoption of market-oriented *energy pricing policies and tariff collection* mechanisms;
- *reform of the financial sector* through the privatization of state-owned banks, and strengthening of the supervision and regulation of bank and non-bank financial institutions;
- improvements in the *business environment* by lowering barriers to entry for firms and joint ventures, simplifying the tax code, implementing internationally recognized accounting and financial audit standards, introducing more effective and efficient procedures for bankruptcy and liquidation, and strengthening corporate governance; and
- expansion of *labor redeployment programs* to support privatization – including job counseling, retraining, support to microenterprise development, and short-term community public works programs.

65. The centerpiece of Bank support to private sector development is the proposed *Second Private Sector Adjustment Loan (PSAL 2)* and the complementary Technical Assistance loan. These operations are expected to support actions taken to meet the triggers for the high-case assistance program (see paras. 52 - 53). In addition, they will support initiation of privatization of remaining SOEs, to be completed under the PAL program. The implementation of continued structural reforms in the enterprise and financial sectors under this operation will enhance Romania's prospects for growth and reinforce the sustainability of its macroeconomic stabilization. These reforms combined with a wide range of efforts to mitigate the social costs of restructuring are expected to provide the needed resource cover for a smooth transition to a genuinely market-based economy. These measures are also consistent with Romania's quest to accede to the EU.

66. Subsequent to the PSAL 2 program under the high-case scenario, Bank assistance would consider support for the completion of the Government's privatization agenda, particularly privatization of the infrastructure and energy enterprises, as well as the remaining state enterprises, through a series of proposed *Programmatic Adjustment Loans (PALs)* – (see paras. 49 - 50). Support could also come, if appropriate, through the Bank's partial risk guarantee instrument.

67. After the structural reforms for promotion of growth are in place (i.e., post-PSAL 2), the proposed *Regional Development* loan would support private sector development in an area particularly hard hit by the economic transition, the Jiu Valley Region. This region is currently almost completely dependent on coal mining for its economic viability. With the closure of non-viable state-owned coal mines (supported by the Bank's ongoing Mine Closure and Social Mitigation loan), large numbers of miners are out of work with limited local opportunities for alternative industrial employment. The surrounding area does, however, have significant tourism potential. The proposed activities would support capacity building for the local authorities and other civil society stakeholders to work in partnership to articulate a local development strategy that builds on the region's natural and human resources. Infrastructure investment (including transport and waste management systems) and environmental clean-up of the Jiu River could also be considered.

68. *Non-lending services* in support of private sector development in the high case would aim at providing the underpinnings of the reform program under the proposed PSAL 2 and subsequent PALs. These include a Financial Sector Assessment, Energy Sector Technical Assistance, a Tax Policy Study, a Labor Market Assessment, and a Capital Markets Assessment. In addition, grant funding would be sought for the development of a Jiu Valley Regional Development Strategy that would help lay the groundwork for the Regional Development loan.

69. *IFC* will complement the Bank's efforts in private sector development by focusing on four key areas: restructuring of municipal infrastructure, marshalling financing for post-privatization restructuring; supporting capital markets and SMEs development, and selected private sector investments in the forestry sector. Overall, the level of IFC activity will depend very much on the extent of improvements in the enabling environment for business in the country. In the forestry sector, through a collaborative Bank Group approach, improvements in the legislative framework have been achieved, and resulted in substantial private sector investment in wood processing projects. In addition to investing in such projects directly, IFC will continue to catalyze the entry of FDI into the country, where possible. Support for the restructuring of municipal infrastructure enterprises could be achieved through the use of the concession model and funding mobilization already used by IFC in the contract for the Bucharest Water Supply Company. In another pioneering operation, IFC is considering the first privately structured deal for municipalities investing in co-generation plants. This is being prepared for two major cities in Romania and is based on *carbon credit agreements* under the Kyoto Protocol. This would allow substantial savings in financing and other costs, and would include technical advice on the privatization process in particular transactions.

70. *MIGA* will support the Government's efforts to attract FDI by offering technical assistance for the development of investment promotion capabilities. MIGA could also have an impact by issuing guarantees in the areas of banking (notably in support of SMEs and rural

finance) and infrastructure. Should the Romanian authorities make progress in their privatization program, MIGA's political risk insurance could help bring in additional bidders as well as additional financing by foreign banks. While MIGA has the ability to facilitate FDI, the level of its activities in Romania will depend upon progress in improving the country's legal framework and the business environment.

(iii) Institution Building and Governance Reform

71. The Bank Group's strategy to support institution building and governance reform in the high case aims at assisting the Romanian Government to break key bottlenecks in an accelerated reform scenario. These range from strengthening public expenditure management and improving the inter-Governmental finance framework, to supporting regulatory and judicial reforms, and assisting in anti-corruption strategies (see Annex E). The broad aim is to develop a culture of accountability in the public sector. A series of programmatic adjustment loans (PALs) mentioned above (see paras. 49 - 50) and several investment operations would support these efforts. Given the cross-cutting nature of the Bank's assistance strategy for institution building and governance reform, the relevant proposed operations fall into two broad categories, described below.

72. **Government capacity building.** Critical to improving the efficiency of Romania's public sector and to strengthening its public institutions is the decentralization of service delivery across a range of sectors. In recent years the Government has undertaken a wide range of legislative and fiscal reforms in order to devolve public sector activities to local Governments. Recent laws on local public finance and local taxation have greatly increased the autonomy of local Governments. Nevertheless, a number of issues remain and, as Romania moves closer to EU accession, these will need to be addressed. The remaining inter-governmental issues fall into two main categories: those measures needed at the national level to create the appropriate incentives for subnational levels of Government, and those measures needed at the local level to strengthen capacity and help subnational Governments respond effectively to the increasing demands placed upon them. The PAL-supported program of reforms would focus on the institutional and regulatory framework, and aim at improving municipal management and delivery of local utility services. There is a strong sense of partnership in this area, both within the Bank Group and between the Bank Group and its bilateral partners. USAID has had a long presence in this area in Romania, and DFID has named Romania a priority country and is keen to support these efforts.

73. In addition to addressing inter-governmental issues, Bank support for institutional reform will focus on governance and anti-corruption efforts. PAL components would include the development of systems for policy formulation and coordination, stabilization of the legal framework, strengthening of public expenditure management, meritocratic and de-politicized human resource (civil service) management, judicial reforms, anti-corruption measures, and strengthening of monitoring and evaluation (M&E) systems that introduce accountability for reform results. Non-lending services include a Public Expenditure Review, a Country Financial Accountability Assessment, a follow-up governance surveys, and a Country Economic Memorandum focusing on EU accession.

74. **Environmental and hazard mitigation management.** Environmental and hazard mitigation management will become particularly important over the next several years, as the Government completes enterprise privatization and land restitution. While legislation is being aligned to conform to EU requirements, enforcement has been lagging behind, and environmental management is largely delegated to the enterprises that focus primarily on achieving production targets, without due consideration to environmental standards. In this context, the country is ill-prepared to deal with the challenges posed by toxic spills and other environmental hazards to which Romania is prone, especially in mining areas in the Danube River Basin.

75. Bank assistance for environmental and hazard mitigation management would be delivered through one of the components of the PAL program as well as a Hazards Mitigation loan and three targeted, stand-alone projects related to environmental management. The *PAL* program would include an *environmental liability component* to address the need for building capacity, reforming environmental legislation, and establishing a consistent framework for environmental liability and clean-up. This would greatly facilitate the Government's privatization program. (See para. 80 below regarding the low case.) As part of its due diligence, IFC would continue to ensure that, in accordance with Romanian law, privatization transactions in which it is participating, either in a financial or advisory capacity, are done on the basis of a satisfactory environmental assessment.

76. The *Hazards Mitigation* loan, cofinanced by a GEF grant, would assist in Romania's efforts to mitigate the costs of damage from earthquakes (Bucharest is considered to be at high risk of major damage), floods, droughts, toxic waste, and other natural and man-made disasters which, taken together, regularly plague the country. In the high-case lending scenario, this operation would focus on disaster preparedness and strengthening Romania's existing rapid response capacity (including through information technology). This could include changes in land-use planning, community involvement and education, flood protection works, safety of flood control dams, some retrofitting of public buildings in Bucharest to meet earthquake building codes, and the establishment of a national catastrophic insurance scheme. (See para. 80 below regarding the low case.)

77. This IBRD operation, to be cofinanced by a GEF grant, would support the development and implementation of an environmental monitoring and flood warning system, as well as priority rehabilitation investments for addressing toxic pollution stemming from the use of dams to store mine tailings in the Danube River Basin.

78. In 1997, the export value of forest products was \$860 million, and the sector's contribution to GDP was approximately 5 percent. This contribution could be significantly increased through improving the competitiveness of private sector forest industries. Romania is in the midst of restitution of a large portion of its forest land to private owners. Sustainability is therefore at risk. The *Forestry Development* loan planned for FY02 would finance institution building to ensure a smooth transition during the restitution process and sustainable forest resource management post-restitution, establishment of a national private forest owners association, the creation of a public-private partnership for business development and advisory services for wood products industries (inspired by the CDF consultations), support for public awareness campaigns, and provision of infrastructure (roads) compatible with the Bank's

environmental safeguard policies. (See para. 80 below regarding the low case.) Two other operations related to environmental management would include two GEF grants in the areas of *Energy Efficiency* and *Agricultural Pollution Control*. In addition, there are several possible projects for funding by the Prototype Carbon Fund (PCF).

Low-Case Program Instruments

79. The Bank Group's low-case program would limit its support to a few small operations emphasizing poverty interventions, and institution building and governance reform. Included in the *poverty-focused operations* would be the second infusion of funds for the Romanian Social Development Fund (the same second phase APL as in the high case – see para 62 above) and a Rural Education loan, much more limited in scope (e.g., primarily for teaching materials as opposed to teacher training and monitoring and evaluation capacity building) than the comparable high-case loan (\$25 million versus \$60 million), in light of the slow-down in reforms that would trigger the low case.

80. Bank operations supporting *institution building and governance reform* would consist of three loans in the area of environmental and hazard mitigation management:

- a Forestry Development loan limited to technical assistance for institution building and significantly reduced in dollar terms from the comparable high case loan (\$10 million versus \$25 million);
- an Environment loan limited to technical assistance for environmental regulatory capacity building; and
- a Hazards Mitigation loan limited to a small amount of technical assistance (\$5 million) for natural disaster preparedness and rapid response capacity building.

Monitoring Outcomes

81. Success in the implementation of this CAS will depend to a large degree on the ability of Romania's new Government to articulate and implement a coherent social and economic reform program. If the scenario of accelerated reforms prevails, the indicators to assess progress in implementation of this CAS would be measured against Romania's desired outcomes of poverty reduction and EU accession, articulated during the CDF consultations. These indicators include a reduction in the poverty headcount ratio; a reduction in maternal and infant mortality rates; a narrowing of the gap between urban and rural secondary school enrollment; sustained real GDP growth; a net increase in the number of registered SMEs; and favorable annual accession progress reports by the European Commission (EC). The Bank will work closely with the Romanian Government to specify time horizons for these indicators, as well as for indicators measuring Romania's progress against the International Development Goals, in the context of the Government's forthcoming Action Plan. The Bank will also help introduce monitoring and evaluation systems for reform results. Monitoring will also be included in planned Bank-financed projects, in particular in the Social Sector Development loan, the Rural Education loan, and PSAL 2 and subsequent adjustment operations. In addition, the Bank will assess whether a

CAS update is warranted within the next 12-18 months, to take account of the Government's forthcoming Action Plan.

Selectivity and Partnership

82. The Bank's comparative advantages relative to other development partners active in Romania lie mainly in (i) policy advice and financial support for structural and sector policy reform (e.g., strengthening of the social safety net, governance⁴, enterprise unbundling, institution building, regulatory frameworks, privatizations and enabling environments for private sector participation), and (ii) support for poverty-focused investments (e.g., social protection, community development), and investments in reforming sectors (e.g., rural finance, education, health, environment). Other partners such as the EU and bilaterals (e.g., USAID and DFID) are better suited to finance technical assistance, training, and public information activities, while the European Bank for Reconstruction and Development (EBRD) and European Investment Bank (EIB) are best placed to invest directly in large-scale activities (e.g., some municipal services) shifting from the public sector to the private sector, and in some activities specifically geared to compliance with very specific EU standards (e.g., national transport systems to be linked with those in Western Europe). The Bank plans to continue its collaboration with the UNDP in the areas of donor coordination, monitoring and evaluating capacity building, and regional development.

83. The Bank's interaction with Non Governmental Organizations (NGOs) in Romania has been generally positive during the past ten years. Until 1997, the degree of interaction was fairly low due to both the nature of the Bank's activity as well as the low capacity of the NGOs to engage with the Bank. 1997 was a turning point in the Bank's collaboration with Romanian NGOs, as the Bank increased its proactivity in consultations with NGOs as well as in engaging them in the preparation and implementation of Bank-financed operations in the social sectors. Another reason for the improvement of Bank – NGO relations was the decentralization of the Small Grants Program that has helped the Bank maintain consistent communication with the non-profit community. An important qualitative step in the relationship with the NGOs was the implementation of the CDF in Romania. The CDF consultations raised the quality and scope of consultations with civil society and with the NGO community in particular. This interaction was followed by regular meetings with Romania's representative on the ECANGO Committee as well as by CAS consultations.

C. World Bank Portfolio Management

84. Integral to the Bank's assistance strategy is continued intensive portfolio management, in order to improve the development impact of Bank lending. Since FY91, the Bank has financed 30 operations totaling US\$ 3.2 billion in commitments, of which US\$557 million remained undisbursed as of January 2001.

⁴ In the area of governance, the Bank is in a collaboration with the Stability Pact, Organization for Economic Cooperation and Development (OECD), Council of Europe, UN Center for International Crime Prevention, and several bilateral agencies, notably USAID and the UK's DFID. The Bank's comparative advantage in this regard is in diagnostics, analytical work and institutional reforms, while other partners focus on deterrence and law enforcement.

85. Romania recently graduated from the "high risk country portfolio" category, and as of FY01 the portfolio is rated 100 percent satisfactory for the first time in many years. Nonetheless, this progress remains fragile and continued vigilance is required. The Joint Portfolio Review (JPR) held in Bucharest in March 2001 identified five areas that are causing a number of operations to lag behind schedule: (i) implementation capacity⁵, (ii) counterpart funding⁶, (iii) financial management, (iv) project readiness, and (v) accountability. Specific actions to address each of these issues were agreed, including the designation of a high-level Government official to have Bank portfolio oversight responsibility.

86. The World Bank's Operations Evaluation Department (OED) has evaluated six projects in Romania during the last five years. OED rated two of the loans – accounting for 44 percent of dollars lent – as unsatisfactory or highly unsatisfactory (See Annex B2). OED's assessments of the early projects (approved in 1991) were indicative of the country's as well as the Bank's lack of experience with transition economies. Projects were large and complex relative to the Government's capacity to implement them. This resulted in less than favorable project outcomes and unlikely sustainability. Over time, the ratings have improved as the Bank and Government have gained more experience. For example, the Transport Project, approved in FY93 and closed in FY99, accomplished significant institutional reforms under the leadership of a highly professional agency empowered to implement the project. Unfortunately, the adjustment operation (FESAL) that followed was again too complex and did not have the Government's full support.

D. World Bank Group Decentralization

87. Bank Group management has recently decided to decentralize management of the Bank and IFC's Romania programs. By bringing decision making closer to the Governments, donors and stakeholders in Romania and elsewhere in Europe, this should improve the Bank Group's client responsiveness, turn-around time, and development impact. It should also produce further synergies among neighboring countries which face many of the same development challenges over the next several years, including in the area of closer integration with the European Union. The Bank's Country Director for South Central Europe (Bulgaria, Croatia and Romania) will be based in a regional hub being established in Zagreb, Croatia, while IFC's Director will be based in a regional hub in Istanbul, Turkey. This decentralization initiative is expected to be fully implemented by end-2001.

⁵ The cross-cutting issue of implementation capacity has in part been due to the inconsistencies and ambiguities in laws and regulations governing public procurement. The Bank had previously advised the Government on this issue in the context of a Bank Country Procurement Assessment Review in early 1999. The Bank, EU, and Government are now in discussions to finalize the legal framework for public procurement, to ensure its consistency with eligibility criteria for EU accession as well as with the Bank's Procurement Guidelines.

⁶ Delays in provision of counterpart funds took on more significance this fiscal year, in light of the recent change in the Bank's cost-sharing limit for Romania, from 75 percent (for countries in Category II) to 60 percent (for countries in Category III). The Bank's country categories for FY01 are based on 1999 GNP per capita. Romania's GNP per capita rose to \$1,520 in 1999, from \$1,430 the previous year. While Romania remained within its previous limit of 75 percent, the newly reduced ceiling for Bank cost-sharing puts the current three-year rolling average at 62 percent, or slightly above the new limit of 60 percent. As with other countries moved from one country category to another, Romania has two years (FY01 and FY02) during which to transition to an average not exceeding 60 percent Bank financing of projects. The implication is that the Government will need to ensure a larger Government share and/or cofinancing from other donors for future lending, as well as timely provision of counterpart funds.

III. RISKS

88. The proposed Bank Group assistance strategy faces risks. The most important risk is *political*, and stems from potential divisions within the Government that would delay the articulation and implementation of a reform program, and SOE privatizations in particular. Such delays could erode the support of IFIs and access to credit markets, as well as trigger a steep deterioration in economic performance and, possibly, external financing difficulties. The new Government's room to maneuver is much more circumscribed than in the mid-1990s because of the external debt build-up and the depletion of the country's human and capital stock.

89. Political risk, while high, is mitigated by three factors. First, in contrast to the previous Government, the new Government is not a coalition and has shown signs of acting in a more disciplined and decisive fashion in some reform areas. Second, there is broad political consensus around the goal of Romania's joining the EU. This should create additional momentum for reforms. Third, the international community has shown a clear commitment to continue to engage Romania in an active dialogue, including contacts at very high levels and regular participation in international events. The Bank in particular has maintained, and will continue to maintain, a strong presence in the country, including the provision of analytical and advisory services, even in the low-case scenario.

90. A fragile fiscal position and relatively large external financing needs over the next three years pose interrelated *economic* risks. Without early and decisive action to limit Government spending and lending by state-owned banks, there could be a loss of confidence in economic management. This in turn would result in a decline in the availability of external financing at favorable terms for the country and make its balance of payments position vulnerable. These economic risks are exacerbated by the slippage in fiscal consolidation in late 2000 and early 2001 that eased pressures on state enterprises to restructure, and are likely to put additional strain on the balance of payments. Over the next few months, therefore, the international financial community is likely to assess the new Government's commitment to reform by how well it manages fiscal policy.

91. In addition to sound fiscal and external financing management, keeping the current account deficit under control will require efforts to sustain exports and action to contain any surge in imports driven by excessive domestic consumption. This will require sound exchange rate management and progress on structural reforms, in particular enterprise adjustment and public sector wage restraint. While the Government has given some early indications that it intends to manage its fiscal situation carefully and pursue structural reforms, close monitoring from the international financial community (including via the lending scenario triggers contained in the Bank Group's assistance strategy) should mitigate these risks.

92. While further financial sector reforms are needed (see para. 21), the closure of Bancorex and several small private banks has contributed to the healthiest banking sector since the transition process began. Another factor that mitigates economic risks is the recent improvement in Romania's external indicators. Romania now ranks around the middle of the group of transition countries in indicators such as external debt to GDP ratio, the rate of growth of exports of goods and services, the current account deficit and the alignment of the real exchange rate. Romania also holds the same ranking on liquidity indicators, such as reserves to GDP, reserves

to imports, and reserves to short-term debt position. Finally, a considerable rebuilding of foreign exchange reserves took place in 1999 and 2000, and this trend appears to have continued thus far in 2001.

93. Despite these improvements, however, there are important risks of policy backtracking that cannot be ignored. As mentioned above, the fiscal situation remains fragile, and delays in addressing structural components of the deficit could easily lead to a deterioration of the balance of payments and external financing difficulties. The structural components of the fiscal deficit include large loss-making state-owned enterprises, such as the energy utilities, and the increase in state bank lending to enterprises in financial distress. Despite a moderate external debt burden, Romania has experienced liquidity difficulties in the past. While the country's financial situation is now more comfortable, liquidity difficulties could arise again in the future, particularly in the event of sustained policy slippage.

94. Another concern is Romania's ability to attract the necessary investment inflows. FDI flows to Romania have, so far, been very low, despite their having reached a peak in 1998, on the heels of the 1997 reform program. Through its sheer size, natural endowments and cost competitiveness, Romania ought to be an attractive destination for FDI, but this hope has been eroded by political instability, red tape, corruption scandals, and inconsistent economic policies (particularly toward foreign investors). The forecasts are therefore moderately optimistic on the grounds that the new Government will continue to engage the international community, and that investors will support the return of Europe's second largest transition economy (after Poland) to growth. FDI is essential for sustaining growth and the modernization of Romania's economy. It is also essential to provide a source of external inflows into the balance of payments. If for political or other reasons FDI continues to flag, sustained growth would not be possible.

IV. EXPOSURE MANAGEMENT

95. Romania started its transition in 1990 debt-free. Despite growth in its external debt, Romania's total outstanding debt is still modest and is likely to remain so in the short or medium term. As a share of GDP, external debt outstanding is now approximately 27 percent of GDP (or 82 percent of export revenues, a figure which is likely to decline gradually to about 76 percent by 2003 if GDP growth materializes as predicted in the accelerated reform scenario). To ensure debt sustainability and maintain external creditworthiness, Romania's key challenge is to restore fiscal and external balances to slow the rate of increase in foreign debt.

96. In the high-case lending scenario (see Annex B7a) total debt outstanding relative to export revenues would decline from 82.4 percent in 2000 to 75.8 percent in 2003, as Romania becomes increasingly integrated into the EU and Central European Free Trade Agreement (CEFTA) economic structures, with exports continuing to expand faster than growth. By contrast, in the low-case lending scenario (see Annex B7b), both total debt outstanding and export revenues would remain fairly flat through 2003.

97. For the Bank Group, an important issue is the composition of Romania's external debt, as the debt structure contains a high percentage of public and publicly guaranteed (P&PG) debt, particularly preferred creditors. Total debt outstanding (including short-term) was approximately \$10 billion at the end of 2000 (or about 27 percent of GDP), of which nearly 70 percent was

P&PG debt, and P&PG debt service accounted for 58 percent of total debt service, for a debt service ratio of 11 percent. The share of P&PG debt service is expected to reach 70 percent by 2002 in both the high-case and low-case lending scenarios.

98. Because of the major role IFIs have played in Romania's external financing, preferred creditors (IBRD, EBRD, IMF, and EIB) account for a high percentage of P&PG debt service (see Table 7)⁷. Preferred creditors' share of P&PG debt service is expected to rise from the current 30 percent level to 33 percent in 2002 (31 percent in the low case scenario) and to 37 percent in 2003 (35 percent in the low case scenario).⁸ While this would exceed the Bank's exposure guideline (35 percent), it is worth noting that this is due to earlier lending decisions, made when Romania was facing difficulties in accessing private sources of external financing. Furthermore, under both lending scenarios, the preferred creditors ratio would be well below its level in the period prior to 1997, when the ratio was in the 60 percent range.

99. The World Bank is the largest creditor, accounting for about 20 percent of the total debt outstanding and nearly 15 percent of P&PG debt service at end-2000. The Bank Group's CAS for Romania has been developed to ensure that further increases in exposure are closely matched by increases in overall creditworthiness as well as by proportionate burden sharing among the IFIs, given the limited quantities of IFI financing available worldwide.

Table 7: Romania IBRD Exposure Percentage Ratios -- 2001 - 2003

	Actual	High Case Lending Program			Low Case Lending Program		
		2000	2001	2002	2003	2001	2002	2003
Preferred Creditor Share of Public and Publicly Guaranteed Debt Service	30.5	26.0	32.9	36.9	25.2	31.2	34.9
IBRD Share of Total Debt Outstanding and Disbursed	19.6	20.0	20.8	20.4	19.2	20.0	19.9
IBRD Share of Public and Publicly Guaranteed Debt Service	14.6	10.2	11.9	14.2	10.0	11.5	13.7

100. The longer the high case is sustained, the more the Bank's relative exposure would be expected to decrease over time, as private sources of P&PG financing would be increasingly available under an accelerated reform program. In the low-case lending program, however, due to the undisbursed pipeline of \$557 million (as of January 2001), and the likelihood of Romania's difficulty in accessing private financing, the Bank's relative exposure would remain high, even in the medium term.

⁷ Like the Bank, the EIB and the EBRD have significantly increased their exposure to Romania in recent years. EBRD's share of Romania's P&PG debt increased from 2 percent in 1993 to 13 percent (at \$528 million) in 1999. The EIB, active in financing primarily infrastructure projects within the framework of the Stability Pact, has seen its share of Romania's P&PG debt increase as well, from 0.5 percent to 6.4 percent (at \$411 million) over the same period. The IMF's exposure remains low, in part because Romania has not completed any of the past programs with the Fund.

⁸ In the low case, since there would be limited options for external finance and the Bank's pipeline would continue to disburse, the preferred creditor ratio would continue to rise for several years and exceed the Bank's exposure guidelines. Under the high case, the preferred creditor ratios would decline in the medium term, despite the higher disbursements from preferred creditors, because of the increasing availability of other sources of external finance.

V. CONCLUSION

101. While the new Romanian Government has taken a number of actions that signal its intention to accelerate the pace of reform relative to that of its predecessors, the remainder of 2001 will be an important period for this Government to demonstrate a sustained commitment to accelerated reform. It could make significant and sustained progress in fiscal management and structural reforms – particularly in the area of privatization – and hence adopt a program that could receive support from the Bank. This would usher Romania into the high-case scenario by the end of this calendar year. Alternatively, the new Government could take a more hesitant approach to reforms, or even reverse past progress in some areas. This would result in a significant decrease in Bank Group support for two reasons. In the policy environment implicit in the low-case scenario, the Romanian Government should not commit its citizens to additional debt obligations, not least because Bank Group financing would not generate the growth needed to service the debt. In addition, there would be exposure and creditworthiness concerns on the Bank's side.

102. The Government will need to weigh the political as well as economic implications of its chosen pace of reform. However, with poverty reduction and EU accession as the long-term outcomes for which Romanians are striving, the Government is likely to conclude that the political and economic considerations converge rather than conflict. Should the Government pursue this conclusion in a sustainable way, the World Bank Group stands ready to support the Government's efforts to break critical bottlenecks in the reform process by ensuring improvement in the delivery of key services to the poor, moving forward on critical and irreversible steps of the privatization program, and helping to lay the foundations of key public sector institutions.

James D. Wolfensohn
President

By:

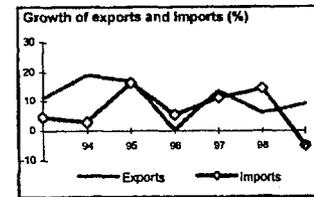
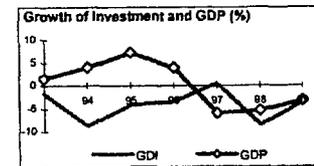
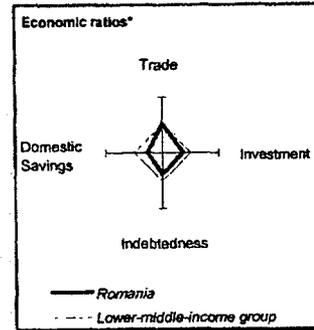
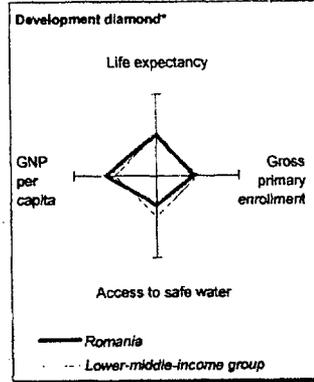
Sven Sandström

Peter Woicke

Washington, D.C.
May 21, 2001

Romania at a glance

	Romania	Europe & Central Asia	Lower-middle-income		
POVERTY and SOCIAL					
1999					
Population, mid-year (millions)	22.5	475	2,094		
GNP per capita (Atlas method, US\$)	1,470	2,150	1,200		
GNP (Atlas method, US\$ billions)	32.9	1,022	2,513		
Average annual growth, 1993-99					
Population (%)	-0.2	0.1	1.1		
Labor force (%)	0.5	0.6	1.2		
Most recent estimate (latest year available, 1993-99)					
Poverty (% of population below national poverty line)	41	..	..
Urban population (% of total population)	56	87	43		
Life expectancy at birth (years)	69	69	69		
Infant mortality (per 1,000 live births)	21	22	33		
Child malnutrition (% of children under 5)	..	8	15		
Access to improved water source (% of population)	62	..	86		
Illiteracy (% of population age 15+)	2	3	16		
Gross primary enrollment (% of school-age population)	104	100	114		
Male	104	101	114		
Female	103	99	116		
KEY ECONOMIC RATIOS and LONG-TERM TRENDS					
	1979	1989	1996	1999	
GDP (US\$ billions)	..	41.5	41.5	34.0	
Gross domestic investment/GDP	39.6	26.8	21.4	19.9	
Exports of goods and services/GDP	..	20.9	23.7	30.1	
Gross domestic savings/GDP	..	29.5	13.3	15.7	
Gross national savings/GDP	..	29.7	14.0	16.4	
Current account balance/GDP	..	-6.1	-7.0	-3.8	
Interest payments/GDP	..	0.2	1.1	1.5	
Total debt/GDP	..	2.6	24.1	27.5	
Total debt service/exports	1.4	16.9	23.5	31.3	
Present value of debt/GDP	..	..	..	26.6
Present value of debt/exports	..	..	..	90.3
	1979-89	1989-99	1996	1999	2000-9
(average annual growth)					
GDP	1.5	-1.5	-5.4	-3.2	2.1
GNP per capita	1.2	-1.4	-5.7	-2.9	..
Exports of goods and services	..	4.6	5.9	8.8	24.6
STRUCTURE of the ECONOMY					
	1979	1989	1996	1999	
(% of GDP)					
Agriculture	..	15.7	16.1	15.5	
Industry	..	56.4	36.5	36.4	
Manufacturing	..	..	26.5	26.9
Services	..	27.9	47.4	48.1	
Private consumption	..	58.9	72.7	69.6	
General government consumption	..	11.6	14.0	14.7	
Imports of goods and services	..	18.2	31.8	34.3	
	1979-89	1989-99	1996	1999	
(average annual growth)					
Agriculture	..	1.2	-10.2	4.0	
Industry	..	-1.9	-3.0	-4.0	
Manufacturing	..	..	-3.3	-3.1
Services	..	-0.4	-5.4	-5.9	
Private consumption	..	0.1	-4.6	-4.9	
General government consumption	..	2.8	-0.8	-2.3	
Gross domestic investment	..	-5.7	-8.6	-3.7	
Imports of goods and services	..	4.4	14.4	-5.1	
Gross national product	1.7	-1.7	-5.9	-3.1	

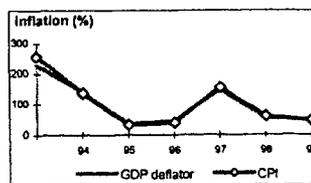


Note: 1999 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

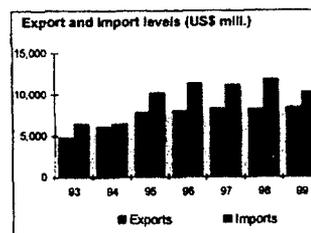
PRICES and GOVERNMENT FINANCE

	1979	1989	1998	1999
Domestic prices				
(% change)				
Consumer prices	..	1.1	59.1	45.8
Implicit GDP deflator	3.2	-0.9	54.0	46.4
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	51.0	30.1	33.3
Current budget balance	..	31.1	-1.2	-0.8
Overall surplus/deficit	..	13.5	-5.0	-3.4



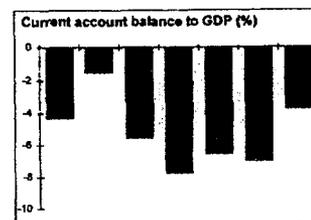
TRADE

	1979	1989	1998	1999
(US\$ millions)				
Total exports (fob)	..	10,487	8,302	8,503
Textiles	1,583	1,310
Metals	508	502
Manufactures	..	7,056	5,238	5,652
Total imports (cif)	..	8,437	11,838	10,392
Food	..	124	523	417
Fuel and energy	..	4,728	1,887	1,251
Capital goods	..	2,148	3,206	2,689
Export price index (1995=100)	..	93	95	97
Import price index (1995=100)	..	99	98	101
Terms of trade (1995=100)	..	93	97	95



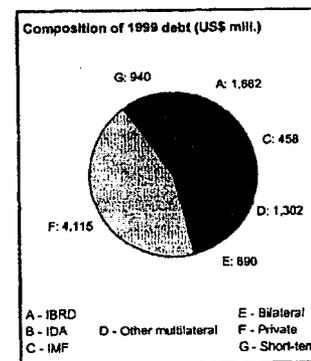
BALANCE of PAYMENTS

	1979	1989	1998	1999
(US\$ millions)				
Exports of goods and services	10,133	11,321	9,519	9,870
Imports of goods and services	11,428	8,887	12,798	11,381
Resource balance	-1,295	2,434	-3,279	-1,511
Net income	-358	80	-392	-403
Net current transfers	..	0	753	826
Current account balance	-1,653	2,514	-2,918	-1,288
Financing items (net)	1,791	-1,160	2,075	1,461
Changes in net reserves	-138	-1,354	843	-173
Memo:				
Reserves including gold (US\$ millions)	..	..	3,792	3,657
Conversion rate (DEC, local/US\$)	..	19.3	8,875.8	15,332.8



EXTERNAL DEBT and RESOURCE FLOWS

	1979	1989	1998	1999
(US\$ millions)				
Total debt outstanding and disbursed	3,583	1,087	10,014	9,367
IBRD	590	0	1,442	1,662
IDA	0	0	0	0
Total debt service	142	1,941	2,303	3,138
IBRD	54	756	150	170
IDA	0	0	0	0
Composition of net resource flows				
Official grants	0	0	134	192
Official creditors	151	-1,188	-132	14
Private creditors	1,680	-432	254	-327
Foreign direct investment	0	0	2,040	1,007
Portfolio equity	0	0	130	-709
World Bank program				
Commitments	340	0	66	..
Disbursements	142	0	153	315
Principal repayments	7	727	69	83
Net flows	135	-727	84	233
Interest payments	47	29	82	88
Net transfers	88	-756	3	145



ROMANIA
Selected Indicators of Bank Portfolio Performance and Management

Indicator	1998	1999	2000	2001
<i>Portfolio Assessment</i>				
Number of Projects Under Implementation <i>a</i>	16	17	21	19
Average Implementation Period (years) <i>b</i>	2.6	2.5	2.9	3.4
Percent of Problem Projects by Number <i>a, c</i>	19	6	9	0
Percent of Problem Projects by Amount <i>a, c</i>	21	13	12	0
Percent of Projects at Risk by Number <i>a, d</i>	25	12	10	5
Percent of Projects at Risk by Amount <i>a, d</i>	30	25	12	8
Disbursement Ratio (%) <i>e</i>	11	17	17	20
<i>Portfolio Management</i>				
CPPR during the year (yes/no)	no	yes	yes	yes
Supervision Resources (total US\$'000) <i>f</i>	1688	1542	2073	2902
Average Supervision (US\$'000/project) <i>g</i>	89	86	99	138

Memorandum Item	Since FY 80	Last Five FYs
Projects Eval by OED by Number	35	6
Projects Eval by OED by Amt (US\$ millions)	3117	795
% of OED Projects Rated U or HU by Number	31	33
% of OED Projects Rated U or HU by Amt	31	44

- a. As shown in the Annual Report on Portfolio Performance (except for current FY), excludes GEF.
- b. Average age of projects in the Bank's country portfolio.
- c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
- d. As defined under the Portfolio Improvement Program.
- e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only. Ratio shown for 2001 is projected based on the actuals of the first six months of the fiscal year.
- f. FY00 (actuals) and FY01 (planned) include direct and indirect. Earlier years are direct costs only.
- g. Includes costing for projects that closed during the fiscal year.

Annex B3a

ROMANIA
Bank Group Program Summary

Proposed IBRD High-Case Lending Program ^a

<i>Fiscal year</i>	<i>Project</i>	<i>US\$(M)</i>	<i>Strategic Rewards (H/M/L) ^b</i>	<i>Implementation Risks (H/M/L) ^b</i>
2002	Private Sector Adjustment 2 (SAL)/	300.0	H	H
	Private Sector Institution Building 2 (TA)	40.0	H	H
	Rural Development	40.0	H	M
	Social Development Fund 2 (APL)	10.0	H	L
	Forestry Development	25.0	H	M
	Total FY02	415.0		
2003	Irrigation Rehabilitation	75.0	M	M
	Rural Education	60.0	H	L
	Programmatic Adjustment 1 (PAL)	100.0	H	H
	Total FY03	235.0		
2004 ^c	Hazards Mitigation	150.0	H	M
	Health Sector Reform 2 (APL)	20.0	H	H
	Programmatic Adjustment 2 (PAL)/	150.0	H	H
	Public Institution Building (TA)	25.0	H	M
	Total FY04	345.0		
	TOTAL FY02-04	995.0		

a/ Proposed program for the next three fiscal years.

b/ Project ratings indicate whether the strategic reward and implementation risks are expected to be high (H), moderate (M), or low (L).

c/ FY04 program also includes a possible stand-by operation (Regional Development) for \$50 million

ROMANIA
Bank Group Program Summary

Proposed IBRD Low-Case Lending Program ^a

<i>Fiscal year</i>	<i>Project</i>	<i>US\$(M)</i>	<i>Strategic Rewards (H/M/L) ^b</i>	<i>Implementation Risks (H/M/L) ^b</i>
2002	Social Development Fund 2 (APL)	10.0	H	L
	Forestry Development (TA)	10.0	H	M
	Total FY02	20.0		
2003	Rural Education	25.0	H	M
	Total FY03	25.0		
2004	Environment (TA)	10.0	M	L
	Hazards Mitigation (TA)	5.0	M	L
	Total FY04	15.0		
	TOTAL FY02-04	60.0		

Annex B3c

ROMANIA
Bank Group Program Summary

Global Environment Facility (GEF) Program				
<i>Fiscal year</i>	<i>Project</i>	<i>GEF US\$(M)</i>	<i>Strategic Rewards (H/M/L)^a</i>	<i>Implementation Risks (H/M/L)^a</i>
2002	Energy Efficiency	10.0	H	H
	Agriculture Pollution Control	7.3	H	M
	Total FY02	17.3		
2004	Hazards Mitigation ^b	5.0	M	L
	Total FY03	5.0		
TOTAL FY02-04		22.3		

a/ Project ratings indicate whether the strategic reward and implementation risks are expected to be high (H), moderate (M), or low (L).

b/ Cofinancing IBRD Loan.

ROMANIA			
IFC and MIGA Program			
FY 1998-2000			
	1998	1999	2000
IFC approvals (US\$m)	44.6	12.8	15.0
Sector (%)			
FINANCIAL SERVICES	76.0		
INFRASTRUCTURE	0.0		100.0
MOTOR VEHICLES & PARTS	24.0		
TIMBER, PULP & PAPER		100.0	
OTHER			
Total	100.0	100.0	100.0
Investment instrument(%)			
Loans	46.0	100.0	100.0
Equity	32.0		
Quasi-Equity	22.0		
Other			
Total	100.0	100.0	200.0
MIGA guarantees (gross portfolio in US\$m)	35.2	43.1	35.2
MIGA guarantees (gross portfolio in %)	1.2%	1.2%	0.8%

Annex B4

ROMANIA
Summary of Nonlending Services ^a

<i>Product</i>	<i>Completion FY</i>	<i>Cost (US\$000)</i>	<i>Audience ^b</i>	<i>Objective ^c</i>
Recent completions		Actual		
Health Sector Strategy	99	84	G, B	KG, PS
Financial Sector Review	99	145	G, B	KG, PS
Education Finance Advisory Note	99	33	G	KG, PS
Country Procurement Assessment	00	80	G, B	PS
Rural Finance Review	00	175	G, B	KG, PS
Childcare & Women's Labor Force Participation	01	20	B, PD	KG
Anti-Corruption Diagnostic Study	01	56	G, D, B, PD	KG, PD, PS
Country Economic Memorandum	01	450	G, B, PD	KG, PD, PS
Underway		Budgeted		
Local Social Services Delivery Study	01	290	G, B	KG, PS
Romania Global Gateway	Ongoing	75	G, D, PD	KG, PD
Legal/Judicial Sector Diagnostic Review	01	45	G, B, PD	KG, PD, PS
Public Expenditure Review ^d	02	299	G, D, B	KG, PS
IDF: Economic Communications Capacity	02	47	G, PD	KG, PD
IDF: Capacity Building for Macro Analysis	02	31	G	KG, PD, PS
Planned		Planned		
Poverty Assessment ^d	02	40 ^e	G, D, B	KG
Education Sector Review	02	100	G, B	KG, PS
Energy Sector Study and TA	02-04	150	G, B	KG, PS
Country Financial Accountability Assessment ^d	03	100	G, B	PS
Rural/Urban Growth Study	03	145	G, B	KG
Community Networks Study	03	100	G, B, PD	KG, PS
Financial Sector Assessment	03	135	G, D, B	KG, PS
Tax Policy Study	03	145	G	PS
EU Country Economic Memorandum ^d	04	425	G	KG, PS
Regional Development Strategy ^f	04	30	G, D, B, PD	KG, PD, PS
Poverty Policy Capacity Building ^{d, f}	04	90	G, B, PD	KG, PD, PS
Pension Study	04	200	G, B	KG, PD, PS
Governance Surveys	04	30	G, D, B, PD	KG, PD, PS
Labor Market Analysis ^d	04	100	G, B	PD, PS
Capital Markets Assessment	04	145	G, B	KG, PS

a. High case unless otherwise noted.

b. Government (G), donor (D), Bank (B), public dissemination (PD).

c. Knowledge generation (KG), public debate (PD), problem-solving (PS).

d. Included in low case scenario.

e. To be supplemented by trust funds.

f. Grant funding to be sought (e.g., JSDF).

Romania Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1993-98	Europe & Central Asia	Lower-middle-income
POPULATION					
Total population, mid-year (millions)	21.2	22.7	22.5	474.7	886.5
Growth rate (% annual average)	1.0	0.5	-0.2	0.1	0.9
Urban population (% of population)	46.2	51.4	55.7	66.2	57.7
Total fertility rate (births per woman)	2.6	2.3	1.3	1.6	2.5
POVERTY					
<i>(% of population)</i>					
National headcount index	..	..	21.5	..	..
Urban headcount index	..	..	20.4	..	..
Rural headcount index	..	..	27.9	..	..
INCOME					
GNP per capita (US\$)	..	..	1,360	2,200	1,740
Consumer price index (1995=100)	..	..	563	155	131
Food price index (1995=100)	..	1	509	..	..
INCOME/CONSUMPTION DISTRIBUTION					
Gini index	..	..	28.2	..	..
Lowest quintile (% of income or consumption)	..	..	8.9	..	..
Highest quintile (% of income or consumption)	..	..	37.3	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	2.9	4.0	3.0
Education (% of GNP)	3.5	2.2	3.6	5.1	4.9
Social security and welfare (% of GDP)	6.1	6.9	9.9	8.8	..
Net primary school enrollment rate					
<i>(% of age group)</i>					
Total	..	88	100	100	94
Male	..	89	100	100	95
Female	..	87	100	99	93
Access to safe water					
<i>(% of population)</i>					
Total	..	71	62	..	..
Urban	..	91	69	..	..
Rural	..	50	10	..	..
Immunization rate					
<i>(% under 12 months)</i>					
Measles	..	88	97	91	89
DPT	..	95	97	89	89
Child malnutrition (% under 5 years)					
Total	..	..	..	..	..
Life expectancy at birth					
<i>(years)</i>					
Total	70	70	69	69	68
Male	67	67	66	65	65
Female	72	73	73	74	72
Mortality					
Infant (per thousand live births)	35	26	21	22	35
Under 5 (per thousand live births)	43	32	25	26	44
Adult (15-59)					
Male (per 1,000 population)	184	228	256	283	244
Female (per 1,000 population)	112	114	122	120	137
Maternal (per 100,000 live births)	..	..	41	..	..

Romania - Key Economic Indicators: Sustained Reform Scenario

	2000	2001	2002	2003	2004	2005	2006	2007	2008
National accounts (as % of GDP)									
Gross domestic product ¹	100	100	100	100	100	100	100	100	100
Agriculture	20	19	18	15	14	13	14	13	12
Industry (incl. construction)	39	40	36	33	33	35	34	33	32
Services	41	41	46	53	53	52	52	54	56
Total Consumption	81	83	86	87	84	84	85	85	85
Gross domestic fixed investment (includes increase in stocks)	21	23	21	19	18	17	19	21	21
Exports (GNFS)	28	28	29	24	30	33	36	37	38
Imports (GNFS)	33	37	36	32	34	38	42	45	46
Gross domestic savings	19	17	14	13	16	14	15	18	18
Memorandum items									
GDP, (US\$ bn at current prices)	35	35	35	41	34	37	38	40	43
GNP per capita (US\$, Atlas method)	1,400	1,450	1,420	1,430	...	...	...	...	...
Real annual growth rates (% , calculated from 1993 prices)									
Gross domestic product at market p	7.1	3.9	-6.1	-5.4	-3.2	1.6	4.0	5.0	5.0
Gross Domestic Income	3.9	3.3	-6.2	-6.0	-2.8	1.5	4.0	5.0	5.0
Real annual per capita growth rates (% , calculated from 1993 prices)									
Gross domestic product at market p	7.4	4.2	-5.8	-5.2	-3.0	1.6	4.0	5.0	5.0
Total consumption	11.1	8.3	-7.7	-0.1	-9.3	2.1	2.0	4.0	4.0
Private consumption	13.2	11.2	-9.5	-0.1	-10.5	-0.8	2.0	4.0	4.0
Balance of Payments (US\$ millions)									
Exports (GNFS)	9,404	9,648	9,955	9,519	9,870	12,120	13,707	15,078	16,435
Merchandise FOB	7,910	8,085	8,431	8,302	8,503	10,367	11,809	12,990	14,159
Imports (GNFS)	11,306	12,503	12,349	12,798	11,381	14,042	16,088	18,019	19,821
Merchandise FOB	9,487	10,555	10,411	10,927	9,595	12,050	13,563	15,191	16,710
Resource balance	-1,902	-2,855	-2,394	-3,279	-1,511	-1,922	-2,381	-2,941	-3,386
Net current transfers	369	593	579	753	626	860	959	1,215	1,113
Current account balance	-1,774	-2,571	-2,137	-2,918	-1,288	-1,400	-1,622	-1,926	-2,472
Net private foreign direct investment	417	263	1,224	2,040	1,007	1,009	1,350	1,700	2,000
Long-term loans (net)	783	628	980	108	-45	1,100	767	849	824
Official	707	1,217	336	-131	14	785	467	449	324
Private	77	-589	644	239	-59	315	300	400	500
Other capital, net ²	317	1,897	1,598	-73	499	219	500	300	500
Change in reserves ³	257	-217	-1,665	843	-173	-928	-995	-923	-852
Memorandum items									
CA balance as % of GDP	-5.0	-7.3	-6.1	-7.0	-3.8	-3.8	-4.2	-4.8	-5.8
Resource balance	-5.4	-8.1	-6.9	-7.9	-4.4	-5.2	-6.2	-7.3	-7.9
Annual growth rates (US\$ values)									
Memo: Exports nominal growth	28.6	2.2	4.3	-1.5	2.4	21.9	13.9	10.0	9.0
Memo: Imports nominal growth	44.6	11.3	-1.4	5.0	-12.2	25.6	12.6	12.0	10.0

(Continued)

Romania - Key Economic Indicators: Sustained Reform Scenario
(Continued)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Public finance (as % of GDP at market prices)¹									
Current revenues	31.3	28.9	28.4	30.1	33.2	32.1	35.7	36.7	36.7
Current expenditures	28.9	28.3	28.4	31.3	34.1	35.1	33.6	33.3	32.3
Current account	2.4	0.6	0.0	-1.2	-0.9	-3.0	2.1	3.4	4.4
Capital expenditure	5.3	5.2	4.8	3.7	2.9	2.1	6.1	6.4	6.9
Foreign financing	0.8	0.9	3.0	0.4	0.3	1.8	0.8	0.8	1.0
Primary Deficit	-1.4	-2.8	-0.8	-0.1	1.8	1.4	1.0	0.0	-0.5
Consolidated Budget Deficit	-3.4	-4.8	-5.2	-5.5	-3.8	-3.7	-4.0	-3.0	-2.5
Monetary indicators									
M2/GDP	25.3	28.0	24.9	27.3	26.3	25.0	23.8	24.4	24.4
Growth of M2 (%)	71.6	66.0	104.9	48.9	44.9	43.0	28.1	26.6	26.6
total credit growth (%)	...	...	...	...	...	24.6	32.0	30.0	30.0
Price indices(YR93 =100)									
Real Exchange Rate	111.0	99.0	106.0	134.0	110.0	111.0	109.6	109.3	109.0
RER: Previous year = 100	4.7	-11.0	7.1	26.5	-17.4	-0.4	-1.2	-0.3	-0.2
Real interest rates	12.3	12.2	-35.8	-1.4	13.8	...	...	...	...
Consumer price index (% change)	32.3	38.8	154.8	59.1	45.8	45.7	30.0	22.0	15.0
GDP deflator (% change)	35.3	44.6	146.7	55.0	46.4	50.3	29.0	21.0	14.0
Memo:									
Lending rate to non-bank (% pa)	48.6	55.8	63.7	56.9	65.9	...	...	...	...
NBR Discount Rate	39.6	35.0	47.2	38.0	35.0	...	...	...	...

1. GDP at factor cost
2. Projections include EU capital grants (Phare, SAPARD, ISPA).
3. Includes use of IMF resources.
4. Consolidated central government.

Romania - Key Economic Indicators: Sustained Reform Scenario

	2000	2001	2002	2003	2004	2005	2006	2007	2008
National accounts (as % of GDP)									
Gross domestic product ¹	100	100	100	100	100	100	100	100	100
Agriculture	20	19	18	15	14	13	14	13	12
Industry (incl. construction)	39	40	36	33	33	35	34	33	32
Services	41	41	46	53	53	52	52	54	56
Total Consumption	81	83	86	87	84	84	85	85	85
Gross domestic fixed investment (includes increase in stocks)	21	23	21	19	18	17	19	21	21
Exports (GNFS)	28	28	29	24	30	33	36	37	38
Imports (GNFS)	33	37	36	32	34	38	42	45	46
Gross domestic savings	19	17	14	13	16	14	15	18	18
Memorandum items									
GDP, (US\$ bn at current prices)	35	35	35	41	34	37	38	40	43
GNP per capita (US\$, Atlas method)	1,400	1,450	1,420	1,430	...	...	...	...	...
Real annual growth rates (% , calculated from 1993 prices)									
Gross domestic product at market p	7.1	3.9	-6.1	-5.4	-3.2	1.6	4.0	5.0	5.0
Gross Domestic Income	3.9	3.3	-6.2	-6.0	-2.8	1.5	4.0	5.0	5.0
Real annual per capita growth rates (% , calculated from 1993 prices)									
Gross domestic product at market p	7.4	4.2	-5.8	-5.2	-3.0	1.6	4.0	5.0	5.0
Total consumption	11.1	8.3	-7.7	-0.1	-9.3	2.1	2.0	4.0	4.0
Private consumption	13.2	11.2	-9.5	-0.1	-10.5	-0.8	2.0	4.0	4.0
Balance of Payments (US\$ millions)									
Exports (GNFS)	9,404	9,648	9,955	9,519	9,870	12,120	13,707	15,078	16,435
Merchandise FOB	7,910	8,085	8,431	8,302	8,503	10,367	11,809	12,990	14,159
Imports (GNFS)	11,306	12,503	12,349	12,798	11,381	14,042	16,088	18,019	19,821
Merchandise FOB	9,487	10,555	10,411	10,927	9,595	12,050	13,563	15,191	16,710
Resource balance	-1,902	-2,855	-2,394	-3,279	-1,511	-1,922	-2,381	-2,941	-3,386
Net current transfers	369	593	579	753	626	860	959	1,215	1,113
Current account balance	-1,774	-2,571	-2,137	-2,918	-1,288	-1,400	-1,622	-1,926	-2,472
Net private foreign direct investment	417	263	1,224	2,040	1,007	1,009	1,350	1,700	2,000
Long-term loans (net)	783	628	980	108	-45	1,100	767	849	824
Official	707	1,217	336	-131	14	785	467	449	324
Private	77	-589	644	239	-59	315	300	400	500
Other capital, net ²	317	1,897	1,598	-73	499	219	500	300	500
Change in reserves ³	257	-217	-1,665	843	-173	-928	-995	-923	-852
Memorandum items									
CA balance as % of GDP	-5.0	-7.3	-6.1	-7.0	-3.8	-3.8	-4.2	-4.8	-5.8
Resource balance	-5.4	-8.1	-6.9	-7.9	-4.4	-5.2	-6.2	-7.3	-7.9
Annual growth rates (US\$ values)									
Memo: Exports nominal growth	28.6	2.2	4.3	-1.5	2.4	21.9	13.9	10.0	9.0
Memo: Imports nominal growth	44.6	11.3	-1.4	5.0	-12.2	25.6	12.6	12.0	10.0

(Continued)

Romania - Key Economic Indicators: Slow Reform Scenario
(Continued)

Indicator	1995	1996	1997	1998	1999	2000	2001	2002	2003
Public finance (as % of GDP at market prices)⁴									
Current revenues	31.3	28.9	28.4	30.1	33.2	32.1	31.8	31.3	30.6
Current expenditures	28.9	28.3	28.4	31.3	34.1	35.1	33.8	32.3	30.6
Current account	2.4	0.6	0.0	-1.2	-0.9	-3.0	-2.0	-1.0	0.0
Capital expenditure	5.3	5.2	4.8	3.7	2.9	2.1	2.9	3.1	2.5
Foreign financing	0.8	0.9	3.0	0.4	0.3	1.8	...	...	...
Primary Deficit	-1.4	-2.8	-0.8	-0.1	1.8	1.4	1.0	-1.3	-2.5
Consolidated Budget Deficit	-3.4	-4.8	-5.2	-5.5	-3.8	-3.7	-3.8	-4.3	-5.0
Monetary indicators									
M2/GDP	25.3	28.0	24.9	27.3	26.3	25.0	25.0	25.0	24.0
Growth of M2 (%)	71.6	66.0	104.9	48.9	44.9	43.0	36.0	38.0	44.0
total credit growth (%)	...	...	...	...	...	24.6	35.0	46.0	52.0
Price indices(YR93 =100)									
Real Exchange Rate	111.0	99.0	106.0	134.0	110.0	110.0	107.0	104.9	102.1
RER: Previous year = 100	4.7	-11.0	7.1	26.5	-17.4	-0.4	-2.7	-2.0	-2.7
Real interest rates	12.3	12.2	-35.8	-1.4	13.8	na	...	...	...
Consumer price index (% change)	32.3	38.8	154.8	59.1	45.8	45.7	33.0	32.0	38.0
GDP deflator (% change)	35.3	44.6	146.7	55.0	46.4	50.3	34.0	31.0	42.0
Memo:	48.6	55.8	63.7	56.9	65.9	...	...	...	...
Lending rate to non-bank (% pa)	...	...	...	...	...	...	...	...	...
NBR Discount Rate	39.6	35.0	47.2	38.0	35.0	...	...	...	...

1. GDP at factor cost
2. Projections include EU capital grants (Phare, SAPARD, ISPA).
3. Includes use of IMF resources.
4. Consolidated central government.

Annex B7a

Romania - Key Exposure Indicators: Accelerated Reform Scenario

Total debt outstanding and disbursed (TDO) (US\$m) ¹	6,666	8,519	9,477	10,014	9,367	9,991	10,764	11,652	12,459
Net disbursements (US\$m)	995	2,150	1,475	176	-588	1,100	774	888	807
Total debt service (TDS) (US\$m)	967	1,228	1,540	2,303	3,138	2,288	3,332	2,975	2,813
Memo: P&PG debt service	...	...	...	...	...	1,336	2,094	2,070	1,977
Memo: Private debt service	...	...	...	...	...	952	1,238	905	836
Debt and debt service indicators (%)									
TDO/XGS	70.9	88.3	95.2	105.2	94.9	82.4	78.5	77.3	75.8
Memo: XGS mn US\$	9,404	9,648	9,955	9,519	9,870	12,120	13,707	15,078	16,435
Memo: GDP, bn US\$	35	35	35	41	34	37	38	40	43
TDO/GDP	18.8	24.1	27.1	24.1	27.5	27.2	28.2	28.8	29.1
TDS/XGS	10.3	12.7	15.5	24.2	31.8	18.9	24.3	19.7	17.1
Concessional/TDO	..	..	..	..	..	..	..	..	..
IBRD exposure indicators (%)									
IBRD DS/public DS	6.3	5.9	7.0	9.2	7.9	14.6	10.2	11.9	14.2
Memo: IBRD debt service	...	...	...	...	...	195.0	214.0	246.0	280.0
Memo: Preferred creditor DS	...	...	...	...	...	408.2	545.0	680.8	730.4
Preferred creditor DS/public DS	63.1	54.7	28.6	30.5	22.7	30.5	26.0	32.9	36.9
IBRD DS/XGS	0.6	0.6	1.0	1.6	1.7	1.6	1.6	1.6	1.7
IBRD TDO (US\$m)	844	1009	1305	1443	1662	1955	2152	2428	2536
Memo: IBRD net flows	...	...	...	...	...	293	197	276	108
Guarantees (US\$m)	1546	1832	2038	2152	2249	2398	2583	2330	2492
IFC (US\$m)²									
Loans	...	4.1	16.4	93.1	106.5	113.0	100.0	125.0	150.0
Equity and quasi-equity	...	3	5	53	66	74	80	100	125
MIGA	...	1	12	41	41	39	20	25	25
MIGA guarantees (US\$m)	0	0	0	16	35	43	35	20	20

1. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.
2. IFC projections for 2001-2003 are indicative only.

Romania - Key Exposure Indicators: Slow Reform Scenario

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total debt outstanding and disbursed (TDO) (US\$m) ¹	6,666	8,519	9,477	10,014	9,367	9,991	10,434	10,090	10,118
Net disbursements (US\$m)	995	2,150	1,475	176	-588	1,100	443	-344	-632
Total debt service (TDS) (US\$m)	967	1,228	1,540	2,303	3,138	2,288	3,312	2,869	2,607
Memo: P&PG debt service	...	...	...	...	...	1,336	2,084	2,004	1,823
Memo: Private debt service	...	...	...	...	...	952	1,228	865	783
Debt and debt service indicators (%)									
TDO/XGS	70.9	88.3	95.2	105.2	94.9	82.4	82.8	79.8	81.7
Memo: XGS mn US\$	9,404	9,648	9,955	9,519	9,870	12,120	12,605	12,643	12,390
Memo: GDP, bn US\$	35	35	35	41	34	37	38	38	38
TDO/GDP	18.8	24.1	27.1	24.1	27.5	27.2	27.7	26.3	26.8
TDS/XGS	10.3	12.7	15.5	24.2	31.8	18.9	26.3	22.7	21.0
IBRD exposure indicators (%)									
IBRD DS/public DS	6.3	5.9	7.0	9.2	7.9	14.6	10.0	11.5	13.7
Memo: IBRD Debt Service	...	...	...	...	...	195.0	209.0	231.0	249.0
Memo: Preferred creditor DS	...	...	...	...	...	408.2	525.8	624.7	636.5
Preferred creditor DS/public DS	63.1	54.7	28.6	30.5	22.7	30.5	25.2	31.2	34.9
IBRD DS/XGS	0.6	0.6	1.0	1.6	1.7	1.6	1.7	1.8	2.0
IBRD TDO (US\$m)	844	1,009	1,305	1,443	1,662	1,955	1,999	2,015	2,012
Memo: IBRD net flows	128	227	371	84	233	293.2	44.0	16.0	-3.0
Guarantees (US\$m)	1,546	1,832	2,038	2,152	2,249	...	...	...	...
Share of IBRD portfolio (%)	...	...	...	...	...	...	...	...	...
IFC (US\$m)	...	4.1	16.4	93.1	106.5	113	...	...	...
Loans	...	3	5	53	66	74	...	...	...
Equity and quasi-equity	...	1	12	41	41	39	...	...	...
MIGA	...	...	...	...	...	...	...	...	...
MIGA guarantees (US\$m)	0	0	0	16	35	43	35	20	20

1. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

ROMANIA
Status of Bank Group Operations (Operations Portfolio)

Project ID	Project Name	Development Objectives	Supervision Rating	Last PSR Implementation Progress	Fiscal Year	Amounts in US\$ Millions			Difference : Expected Disbursements Orig.
						IBRD	Cancel.	Undisb.	
Closed Projects 44									
IBRD									
Total Disbursed (Active)						175.6	0.0	79.1	79.1
of which has been repaid						50.0	0.0	20.8	20.8
Total Disbursed (Closed)						55.4	0.0	36.2	35.8
of which has been repaid						110.0	33.5	60.1	93.6
Total Disbursed (Active + Closed)						120.0	0.0	42.5	41.1
of which has been repaid						25.0	0.0	10.2	10.0
Total Undisbursed (Active)						50.0	0.0	29.5	29.5
Total Undisbursed (Closed)						150.0	0.0	32.4	-30.1
Total Undisbursed (Active + Closed)						70.0	0.0	59.3	34.4
P008777	Petroleum Sector Rehabilitation	S	S	S	1994				
P008784	Education Reform	S	S	S	1994				
P008776	Employment and Social Protection	S	S	S	1995				
P008794	Power Sector Rehabilitation	S	S	S	1996				
P036013	Railway Rehabilitation	S	S	S	1996				
P008778	Bucharest Water Supply	S	S	S	1997				
P008793	Higher Education	S	S	S	1997				
P039250	Second Roads	S	S	S	1997				
P044614	Schools Rehabilitation	S	S	S	1998				
P034213	General Cadastre and Land Registration	S	S	S	1998	25.5	0.0	23.7	7.0
P008788	Telecommunications	S	S	S	1998	30.0	7.0	17.5	21.4
P055495	Child Welfare Reform	S	S	S	1998	5.0	0.0	3.6	2.7
P058284	Cultural Heritage	S	S	S	1999	5.0	0.0	4.4	3.5
P049200	Social Development Fund	S	S	S	1999	10.0	0.9	3.8	3.8
P039251	Private Sector Institution Building	S	S	S	1999	25.0	1.1	17.3	4.4
P056337	Mine Closure and Social Mitigation	S	S	S	2000	44.5	0.0	43.5	12.1
P043882	Agriculture Support Services	S	S	S	2000	11.0	0.0	10.9	0.4
P065041	Trade and Transport Facilitation in Southeastern Europe	S	S	S	2000	17.1	0.0	16.8	-0.3
P008797	Health Sector Reform	S	S	S	2000	40.0	0.0	40.0	3.1
TOTAL						1019.1	41.6	551.6	372.3

ROMANIA

Statement of IFC's
Held and Disbursed Portfolio
As of January 2001
(In US Dollars Millions)

FY Approval	Company	Held				Disbursed			
		Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1999	Ambro	8.3	0.0	0.0	0.0	5.5	0.0	0.0	0.0
1998	Banc Post	0.0	0.0	10.0	0.0	0.0	0.0	10.0	0.0
1998	Bilstein Compa	1.9	0.0	0.0	1.9	1.9	0.0	0.0	1.9
1996	Danube Fund	0.0	2.0	0.0	0.0	0.0	2.0	0.0	0.0
1998	Demir Romania	4.3	3.2	0.0	0.0	4.3	2.6	0.0	0.0
1997	Efes Brewery	8.2	0.0	0.0	6.0	8.2	0.0	0.0	6.0
1998	FCR Fund	0.0	10.0	0.0	0.0	0.0	10.0	0.0	0.0
1998	Garanta	0.0	0.2	0.0	0.0	0.0	0.2	0.0	0.0
1998	Krupp Compa	6.0	0.0	0.0	2.6	4.9	0.0	0.0	2.1
1997/98/00	Mobil Rom	55.0	0.0	10.0	180.0	40.0	0.0	10.0	160.0
1997	Rambox	1.5	2.0	0.0	0.0	1.5	2.0	0.0	0.0
1994/98/01	Romlease	4.0	0.8	0.0	0.0	4.0	0.8	0.0	0.0
1998	Small Bus. Loan	3.0	0.0	0.0	0.0	3.0	0.0	0.0	0.0
Total Portfolio:		92.1	18.2	20.0	190.5	73.2	17.5	20.0	170.0

Approvals Pending Commitment				
	Loan	Equity	Quasi	Partic
2001 Banca Romaneasca	3.0	0.0	3.0	0.0
2001 Romlease Restr.	4.0	0.0	0.0	0.0
Total Pending Commitment:	7.0	0.0	3.0	0.0

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
TARGETED POVERTY REDUCTION

Development Objectives	Key Messages	Key Messages	Key Messages	Key Messages	Key Messages	Key Messages
<p>Revitalization of Economy in Rural Areas</p> <ul style="list-style-type: none"> • Low elementary school enrollment in rural areas • Very few university students from rural areas • A learning tradition that emphasizes accumulation of facts rather than independent thinking needed for a market economy • Poor access to education for children of certain ethnic minority groups (e.g., Roma) • High incidence of poverty in rural areas • Limited rural opportunities due to inefficient factor and agricultural commodity markets, to which small semi-subsistence farm households have limited access • Inadequate rural access to well maintained infrastructure (roads, water, supply, sanitation) 	<ul style="list-style-type: none"> • Shift emphasis to student learning outcomes, to increase accountability • Invest in education in rural areas to make access more equitable • Involve local communities in education system • Reorient governance system to support the above • Maintain a stable market-oriented policy environment • Improve local ownership and sustainability of rural infrastructure • Facilitate access to finance in rural areas, as a way to support private sector growth in farm and off-farm income • Invest in agriculture extension programs and job-training programs • Strengthen absorptive capacity, including at community and local government levels, to take advantage of large sums of EU SAPARD grant funds available through 2006 and ensure efficient, sustainable rural investments 	<ul style="list-style-type: none"> • Completion of state farms privatization • Agricultural subsidies (if any) are transparent, well targeted, affordable, minimally distorting, and temporary • Withdrawal of the public sector from on-farm and related off-farm irrigation facilities, and replacement of subsidies to SNIF with direct transfers to farmers (e.g. with irrigation vouchers) • GOR abstention from introducing directed credit programs and funds financing rural and agricultural credit • Improved local government and community maintenance of infrastructure • Improvement in access to health services in rural areas • Establish decentralized capacity for protected area and conservation planning including local community participation 	<p>Lending:</p> <ul style="list-style-type: none"> • Rural Education • Rural Development • SDF 2 • Rural Finance • Health Sector Reform 2 • Irrigation • Rehabilitation <p>Portfolio:</p> <ul style="list-style-type: none"> • Education Reform • Higher Education • Schools • Rehabilitation • General Cadastre • SDF 1 • Mine Closure & Social Mitigation • Agriculture Support Services • Health Sector Reform 1 • Biodiversity Conservation • Management GEF Grant • Agriculture Pollution Control GEF Grant <p>Nonlending:</p> <ul style="list-style-type: none"> • CEM/EU CEM • PER • Education Sector Review 	<ul style="list-style-type: none"> • Continued agricultural policy dialogue with Government, e.g., providing feedback on subsidy design issues • Delivery of policy advice on rural and agricultural risk management • Delivery of policy advice on rural-urban aspects of regional development • Prototype decentralized protected area management plans effectively operating at three forested sites in the Carpathian range 	<p>EU/SAPARD, DFID, USAID, ACDI/VOCA, Dutch aid, GEF, community-based organizations and NGOs</p>	

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
TARGETED POVERTY REDUCTION

Development Objectives	Diagnosis	Strategy/Actions	Government Benchmarks	WBG Instruments	WBG Benchmarks	Development Partners
Improvement in Delivery of Health Services	<ul style="list-style-type: none"> Poor health indicators relative to EU Inefficient allocation of resources Informal payments needed to access healthcare services Medical professionals paid low wages Poor access to primary health care services in some areas 	<ul style="list-style-type: none"> Develop more effective programs for tobacco control, TB control, and prevention of STD and HIV/AIDS Strengthen governance of new health insurance houses at local levels Develop planning and policy tools for better resource allocation from the center Improve quality and cost-effectiveness of primary, essential hospital and emergency care Increase training of staff in management and primary care. 	<ul style="list-style-type: none"> Increased patient compliance with DOTS in 80% or more Judets Increased HIV/AIDS awareness Financial results and viability of regional health insurance houses Reduced variation in available facilities and health professionals between judets Reductions in case fatality rate in areas provided with new emergency and intensive care equipment and training Response times for EMS attendance at major emergencies reduced to less than 8 minutes 50% or more primary care practices in Phase I judets trained according to guidelines 	<p>Lending:</p> <ul style="list-style-type: none"> Health Sector Reform 2 PALs Public Institution Building <p>Portfolio:</p> <ul style="list-style-type: none"> Health Sector Reform 1 Bucharest Water Supply <p>Nonlending:</p> <ul style="list-style-type: none"> CEM/EU CEM PER Anti-Corruption Diagnostic 	<ul style="list-style-type: none"> Progress toward trigger indicators Implementation progress 	<p>DFID, Swiss Agency for Development and Cooperation, Open Society Institute, USAID</p>
Outreach to Ethnic Groups	<ul style="list-style-type: none"> Poverty more severe among certain ethnic minorities (e.g., Roma), who are isolated from the 	<ul style="list-style-type: none"> Ensure better targeting of social assistance to those most in need Support community-based development 	<ul style="list-style-type: none"> Database and website on ethnicity established by Q2 2002 Ethnic integration programs designed 	<p>Lending:</p> <ul style="list-style-type: none"> SDF 2 Social Sector Development Rural Education <p>Portfolio:</p>	<ul style="list-style-type: none"> Grant in support of ethnicity programs operational Q4 2001 RSDF outreach to ethnic minorities 	<p>EU, NGOs</p>

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
TARGETED POVERTY REDUCTION

Development Objectives	Diagnosis	Strategic Actions	Interventions	Key Indicators	Responsible Parties
	rest of the economy and social structures	initiatives by Q4 2001	<ul style="list-style-type: none"> SDF 1 Nonlending: CEM/EU CEM PER Education Sector Study Poverty Policy Capacity Building Labor Market Study 	functional by Q4 2001	
Economic and Social Equity for Women	<ul style="list-style-type: none"> Disparity in earning power of women versus men Women not given same economic opportunities as men, due to traditional attitudes in the workplace and in the home 	<ul style="list-style-type: none"> Social services to target vulnerable groups, including poor women 	<p>Lending:</p> <ul style="list-style-type: none"> Social Sector Development <p>Nonlending:</p> <ul style="list-style-type: none"> Pension Study Labor Market Study 	<ul style="list-style-type: none"> Social service sub-projects targeted to women established by Q4 2001 	NGOs
Promotion of Social Capital through Community Development	<ul style="list-style-type: none"> Low social capital in Romania after so many years of authoritarian rule Low level of trust makes horizontal collaboration difficult Communities' access to resources limited as a result Low level of interaction between local authorities and their constituency impairs participatory decision-making 	<ul style="list-style-type: none"> Create opportunities for more proactive community participation in decision-making by local authorities, particularly in investment-related activities Create stable channels of communication between local authorities and communities 	<p>Lending:</p> <ul style="list-style-type: none"> SDF 2 Rural Development Forestry Development Rural Education Hazards Mitigation Portfolio: SDF 1 Biodiversity Conservation Management GEF Grant <p>Nonlending:</p> <ul style="list-style-type: none"> Community Networks Study 	<ul style="list-style-type: none"> Sub-projects designed and implemented by the poor under SDF 1 and 2 At least 5 municipalities implementing participatory budgeting by Q4 2002 Establishment of functioning forest owners associations, and forest industry advisory services and outreach program Establishment of 	EU, SAPARD, LEB

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
TARGETED POVERTY REDUCTION

Development Objective	Government Strategy/Actions	Indicators	Interventions	Development Partners	
Improved Child Welfare	<ul style="list-style-type: none"> Some poor families turn their children over to state institutions for lack of resources to provide for their children themselves No effective transition system for teens old enough to leave state institutions Bleak future of crime, drugs, and prostitution 	<ul style="list-style-type: none"> MIS and child tracking system fully functional Q4 2001 Number of institutionalized children reduced Services provided to street children Development of pilot linking social assistance to abandonment of children 	<p>Lending:</p> <ul style="list-style-type: none"> Social Sector Development <p>Portfolio:</p> <ul style="list-style-type: none"> Child Welfare Reform Health Sector Reform I CEM/EU CEM PER Local Social Service Delivery Study 	<ul style="list-style-type: none"> MIS implemented at Judets level by Q2 2002 36 child welfare sub-projects implemented by Q4 2002 6 street children sub-projects implemented by Q4 2002 	EU, DFID
Pension Reform	<ul style="list-style-type: none"> High pension tax rates on the current workforce drives employers to the grey economy Low retirement age Indexation makes pension one of highest cost items 	<ul style="list-style-type: none"> CNPAS fully established by Q2 2002 Pillar 2 law passed by Q4 2001 Pension Supervision Commission (PSC) established by Q4 2002 	<p>Lending:</p> <ul style="list-style-type: none"> Social Sector Development PALs <p>Portfolio:</p> <ul style="list-style-type: none"> Employment & Social Protection <p>Nonlending:</p> <ul style="list-style-type: none"> CEM/EU CEM PER Pension Study 	<ul style="list-style-type: none"> IT system for pensions installed by Q4 2002 PSC built up to viable regulatory body by Q4 2003 	USAID

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 – 2004
TARGETED POVERTY REDUCTION

Development Objectives	Diagnosis	Strategic Actions	Government Reforms	Interventions	Key Results	Development Partners	
Effective, Targeted Delivery of Social Assistance	<ul style="list-style-type: none"> in state budget Fiscally unsustainable situation in light of aging population Government's Minimum Income Guarantee Program is inefficient, underfunded (dependent to large extent on municipal budgets), and unsustainable 	<ul style="list-style-type: none"> New legal framework Institution building at central and local levels Built-in flexibility for local governments to be more responsive to needs of the poor 	<ul style="list-style-type: none"> supervision of private pension funds 	<ul style="list-style-type: none"> Social Assistance Framework law passed by Q4 2001 MIG law passed by Q4 2001 MIG financed from state budget at 0.4% of GDP by Q1 2002 Targeting coverages improved by 25% by Q4 2003 	<ul style="list-style-type: none"> Lending: Social Sector Development Portfolio: Employment & Social Protection Child Welfare Reform Nonlending: CEM/EU CEM PER Local Social Service Delivery Study Pension Study 	<ul style="list-style-type: none"> 2 Social Assistance pilots completed by Q4 2001 IT system installed by Q4 2003 	EU, DFID

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
PRIVATE SECTOR DEVELOPMENT

Development Objectives	Diagnosis	Strategy/Actions	Government	WBG	Development Partner	
		Strategy/Actions	Government	Instruments	Benignitas	
Macroeconomic Stabilization	<ul style="list-style-type: none"> High external debt High inflation Low growth Budget deficits largely driven by heavy subsidies to enterprise sector, in the form of tax arrears and low energy prices 	<ul style="list-style-type: none"> Improving public expenditure management, aiming at achieving greater fiscal discipline Privatizations and liquidations of large loss-making SOEs Transition to market-based energy pricing 	<ul style="list-style-type: none"> Reduced losses of national companies and <i>Regies Autonomes</i> Reduced fiscal and quasi-fiscal costs related to support for loss-makers Enforcement of hard budget constraints Adopt new energy pricing policies and tax regime Reduce payment arrears by SOEs Progressive reduction in thermal energy subsidies 	<p>Lending:</p> <ul style="list-style-type: none"> PSAL 2/PIBL 2 PALs <p>Portfolio:</p> <ul style="list-style-type: none"> PIBL 1 <p>Nonlending:</p> <ul style="list-style-type: none"> PER/EU CEM Macroeconomic Management IDF Grant Energy Sector Study/TA 	<ul style="list-style-type: none"> Finalizing of privatization process started under PSAL 1 Introduction and completion of new privatization projects, including National Rail Freight System, National Salt Company and National Mineral Water Company 	IMF (in lead), EU
Structural Adjustment of Financial Sector	<ul style="list-style-type: none"> State-owned banks dominate sector and effectively subsidize loss-making enterprises Inadequate supervision and regulatory framework in bank and non-bank sectors High interest rates and state borrowings crowd out private sector 	<ul style="list-style-type: none"> Privatization or liquidation of state-owned banks (including BA, BCR) Bring credit cooperatives under supervision authority of NBR Modernize regulatory framework for banks and non-bank financial intermediaries 	<ul style="list-style-type: none"> Improved law enforcement and regulatory framework in the banking sector Adequate legal and regulatory framework for capital and equity markets Improved corporate governance of banks, including enhanced management operations and financial performance 	<p>Lending:</p> <ul style="list-style-type: none"> PSAL 2/PIBL 2 PALs <p>Portfolio:</p> <ul style="list-style-type: none"> PIBL 1 <p>Nonlending:</p> <ul style="list-style-type: none"> PER/EU CEM Financial Sector Assessment 	<ul style="list-style-type: none"> Full privatization of banking sector Improvements in the Law on Credit Cooperatives Adequate bank infrastructure systems such as Payment and Clearing systems, use of IAS, Deposit Guarantee Fund, Risk Classification System 	IMF, EU, USAID

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
PRIVATE SECTOR DEVELOPMENT

Development Objective	Diagnosis	Government Strategy/Actions	Government Instruments	Private Sector Benchmarks	Development Results	
	<ul style="list-style-type: none"> borrowing Under-developed capital and money market structure in primary and secondary markets Weak banking and capital market infrastructure Weak institutional capacity in the banking system 	<ul style="list-style-type: none"> Strategic plan and blueprint for developing capital and equity markets Strengthen the National Securities Commission and the Insurance Commission Develop and strengthen Deposit Insurance, Credit Bureau, Credit Rating system, and Payment and Clearing System Technical assistance for banks in credit and risk management, treasury operations, branch management, loan workouts and debt recovery, etc Licensing or exit of credit cooperatives for supervision and regulatory oversight by the NBR Require IAS for financial reporting by banks 				
Structural Adjustment of Enterprise Sector	<ul style="list-style-type: none"> Losses and inter-enterprise arrears burdening state budget Low investment levels Low value added of 	<ul style="list-style-type: none"> Seek strategic investor(s) through international investment bank for Petrom, natural gas production companies and gas/ 	<ul style="list-style-type: none"> Reduced arrears to utilities, other commercial creditors, and the budget Unbundle energy sector to achieve 	<ul style="list-style-type: none"> Lending: <ul style="list-style-type: none"> PSAL 2/PIBL 2 PALs Portfolio: <ul style="list-style-type: none"> PIBL 1 Petroleum Sector Rehabilitation 	<ul style="list-style-type: none"> Liberalization and privatization of network industries, including majority or strategic sales under market conditions of SOEs in the oil, gas 	IMF, EBRD, EIB, EU/ISPA

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
PRIVATE SECTOR DEVELOPMENT

Development Objectives	Diagnosis	Strategy/Actions	Government	WBG	Development Partners
			Benchmarks	Instrument	Benchmarks
Strengthening of Business Environment	<ul style="list-style-type: none"> Complex tax payment procedures Changeable SME facilities Bureaucratic business registration procedures Costly labor rules Cumbersome customs operations 	<ul style="list-style-type: none"> Establish business environment task force with members from public and private sector Simplify tax payment procedures Develop plan for reducing labor rule costs Develop an anti-corruption strategy 	<ul style="list-style-type: none"> efficient industry structures Offer energy companies and assets to strategic investors Streamline legal and policy frameworks for independent functioning of regulatory agencies Dilute government share in RomTelecom and privatize National Radio Communications company 	<ul style="list-style-type: none"> Power Sector Rehabilitation Railway Rehabilitation Telecommunications Reform & Privatization Support Mine Closure & Social Mitigation Nonlending: PER/EU CEM Anti-Corruption Diagnostic Energy Sector Study/TA 	<ul style="list-style-type: none"> and electricity distribution sectors
				<ul style="list-style-type: none"> Lending: PSAL 2/PIBL 2 PALS Portfolio: PIBL 1 Petroleum Sector Rehabilitation Railway Rehabilitation General Cadastre Cultural Heritage Trade & Transport Facilitation Energy Efficiency GEF Grant Nonlending: PER/EU CEM Anti-Corruption Diagnostic 	<ul style="list-style-type: none"> Removal of administrative barriers to establishing and operating businesses in Romania Improvements in the building permit process Abolition of special funds Introduction of more equitable and efficient taxation Implementation of sound, internationally recognized accounting standards and

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
PRIVATE SECTOR DEVELOPMENT

Development Objective	Diagnosis	Government Strategy/Actions	Government Requirements	Private Sector Requirements	Developing Partner
Improved Energy Efficiency	<ul style="list-style-type: none"> High energy intensity reduces competitiveness of Romanian industry, burdens balance of payments with high energy import bill, and increases environmental problems 	<ul style="list-style-type: none"> Development and implementation of commercially viable energy efficiency investments financed by a dedicated, market-based financing facility 	<ul style="list-style-type: none"> Sustained increase in commercially funded investments in energy efficiency Reduce GNG emissions 	<ul style="list-style-type: none"> Facilitate functioning of a revolving fund for energy efficiency investments 	GEF
Redeployment of Dislocated Labor	<ul style="list-style-type: none"> Low mobility of labor force Heavy dependence on employment by unprofitable state-owned enterprises 	<ul style="list-style-type: none"> Establish M&E system for social impact of PSAL 2 program Funding of labor redeployment services (with built-in incentives for employment) for dislocated workers stemming from privatizations or liquidations, for some transition period 	<ul style="list-style-type: none"> M&E system established by Q4 2001 Redeployment Program (LRP) services provided to 35,000 workers a year Job counseling services provided to all unemployed 	<ul style="list-style-type: none"> M&E reports reviewed and discussed with Government (ongoing) (LRP) operating fully, reaching 35,000 clients a year Micro-credit funds operational (4 by Q4 2002) 	EU/RICOP, US Department of Labor
Information Technology	<ul style="list-style-type: none"> Low investment in IT sector Brain drain as IT-skilled youth emigrate to work elsewhere (nearly one-third of Romania's IT graduates 	<ul style="list-style-type: none"> New Government Ministry to give IT strategic focus Increase access to IT Use IT to improve quality of and access to education at all levels Use IT to implement 	<ul style="list-style-type: none"> Adopt modern IT strategy and policy, including e-governance and rural service access Establish enabling legal and regulatory framework Adopt IT curricula 	<ul style="list-style-type: none"> Grant financing: GEF Energy Efficiency 	EU, Private Sector

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
PRIVATE SECTOR DEVELOPMENT

Development Objectives	Diagnosis	Government Strategy/Action	Government Initiatives	WBG Instruments	WBG Benchmarks	Development Targets
	<ul style="list-style-type: none"> emigrating every year) Uneven access to IT 	<ul style="list-style-type: none"> cost-saving efficiencies in public sector (e-government) Create enabling environment for private sector participation 	<ul style="list-style-type: none"> in schools 	<ul style="list-style-type: none"> PIBL 1 Telecommunications Reform & Privatization Support Nonlending: <ul style="list-style-type: none"> Romania Global Gateway eCAS InfoDev 		

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 – 2004
GOVERNANCE AND INSTITUTIONAL REFORM

Development Objectives	Diagnosis	Government Strategy/Actions	Government Benchmarks	WBG Instruments	WBG Benchmarks	Development Objectives
Efficient Public Sector with Minimal Corruption	<ul style="list-style-type: none"> Widespread corruption perceived by and experienced by the population Corruption closely linked with qualities of public administration Corruption in the formation of laws, rules and decrees. 	<ul style="list-style-type: none"> Development of comprehensive anticorruption strategy, focusing on preventive as well as enforcement aspects Full implementation of the Civil Service Law, strengthened provisions on meritocratic depoliticized decision making Improved budget preparation and execution Establishment of a regime of openness with free access to state information, without excessive penalties for disclosing vaguely defined state secrets Strengthened transparency in party financing Strengthened oversight by Parliament, the Judiciary, civil society and external audit Establishment of civil service Code of Ethics 	<ul style="list-style-type: none"> Detailed, monitorable, sectoral action plans (e.g., health, courts) to reduce corruption and improve efficiency Increased use of rule-based equalization formulae to allocate general revenue grants to local councils in a manner that is transparent, predictable and less dependent on subjective judgments Increased local government decision making ability and accountability Establishment of system of regular monitoring and evaluation of government policies and programs Strengthen capacities and independence of Court of Accounts Reduced prevalence of informal payments Reduced turnover of civil servants 	<ul style="list-style-type: none"> Lending: <ul style="list-style-type: none"> PALS Public Institution Building Portfolio: <ul style="list-style-type: none"> Trade & Transport Facilitation Health Sector Reform Nonlending: <ul style="list-style-type: none"> CEM/EU CEM PER Anti-Corruption Diagnostic Study Local Social Service Delivery Study Legal/Judicial Assessment 	<ul style="list-style-type: none"> Bank to help with TOR for development of AC Strategy More vertical dialogue budget formulation process; earlier availability of reliable budget forecasts Strengthen professionalism of civil service; remove ambiguities of political versus non-political appointments Development of implementation capacity of free access to information law (e.g., clear guidelines for civil servants on how to comply with requests, clear advice to citizens how to file a request) Development of Code of Ethics, with detailed plans for training and implementation Detailed plan for enforcing rules on transparency in party and campaign financing 	<ul style="list-style-type: none"> USAID, EU, UNDP, DFID, Stability Pact Anti-Corruption initiative, OECD, Council of Europe, UN Center for International Crime Prevention

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 – 2004
GOVERNANCE AND INSTITUTIONAL REFORM

Development Objectives	Policy Objectives	Key Messages	Strategic Actions	Development Partners	Development Partners	
Improved Policy Formulation, Coordination, and Implementation	<ul style="list-style-type: none"> • Policy reversals • Instability of legal framework for business • Excessive reliance on emergency decrees • Legislation and reforms not implemented • Inconsistencies in the legislative framework • Excessive and vague regulations • Non-transparent and inefficient law-making process • Weak administrative capacity at the local level to 	<ul style="list-style-type: none"> • Improved analysis, consultation and deliberation of the merits, costs and benefits of policy proposals • Strengthen policy formulation capacities in both Cabinet and line ministries • Build incentives for implementation of public sector reforms • Improve and make transparent policy formulation process • Establish business environment task force with members from public and private sector • Increased awareness of need for reform 	<ul style="list-style-type: none"> • Development of system of regulatory impact analysis • Draft laws publicly available for discussion before vote • Develop capacity at the local level to deliver infrastructure and social services effectively 	<ul style="list-style-type: none"> • Lending: <ul style="list-style-type: none"> • PALS • Public Institution Building • Portfolio: <ul style="list-style-type: none"> • Trade & Transport Facilitation • Health Sector Reform • Nonlending: <ul style="list-style-type: none"> • IDP Grant for Economic Communications • CEM/EU CEM • PER • Anti-Corruption Diagnostic Study • Local Social Service Delivery Study • Legal/Judicial Assessment 	<ul style="list-style-type: none"> • Greater dialogue with civil society and business associations on proposed legislation—mandated public hearings • Detailed plan for monitoring of implementation of public sector reforms • Training, including financial management, provided 	<p>USAID, EU/ISPA, UNDP, DFID, Stability Pact Anti-Corruption Initiative, OECD, Council of Europe, UN Center for International Crime Prevention</p>
<ul style="list-style-type: none"> • Greater budget predictability • Free access to state information not otherwise legislated to be secret • Public debate on draft laws and regulation • Greater enforcement of existing rules on disclosure of party financing 	<ul style="list-style-type: none"> • following elections 	<ul style="list-style-type: none"> • Greater budget predictability • Free access to state information not otherwise legislated to be secret • Public debate on draft laws and regulation • Greater enforcement of existing rules on disclosure of party financing 	<ul style="list-style-type: none"> • Development of system of regulatory impact analysis • Draft laws publicly available for discussion before vote • Develop capacity at the local level to deliver infrastructure and social services effectively 	<ul style="list-style-type: none"> • Lending: <ul style="list-style-type: none"> • PALS • Public Institution Building • Portfolio: <ul style="list-style-type: none"> • Trade & Transport Facilitation • Health Sector Reform • Nonlending: <ul style="list-style-type: none"> • IDP Grant for Economic Communications • CEM/EU CEM • PER • Anti-Corruption Diagnostic Study • Local Social Service Delivery Study • Legal/Judicial Assessment 	<ul style="list-style-type: none"> • Greater dialogue with civil society and business associations on proposed legislation—mandated public hearings • Detailed plan for monitoring of implementation of public sector reforms • Training, including financial management, provided 	<p>USAID, EU/ISPA, UNDP, DFID, Stability Pact Anti-Corruption Initiative, OECD, Council of Europe, UN Center for International Crime Prevention</p>

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
GOVERNANCE AND INSTITUTIONAL REFORM

Development Objectives	Diagnosis	Government Strategy/Action	Institutional Environment	WB/ Government Instruments	Requirements	Development Instruments
Local Government Capacity Building	<ul style="list-style-type: none"> • deliver infrastructure and social services • Losses and inter-enterprise arrears burdening state budget • Low investment levels • Decreasing quality of municipal services, due to lack of efficiency in operations and capital for investments along with inadequate institutional capacity 	<ul style="list-style-type: none"> • Liberalize market, adopt competitive industry structure, strengthen regulatory framework, seek/expand private sector participation in electricity, oil, gas, telecoms, railways • Improve conditions for private sector involvement in delivery of local public utility services 	<ul style="list-style-type: none"> • Reduced arrears to utilities, other commercial creditors, and the budget • Streamline legal and policy frameworks for independent functioning of regulatory agencies • Provide quality municipal services at affordable prices • Increase efficiency of service delivery through the private sector • Create environment for economic and sustainable municipal financing 	<p>Lending:</p> <ul style="list-style-type: none"> • PALs • Rural Development SDF 2 <p>Portfolio:</p> <ul style="list-style-type: none"> • Bucharest Water Supply • Nonlending • PER/EU CEM 	<ul style="list-style-type: none"> • Promote policy changes that will increase the role of the private sector in the provision of municipal services • Create a framework that would promote private sector participation and sustainable municipal financing 	IMF, EBRD, EIB, EU/ISPA
Improved National Preparedness for Natural Disasters	<ul style="list-style-type: none"> • Bucharest at high risk of major earthquake damage • Romania regularly suffers from drought and flooding • Poor are particularly vulnerable • No effective national system for coping with such 	<ul style="list-style-type: none"> • Institution building for national emergency response capacity, with effective networking between central and local authorities • Update building codes in light of latest technology, retrofit selected public buildings • Introduce national 		<p>Lending:</p> <ul style="list-style-type: none"> • Hazards Mitigation (IBRD & GEF) • Nonlending: • CEM/EU CEM 		Private sector

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 – 2004
GOVERNANCE AND INSTITUTIONAL REFORM

Development Objective	Diagnosis	Subject/Action	Government	Intervention	Benchmarks	Development Bank
Strengthening of Forest Resource Management	<ul style="list-style-type: none"> emergencies Restitution of forest land is putting rich natural resource at risk of short-term exploitation with long-term consequences Forest resources could be developed in sustainable manner with higher value added 	<ul style="list-style-type: none"> catastrophic insurance scheme Institute environmental monitoring and flood warning system Institution building centrally/ and locally to ensure smooth transition during restitution process Investment in infrastructure (roads) Establish public-private partnership for business development and advisory services for wood products industries 	<ul style="list-style-type: none"> Adoption of National Forest Policy and Strategy (finalized in Dec. 2000) Capacity for supporting and monitoring sustainable management of public and private forest resources No loss of forest cover or biodiversity Increased contribution to GDP derived from sustainable forest management Increased public awareness and support for sustainable management of forest resources 	<p>Lending:</p> <ul style="list-style-type: none"> Forestry Development <p>Portfolio:</p> <ul style="list-style-type: none"> General Cadastre Biodiversity Conservation Management GEF Grant <p>Nonlending:</p> <ul style="list-style-type: none"> PER CEM/EU CEM 	<ul style="list-style-type: none"> Forest owners associations established Effectively trained and equipped forest inspectorate and outreach services Forest management information system Improved environmentally and economically sustainable forest management (forest roads) Forest industries advisory services 	<ul style="list-style-type: none"> Forest owners associations, forest industries, private investors, NGOs
Toxic Site Management	<ul style="list-style-type: none"> No clear mechanism for resolving liability issues, with inhibiting effect on 	<ul style="list-style-type: none"> Institution building for response capacity, with effective networking between central and 		<p>Lending:</p> <ul style="list-style-type: none"> Hazards Mitigation GEF Grant <p>Portfolio:</p> <ul style="list-style-type: none"> Agriculture 		GEF

ROMANIA COUNTRY ASSISTANCE STRATEGY MATRIX
HIGH CASE: FY 2002 - 2004
GOVERNANCE AND INSTITUTIONAL REFORM

Development Objectives	Country Strategy/Action	Government	Private Sector	International Community	Borrowers
<p>some privatizations</p> <ul style="list-style-type: none"> inefficient response to toxic emergencies 	<p>local authorities</p> <ul style="list-style-type: none"> Establish inter-sectoral, participatory planning and sustainable management capacity in biodiversity conservation 	<p>Pollution Control GEF Grant</p> <p>Nonlending: PER</p>	<p>Establishment of new systems for decentralized, participatory planning and management of protected areas and biodiversity conservation in the production landscape</p> <ul style="list-style-type: none"> Increased awareness of the needs and opportunities for sustainable conservation of biodiversity 	<p>Portfolio:</p> <ul style="list-style-type: none"> Biodiversity Conservation Management GEF Grant 	<p>Prototype decentralized protected area management plans effectively operating at three forested sites in the Carpathian range</p> <ul style="list-style-type: none"> Capacity to develop, implement and monitor a prioritized national conservation strategy, including catalyzing establishment of decentralized systems for protected area and conservation management at priority sites
<p>Biodiversity and Natural Resource Conservation</p>	<p>Fragile ecosystems at risk due to land restitution process and resulting changes in land use</p>				<p>GEF, natural resource owners and managers (e.g., Romsilva, private forest owners, farmers, water authorities, etc.)</p> <p>local government, NGOs the academic community</p>
<p>Harnessing of Renewable Energy Resources</p>	<p>Romania has considerable renewable energy resources (hydro) and excess thermal capacity</p>	<p>Lending:</p> <ul style="list-style-type: none"> Carbon Credits (PCF) 	<p>Develop integrated least cost program of hydropower rehabilitation and thermal power decommissioning</p>	<p>Possible carbon trading projects to rehabilitate hydroelectric units and decommission thermal, and/or several forest-based activities</p>	<p>Availability of renewable capacity enhanced</p> <p>PCF, private sector</p>

ROMANIA

CAS Summary of Development Priorities

Network area	Country performance	Major issue	Country priority	Bank priority	Reconciliation of country and Bank priorities
Poverty Reduction & Economic Management					
Poverty reduction	Poor	Low growth	High	High	
Economic policy	Good	New SME growth	High	High	
Public sector	Fair	Corruption	High	High	
Gender	Good	Equal job opportunities and pay	Low	Low	
Human Development Department					
Education	Good	Rural education	High	High	
Health, nutrition & population	Fair	Health financing and primary care access	Moderate	Moderate	
Social protection	Fair	Pension reform	High	High	
Environmentally & Socially Sustainable Development					
Rural development	Fair	Rural poverty	High	High	
Environment	Fair	Regulatory framework	High	High	Major focus of Social Development Fund and Rural Development loans
Social development	Fair	Community development	Moderate	High	
Finance, Private Sector & Infrastructure					
Financial sector	Poor	Regulatory framework and bank privatization	High	High	
Private sector	Poor	Business environment	High	High	
Energy & mining	Fair	Pricing and regulatory framework	Moderate	High	Active dialogue
Infrastructure	Good	Private sector participation and investment	High	Moderate	European institutions in lead for investment

**SUMMARY OF FEEDBACK ON
WORLD BANK'S DRAFT COUNTRY ASSISTANCE STRATEGY
FOR ROMANIA**

The CAS Consultation Process

The Bank Group's assistance strategy takes account of feedback received in the course of in-country consultations with the Government and other stakeholders on its draft of the Romania Country Assistance Strategy (CAS). The Bank gave a draft of the CAS to the Government in January 2001, for its review and comment. In February the Government sent detailed comments to the Bank. Many of them were aimed at describing Romania's performance over the past eighteen months in more positive terms and to note the challenges that inhibited more progress. In response, the Bank made several revisions but retained the candor and objectivity needed for a CAS. Other comments from the Government related to specific instruments of assistance. For example, the Government requested continued assistance from the Bank and IFC in information technology and communications, and in the area of private sector participation in municipal infrastructure and services. The document was modified to reflect these areas of Bank Group assistance more explicitly. It was also agreed that once the new Government has been in office for about a year, it will consider with Bank management the possibility of a CAS update.

Feedback was also obtained during focus group sessions hosted by the Bank, and from comments received electronically from the World Bank's eCAS website, on which the draft CAS was posted (web address: www.worldbank.org/romaniacas). These comments were submitted either via email to the Bank's Romania CAS team, or via a public discussion space ("chat space") on the eCAS website. Seven focus group sessions were held: five in Bucharest with Parliamentarians, Government economists, private sector representatives, union leaders, and NGOs and think tanks; and two in the Jiu Valley, one with NGOs and the other with local public officials.

The eCAS website has been quite active since its launch on January 18, 2001, with more than 4,000 "hits" to date. The level of interest in the draft CAS has been high, and the feedback received, including from some Romanians working or studying abroad, has been constructive and thoughtful. It was largely incorporated into the final version of the CAS.

Major Cross-Cutting Themes

A number of cross-cutting themes emerged and are summarized below:

- **Need for Action** – Romania lacks an action-oriented roadmap for its development, and the capacity to translate words into concrete actions. Despite the many strategies

developed in the last 11 years, Romanians do not have a clear idea about how the various strategies relate to each other, to what extent they will, in fact, to be implemented, and how. In 1999 the National Strategy for Sustainable Development, signed by all partners including representatives of the civil society, articulated a strategy with a broad base of support. However, without legal standing, that strategy cannot be considered a meaningful national strategy. The development agenda proposed in the CAS needs to be harmonized with the new Government's Action Plan. In addition, the Romanian Government needs to strengthen significantly its implementation capacity. This is a major challenge.

- Need for Selectivity - The objectives need to be prioritized and translated into specific, phased and time-bound actions to be taken, in order to reach stability, profitability and openness. The Government needs to take political decisions as to relative priorities, and develop its multi-year Action Plan on that basis. One way to set priorities would be to identify the existing resources and the likely "quick wins." Also stressed is the need to finalize whatever action once started. It would be better to work on only 15% of the objectives but to conclude them successfully, than to embark on all of them but leave them unfinished.
- Linkages Among Objectives - There is a need for linkages and cause/effect relationships among Romania's objectives presented in the CAS, as well as phased timing for actions to address them. All development pillars need to be equally strong and consolidated, and their construction should rely on the third level (the development objectives) where activities need to be correlated across the strategic pillars - e.g., strong forestry management (under the fifth pillar) can be achieved only in close linkage with rural development (under the third pillar) and improved legislation (under the second pillar).
- Need to Integrate CAS Objectives with IMF and EU Programs - There should be a correlation between the first strategic pillar (promotion of economic growth) and agreements with the IMF (Stand-By Arrangement) and EU (Medium-Term Economic Strategy).
- Need for Political Resolve to Reform - Until now, the Government has taken only half-steps toward reform. This half-step approach has led only to losses of the resources involved and to incomplete reforms. Therefore some Romanians can see the cost of reform but not its benefits.
- Need for Greater Role for Civil Society in Romania's Development - The Government needs the support of civil society in order to succeed. The Government should therefore institute a communications program to explain to citizens how they can benefit from Government's actions, in order to enlist their support for these reforms. Equally, there will be more public support for reforms if the public sees that the Government considers itself accountable to the Romanian population for delivering on the reform agenda. This accountability should be formalized through more than just the next round of elections. Specifically, periodic evaluations of the

implementation process should be available to the public, and civil society should collaborate with the Government in the design of this monitoring system. The Government should also work with civil society as a partner for achieving Romania's development objectives (e.g., in regional development). One way to formalize this partnership, as well as to reinforce accountability, would be to make each Ministry's existing State Secretary responsible for Parliamentary relations, also responsible for the Ministry's relations with civil society. In parallel, civil society needs to take more responsibility for Romania's development, and not wait for the Government to devise all of the solutions. Given their prestige within Romanian civil society, religious leaders might consider how they could play a larger role in this regard than they typically have in the past.

- Need for Change in Romanian Mindset – A change in the Romanian mindset is needed if the country is to succeed in (i) institutional reform to strengthen the rule of law (the first strategic pillar), (ii) shifting from a supply-driven to a demand-driven, client/customer service-oriented economy, and (iii) building a proactive society in which civil society and the private sector take initiatives on their own and in partnership with the Government, rather than expecting the Government to solve all problems. This requires, inter alia, adult training and new approaches in curricula for school-age children. The Government should enlist the private sector as a partner in this endeavor.
- High Case is Only Option - Of the three lending scenarios, only the high case should be considered, as it is the one which corresponds to the Government's program aimed at accelerating economic growth. The other scenarios would mean giving up any hope for improvement in Romania.

Romania's Development Agenda

Much of the feedback focused on the different elements of Romania's development agenda as portrayed in Figure 1 (the Roman temple) in the draft CAS, with the two outcomes of poverty reduction and EU accession supported by five strategic pillars, which in turn are underpinned by a number of development objectives. These specific comments are summarized below:

Poverty Reduction and EU Accession as Key Outcomes – There is widespread agreement that poverty reduction is critical, and time is of the essence – not only if the poor are to survive, but also if Romanian democracy is to survive. Some feel that the only meaningful outcome is poverty reduction, from which EU accession will naturally follow. Others feel that the key outcome of poverty reduction should be replaced with economic growth (currently shown as the first of the five strategic pillars). One tends either to see economic growth as the means by which to achieve poverty reduction, or poverty reduction as a by-product of the ultimate objective of economic growth for its own sake.

Five Strategic Pillars – Most of those who commented on the draft CAS consider the first two pillars – promotion of economic growth and institution building to strengthen the rule of law – to be the most important. There is consensus that institution building to strengthen the rule of law is a prerequisite to economic growth, and therefore more urgent in terms of sequencing multiple priorities. There is general agreement that the other three pillars – greater access to opportunity, strengthening of the social safety net, and natural resource and environmental protection and sustainable development – are valid as well, but there is somewhat less of a sense of urgency with regard to them.

Development Objectives – The feedback on the development objectives is discussed below, correlated to the relevant Strategic Pillar:

- *Promotion of Economic Growth*

- A consistent and forceful message in the electronic feedback is that both the Government and the Bank should specifically and urgently address the need to mitigate against the exodus of Romania's educated young adults to economies with higher salary opportunities (the "brain drain"). It is stressed that one of Romania's greatest assets is its human capital, particularly its young people; yet too many are leaving the country for better opportunities in Western Europe or North America. A critical mass of this intellectual elite is needed back in Romania. The Government should create incentives for them to return to work not only in the private sector, but in the public sector as well. Specific proposals include establishing Romania's first public administration and management university program, a system of post doctoral scholarships, and a national program of research grants in academic centers of excellence.
- The new Government needs to compensate for its predecessors' delays in reforms by accelerating long overdue actions in areas critical to spurring economic growth, namely, financial sector reform, enterprise reform, and utilities reform (including demonopolization). Otherwise, the majority of Romania's assets will remain in the public sector as a drain on the Government's budget, and economic growth will continue to be at best slow, or yet again negative. At the same time, programs need to be implemented to facilitate the reabsorption into the workforce of labor dislocated by these structural changes.
- Much of the feedback focuses on the need for growth promotion as a vehicle for job creation. Job creation is seen as a national priority, especially in economically depressed regions such as the Jiu Valley, e.g., through tourism development. (A specific project proposal has been posted on the eCAS website's discussion space for the Government and Bank's consideration.) This in turn will require investment in infrastructure and environmental clean-up, for which the local population should be hired to the maximum extent possible. It is also stressed that job creation will facilitate pension reform and health sector reform.

- The Government should ensure that the size of the fiscal deficit is tied to the rate of economic growth, so that the gap between the two is not inflationary.
- The private sector should play an active role in the development of market mechanisms. There are many actions the private sector could take on its own, without Government involvement or intervention, but this will require the private sector to organize and mobilize itself for this purpose. The Government should work with the private sector as its partner in furthering the transition to a market-based economy. To that end, the Government should establish professional, non-political agencies to deal with the business community and to engage in active dialogue and consultation.
- Support for the development of small and medium-sized enterprises (SOEs) should not take the form of the excessively generous facilities included in the 1999 law for SMEs, as these run counter to a market economy.
- The Government should foster partnerships between academia and the private sector to engage in applied research in strategic areas where Romania has competitive advantages.
- Strengthening of the business environment should include the establishment of a public agency similar to the Small Business Administration in the U.S., which makes small loans to qualifying start-up firms.
- The private sector should be allowed to take the lead in infrastructure. For example, water treatment and supply should be privatized.
- The following should be added to the list of development objectives aimed at promoting economic growth: (i) stimulation of investment, particularly foreign direct investment (FDI), which will create jobs; (ii) formation of capital markets; (iii) nurturing of the information technology (IT) and e-commerce sectors (e.g., through the establishment of a "technology park"); (iv) development of the leasing market; (v) improved corporate governance, including better accounting and audit standards, training and effective enforcement; (vi) strengthening of the agriculture sector; and (vii) improvement of Romania's image, including through innovative use of the worldwide web.
- *Institution Building to Strengthen the Rule of Law*
 - To attract FDI and to stimulate the development of Romania's private sector, the country's legal framework must be stabilized and corruption significantly reduced. Anti-corruption efforts should be concentrated initially on a few specific areas with the potential for "quick wins" – e.g., registration of cars, registration of firms.
 - The private sector, especially the foreign investment community, is part of the corruption problem, to the extent that they pay bribes to public officials.

- Decentralization, anti-corruption policies, and elimination of bureaucratic red tape are critical to both private sector development and efficient use of public resources. This will require significant capacity building. With respect to decentralization, capacity building should include training of local officials in management, project development, and proposal writing.
- Enforcement of tax collection should be a high priority, not only to strengthen the rule of law but also to increase the resources available for public investment and provision of public services -- particularly in rural areas, where taxes are generally not collected and the lack of public services contributes to rural poverty.
- It is widely agreed that protection of property rights is of utmost importance, not only as part of strengthening the rule of law but also as a prerequisite for private sector development and agricultural and rural development.
- Labor courts should be established.
- Feedback emphasizes the need for political reform, particularly in two respects. One is that the national political culture should embrace more readily the spirit of compromise, in order to move the country away from contentious fragmentation and the resulting paralysis. The other is that politicians should be required to disclose the sources and amounts of their political contributions, in the interest of transparency. Equally, legislation to eliminate perceived and real conflicts of interest of public officials is needed.
- *Greater Access to Opportunity*
 - Rural development is very important, particularly in terms of EU accession.
 - Priority should be given to ensuring Romanians' access to quality healthcare. Particularly vulnerable are children in rural areas. Paramedic training is proposed.
 - It will be extremely important to eliminate the current constraints to the mobility of Romania's workforce. This will require more fluidity in the real estate market, better infrastructure (especially transport), and affordability of transportation costs (whether for commuting or for relocating) in relation to one's wages.
 - Improved quality of education is important, particularly in rural areas, where students rarely progress to secondary or higher education. It is noted that only 2-3% of university students are from rural areas. Roma children are also generally excluded from the education system, especially after grade 4. In addition to policy reforms and school construction and rehabilitation, education reforms should include training for teachers in rural areas and community awareness raising.

- *Strengthening of Social Safety Net*

- There is widespread support for the reinstatement of pension reform, to which the Government should give high and urgent priority, for a number of equally significant reasons. One is that the current pension scheme is an unsustainable fiscal burden leading to macroeconomic vulnerability and instability. It is postulated that if tax rates were lower, tax revenue would actually increase because more firms would enter the formal economy, which would strengthen the Government's fiscal position and thereby move Romania closer to a high-case scenario. A second and related reason is its importance to SME development. With tax rates so high in order to cover the Government's pension obligations, many SMEs are forced into the gray economy. Third, pension reform is critical to reducing poverty among the elderly population.
- Social assistance programs need to be reformed in order to provide incentives for the unemployed to rejoin the workforce. Currently, a person's social assistance payments are often higher than his or her potential wages would be, if employed. This results in the perpetuation of unemployment. In addition, social assistance needs to be better targeted, to ensure that it goes to those in most need rather than to those who are most vocal about their need.
- Priority should be given to training of social service providers.
- The Government has created too many child welfare agencies since 1996. This has made collaboration with NGOs extremely difficult. Family social services should be strengthened with the aim of preventing, and reducing the incidence of, child abandonment. Staff of state-run institutions need training. A three-way partnership among the Government, the private sector, and NGOs needs to be strengthened to address the needs of children infected with HIV (mainly due to contaminated medical procedures).
- Consumer protection should be included as a development objective.
- *Natural Resource and Environmental Protection and Sustainable Development*
- Anti-pollution enforcement should be so effective, and penalties for violations of environmental regulations so severe, that a non-compliant firm would no longer be financially viable.
- Policies for pollution control and for biodiversity conservation need to be mutually reinforcing.
- Biodiversity conservation should be integrated with policies relating to restitution of land. Otherwise, there is great risk of deterioration of Romania's natural resources during the land restitution process.

- Romanians need better access to information about the EU's environmental standards.

Client Survey

Eighteen months prior to the CAS consultations, the Bank conducted a client survey as input to the CAS. There were nearly 600 respondents (an 80 percent response rate), including Government officials, private sector representatives involved in Bank projects, journalists, and non-Governmental organization (NGO) representatives. The survey was conducted by an independent private organization, to ensure professionalism and confidentiality. The results indicated that (i) the Bank should engage in wider participation and consultation in project preparation and overall policy dialogue; and (ii) the Bank should take a more active role in the areas of business environment and institution building aimed at strengthening the market economy. The CDF process and this CAS are intended to be responsive to this feedback, by emphasizing consultation and the development themes identified.

Romania and the EU Grant Programs

PHARE

The *PHARE* program was launched in 1989, following the collapse of the communist regimes in Central and Eastern Europe. It is intended to help these countries reconstruct their economies. Originally, it assisted only Poland and Hungary, but it has gradually been extended to cover thirteen Central and Eastern European countries today (Albania, Bosnia-Herzegovina, Bulgaria, the Czech Republic, Estonia, Former Yugoslav Republic of Macedonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia).

For the period 1995-99, funding under PHARE totaled roughly EUR 6.7 billion and covered 15 sectors, the main five of which were:

- infrastructure (energy, transport, telecommunication);
- development of the private sector and assistance for businesses;
- education, training and research;
- environmental protection and nuclear safety; and
- agricultural restructuring.

At the same time, PHARE is the main financial instrument for the pre-accession strategy for the ten Central and Eastern European countries (CEECs) which have applied for membership of the European Union. Since 1994, PHARE's tasks have been adapted to the priorities and needs of each CEEC.

The revamped program with a budget of over EUR 10 billion for the period 2000-2006 now has two specific priorities, namely, institution building and financing investments.

Following the proposals put forward by the Commission in its Agenda 2000 communication in July 1997, new forms of pre-accession aid have been added to that already provided by PHARE. These are:

- aid to agriculture (*SAPARD*); and
- structural measures to bring the level of environmental protection and of transport infrastructure development in the applicant countries closer to that of the European Union (*ISPA*).

SAPARD

The *Special Accession Program for Agriculture and Rural Development (SAPARD)* aims at helping CEECs implement the *acquis* related to the common agricultural policy, and at supporting the competitiveness of the sectors concerned, job creation and sustainable economic development in rural areas. The measures financed for this purpose focus on investment in farms, improving the processing and marketing of agricultural and fishery products, developing and improving rural infrastructure, developing and diversifying economic activities, particularly with the aim of creating alternative sources of income, renovating and developing villages, and protecting and conserving the rural heritage.

Priority is given to operations designed to improve the effectiveness of the market, quality and health standards, with attention being paid to environmental conservation. The SAPARD instrument has been allocated EUR 150 million for Romania annually through 2006.

ISPA

The Instrument for Structural Policies for Pre-accession (ISPA) is the European Commission's instrument for helping the ten CEEC candidate countries to adapt to the EU environmental and transport rigors in the view of accession. The Community assistance granted under ISPA contributes to the objectives laid down in the accession partnership agreements for each beneficiary country, and to corresponding national programs for the improvement of the environment and of transport infrastructure sectors. ISPA contributes to the funding of environment-related projects including waste management, air pollution or water supply, as well as to the development of railways, roads, ports and airports, taking into account requirements for sustainable transport. ISPA has an annual budget of about EUR 1 billion, of which around EUR 230 million are for Romania.

RICOP

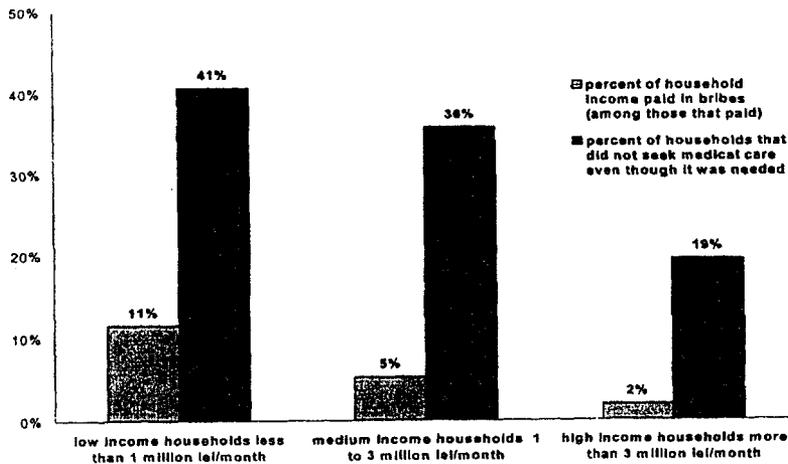
The *RICOP* is the European Union's grant program aimed at providing budget support for costs associated with restructuring, job creation, initiatives for encouraging employment, financing micro-businesses, social mitigation measures (including severance pay), and technical assistance. The initial RICOP allocation of EUR 100 million for Romania in late 1999 expired on March 31, 2001, with only 0.5 percent of it actually disbursed, due to limited absorptive capacity. Negotiations for a second allocation are planned.

Source: European Commission

Corruption in Romania

Two recent World Bank studies shed light on the problem of corruption in Romania. The report, *Anticorruption in Transition—A Contribution to the Policy Debate*, unbundles corruption into two conceptually distinct forms of corruption: (i) “administrative corruption,” defined as corruption surrounding the implementation of laws, rules, and regulations; and (ii) “state capture,” defined as corruption that affects the actual design of laws and regulations themselves. Both forms of corruption have pernicious effects on growth and equity alike. Based on a cross-country survey of over 3,000 enterprise managers in 22 transition countries, the report provides a comparative perspective on the severity of both forms of corruption for businesses. Among Central and Eastern European (CEE) countries, the survey suggests that Romania has relatively high levels of administrative corruption. The level of state capture was not as high as reported in several other CEE countries but was notably higher than in the more advanced reformers.

Recognizing the need to address the problem of corruption, the Government of Romania requested the World Bank to prepare a diagnostic study of corruption. The report, *Diagnostic Surveys of Corruption in Romania*, was based on interviews with some 1,800 enterprise managers, public officials, and households. The survey results confirm the perception of widespread corruption throughout many governmental structures, and also show that a large number of Romanians—public officials, enterprise, and households—experience corruption firsthand. Enterprise managers also report being significantly affected by various forms of state capture. More than four in ten enterprises said their firms were significantly affected by the corrupt misdirection of parliamentary votes to support narrow interests. Although state capture has many sources, the surveys indicate that non-transparent candidate and party financing plays an important role in supporting capture. Firms that make political party contributions were significantly more likely to engage in state capture and more likely to pay bribes generally.



Note: The left bar includes only those households which reported paying bribes and reported the amounts of those bribes and overall household income. Sample sizes were 19, 68, and 54 households. The right bar shows the percentage of households that did not seek medical care even though it was required. Sample sizes were 98, 143, and 82.

The level and pattern of corruption impose significant costs detrimental to Romania's development. Besides the well-known disincentive for investment and growth, corruption has a disproportionate impact on the poor. Since unofficial payments often mimic flat taxes, the poorest households pay a larger share of income in bribes than the wealthier households. While the regressive nature of unofficial payments may be the most visible way that corruption hurts the poor, it is by no means the most worrisome impact on the poor. The impact that corruption has on access to key services, and the unaffordability of unofficial payments for the poorest, may lead those that need state assistance the most to go without. For example, the poorest households were significantly more likely to go without health care treatment, even if it was needed, than those more fortunate.

Addressing administrative corruption and state capture will require a broad-based program that brings transparency and accountability to political life and to public administration. Although the needed reforms may meet with resistance, the experience of other countries shows that progress can be made. Slovakia has recently passed a law guaranteeing the public free access to all state information that is not specified in legislation to be secret, while a Slovak NGO has prepared a brochure to inform public officials how to comply with requests. Latvia has developed an anticorruption program focusing on prevention, education, and enforcement that has been sustained through several changes in Government. Poland has enacted reforms that eliminate the politicization of civil service appointments. Lithuania has successfully used income and asset declarations to remove allegedly corrupt officials from their positions.

The climate for reforms is positive in Romania. The new Government is putting anti-corruption initiatives and other public administration reforms high on their agenda. And if the CDF and CAS consultations are any indication, the Romanian public is eager to hold the Government accountable for results in this area. Developing a comprehensive, monitorable anticorruption program will help to improve the efficiency and quality of government services and strengthen trust in political and state institutions.

Sources: World Bank, 2000, *Anticorruption in Transition—A Contribution to the Policy Debate*; World Bank, 2001, *Diagnostic Surveys of Corruption in Romania*. The surveys on which the former report was based were undertaken in cooperation with the European Bank for Reconstruction and Development. The surveys on which the latter was based were undertaken in cooperation with Management Systems International, an implementing partner of USAID.

Ethnic Minorities

Romania is an ethnically diverse country, with significant populations of ethnic minorities. Ethnic Hungarians constitute approximately seven percent of the population. Romania has the largest Roma population in Europe, estimated at between 1.5 and 2 million people, or eight to ten percent of the total population. Estimates of the size of the Roma population vary significantly. Household surveys and censuses often do not distinguish respondents by ethnicity, and even when ethnicity is included, a range of issues arise, including undersampling of areas where Roma are likely to reside, difficulties in locating and identifying populations which may not be officially registered, and problems with self-reporting.

The socioeconomic status of the Roma minority poses one of the most significant development challenges for the country. Despite the dearth of quantitative information, there are growing indications that the living conditions of Roma have deteriorated since the collapse of communism in 1989. Results from the Romania Integrated Household Survey (RIHS) indicate striking levels of poverty among the Roma, in comparison with other groups. For three survey years (1995-97) the poverty rate among Roma was significantly higher than that among other population groups, and reached 79 percent in 1997, in comparison with the national poverty rate of 31 percent. Conversely, ethnic Hungarians have lower poverty rates than the national average.

	% of Survey Population (1997)	Poverty Rate				Poverty Depth		Poverty Severity	
		1995 (%)	Share	1997 (%)	Share	1995	1997	1995	1997
Romanian	89.8	24.5	87.4	29.7	86.6	6.1	7.3	2.2	2.7
Hungarian	6.8	22.8	6.1	28.4	6.0	5.7	6.7	2.2	2.3
Roma	2.3	76.4	5.4	78.8	6.3	28.2	33.2	13.1	17.1
Other	0.3	23.5	1.1	32.6	1.1	6.4	8.9	2.6	3.6
Total	100.0	25.3	100	30.8	100	6.4	7.9	2.4	3.0

Source: Romania Integrated Household Survey, 1995 and 1997.

Note: The poverty line is 60 percent of adult equivalent consumption. Population percentages differ from estimates above due to undersampling and low self-reporting of minorities.

Poverty among Roma is related to a complex combination of interrelated factors. Educational attainment is low relative to other population groups, and recent survey data suggest that these gaps are increasing. The share of the Roma population that had not completed basic school education (grades one through eight) grew from 36 percent in 1994 to 44 in 1998. As a result of low education status, Roma were frequently among the first to be laid off at the outset of restructuring, and have faced significant barriers to labor market reentry because of low skills and discrimination. In both rural and urban areas, Roma communities are frequently concentrated in settlements with poor infrastructure and lacking basic utilities such as water, sanitation and electricity. Because of quasi-legal housing arrangements, some Roma lack the documentation necessary for enrolling in school and claiming social assistance and health benefits.

Roma women face dual challenges arising from their ethnicity and gender, although information on this population group is limited. Because of early childbearing (sometimes before age 15) and substantial family responsibilities, Roma girls tend to drop out of school earlier than their male counterparts, and hence are less equipped for the labor market. Roma women have heightened health risks stemming from poor reproductive health, including high numbers of closely spaced births, inadequate prenatal care and poor nutrition. There is also some evidence that Roma women are increasingly involved in prostitution and are at higher risk of sexually transmitted diseases, including HIV/AIDS. This is an area where further analysis is needed.

Over 70 percent of street children are Roma. Roma boys are disproportionately represented within the juvenile delinquent population, as poverty and sometimes outright discrimination drive them to petty crime. Those adolescents who end up on the streets are more likely to engage in male prostitution and be exposed to sexually transmitted diseases.

The new Government has taken some initial steps toward addressing the conditions of the Roma. A Sub-Secretariat for Roma Affairs has been established within the Ministry of Public Information, and is charged with drafting a strategy for the Government. The Ministry of Education has also undertaken important steps, including adopting anti-discrimination policies and reserving places for Roma in secondary and university education. The EU is closely monitoring the status of Roma as part of the political criteria for accession, and is providing support for community-based projects through the PHARE program. The Bank will support social inclusion by ensuring that issues of ethnicity are addressed appropriately in its operations, especially through its financing of projects in the education and social protection sectors.

CDF Findings in Romania

CDF consultations were held in Bucharest as well as various locations around the country in 1999 and 2000. There were more than 500 participants: leaders of industry, labor, academia, religion, the media, other parts of civil society, and local and national Government officials, as well as members of the political opposition – some of whom are now in the newly formed Government. Widespread consensus emerged around the following themes regarding Romania's development constraints and priorities:

- Frustration with the legal framework and public institutions: A top priority among union leaders and management (of both public and private enterprises) was restitution of property and better protection of property rights. There was also broad agreement among all participants that the legal framework is in need of repair. The approval of emergency ordinances by the Cabinet, while often more expeditious (and on which Bank operations have come to rely), creates confusion vis a vis the legislative authority of Parliament. It also leads to an unstable legal environment where laws often change, as well as inconsistencies among various laws such that citizens do not know which law pertains. In addition, the enforcement of laws is often uneven (e.g., tax collection) or non-existent. There was widespread frustration with bureaucratic procedural requirements, e.g., for establishing and maintaining a private firm. There was also a general perception that the provision of public services is more politicized than professional, and that anti-corruption measures are needed. Participants felt that all of these factors create risks which discourage private investment.
- A keen desire to become "Western" via EU accession, but also a lack of understanding of the requirements: A driving ambition for virtually all participants was for Romania to become a member state of the EU. However, there did not seem to be an equally pervasive understanding of what would be required of Romania to attain this goal. The focus was more on the higher standard of living, democratic society, and good governance associated with EU accession, and less on the implications for current vested interests and the interim dislocations that such social and economic transition would entail.
- An urgent need to improve access to opportunity: There was general agreement that the Romanian standard of living needs to be improved, and that this could happen only with significant public investment in education, health, infrastructure, and rural development.
- Frustration with Romania's poverty in the midst of "natural wealth": Participants consistently lamented that while Romania at one time was known in Europe and beyond for its agricultural production, quality furniture carved from its high-value forests, and natural beauty (particularly at locations on the Danube and Black Sea), and continues to have high potential in these areas, Romania now seems unable to exploit these opportunities and is a poor country.
- The need to take risks and a plea for knowledge transfer on how to adapt production to market demand: There was a widely held view that Romanians are technically very competent and that their experience with a state-dominated economy at least provided them with an understanding of design and production from a technical standpoint. However, they appreciate that a market-oriented economy requires additional expertise

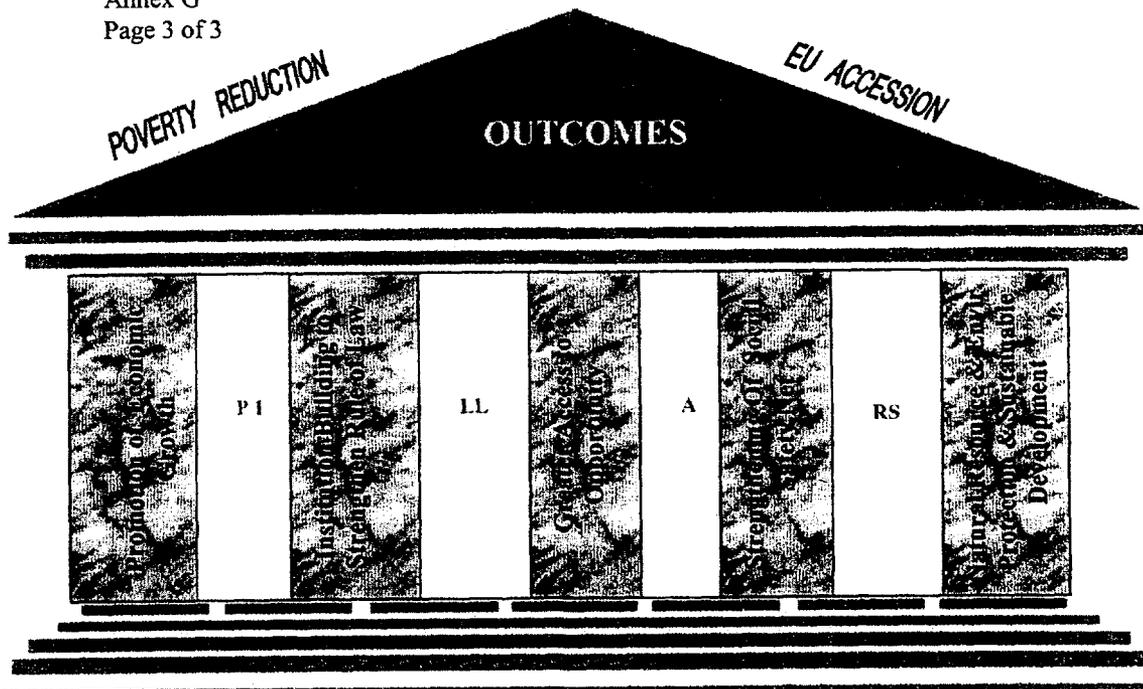
which they lack, inter alia an understanding of market forces, how to adapt production to cater to market demand, and how to access information about markets. Equally important, they recognize that a change in attitudes is needed to facilitate the risk-taking that private sector commercial activity requires.

- A legacy of distrust that impedes partnerships: Romania's oppressive past, and its pre-transition regime shrouded in secrecy and betrayal (it was not uncommon for citizens to pass incriminating information about persons close to them to the Secret Police), have left the country with a legacy of distrust. There is a distrust of Government, in part for this reason but also because the public's expectations for the economic transition have not been met. Many people are worse off now than they were before the transition. Romania's major political parties, of which there are nearly a dozen, do not collaborate effectively when they form a coalition Government. There is no shared ideology that allows them to form natural alliances. Instead parties resemble interest groups and alliances are determined more on an opportunistic and therefore temporary basis. This adds to a distrustful environment, in which political leaders know that party alliances are unstable. It is therefore more difficult for political consensus to emerge within either the legislative or executive branches of Government. The legacy of distrust also makes business partnerships difficult to form, both within the private sector and between the private and public sector. This hinders private sector development.
- Continued reliance on Government despite distrust of it: Despite their readily acknowledged distrust of Government, participants consistently made it clear that they expect the Government to solve their problems. They typically did not recognize the ability that they might already have as private citizens or as private sector firms to mobilize and to act on their own behalf. The participants generally did not feel empowered to improve their situation and instead felt it was up to the Government, i.e. the same Government they distrust. Social capital and public activism are weak.

The above themes translate to a development agenda summarized in the schematic diagram below, in which the two major desired outcomes are poverty reduction and EU accession. These are to be achieved through the promotion of economic growth, institution building to strengthen the rule of law, greater access to opportunity, strengthening the social safety net, and natural resource and environmental protection and sustainable development.

ROMANIA'S DEVELOPMENT AGENDA

Annex G
Page 3 of 3



DEVELOPMENT OBJECTIVES

- | | | | | |
|---|--|---|--|---|
| <ul style="list-style-type: none"> • Macro Stabilization • Structural Reform of Financial Sector, Capital Markets, Enterprise and Utilities Sectors • Strengthening of Business Environment • Public/Private Sector and Private Sector /Academia Partnerships • Incentives to Stop "Brain Drain" • Private Participation in Infrastructure and Energy • Investment in National Transport Systems | <ul style="list-style-type: none"> • Curtailed Corruption • Government Transparency and Accountability • Elimination of Red Tape • Political Reform • Public Administration and Civil Service Reform • Civil Society Participation • Objective, Stable Judicial & Legal Framework • Decentralization of Government • Local Capacity Building • Restitution of Property and Protection of Property Rights | <ul style="list-style-type: none"> • Redeployment of Dislocated Labor • Equitable Access to Education • Creation & Sharing of Knowledge through IT and Public Awareness Campaigns • Health Sector Reform • Investment in Local Infrastructure • Rural Development • Outreach to Ethnic Groups • Economic & Social Equity for Women • Promotion of Social Capital through Community – Based Development | <ul style="list-style-type: none"> • Improved Child Welfare • Pension Reform • Effective, Targeted Delivery of Social Assistance & Services • Improved National Preparedness for Natural Disasters | <ul style="list-style-type: none"> • Strengthening of Forest Resource Management • Toxicity Management - Crisis Management - Site Liability/ Clean-Up Mechanisms • Biodiversity and Natural Resource Conservation • Harnessing of Renewable Energy Resources • Improved Energy Efficiency • Anti-Pollution Regulatory Framework & Enforcement |
|---|--|---|--|---|

Barriers to Romania's Business Environment

There are a number of administrative barriers to the registration and operation of private enterprises in Romania. Examples cited in a recent report by the Foreign Investment Advisory Service (FIAS) include the following:

Company registration. Company registration is based on an "Operations Approval" document obtained from the Mayor's Office. To obtain this document, enterprises must present as many as eight different prior approvals (sanitary, electric network connection, natural gas hook-up, environmental, prevention and extinguishing of fires, sewer system connection, water management, and thermal network hook-up) The process is therefore extremely time-consuming. Also, special licenses are often required at the company registration stage, and obtaining these licenses is usually a time-consuming process since procedures are not always clearly established. Typically, the firm must first obtain a registration approval in principle, to be submitted to the trade registry. After business registration the firm must apply for the actual license, authorization, or approval from the same Ministry. Also, while many special licenses are justified on the grounds that they are required for activities that affect public health and safety (food and drug production and distribution, transportation, and construction, water and waste water treatment), many others such as tourism are not.

Tax registration, assessment and payment. Tax registration is cumbersome. It requires unnecessary steps such as a pre-approval by the General Department of Public Finance (GDPF) in the form of a certificate and substantial original documents that duplicate those required by the Trade Registry. Tax assessment and payment are also fraught with problems. Accounting principles and methodologies are not clear and change constantly. Payment procedures are time-consuming and require a vast amount of paperwork.

Labor regulations. Romania's labor regulations are reasonably consistent with those of other countries in the region. However, the Ministry of Labor issues new regulations frequently, many of which are confusing and inconsistent with prior regulations in effect. Employer reporting requirements are substantial. Workforce reporting is required every time an employee's status changes (e.g., from part-time to full-time), and employers must do so within a certain number of days after the change has occurred. To report, the employer must submit three copies of labor contracts to the local Chamber of Labor. Monthly reports providing proof of payment of contributions to the Social Protection Fund, Unemployment Fund, and Health Insurance Fund are also required. Employers must pay a monthly commission of 0.75 percent of their total gross salaries to the Ministry of Labor to support the local Chamber of Labor. In addition, employers must pay 30 percent of their employees' gross monthly salaries to the Social Insurance Fund, five percent to the Unemployment Benefit Fund, seven percent to the Health Insurance Fund, and one percent to a risk and accident fund for disabled persons. Investors view these contributions, which sometimes add up to twice or more one's basic salary, as prohibitive.

Customs. Customs procedures have been rapidly modernized and are now in line with EU declaration procedures. Ninety percent of customs entry points have been computerized. Significant technical assistance and financial support from international and bilateral agencies have accomplished this. However, implementing the new procedures is proceeding slowly. Private companies complain that some of the systems put in place (e.g., drawbacks) have never worked, and there is a serious lack of information on customs procedures. Moreover, corruption of customs officials is perceived to be widespread (see Annex E). Finally, there appears to be overlapping and sometimes serious friction between customs authorities and other state officials such as the Economic Police (of the Ministry of Interior) or the Financial Guard (of the Ministry of Finance), which confuses investors and disrupts the collection of tariffs.

Land purchase and registration. Most of the land suitable for new investment still remains in the public domain (under the control of ministries, local authorities, and state-owned enterprises) and is difficult for private investors to access, either through purchase or long-term lease. Privately owned land is easier to purchase, but the supply is limited. More importantly, the risk for investors purchasing land is very high due to the incomplete land registration and slow restitution process. Seventy percent of the land titles issued have been challenged in the courts.

Court system. Romania's court system is weak. Court procedures take about two years to complete and judgments are highly unpredictable. The courts for commercial matters are understaffed and insufficiently skilled. In 1998 about three-quarters of the judges were less than 30 years old. Officials often lack expertise in specialized commercial fields such as intellectual property issues. Corruption is reported to be a serious problem in the judiciary.

WBI Activities

The substantial involvement of WBI in Romania over the past two years has established a broad network of local partners providing a solid base for leveraging the outreach of training activities. More than 300 participants attended WBI training in the areas of intergovernmental fiscal relations, decentralization, civic association and participation, investigative and business journalism, urban and city management, health and pension reform, social funds, financial sector, and capital markets. Looking forward, WBI plans to increase its efforts to bring cutting-edge knowledge by using new dissemination technologies such as distance learning via internet and videoconference. This should provide opportunities for learning from other countries' experiences. WBI activities will continue to give priority to human development issues by offering training and policy workshops in the areas of health financing, education reform, pension and social protection.

WBI's governance program will continue to include work with parliamentarians, civil society, and public officials to attain concrete impact at the country level. The focus of the program centers on effective use of public resources and on implementation of rules, regulations, and policies, at the national and sub-national level. To strengthen the linkages between corporate responsibilities and sub-national governance, WBI will continue to provide training in decentralization, local Government finance, corporate governance, and business ethics. The Financial Sector Learning Program will cover topics such as the banking system, capital markets, financial sector policies, insurance and contractual savings, and rural and micro finance. These planned activities will support the promotion of economic growth and the creation of an enabling environment for private sector development.

While most WBI programs would be triggered only under a high case lending scenario, there are two exceptions. One is WBI's work on environment – the Clean Air Initiative and the Environmental Compliance and Enforcement Program – that aims at contributing to the objective of protection and sustainable management of natural resources and the environment. The other is the Street Children Initiative, that involves local NGOs and partner organizations in strengthening the institutional infrastructure and capacity for improving the opportunities of the most vulnerable.

Vol. II of II

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**BEFORE THE UNITED STATES DEPARTMENT OF COMMERCE
INTERNATIONAL TRADE ADMINISTRATION**

IN THE MATTER OF:)
)
CARBON AND ALLOY SEAMLESS)
STANDARD, LINE, AND PRESSURE PIPE)
(UNDER 4 1/2 INCHES) FROM ROMANIA)
)

**COMMENTS REGARDING THE NON-MARKET ECONOMY
STATUS OF ROMANIA FILED ON BEHALF OF BETHLEHEM STEEL
CORPORATION, NATIONAL STEEL CORPORATION, AND
UNITED STATES STEEL CORPORATION**

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November 8, 2002

EXHIBIT J

CORPORATE GOVERNANCE IN ROMANIA



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PREFACE

The issue of corporate governance has risen in prominence over the last decade, as the role of the private sector has increased around the world. In OECD countries, there has been substantial reform to improve the corporate governance framework. Financial crises in emerging markets, and a long transition process in many countries from plan to market, have made clear the relevance of good corporate governance as a key structural and institutional feature of a functioning market economy. This has been true in Romania, which had no private corporations at the beginning of the last decade, but now has a large corporate sector producing over sixty percent of Romanian's GDP and employing the majority of its workers.

Good corporate governance ensures that companies use their resources more efficiently and leads to better relations with workers, creditors, and other stakeholders. Most importantly for a transition economy like Romania, good corporate governance enhances the confidence of domestic and foreign investors. It is an initial prerequisite for attracting international investment, especially the patient capital needed for sustained long-term economic growth.

The Organization for Economic Co-operation and Development (OECD) pioneered the development of policy standards for corporate governance. In 1998, at the recommendation of the OECD Council, the OECD established an Ad-Hoc Task Force on Corporate Governance to develop a set of corporate governance principles. Adopted in 1999, the *OECD Principles of Corporate Governance*¹ have become the global benchmark for corporate governance reform. Admitting that no one model of corporate governance can work for all countries and for all companies, the OECD Principles identify standards that can apply across a broad range of legal, political and economic environments. The Principles are intended to assist governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries. They also provide guidance for stock exchanges, investors, corporations and other parties that have a role in the process of developing good corporate governance.

As part of a broad co-operation agreement between the OECD and the World Bank to assist in the improvement of corporate governance worldwide by using the principles as a standard, regional Roundtables on corporate governance have been established in Russia, Latin America, Asia and Eurasia. A similar Roundtable has also been established in South East Europe (SEE) in conjunction with the Stability Pact in 2001. In this context, the OECD, with the support of USAID, developed a specific program to improve corporate governance in Romania. The objectives of the OECD/USAID Romanian corporate governance effort were to:

- Evaluate corporate governance in Romania;
- Offer a set of key recommendations for improving corporate governance in Romania and bring it closer to the international standard of the OECD Principles
- Identify needed technical assistance in the area of corporate governance;
- Improve the understanding of present corporate governance practices in Romania, informing the international community about progressive national reform initiatives;
- Facilitate full Romanian access to the ongoing international dialogue on corporate governance.

These objectives are the key drivers of the present *Report on Corporate Governance in Romania*. A draft version of this Report was discussed at a high-level policy meeting on Corporate Governance in Romania held September 18-19, 2001 in Bucharest. The meeting was co-hosted by the Bucharest

¹ The Principles as well as other documents related to corporate governance may be found at www.oecd.org

Stock Exchange and the National Securities Commission. It brought together the leadership of the Stock Exchange and the Securities Commission with prominent members of Romania's business and financial communities and academia, trade union representatives, and senior experts on corporate governance from Romania and OECD member countries, as well as government officials. Immediately following the meeting, September 20-21, the SEE regional corporate governance roundtable was also launched in Bucharest with the participation of private and public sector experts from a number of countries in the region.

The Report has been finalized on the basis of comments and presentations offered at the meeting, as well as written comments. The meeting provided a crucial forum to discuss Corporate Governance in Romania, and has had a great impact on the final report.

The key Recommendations of the report constitute a comprehensive agenda for reform. The Recommendations not only emphasize legislative changes, but also underline the importance of reform in the areas of enforcement, institution building and private behaviour/capacity building that are necessary for improved corporate governance in Romania.

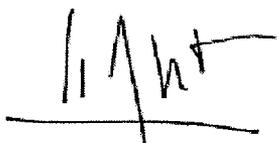
Part One of the Report gives a comprehensive picture of the current situation of the corporate sector in Romania, and the process of transition that created it. Part Two examines the main aspects of the regulatory environment for corporate governance. In each case, the legal provisions are compared with current practice in order to assess the institutional framework's effectiveness and identify shortcomings that should be dealt with. The *OECD Principles of Corporate Governance* are the benchmark against which regulations and current practice are evaluated.

We would like to extend our sincere appreciation to the Bucharest Stock Exchange and the National Securities Commission, our co-hosts for the meeting on Corporate Governance in Romania in Bucharest, whose help was critical for the successful outcome of the meeting and hence this Report. We would also like to thank the Government of Romania for agreeing to co-host the final presentation of this important Report in December 2001.

This report was produced by the Corporate Affairs Division of the OECD and is a part of the program of work of the OECD Center for Cooperation with Nonmember Economies. Aurelian Dochia was the principal Romanian consultant.

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RECOMMENDATIONS

Overall Reform Priorities

As recognized in this report, during the complex process of transition Romania has taken several important steps to improve the legal and regulatory underpinnings of corporate governance. These efforts have made extensive use of both national and international expertise and have resulted in broad familiarity with the issues involved. A company law, which was introduced in 1990 and to a large extent meets internationally accepted standards, and a similarly solid securities regulation which was issued in 1994, are two examples. Over the last few years, the desire to improve corporate governance in Romania has also increased considerably; an ambition that was clearly seen during the consultation and drafting phases of this report. One example is the listing requirements for the newly created Transparency Tier of the Bucharest Stock Exchange (BSE), which include higher standards of corporate governance.

In assessing the strengths and weaknesses of Romanian corporate governance today, **it is recommended that top priority be given to reforms that will improve effective implementation and enforcement of existing laws and regulations.** As recommended below, priority should be given to ensure that the National Securities Commission has sufficient independence and resources to carry out its mandate. It is also urgent to increase the capacity of the judicial system to deal with commercial disputes, and to ensure the integrity of Romanian accounting and auditing practices. Progress in the area of implementation and enforcement will depend on a mix of measures, such as training and capacity building on the one hand, and institution building on the other. As results may take time to emerge, it is important that changes are initiated immediately if Romania is to catch up with international developments.

Top priority should also be given to facilitating the emergence of a strong private sector in Romania with an effective ownership and control structure. This will not only increase corporate productivity but also create sound domestic and international demand for good corporate governance. Concretely, this calls for immediate measures to intensify privatisation efforts and to facilitate delisting of many of the small- and medium-sized companies presently listed on the Romanian exchanges.

The third area of priority is prevention of expropriation by controlling shareholders and/or managers. As noted in the more detailed recommendations below, this should include effective enforcement of shareholder rights with respect to changes in share capital and the introduction of control mechanisms to prevent abusive related party transactions. The Stock Exchange should participate in these efforts and, building on the newly created Transparency Tier, immediately initiate the development of a voluntary code, which should be tied to listing requirements.

1. Ownership Structure

1.1. Privatisation efforts should be intensified and include a program to improve corporate governance in the National Companies.

In spite of numerous reforms, the management of the National Companies remains politicized and inefficient. Privatisation is therefore the best solution to improve their overall performance. However, a poor corporate governance record has sometimes made it more difficult to find buyers for these companies. It is reasonable to assume that improved corporate governance practices will facilitate placement, and ensure a higher valuation and better access to capital for these firms.

OECD member governments have made great efforts in reforming their state-owned firms in the process of privatisation. Their experiences could provide Romania with some guidance regarding the reform of the national companies. Some important steps include the transfer of

control from the ministries to professional boards with commercial objectives and the institution of performance-enhancing compensation combined with high standards for management (see recommendation 6.2). It is also important that public policy priorities are clearly defined in legislation and exercised via regulation rather than ownership. This would allow for a substantial reduction in the number of enterprises that require some sort of state ownership.

1.2. Ownership in most of the small and medium-sized listed companies should be consolidated, and the companies delisted.

Mass privatisation resulted in more than 5,000 public companies listed on the Romanian over-the-counter trading system (RASDAQ). Currently, a vast number of these companies are de facto insolvent, with no prospects of their shares being traded. Consequently, ownership should be consolidated and these companies delisted. However, Romanian creditors face extreme delays when attempting to restructure or liquidate insolvent companies. Bankruptcy procedures must therefore be streamlined, accelerated and conducted with less bias for corporate incumbents. Where a company can be restructured its creditors should be allowed to agree on restructuring as quickly as possible without undue administrative, or other, obstacles.

The privatisation process also led to extremely dispersed ownership in individual companies, with ten million Romanians becoming shareholders. While the RASDAQ has facilitated some concentration for those companies that are effectively solvent, many of them still have very large numbers of shareholders. This ownership structure makes it almost impossible to monitor management or controlling interests, resulting in very poor treatment for minority shareholders. These companies also face large administrative burdens for being publicly listed, burdens that will almost certainly increase as the standards for shareholder treatment and transparency and disclosure are raised. Regulating and monitoring such a large number of companies imposes a burden on the National Securities commission that exceeds any potential benefit.

In order to facilitate ownership consolidation and delisting, regulation should provide for incentives for the controlling interests in listed companies to buy out dispersed shareholders through a fair and equitable system of tender offers. This could include the development of a 'squeeze out' procedure, to be initiated by the company or shareholders, when the fraction of shares held by minority investors falls below a certain threshold. This would be a mandatory buy out of minority shareholders at a price set through a fair and independent appraisal of the share's value. The independence of the assessment should be confirmed either by shareholder agreement/consensus or by an independent authority. This process may also include the establishment of an independent authority to assist in consolidating claims.

2. Enforcement and Implementation

2.1. The capacity of the judicial system to effectively deal with commercial disputes must be strengthened.

The judiciary has had great difficulty in dealing with the very rapid growth of commercial litigation that has occurred since the end of central planning. Politicization, insufficient training, lack of experience and precedent and a shortage of resources have all plagued the system, leading to long delays and sometimes questionable judgments. Strengthening the judicial system should be an essential element in Romanian corporate governance reform, given that it underpins many of the recommendations listed in this report.

Successful reform of the judiciary will require a number of steps. Priority should be given to the following: (a) The training of lawyers and judges in commercial law and procedures,

especially with respect to bankruptcy and company law. Multilateral and bilateral assistance could play an important role in achieving this. (b) The compensation of judges and other court personnel should be increased to ensure the education, experience and integrity required for the position. (c) Greater specialization of the judiciary should be encouraged. (d.) Court written opinions and decisions should be made public to increase public awareness, facilitate interpretation of the law and enhance the accountability of the legal system. (e.) An effective mechanism to counter corruption in the judiciary should be put in place.

2.2. The public and private redress mechanisms for shareholders must be improved and include the use of professional arbitration and collective shareholder action.

Due to an overburdened and inefficient judicial system shareholders that seek legal redress experience delays and costs that in the vast majority of cases exceed the value of their shares. This discourages shareholders from seeking redress when their rights are abused.

As a remedy, it might prove useful if the stock exchanges provide for professional arbitration mechanisms to settle disputes between companies and shareholders. Improving the legal redress mechanisms for shareholders could also include allowing low cost collective action through shareholders' associations or other collective institutions, and allowing the Securities Commission to file lawsuits on behalf of shareholders, provided that sufficient resources are made available for this function.

2.3. Parliament should ensure that the National Securities Commission has the independence and resources necessary to fulfil its mandate, including the supervision of the self-regulatory organizations.

The National Securities Commission is headed by five commissioners appointed by the parliament, which also approves its budget on an annual basis. As a consequence of a long and expanding list of responsibilities, the resources of the National Securities Commission are generally strained. Part of these responsibilities includes the supervision of the self-regulatory organizations (SRO), which have often failed to assume their responsibilities, adding to the work load of the Commission. In addition, the division of responsibility between the National Securities Commission and other authorities is not always clear and the commission is sometimes seen to be subject to political influence.

Effective enforcement on the part of the National Securities Commission requires budgetary stability, regular staff training, including exchange of expertise with similar institutions regionally and worldwide, competitive salaries and adequate facilities. Commissioners should be appointed and carry out their functions on the basis of professional merit and their respectability in financial markets. The commission must demand the highest ethical and professional standards of the SROs. In particular, the National Association of Securities Dealers must be provided with incentives to improve its performance and credibility sufficiently to allow it to qualify again for SRO status. Technical assistance programs could be initiated in order to identify the weaknesses and needs of the SROs

2.4. Listing requirements should stipulate disclosure of compliance with a Voluntary Corporate Governance Code

A Voluntary Code of Corporate Governance is an important part of successful corporate governance reform, having the advantage that it can be developed and implemented independently of the legislative process. Building on earlier efforts in Romania, such as the recently established requirements for listing on the Transparency Tier, it is recommended that the BSE initiate the development of such a code in close cooperation with investors and issuers and all other relevant parties.

Disclosure of compliance with a Voluntary Code should ultimately be required for listing on certain tiers of the BSE. Disclosure of compliance should also be required by the RASDAQ when and if it develops a 'top tier'. Those institutional investors backed by international development agencies -- including the EBRD, IFC, and USAID -- as well as the Financial Investment Companies (SIF), could also take into account compliance with the code when making investment decisions. The Code should require high standards with respect to transparency and disclosure, and should be consistent with the *OECD Principles of Corporate Governance*. It should focus primarily on the duties of directors and what they can do to improve corporate governance, including the recommendations of this report.

3. The Rights and Equitable Treatment of Shareholders

3.1. Changes in share capital must be approved by shareholders, respect preemptive rights, and be priced in a manner consistent with a fair and independent assessment of the company's value.

Abusive capital increases are all too common in Romania, and the rights of shareholders to approve such changes and to exercise their preemptive rights have frequently been circumvented. Dubious means have sometimes been used to price new shares for certain buyers, with the effect of diluting existing shareholders. The most common and severe abuses include the use of nominal book value in a hyperinflationary environment, and in-kind contributions where the value of the contribution was grossly inflated.

Good corporate governance requires that a general shareholder's meeting must approve any change in the capital structure. The meeting must follow all the stipulated procedures, including requirements for notification and attendance required for general shareholder meetings. In announcing the general meeting, it must also be made clear that the meeting will consider a change in share capital, and the terms of that change. Once a change has been approved, the pre-emptive rights of shareholders must be honored. If they are not, the new issue should be null and void. 'In-kind' contributions for share capital should not be allowed and joint stock companies should not use nominal book value as a basis for pricing new shares in the context of a capital increase. Since the stock market value of Romanian companies is often an ineffective means for valuation, it is important to develop and increase the use of independent assessments of a company's share value.

3.2. Control mechanisms must be put in place to monitor and prevent abusive related party transactions.

Controlling interests, such as majority shareholders and management, have repeatedly used abusive transactions to extract value from the company at the expense of minority shareholders. Such practices fundamentally violate the principle of equitable treatment of shareholders.

To inhibit such practices, major transactions that involve a substantial part of the company's assets should always be approved by the general shareholders meeting. In all other transactions, regardless of size, managers and board members should be obliged to disclose any potential conflicts of interest before the decision is made. In the case of a conflict of interest, the manager or director should not participate in the decision. Conflicts of interest may arise in transactions with a party who is affiliated with a member of the board, management, and their relatives or close associates. Conflicts of interest are also likely to occur when elected officials or cabinet members serve on the boards of business corporations. All major transactions, and all transactions that include conflicts of interest, should be disclosed to shareholders.

3.3. Shareholders, including institutional investors, should be encouraged to increase their participation in the corporate governance process.

The great majority of shareholders play no role in the corporate governance process of the companies they own. This reflects both the very small stakes that most shareholders possess, as well as an underdeveloped equity culture. Raising the awareness of the shareholding public is therefore an important condition for improved corporate governance. It is recommended that educational and public awareness programs be initiated in order to allow for a better understanding of corporate governance issues. International institutions could play an important role by supporting such programs that should also include active participation from journalists and media representatives. Initiative could also include assisting companies and investors in organizing proxy voting.

Institutional investors play a much smaller role in Romania's capital market than in other transition economies that have experienced voucher based mass privatisation. In order to contribute to an improved corporate governance culture in Romania, institutional investors, including foreign investors, should be encouraged to formulate and make public their ownership policies, especially with regard to voting in the general shareholder meeting. Institutional investors must also strive to improve their own corporate governance practices, especially with regard to transparency.

3.4. Techniques designed to prevent shareholder participation in the general meeting must not be allowed, the notification period for the meeting should be extended and the decisions of the meeting should be implemented.

The general shareholders meeting is the company's ultimate decision making body, vested with the authority to decide on fundamental issues including the composition of the board of directors and the use of corporate profits. In order to facilitate the proper running of the general meeting, it is recommended that a Best Practices Guide be developed for use as a reference manual for listed corporations and shareholders.

Some Romanian companies have established onerous identification requirements, and complicated 'share registration' schemes in order to restrict shareholder participation in the general meeting. It is imperative that all practices that limit the legal right of shareholders to participate in any meeting be abolished.

Though the rights of shareholders to be notified of, and informed about, the general meeting are generally respected, the short notification period makes it difficult for shareholders to be fully informed and prepared for the meeting. To allow shareholders to be properly informed and prepared, the currently required 15-day notification period should be extended to at least 30 days.

Non-payment, or delayed payment, of agreed dividends is a frequent abuse, which is aggravated by Romania's recent history of high inflation. Dividends should be paid promptly, within 60 days. More generally, shareholders should be able to force the implementation of the decisions of general meetings through accelerated court procedures, such as interim measures.

4. The Role of Stakeholders in Corporate Governance

4.1. Romanian companies should put in place governance mechanisms that ensure familiarity and compliance with outstanding legislation related to the rights of stakeholders.

While the censors are formally charged with monitoring compliance with Romanian law, it is not clear whether they have been successful in fulfilling this role. The division of responsibility for the company's external obligations needs to be well-defined, with clearly assigned responsibilities amongst company organs. It should be the ultimate responsibility of the board to assure that such a structure is put in place. From a stakeholder perspective, examples may include company officials dedicated to following developments in areas such as shareholder rights, creditors rights, labor law, or environmental law.

Also, in areas where stakeholder interests are not legislated, companies may find it useful to explicitly address stakeholder issues of concern to international investors. The environmental record and labor relations of companies are two areas that may be of particular concern.

4.2. Greater protection must be given to employees and others that reveal illegal or abusive practices of a company's board and management.

Lacking other means to communicate their concerns, employees in Romanian companies have sometimes felt the need to make internal corporate practices public in order to protect the rights of themselves and others. Currently, such 'whistle-blowers' may find themselves unemployed and in some cases in physical danger. Not only is this a serious violation of civil rights, but better protection of those that point out severe corporate misconduct would provide an important check on bad corporate governance.

4.3. Creditors' rights must be honored, especially with regard to bankruptcy procedures.

In spite of some improvements in recent years, protection of creditors' rights is not satisfactory in Romania. Bankruptcy procedures are especially problematic with delays and a general bias in favor of existing management, making it extremely difficult for creditors to exercise their rights with respect to insolvent companies. Bankruptcy procedures should be expedited, and conducted without bias.

4.4. Effective consultation and communication with employees must be established.

Employees have the legal right to be informed of, and consult the board regarding, labor-related issues. Not only is such consultation required by law, it also provides the board with a potentially useful source of information regarding labor relations and other company matters.

The legal right of employee representatives to consult the board and receive certain information regarding company policies affecting the work force should be respected and enforced. During the privatisation process, for example, authorities should assure that labor and other interested parties are consulted. It is important that the parties involved in these consultations use them as a constructive tool in the process of corporate restructuring and privatisation.

5. Transparency and Disclosure

5.1. In order to ensure the integrity of accounting and auditing, institutional and organizational structure in Romania needs to be strengthened.

Transparency and disclosure is one of the weakest areas of corporate governance in Romania. Investors and the public often do not trust the information that companies provide. To increase credibility, systemic changes between companies, accountants, auditors and their professional bodies, and the government must be instituted.

It is the responsibility of the government to license auditors and regulate the audit process. It is imperative that this is done in a fair, efficient and independent manner, with the interest of protecting the public. Certain responsibilities should be delegated to the audit association provided they follow International Standards of Auditing (ISA) as promulgated by the International Federation of Accountants (IFAC).

While the government has the duty to watch over the accounting and audit profession, the profession and its self-regulatory bodies must also provide support in the form of an infrastructure that assures: (a) the quality and availability of relevant training; (b) appropriate testing and certification of accountants and auditors, and; (c) an internationally recognized Code of Ethics for the profession. Based on international criteria, the profession should also establish a process of quality control and review of Auditors and Audit firms and pursue close cooperation with international accounting bodies such as IFAC and The Fédération des Experts Comptables Européens (FEE) and participate in relevant international fora, including the South East Europe Program for Accountancy Development (SEEPAD).

5.2. Romanian accounting standards must be improved and continue their transition to International Financial Reporting Standards (IFRS).

Romanian law currently requires large companies to transfer their accounts to IFRS by 2005. This transition is critical both to the overall improvement of standards of transparency and disclosure, as well as attracting the interest of foreign investors. Simplified accounting standards for small- and medium-sized companies should also be IFRS based.

Currently, financial and other important information is often reported with significant delays and in a opaque manner. Accounting practices must be improved with respect to content and timeliness. For example, financial statement notes should include schedules of accounts and loans receivable, and accounts and loans payable, indicating how past due they are. The likelihood of collection in the case of accounts and loans receivable should also be indicated. Consistent with recommendation 3.2, related party transactions should be fully disclosed in the financial statements. In the event there are no related party transactions, management and auditor should make an affirmative note of such. Consolidated accounts for business groups should be improved

5.3. Companies should improve the disclosure of their ownership and control structures.

Holding companies and offshore corporations are increasingly being used to conceal the controlling parties in companies and transactions. Such arrangements are often used in conjunction with abusive related party transactions. Both domestic and offshore beneficial owners, or combination thereof, holding over 5% of the shares should be disclosed to the National Securities Commission and the public through the annual report. Sanctions and penalties should be imposed for violations.

5.4. Listed companies must disseminate accurate financial and non-financial information in a timely manner to appropriate agencies, shareholders, and the public at large.

Company information is currently being disseminated in a limited and opaque fashion. The weakness of internal financial controls in Romanian companies raises questions about the quality of information that is disseminated. This impacts not only shareholders and other interested parties, but also raises doubts about the credibility of the corporate sector in general.

To provide accurate information for both internal and external use, internal audits should be conducted by an internal auditor and/or audit department under the direct authority of the audit committee, consistent with recommendation 6.4. Current and complete financial information should be posted on the Web and made available to the public at the same time as information is provided to the Securities Commission. The Annual Company Report should include all relevant corporate governance financial and non-financial information

5.5. The potential liability of outside auditors should be increased and enforced to ensure their independence and integrity.

Auditors in Romania are sometimes seen as pawns of the companies they audit. This reduces the credibility of the whole profession, and raises doubts about the veracity of information provided by companies.

Auditor's liability should be defined more clearly, increased and enforced. The audit association should establish monitoring and enforcement committees that will investigate misconduct and impose sanctions for member violations. The existence of such committees however, does not remove the right to involve the judicial system in disputes. The government needs to retain authority and actively prosecute businesses and auditors for criminal and civil violations.

6. The Responsibilities of the Board

6.1. Legislation should clearly stipulate that the Boards' duty is to serve in the interest of all shareholders.

For the board to function properly, board members must act in the interest of *all* shareholders, not the controlling shareholder or some group of shareholders. The directors' duty of loyalty to all shareholders should be well-defined and specifically sanctioned in the Company Law.

Effective evaluation and monitoring of the Board's work requires that their collective and individual liabilities are clearly defined. While current Romanian law seems strong in this respect, its complex nature provides for numerous exceptions which prevent board members from being held liable by shareholders. For example, a shareholder cannot take action against a board member until it has been determined that the shareholder's general meeting *will not* collectively take action against the board member. Improved corporate governance requires that the collective and individual liability of board members in Romania must be clarified in such a way as to allow effective redress by shareholders.

6.2. Board members should be enabled to carryout their duties in a professional and informed manner.

For board members to properly fulfil their responsibilities, and not merely act as a tool of the majority shareholder and/or management, they must have adequate qualifications and information on the company. It should be clearly stated that management is obliged to provide all relevant information to board members.

Given the limited number of qualified and experienced board members in Romania, a Director's Institute could be established in order to enhance board professionalism. Business schools in Romania and abroad, as well as donor-supported technical assistance, could play an important role in developing the Institute. In addition, the present legal restriction that limits board members from serving on no more than three boards could be relaxed in the interest of using the limited number of capable and experienced board members more efficiently.

Given the many potential areas of conflict, companies should refrain from having on their boards directors who simultaneously hold elected offices or are members of the cabinet. Such practices are not compatible with board professionalism. In the longer term, civil servants should also be precluded from serving as directors. The state should appoint independent professional outsiders to look after its ownership interests. In any event, remuneration for sitting on the board of state-owned firms should be very limited in order to avoid disincentives regarding the privatisation and proper governance of state-owned enterprises.

6.3. Companies should have a sufficient number of independent directors

Independent directors -- i.e. non-executives who are not related to the company or the controlling shareholders -- are rarely found on Romanian boards, and are not currently required by law or listing requirements. This is partly due to the general lack of experienced board members, and is still a serious problem, since independent judgement is a critical factor for the quality of board decisions. Therefore, listing requirements should require a minimum number of independent directors.

6.4. The effectiveness of the Board should be strengthened through the use of specialized committees, including an audit committee, to replace the Censors.

Specialized board committees are rarely used in Romania. This tends to diminish both the role and the competence of the board, and increases their dependence on management. Such specialized Committees should be established, especially an Audit Committee and a Remuneration Committee. These committees should have a majority of independent directors who are not members of the Directors Committee if the latter exists.

The Censors Committee, which is supposed to provide certain auditing and compliance monitoring functions, has been largely ineffective, and has further weakened the board by creating confusion regarding the relative responsibilities of the two bodies. In conjunction with the creation of an Audit Committee, the role of the censors must, therefore, be clarified. Eliminating the Censors Committee and replacing it by the Audit Committee is a possible solution, consistent with recent international best practice.

6.5. The board and board members should operate in a fashion that is transparent, and consistent with the intentions of the general meeting. This includes the nomination and remuneration of directors.

While Romanian law has provisions requiring that shareholders be informed and involved in the nomination and remuneration of board members, as well as having the right to see minutes of board meetings and other rights to information, in practice crucial information regarding board behavior is not provided and the intentions of the general meeting are sometimes subverted. For example, while a board member's compensation must be approved by the general meeting, the approved amount can be augmented by 'bonuses' and adjustments that are not approved by shareholders. The process by which board members are nominated is also generally opaque, and shareholders are rarely given information about the nominees before the general meeting. This effectively transfers of the nominating process from shareholders to management.

All shareholders should, in a timely manner, be adequately and effectively informed about board nominees and their qualifications. Procedures for nomination should be included in legislation. To prohibit undue deviations, the remuneration of board members as decided by the general meeting should be verified by external auditors and disclosed in the financial statements of the company. The right of shareholders to have access to board meeting transcripts and other relevant information should be effectively protected.

What is Corporate Governance?

Throughout the report, “corporate governance” is given the sense proposed in the OECD Principles, i.e.

- a set of relationships between a company’s management, its board, its shareholders and other stakeholders;
- the structure through which the objectives of the company are set and the means of attaining those objectives and monitoring performance are provided;
- the system of incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and to facilitate monitoring, thereby encouraging firms to use resources more efficiently.

Corporate governance standards and practices are instruments devised to address the specific problems that result from separation of ownership and control. Hence the report focuses on publicly traded companies, although occasionally reference is made to state-owned or privately held companies. “Publicly traded” companies are what the Romanian legislation defines as “open” companies.

How Does Romania Rank in Terms Of Corporate Governance?

According to the "Standards of Corporate Governance", a study published in February 2000 by SG Emerging Markets Equity Research, Romania ranked 7th in the ten emerging market economies surveyed for their corporate governance practices (see Table A). A breakdown by main elements of corporate governance reveals Romania's strong and weak points, compared with its peers in the Central and Eastern Europe (Table B). **The most problematic area is clearly enforcement.** The role of the board, and poor information for shareholders are also problem areas. It should be noted that the scores are based on best practices, i.e. the behaviour of blue chip companies, but standards vary widely for lesser grade companies.

Table A: Regional Rankings of Corporate Governance based on overall scores

Ranking	Overall score (out of 36)
Greece	32.5
Israel	32.5
Hungary	31.4
Turkey	28.2
Poland	26.0
Egypt	22.8
Romania	20.6
Czech Republic	18.4
Morocco	18.4
Russia	14.1

Table B: Breakdown of Corporate Governance results for the CEE Region

	Average	Poland	Russia	Romania	Czech	Hungary
■ Fair conduct of shareholders meetings	2	2	2	2	2	2
■ Insider trading effectively prohibited	0.8	2	-1	1	0	2
■ Directors' dealings published	1.4	3	-1	2	0	3
■ All capital changes announced with due warning and opportunity to participate	2.6	3	2	3	2	3
■ Extraordinary transactions carried out at transparent prices	1.8	1	1	2	2	3
■ Publication of results – regular and consistent quality	2.2	2	2	2	2	3
■ Independent audits	2.8	3	3	2	3	3
■ Equal access to information to all shareholders	1.8	2	1	1	2	3
■ Information on shareholding structure freely available	2.4	3	1	3	2	3
■ Role of the boards of directors	0.8	1	1	1	0	1
■ Effective enforcement of shareholders' rights in courts, etc.	-0.2	0	0	-1	0	0
■ Quality of access on visits	2	2	2	1	2	3
Overall (country average) score	1.7	2.0	1.1	1.6	1.4	2.4
Total score	22.1	26.0	14.1	20.6	18.4	31.4

Note: Scores range from -1, where is evidence of consistent, willful abuse, and 3, the best score.

Source: SG Research

PART I: THE CORPORATE GOVERNANCE ENVIRONMENT IN ROMANIA

The corporate governance environment in Romania is very much a product of the transition from central planning to a market economy. This includes the direct impact of that transition, through new laws, the development of new institutions, the creation of new firms and, very importantly, the privatisation process. It also includes the indirect impact in the sense that corporate governance reform was never the central focus of the remaking of the macroeconomic landscape, rather it has been a critical by-product of that process. Part I of the report discusses the main characteristics of corporate governance that have emerged in Romania over the last decade. Chapter 1.1 provides the macroeconomic background. Chapter 1.2 provides an overview of the corporate and financial sectors, and 1.3 discusses in more detail the economic transition of the last ten years. Chapter 1.4. presents some conclusions on corporate behavior and motivation and their implications for corporate governance.

1.1. THE GENERAL ECONOMIC CONTEXT

In 2001, eleven years after the collapse of the communist regime, Romanian GDP is still at around 75% of its 1989 level. At 41% in 2000, inflation is the highest among the Central and Eastern European countries. Due to lax policies and a chronic inability to collect revenues, the resulting fiscal deficit has led to a public debt which, although not high as a proportion of GDP, is very difficult to finance -- in 2001, one-third of the budget had to be dedicated to servicing the public debt. Unemployment, currently at 10.5%, is relatively low² and the fact that it never reached 12% in the last decade indicates that structural change has been slow. Consumption and standards of living have declined in general – the average wage is among the lowest in Europe.

In six out of the last ten years, GDP declined, in most cases by more than 5%. While the first “transformational recession”³ of 1990-1992 was the result of the “institutional interregnum” prevailing in the first years after the December 1989 Revolution, as well as a consequence of the collapse of COMECON markets externally, the second recession of 1997-1999 was due mainly to a “policy shock”⁴. In 1993, several key policy decisions (rise in the nominal interest rates, remonetization of the economy, unification of the foreign exchange market, and stricter control of base money) prompted a recovery peaking at 7.1% growth in 1995. Growth resumed in 2000, mostly on the back of record exports of over USD 10bn.

The trend in industrial output has generally mirrored GDP, with sharp declines (over 20%) in 1990-1992 and 1997-1999. With the exception of 1990, 1992, 1997 and 2000 (when climatic conditions should be taken into account), agricultural output has been fairly stable, despite land atomization resulting from the dismantling of the large cooperative farms, as well as the lack of a clear strategy in terms of government support. Final consumption rose during 1993-1996 but fell over 4% during 1997-1999.

² It should be noted that early retirement was extensively used as an alternative solution to unemployment. As a result, Romania has now more pensioners than employees, a serious strain on the social security budget.

³ The term was proposed by Janos Kornai.

⁴ See Daianu, *Structure, Strain and Macroeconomic Dynamic in Romania*, in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000..

Table 1 – Romania - Macroeconomic indicators

Indicators	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP, annual change, %	-5.6	-12.9	-8.8	1.5	3.9	7.1	3.9	-6.6	-5.3	-2.3	1.6
GDP structure, %											
- Industry	40.5	37.9	38.3	33.8	36.2	32.9	33.2	35.5	27.5	27.1	27.6
- Agriculture and forestry	21.8	18.9	19.0	21.0	19.9	19.8	19.2	18.1	14.6	13.4	11.4
- Construction	5.4	4.4	4.8	5.2	6.5	6.6	6.5	5.3	5.3	4.9	4.8
- Services	26.5	34.8	40.6	37.0	33.7	36.1	36.7	33.1	43.0	43.6	45.4
Exports as % of GDP	16.7	17.6	27.8	23.0	24.9	27.6	28.1	29.5	25.7	23.3	27
Current account surplus/deficit, mil. USD	-3,337	-1,012	-1,564	-1,174	-428	-1,774	-2,571	-2,137	-2,968	-1,288	-1,400
Private sector contribution to GDP, %	16.4	23.6	26.4	34.8	38.9	45.3	54.9	58.1	58.4	61.5	n.a.
The overall state budget surplus/deficit as % of the GDP	1.0	3.2	-4.6	-0.4	-1.9	-2.6	-3.8	-3.6	-3.3	-3.8	-2.7
GDP per capita at Purchasing Power Parity, USD	3,414	-	-	3,643	3,790	4,070	4,244	3,964	3,679		
Inflation, Dec./Dec. %	37.7	222.8	199.2	295.5	61.7	27.8	56.9	151.4	40.6	54.8	40.7
Unemployment rate, end of period	-	3.0	8.2	10.4	10.9	9.5	6.6	8.8	10.3	11.8	10.5
Net average monthly wage, USD	154	98	65	78	86	104	104	88	117	101	100
External debt, US mil.	230	1,143	2,479	3,357	4,546	5,482	7,209	8,504	9,308	8,709	9,555

Source: The National Commission for Statistics; National Bank of Romania

At the macroeconomic level, some structural changes are obvious. Industry and agriculture, which used to contribute more than 50% to GDP, now represent less than 40% of national production. The service sector has taken the lead, its contribution to GDP being over 45% in 2000 – a twenty percentage point jump since 1990.

On closer inspection however, the structural changes are less convincing. Inside the industrial sector few changes took place – most of the fixed assets in the economy remain captive and under-utilized in the large state enterprises that did little to restructure themselves. Agriculture, plagued by land ownership and land consolidation problems, is slow in finding efficient forms of production. As for the services sector, its larger share of GDP was due primarily to price increases: service prices were the only ones to rise more than the average rate of inflation throughout the decade.

With a quite active trade union movement, strong in the state-owned companies, the Romanian authorities feared radical restructuring measures and programs. Unemployment was relatively low and real wages sometimes increased without any relation to productivity. Unemployment peaked at 12% in 1993-1994, declined to 7% in 1996 (election year) and since then increased to around 11-11.5%. Still, most of the state-owned companies are overstaffed and more radical cuts will be needed in the process of corporate restructuring. But, as always, restructuring is more difficult during recession.

The principal structural change in the Romanian economy is the development of the private sector. In fact, the statistics on the contribution of the private sector to GDP are among the few indicators having a steady pattern of growth -- from 16.4% in 1990 to 61.5% in 1999 -- although in the period 1997-1999, progress was slower due to the impact of recession⁵. The private sector clearly dominates agriculture (over 90% of the value added), retail sales (over 90%) and commercial services to the population (around 70%), as well as construction and some forms of transport. The figure is much lower for industry as a whole (around 30% of value added), due in large part to the dragging privatisation process. With prices repressed through administrative controls before 1990, "corrective inflation" is regarded as an inevitable consequence of liberalization in all transition economies. However, in Romania's case, inflation turned into a chronic ill for more than a decade. The reduction in inflation from annual triple-digit rates in 1991-1993 to less than 33% in 1995 was the main achievement of the stabilization program of 1993-1994. However, the expansionary macro-economic policy pursued in 1995 led to a resurgence of inflationary pressures in the middle of 1996, which resulted in year-end inflation of 56.9% in 1996. In the first half of 1997, energy prices (kept artificially low since 1994) were adjusted to international levels which, coupled with the liberalization of the foreign exchange rate, prompted a new inflationary burst. Restrictive monetary and fiscal measures brought inflation down to 41% in 1998, 46% in 1999 and again 41% in 2000. The intricate cross subsidies system that made it difficult to estimate the social impact of price liberalization may be an excuse for the initial hesitations in adopting "shock therapy". However, inflation has persisted in large part thanks to the unwillingness to confront, and difficulty in financing, the loss-making state companies.

Currency devaluation is another major problem in Romania, closely related to that of inflation. Throughout the decade (with the exception of 1995 and 1999-2000), the National Bank of Romania (NBR) preferred a policy of real appreciation of the currency, supposedly to help control inflation. But such a policy had a perverse effect, as it discourages exports and deteriorates the external balance. Moreover, with relatively thin foreign exchange reserves, whose primary role was to provide credibility for debt servicing and foreign borrowings, the NBR has a limited capacity to intervene in the markets under the floating current exchange rate regime. This was painfully confirmed in 1998 when the NBR spent approx. USD 800mn. on a failed attempt to prompt the domestic currency.

In 1990, as a reaction to decades-long frustration accumulated under the communist regime and in an attempt to immediately improve standards of living, the Romanian authorities allowed for a 10% increase in imports, while exports were cut to 55% of their 1989 level. The COMECON trading block was dismantled in 1991, contributing to a further decline in Romanian exports. After 1990, Romania's trade deficit was constantly around USD 1bn., with both imports and exports increasing slightly each year. In 1994, Romania finally experienced a major upturn in exports. The restoration of the Most Favored Nation trading status by the USA, the European Union (EU) and CEFTA trade concessions, economic recovery in the West, as well as the discontinuation of the embargo against Yugoslavia all contributed to a great extent to the recovery in Romanian exports.

After 1996, as result of the removal of most import control quotas, imports soared to over USD 10bn., broadening the trade deficit to USD 2.5bn. in 1996 and 3.5bn. in 1998. The removal of import controls

⁵ For detailed statistics and comments on the particular features of the development of the private sector in Romania, see Dochia *New Private Firms Contribution to Structural Change in the Romanian Economy*, in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000.

increasingly exposed domestic producers to Western quality goods and products and it was only in 2000 that Romanian manufacturers succeeded in breaking the USD 10bn. exports threshold. Over two-thirds of foreign trade is now carried out with the European Union -- Romania became an associated member in 1993, and since 1997, it has become a full member of the Central European Free Trade Association (CEFTA). Export growth has been concentrated on items in which Romania can be expected to be competitive in the long run, such as textiles, clothing, shoes and furniture, followed by iron and steel, fuels and mineral oils, electrical equipment and appliances.

With the current account constantly running a deficit, Romania was in permanent need of foreign financing. The international financial institutions, primarily the International Monetary Fund and the World Bank, were the first providers of funds. Several agreements were concluded after 1990, and though none of them were carried out, they were nevertheless extremely important as they provided the outline for economic reform. At the same time, the IMF agreements paved the way to the international capital markets. In May 1996, Romania won its first credit rating from major international agencies (BB-minus by Standard and Poor's, and Ba3 from Moody's Investors Service) and was able to start raising funds on the external capital markets through several bond issues. The external debt went up steadily, from USD 0.2bn. in 1990 to USD 9.5bn. in 2000.

Considering the adverse macroeconomic conditions, the NBR was fairly successful in building up the foreign exchange reserve. After the drastic drain on the NBR's reserves caused in 1999 by large foreign debt servicing obligations (USD 3.25bn.), the reserve was brought to USD 1.5bn at the end of 1999 and increased to USD 2.5bn in 2000. After an initial period of accelerated devaluation in 1999, which restored the competitiveness of Romanian exports, devaluation followed inflation, with the gap between the two narrowing. According to the government's medium-term economic strategy, the national currency will continue to appreciate in real terms against the USD by 2-3% in the next 2-3 years.

In 1992, and 1994-1996, the budget deficit was over 4% of GDP. Inability to collect taxes from loss-making state-owned companies as well as a chronic inability to reduce public expenditure were the main reasons for consistently high budget deficits. After 1997, the situation improved slightly and slowly, with 1999 closing with a deficit of only 2.6% of GDP. Better control over state companies and restructuring measures in some sectors, such as mining, stabilized losses and reduced the need for subsidies. In 2000, an election year, the deficit "inflated" again to 3.7% of the GDP. As in the past, the deficit and the inflation figures are the government's constantly unmet targets and the center of negotiation hurdles with the IMF.

Moreover, quasi-fiscal operations also had a negative effect on the budget deficit. When the small private banks, DACIA FELIX and CREDIT BANK, failed, the government decided on rescue measures to prevent a systemic crisis which could spread to the two large state banks. The total cost of the operation is estimated to have been 8% of GDP. BANCOREX and BANCA AGRICOLA accounted for, respectively, 25% and 20% of the assets in the banking system and concentrated, respectively, USD 1.7bn and 0.75bn in terms of non-performing loans.. The rescue of the two state banks rendered NBR's sterilization efforts very expensive and difficult. The other banks in the system had to pay part of the price: the minimum reserve for banks increased up to 30%. As BANCOREX held 47% of the hard currency denominated loans in the banking system, its disappearance created significant pressure on the foreign exchange and money markets, and both interest rates and the exchange rate exploded in March 1997.

1.2. THE STRUCTURE OF THE CORPORATE SECTOR AND THE FINANCIAL SECTOR IN ROMANIA

1.2.1. THE CORPORATE SECTOR

As of 31 December 2000, 849,497 economic agents were listed with the Romanian Trade Register, out of which 812,381 were active from a legal point of view. The majority of these are either self-employed or family businesses, or closely-held small companies. Out of the 682,263 entities incorporated as firms, only 3% were organized as joint-stock companies (table 2.).

Table 2: Distribution of economic entities registered at 31 December 2000, by legal form of organization

Type of business	Number of entities
Total, of which:	812,381
Individual entrepreneurs (non-corporate)	130,118
General partnerships	29,806
Limited partnerships	1,
Limited partnerships by shares	4
Limited liability company	623,330
Joint-stock companies	23,016
Autonomous bodies (regies autonomes)	466
Cooperatives	4,273

Source: *Sinteza statistica, no. 109, edited by the Chamber of Commerce and Industries and the Trade Register*

It should be noted however that many companies are economically inactive: the National Statistical Commission records only 330,276 companies as being economically active in 1998⁶. The vast majority of these companies are small – 295,028 have less than 9 employees and only 2,588 have more than 250 employees. There are 12,422 active joint-stock companies.

Table 3: Distribution of active companies by size and sector of activity in 1998:

	Total	size, according to number of employees			
		0-9	10-49	50-249	>250
Companies, of which	330,276	295,028	25,626	7,034	2,588
Agricultural holdings	11,059	8,215	1,857	832	155
Industry, construction, trade and other services	318,376	286,265	23,565	3,140	2,406
Financial and insurance sector	841	548	204	62	27

Source: *The National Commission for Statistics, Romanian Statistical Yearbook, 1999, p. 400*

61% of the large (over 250 employees) active companies in industry, construction and trade are concentrated in the manufacturing sector, while small and medium firms are concentrated in trade and services. Around 10,000 small and medium sized companies are organized as joint-stock companies.

The private sector, which currently contributes more than 62% of GDP, is dominant in terms of numbers: 311,167 companies are private and in another 1,990 the state has less than 50% of the capital. The state sector, with most of the large enterprises, controls the largest portion of the share

⁶ The National Commission for Statistics, *Romanian Statistical Yearbook, 1999*.

capital in the country (Table 4). Indeed, private firms control only 30% of the share capital in the country and make

Table 4: Main economic indicators by company* size and ownership in 1998

	Number of companies	Share capital (ROL bn.)	Turnover (ROL bn.)	Gross investment (ROL bn.)	Gross Result (ROL bn.)
Total, of which	318,376	208,301	594,973	140,643	338
- dominantly private	313,157	61,820	405,508	50,035	8,680
Large (over 250 employees), companies, of which	2,406	173,307	285,694	110,510	-5,436
- private		37,079	106,377	23,136	2,335

Source: The National Commission for Statistics, Romanian Statistical Yearbook, 1999

* *Companies in industry, construction, trade and services*

35% of the gross investments. In spite of their limited resources, the private sector has achieved 68% of turnover. Moreover, the private sector offset the losses (-5436 ROL bn.) produced by the large state companies.

A first provisional conclusion that may be derived from the statistics is that only a small proportion of the approximately 12,000 business entities registered as joint-stock companies are potentially part of the "corporate universe" in terms of size, ownership patterns and organizational model.

In fact, one of the most striking features of the companies in Romania is that a majority even among the largest are closely held, i.e. owned by one or a few investors. The highest ranking by turnover are the state-owned energy and utility companies: PETROM SA (the integrated oil company); CONEL SA (e power production); TERMOELECTRICA SA (producer of thermal energy); SNTFM "CFR MARFA" and SNTFC "CFR CALATORI" SA (railway transport); ROMGAZ SA (gas production and distribution)⁷. Only one of the top ten companies (Automobile DACIA SA) is listed on the Bucharest Stock Exchange (BSE).

The situation is not much different when considering a larger pool. Although the 500 largest companies in Romania (by turnover) are now primarily private entities⁸, closely held ownership is also common for many of the most successful private businesses. Approximately half of the largest 100 private companies are "closely held" and only 13 of the top 200 are listed on the stock exchange. Closely held ownership structures are clearly preferred by foreign capital – many of the largest companies are 100% owned by a single foreign investor or jointly between a foreign and a local investor. It is also important to observe that greenfield investments, domestic or foreign, are more likely to have a closely held ownership structure, while companies with a more diversified ownership are almost always those resulting from the privatisation of state enterprises.

⁷ The TOP TEN according to the National Commission for Statistics, *Economic activity units 1998*, published 2000. Some of the largest companies have been reorganized in the meantime but they are still under the state control.

⁸ 1998 was the first year when the private companies in the turnover based top 500 outnumbered the state-owned entities.

In the end, it looks like neither company size nor the legal form of organization are determinant factors in shaping the corporate sector in Romania. Basically, the "corporate universe" is mainly composed of the 6000 or so small-, medium- and large-sized companies that went through the privatisation process and, as a result, have a diversified ownership. The largest companies in the country are still closely held, either by the state or by domestic or foreign investors.

1.2.2. THE STRUCTURE OF THE FINANCIAL SECTOR

The three segments of the Romanian financial sector -- banking, insurance and capital market -- are not very integrated because of differences in their historical developments and regulatory frameworks. While banking and insurance activities maintained a presence in the economy throughout the years of the communist regime, the market for securities was abolished for almost fifty years and had to be rebuilt from scratch in the 1990s. In 1990, reform of the banking system was perceived as a priority, while securities-related activities seemed to concern a relatively distant future. Three distinct regulatory bodies were created at different moments in time: the National Bank of Romania in 1991 for the banking system, the Insurance and Reinsurance Supervisory Office in 1991, and the National Securities Commission in 1994⁹. The system of three distinct regulatory bodies was well-adapted to the fragmented nature of the financial markets prevailing in the early 1990s; it was also in line with European practice¹⁰. Recently, under the influence of the reforms achieved or envisaged in other countries, Romanian officials launched the idea of creating a single regulatory body for the whole financial sector, on the British model. For the time being though, the initiative has not advanced beyond controversies in the press.

The reform of the BANKING SYSTEM was the first to be initiated in 1990, when a two-tier banking system was implemented. The National Bank of Romania (NBR) was created as an independent central bank, with the Governor and the Board of Administrators appointed by the Parliament for a seven year term. Its main objective stated in the law is to ensure the stability of the domestic currency in order to contribute to price stability. Apart from elaborating and implementing monetary, foreign exchange and credit policies, the NBR also has the role of licensing and supervising the banking system.

At the end of 2000 thirty-three banks were licensed to operate in Romania, in addition to seven branches of foreign banks. Twenty-one of the thirty-three banks have foreign capital, one bank is fully state-owned and another four have a majority of their capital in the state's hands. In spite of the rapid increase in the number of privately held banks, state owned banks are still the most important players in the system, with 43% of the capital base and 47% of the assets. The share in both capital and assets of the Romanian private banks has drastically fallen, while foreign capital banks spectacularly augmented their share from 15% of the assets and 27.5% of the capital in 1998 to 49.55% of the assets and 47.47% of the capital in 2000. The total assets held by the banking system are of more than USD 8.6bn.

The drastic structural changes that took place between 1998 and 2000 reflect two major events: the crisis and eventual collapse of several state-owned and private banks and the privatisation drive. Both resulted in a cleaner and much more solid banking system.

DACIA FELIX and CREDIT BANK, two of the largest private banks, were the first to signal the problems in the system in 1995. The reaction of the National Bank was hesitant and slow, but in the end it took measures to isolate the two ailing banks from the rest of the system. Bankruptcy procedures proved to be long and the intervention instruments controlled by the National Bank inadequate. As a

⁹ The corresponding legislation includes Law no 33/1991 on banking, Law 34/1991 on the Statute of the central bank, Law 47/1991 on insurance activities and Law 52/1994 on securities and stock exchanges. The initial legislation was amended for banking and insurance, but remained unchanged for securities and stock exchanges.

¹⁰ An overview of the current European financial regulation situation and reform, in *The Economist* 3 March 2001.

result, confusion persists even now regarding the resolution of the situation for these two banks. The following year the private COLUMNNA BANK followed the same scenario.

The crisis of the banking system reached its peak in 1999. In April, BANCA ALBINA was declared insolvent, followed shortly afterwards by news that BANKCOOP was unable to meet its obligations. In spite of these problems, their impact on the system was limited because all these banks were relatively small. The shock came when problems surfaced in two of the largest state-owned banks, BANCOREX and BANCA AGRICOLA, which accounted for, respectively, 25% and 20% of the assets of the banking system. While smaller private banks failed because of large-scale fraud and embezzlement, the failure of the state banks resulted from a chronic misallocation of resources and poor performance in the real economy. BANCOREX and BANCA AGRICOLA held USD 1.7bn and 0.75bn, respectively, in terms of non-performing loans. Fear that the collapse of the two banks might have systemic consequences prompted the authorities to decide on a rescue plan. USD 1.5bn of BANCOREX's bad loans were transferred to the public debt, USD 0.6bn were spent on an eventually unsuccessful recapitalization and USD 0.3bn was guaranteed for problem loans issued by the state. When BANCOREX merged with the Romanian Commercial Bank, BANCA AGRICOLA's restructuring was more successful. The first recapitalization occurred in 1997, when some ROL 2,700bn worth of non-performing loans were transferred to the Assets Resolution Agency (AVAB), to clean the bank's balance sheet. In the end, the Austrian REIFFEISEN BANK acquired a majority stake in a smaller but clean BANCA AGRICOLA.

Although 1999 was the worst year for the banking system, 2000 also had its problems. BANCA TURCO ROMANA-BTR was the most promising and fastest growing bank and one of the blue chips on the Romanian stock exchange. After rapid expansion in 1998 and 1999, mostly in terms of balance sheet items (assets, loans, placements in T-bills and interbank deposits as well as source-deposits), the bank was confronted with massive deposit withdrawals starting in October 2000. Investment in IT and network expansion that led to low net profits both in 1998 and 1999 only partially explained the bank's problems. Rumors about illegal operations in favor of the main shareholder and finally the Turkish crisis in 2001 contributed to the aggravation of the situation. The National Bank is expected to take a decision soon on BTR's future.

Another potential problem for the financial system is the credit cooperatives. They hold deposits of around ROL 4,000bn (USD 186mn) and previously did not fall under the supervision of the central bank (NBR) or other regulatory bodies and were not covered by the Deposit Guarantee Fund (DGF). In 2000, after the collapse of the largest credit cooperatives, and panic surrounding most of the others, the NBR decided to introduce stricter regulations, which forced these institutions to clarify their situation and to continue their activities as non-banking institutions under the supervision of the NBR, to apply for a banking license or be liquidated. According to NBR, from the 925 cooperatives in existence at the end of December 2000, 820 have submitted files to NBR to become credit houses grouped into 10 networks. None of them has submitted applications to become a commercial bank.

The successive failures of banks and the strain on the whole financial system prompted the Romanian authorities to be more diligent in privatizing some banks. The French group SOCIETE GENERALE acquired a controlling stake in the ROMANIAN BANK FOR DEVELOPMENT. The State Ownership Fund sold 45% of BANC POST to a consortium composed of GE Capital (35%) and BANCO PORTUGUES DE INVESTIMENTO (10%). The banking system is in much better shape now. As a result of stricter banking regulation and supervision procedures adopted by the National Bank, the solvency ratio for all the banks improved from 10.25% in 1998 to 22.13% in September 2000. The proportion of non-performing loans decreased from 14.5% in 1998 to 0.7% in 2000 (excluding provisioned loans). Higher provisions, however, led to reduced profits with a ROA at the end of 2000 of 1.46%, while ROE declined from 21% in March 2000 to 13.2% in December 2000.

The INSURANCE industry had relatively smooth and continuous development since 1991, when the first legislation was passed, providing for the de-monopolization of insurance activities. The single state insurance company, ADAS, was split into two companies, ASIROM and ASTRA, and the door was

opened for new entrants. In spite of the soft regulatory stance prevailing in the initial phase, the insurance sector had fewer and less spectacular failures than the banking sector. At the end of 1999, 72 insurance companies have been licensed, with a share capital of ROL 1,011bn. (USD 55mn.) and assets of more than ROL 6,077bn. (over USD 330mn.).

The CAPITAL MARKETS, which are reviewed in detail in the annex, were the only segment of the financial sector that started from scratch. Basic notions like capital, shares, and stock exchanges, had to be reinvented. Everybody had a lesson to learn -- the authorities, the companies, the investors and entrepreneurs -- and sometimes they did it the hard way. No crisis has spared the capital markets. The first Ponzi scheme (called CARITAS) inflated until becoming a USD 200mn. mass phenomenon. When it broke up in 1993 the shock-wave menaced the financial system and had the political system shivering. The development of the mutual funds industry outran the legislative framework. When, in 1996, the newly created Securities Commission imposed prudential regulations in calculating the net asset value for investment funds, the largest fund, SAFI/FMOA, suffered a severe correction. Confronted with massive withdrawals it eventually collapsed, smashing investors' confidence in the burgeoning capital market. After several years spent regaining investors' confidence, the industry was again hit by a new scandal: the collapse of FNI (the National Investment Fund) in April 2000. For the first time, the National Securities Commission was held responsible and commissioners, including the president of the Commission, were arrested.

Securities and Stock Exchanges legislation was adopted relatively late, in 1994, and the newly created National Securities Commission gradually assumed a regulatory and supervisory role. In a very short period of time, the whole infrastructure for securities trading was put in place, including both the Bucharest Stock Exchange and the over-the-counter RASDAQ trading system. Designed with a substantial contribution from Western advisors, the Romanian capital markets infrastructure is well adapted to its task under its basic aspects and even, under its technical aspects, is very advanced. From a regulatory perspective, the system evolved mainly through the norms issued by the Securities Commission; Law 52/1994 has remained basically the same since its adoption.

On 20 November 1995 the BUCHAREST STOCK EXCHANGE resumed operations¹¹ as a self-regulated body under the supervision of the Securities Commission. The Bucharest Stock Exchange has all the traditional departments of similar institutions: trading, listing and membership. In addition, the BSE has departments dedicated to auxiliary services including clearing, registration and settlement. A company is listed on the BSE upon request, provided that it meets certain criteria. Two sets of listing criteria have been established: for high-grade companies, listed on the first tier of the Stock Exchange and for lower-grade companies, listed on the second tier of the exchange. There is also an 'unlisted' tier. The first tier companies can be considered the 'blue chips' of Romania¹².

The BSE is responsible for monitoring all market activities in order to ensure compliance with the law and regulations, minimize market volatility and protect investors. To enforce discipline and ensure investors' protection, the BSE can downgrade and delist companies, and suspend brokers from trading. Until recently, the Stock Exchange was hesitant in imposing sanctions and many violations of the rules and regulations were disregarded. However, after serious frauds were discovered, the Executive Committee of the BSE has taken a firmer stance.

In December 2000, the market capitalization of the Bucharest Stock Exchange (BSE) stood at 2.9% of GDP, among the lowest market capitalization in Central and Eastern European countries. Bulgaria, with a capitalization of 1.2% of GDP, is the only country in the region comparable to Romania. Since its inception, the BSE has progressed in terms of volume of activity: the number of companies listed increased from the initial 6 to 127 at the end of 1999 and the number of shares traded in 2000 was

¹¹ The first Stock Exchange in Romania was established in 1882, but it was closed in 1948.

¹² Recently a Transparency Tier has been created for companies that meet higher corporate governance standards.

1,500 times higher than the shares traded in 1996. The total turnover remains low, however, at USD 86mn. in 2000¹³. The valuation of shares on The Bucharest Stock Exchange also seems low compared with other markets

Since its inception, the exchange has been predominantly a trading place, not a capital-raising instrument. The BSE has also played a role in the privatisation process since the State Ownership Fund, the privatisation authority, has used the stock exchange for placing some of the residual blocks of shares it holds.

In the first half of 2001, 114 companies were listed on the Bucharest Stock Exchange, 23 on the first tier (blue chips) and 91 on the second tier, with an average market capitalization of USD 7.5mn per company¹⁴. However, the market is very concentrated, the largest 10 companies accounting for 80% of market capitalization.

The financial sector is clearly dominant on the stock exchange. Two banks and the five FINANCIAL INVESTMENT COMPANIES (SIFs) are among the largest and most traded companies on the stock exchange.

The SIFs are the result of the Romanian mass privatisation program, which provided for a free distribution of 30% of the share capital in state-owned companies to all adult citizens¹⁵. At the end of 2000, each of the five SIFs had over 9 million shareholders. At the same time, each SIF has assets including listed and non-listed companies, as well as financial placements (bank deposits etc.) (see Table 5).

One of the distinguishing features of the SIFs is that they regularly pay dividends. Non-payment of dividends is one of the most frequent complains of investors. Apart from cases of abuse, companies are frequently victims of the Romanian accounting system, which creates illusory profits.

¹³ In 2001 turnover increased to USD 120mn.

¹⁴ During 2001, a number of companies were delisted. Currently 76 are listed, 19 in the first tier and 51 on the second tier, plus the SIFs.

¹⁵ For details, see chapter 1.3.2. below.

Table 5: The Financial Investment Companies' holdings

Indicator	SIF 1	SIF 2	SIF 3	SIF 4	SIF 5
Market capitalization, ROL bn.	373	247	415	369	342
Assets, book value, (ROL bn. 31.12.2000), of which	2,184	3,308	3,233	2,664	2,927
- - shares	2,469	2,950	2,833	2,237	2,505

Source: BSE and annual reports.

In any case, the low level of dividends and payment problems both contribute to making investment in BSE securities unattractive. Analysts¹⁶ have calculated that, with just a few exceptions, the return on investments in BSE listed securities is inferior to the return on a bank deposit.

By 1996, the Romanian Mass Privatisation Program (MPP) created a huge number of shareholders in all state-owned companies. Millions of these shareholders were locked into many obscure companies. Selling stock was difficult and inefficient, as only local, non-transparent and fragmented markets were available. Thanks to substantial financial and technical support the National Association of Securities Dealers (NASD) succeeded in rapidly putting in place an over-the-counter transaction system called the RASDAQ (the Romanian Association of Securities Dealers Automated Quotation) -- the "exchange of the MPP". A company may decide to list its shares on the RASDAQ without any prior conditions or requirements to be fulfilled. There are no disclosure requirements. Most companies have been actually listed on the RASDAQ because of a legal provision imposing listing of all companies included in the mass privatisation program.

There are 5,427 companies listed on the RASDAQ OTC market, however the vast majority of the companies listed on the RASDAQ market are sporadically traded. Only around 15 companies are traded regularly, that is more than half of the time, and 1,500 have never been traded since listing.

Because the RASDAQ was essentially a trading platform for the companies included in the mass privatisation program, the number of companies listed did not significantly change, while the sectoral structure of the companies listed on RASDAQ closely mirrors the structure of the economy in general. However, trades are concentrated in industry, which has made up over 70% of the total volume of trades since the beginning of the OTC market.

As the RASDAQ is based on loose regulation, there are not many sanctions provided. Failed trades are therefore relatively frequent and fraudulent transactions are a serious problem of the RASDAQ market. A growing number of problems led the National Securities Commission to temporarily recall NASD's statute of Self-Regulated Organization. A sense of "crisis" prevails¹⁷ and NASD members seem incapable of agreeing on solutions. Eight restructuring proposals were presented in NASD's General Meeting in April 2001, but no decision was taken¹⁸. Merging the Bucharest Stock Exchange

¹⁶ Carol Popa, *Doar o treime din societatile listate la bursa platesc dividende (Only one-third of the companies listed on the BSE pay dividends)*, published in the weekly Capital, no. 16, 19 April 2001. (in Romanian)

¹⁷ RASDAQ is "short of time, ideas and money" as a journalist depicts the situation -- see Laurentiu Ispir, *Piata RASDAQ isi cauta perlele ingropate (The RASDAQ market is looking for its buried pearls)*, in Ziarul Financiar of 3 April 2001

¹⁸ Laurentiu Gheorghe, *Reformarea RASDAQ este doar in faza de intentie (The RASDAQ reform is only at the intention stage)*, in Capital no. 16/2001

and the RASDAQ or splitting the market into several tiers, where the best companies would be admitted to listing on the first tier, have been among the suggested solutions.

Under the circumstances it is not surprising that the Romanian capital markets are fragile and vulnerable. On the other hand, when considering the starting point, the short period of time elapsed and the fact that some of the components of the system incorporate very advanced technical solutions, one has to admit that progress has been remarkable. Romania now has the basic infrastructure for a modern, robust and effective capital market.

Like the capital market of other transition economies, the Romanian market was created as an instrument for **promoting reform and facilitating the privatisation process**. While in other transition economies foreign investment was quick to take advantage of the existence of the domestic capital markets to carry on a diversified array of transactions, in Romania scarce foreign capital had a very limited impact on the market.

The Romanian capital market never succeeded in taking the lead in what represents one of its main functions -- raising capital for companies. Privatisation and post-privatisation transactions provide both the Bucharest Stock Exchange and the RASDAQ over-the-counter market the substance for their day-to-day existence. In many respects, the Bucharest Stock Exchange and the RASDAQ over-the-counter market have integrated very advanced technical solutions -- logistics and regulations -- inspired by highly evolved markets and best practices. But the best technical solutions cannot provide deals, the essential ingredient necessary for the prosperity of any capital market. This situation has several important consequences for all parties involved in the capital market:

- **Companies** do not perceive real advantages in being listed. The mass privatisation program forced thousands of companies to get listed on the RASDAQ, but most managers complied grudgingly. For them, listing is an extra bother without any rewards. The situation is somewhat better on the BSE because listing was voluntary (although in the beginning it took a lot of persuasion from BSE officials to convince managers!) and provides a certain prestige and visibility that many companies and managers appreciate. However, as long as the companies do not regularly use the capital markets for raising capital, they have no strong incentive in being listed.
- The **regulatory bodies**, from the National Securities Commission to the self-regulated organizations, have been shy in imposing discipline and improving standards. They are in a difficult position as long as de-listing, the ultimate sanction in their hands, is not a real threat for the issuers -- many companies on the RASDAQ had repeatedly attempted to get de-listed.
- The **brokerage houses** were initially the most enthusiast and progressive promoters of the capital market. But soon they realized their dreams about buoyant markets, with diversified products and sophisticated transactions, had to be abandoned, or at least postponed, to the indefinite future. In order to survive, some "cut corners" and took advantage of the weakness of regulatory authorities.
- **Investors** are, for the time being, the most obvious beneficiaries of the existence of organized capital markets. The capital markets provided a means of reshaping ownership patterns from the dispersed ones that resulted from the privatisation process to more concentrated ones; both the BSE and the RASDAQ are predominantly **post-privatisation markets, whose function is the concentration and transfer of ownership from privatisation beneficiaries to investors**. Some of the investors on the capital market are sophisticated institutional investors, who can contribute to imposing higher standards.

Although, in the near future the post-privatisation function of the capital market will continue to be dominant, a different combination of factors and actors will play a role in shaping the institutional framework, the type, volume and diversity of operations:

- Changes in the regulatory framework will have less influence than in the past few years, when it was the main shaping force of the capital market, although improvements in the legislation are still necessary.
- The changing attitude of the regulatory bodies, visible in the second half of 2000, may contribute to improving the discipline and the transparency of the markets.
- The privatisation process will continue to use the capital markets and to provide new blue chip listings, but will not have the same influence as in the past, when the mass privatisation program produced long-lasting effects on the stock exchanges.
- The brokers' community seems quite weak and incapable of coordinating efforts in order to have an influence in the near future. However, if consolidation takes place in the industry and the securities dealers' associations become more organized and better focused, they could play a role in setting and enforcing professional standards.
- The capital markets will be increasingly influenced by foreign investors and by sophisticated domestic institutional investors, who understand the problems, have expertise to identify solutions and have resources to lobby for their implementation. Several investors' associations were actively involved in the debates last year around proposed amendments to the legislation.
- New actors, like private pension funds, may become one of the main driving forces of the capital markets.

However, many things will depend on the evolution of the Romanian economy, which is the most important single factor affecting the market. A strong recovery and macrostabilisation is the best remedy for Romania's ailing stock exchanges.

1.2.3. PATTERNS OF CORPORATE OWNERSHIP

Apart from the companies that are still controlled by the state, there are two types of corporate structures in Romania today: **Greenfield private companies** and **privatised companies**.

Greenfield private companies are the product of the last ten years of economic liberalization. Although many of these companies have rapidly evolved from small- and medium-sized businesses into some of the largest corporations in the country, they are still closed, non-public companies, controlled by their founders. Around half of the largest companies in Romania fall under this category. In many cases, these companies are controlled by international corporations: METRO CASH AND CARRY ROMANIA; MOBIFON, MOBIL ROM, SHELL ROMANIA, BRITISH AMERICAN TOBACCO, LUKOIL ROMANIA, LAFARGE ROMCIM, PROCTER AND GAMBLE, PHILIP MORRIS, COCA-COLA, UNILEVER, ABB ALSTOM POWER, AGIP ROMANIA, HENKEL ROMANIA etc. Romanian interests control some other large corporations: TRANSILVANIA GENERAL IMPORT EXPORT, TOTAL DISTRIBUTION GROUP ROMANIA, TOFAN GROUP, INTERAGRO, TONICAL TRADING, COMPANIA DE DISTRIBUTIE NATIONAL, EUROPEAN DRINKS, RIENI DRINKS, TOPWAY INDUSTRIES, etc. In all cases, the owners/founders of these companies prefer to keep a close control on their operations and avoid raising equity capital on the stock exchange.

However, sooner or later, many of these companies will eventually grow to the point where it becomes desirable to raise capital from public sources. Three companies now listed on the stock exchange have origins in the private sector: BANCA TRANSILVANIA, IMPACT Bucuresti and BANCA TURCO-ROMANA (now suspended). Recently, M.J.MAILIS Romania, a private company controlled by foreign investors, have successfully raised capital on the stock exchange and was subsequently listed on the BSE.

It is primarily the privatised companies that are “public” (or “open” according to Romanian definition), which provide the bread and butter of the stock exchange. In current ownership patterns one can easily distinguish the marks of the privatisation process – less evident in the companies listed on the BSE and more explicit in the companies listed on the RASDAQ.

In 60 of the companies listed on the Bucharest Stock Exchange, ownership is concentrated in the sense that a shareholder has more than 50% of the shares; many of the others are controlled by shareholders having stakes of less than 50%. Only around 12 companies have a dispersed ownership structure, with no evident controlling group; six of them are financial institutions (the five FINANCIAL INVESTMENT COMPANIES – SIFs - and TRANSILVANIA BANK).

There are several **categories of majority shareholders** that control the companies listed on the BSE:

- **Strategic investors** are usually corporations active in the same industry which take a position in a company with a view to long-term strategic considerations like complementarity in industrial activities, potential for cutting costs, expansion on certain markets, getting ahead of competition etc. There are 15 strategic investors in the companies listed on the BSE, most of them foreign investors who acquired shares from the State Ownership Fund in the privatisation process: SOCIETE GENERALE[®] (the Romanian Bank for Development), RENAULT (Dacia Pitesti) SAMSUNG DEUTSCHLAND (Otelinox Targoviste) AKER (Tulcea Shipyard), TRINITY INDUSTRY (Astra Vagoane Arad), etc. The perspective adopted by strategic investors sometimes conflicts with the interest of other investors. Many strategic investors have adopted strategies of increasing their participation (through public offerings or increases of capital), sometimes diluting other shareholders, and in some cases have expressed their will to de-list the companies and turn them into closed organizations.
- **The employees associations (PAS)** which acquired shares under the special conditions granted to them in the privatisation process. Under certain aspects, the employees that have a controlling stake in their company may also be regarded as “strategic investors” but their objectives are frequently different, emphasizing stability and protecting jobs more than profitability and long term development. There are 17 companies listed on the BSE where employees have a majority stake. It is expected many of these associations will cease to exist when shares are integrally paid and many employees choose to sell their shares.
- **Institutional investors** are either specialized financial institutions like mutual or venture capital funds, or holding structures. Although the financial institutions do not usually take majority positions, in four of the companies listed on the BSE different foreign investment funds have stakes of more than 50%. Another nine companies are controlled by holding groups.
- **The state – currently represented by the Authority for Privatisation and Administration of State Property (APAPS)** is still present with more than 50% of the shares in 16 of the companies listed on the BSE, but the situation is changing every month.
- Finally, there are a few cases where **natural persons** hold a majority position in a company listed on the BSE.

The same categories of investors are found as **minority shareholders**, but in different proportions. The **institutional investors** and the **employees associations** frequently have a significant position and in many cases hold a controlling stake. The SIFs are present in 33 of the companies listed on the BSE while other investment funds like BROADHURST, LINDSELL ENTERPRISES, SOCIETE GENERALE ROMANIA FUND, ROMANIAN-AMERICAN FUND, ROMANIAN INVESTMENT FUND, are regularly listed among the significant investors. **Natural persons** make for a special category of minority investors. They are, in general, beneficiaries of the mass privatisation program and they have been the main providers of liquid shares on the stock exchange. When ownership is concentrated in the hands of strategic and institutional investors, liquidity falls dramatically.

The ownership pattern of the companies listed on the RASDAQ is quite similar to the BSE if the most traded companies are considered. The same trend towards concentration of ownership in the hands of strategic and institutional investors can be observed – the RASDAQ is well-known as a market for takeovers. More than half of the top 100 companies on the RASDAQ have a majority shareholder, either strategic or institutional. Frequently, the same institutional investors identified on the BSE are equally active on the RASDAQ.

But the situation changes as we leave the group of the 300 most traded stocks on the RASDAQ and investigate the pattern of ownership of the companies rarely or never traded. Here, the ownership structure petrified at the post-privatisation stage, with companies controlled by employees associations or by the state and with tens of thousands of voiceless minority shareholders who received their shares under the voucher privatisation.

The schemes for indirect company control are just emerging and are not very sophisticated. The most common is the **holding group** by which a private investor takes positions in and eventually controls several other public companies. Cross-shareholdings are occasionally used. It is not easy, and sometimes it is impossible, to track the “ultimate owner” when companies registered abroad are used as vehicles for taking participation, and eventually a controlling stake, in a company.

Holding Companies in Romania

TOFAN Group is a privately held company controlled by its founder, Gelu TOFAN. After an initial period when it was dealing in trade with tyres, it created a fully owned subsidiary specialized in re-threading. After 1996, TOFAN Group acquired successively controlling stakes in several tire companies offered for sale in the privatisation process – DANUBIANA, BUCURESTI, VICTORIA FLORESTI, SILVANIA ZALAU, and ROTRAS – all of them listed on the RASDAQ. NOMURA PLC. became a partner in TOFAN Group through a capital injection of USD 100mn. The group spread out towards other areas – communication, media, bakery and retail trade – based on the same complex holding structure that gives founders a possibility to control a variety of businesses. IN 2001, Tofan sold most of its tire business to Michelin.

INTERAGRO is a private company controlled by its founder, Ioan NICOLAE. It grew into one of the largest holdings in Romania by taking controlling stakes in 15 different companies, among which one oil refinery, two fertilizer producers, the largest insurance company ASIROM and many other agriculture and food industry related companies – all of them listed on the RASDAQ. INTERAGRO has devised a scheme for controlling the BSE listed ASTRA ROMANA oil refinery through cross shareholding: it holds 26% of the shares directly and another 32% through ASIROM, in which InterAgro holds a controlling 33% position.

1.2.4. INSTITUTIONAL INVESTORS

We have seen that the institutional investors play a very important role in the ownership structure of the companies listed on both the BSE and the RASDAQ. There are three categories of institutional investors who are relevant for the Romanian market: the five Financial Investment Companies, the venture capital funds and the mutual funds.

Other institutional investors like banks and insurance companies do not play a significant role, one reason being the poor performance of the investment in shares compared with other alternative placements like treasury bonds, bank deposits or real estate. In any case, the insurance industry, although rapidly growing, is relatively small (total assets of less than USD 500mn.). Pension funds, some of the most important institutional investors in other countries, are in a very incipient stage in Romania – the legislation concerning the “universal pension funds” has been just adopted in 2000 (Emergency Ordinance 230/2000). No fund has been licensed until now and it will take a few years until pension funds generate a steady demand for securities.

With total assets of around USD 550mn., of which more than 90% in shares, the five FINANCIAL INVESTMENT COMPANIES are, for the time being, the largest institutional investors in Romania. In spite of their similarities, the five SIFs each have an individual profile determined by the initial structure of their holdings and by the specific policies implemented over the years. All SIFs have reduced the number of

Table 6: The Financial Investment Companies' holdings – end of 2000

Indicator	SIF 1	SIF 2	SIF 3	SIF 4	SIF 5
Market capitalization, ROL bn.	373	247	415	369	342
Assets, book value, (ROL bn. 31.12.2000)	2,184	3,308	3,233	2,664	2,927
The structure of the portfolio of shares (end of January 2001):					
- Total number of companies, of which:	724	529	467	407	301
- BSE listed	29	13	10	36	27
- RASDAQ listed	458	304	293	182	181
- Closed (non-public)	216	209	150	139	57
- Unlisted, traded on BSE	2	3	1	4	
- Open but unlisted	19		13	46	13
- Companies under liquidation					23
Breakdown of portfolio by size of participation					
- nominal value of participation, ROL bn., of which:	2,469	2,950	2,833	2,237	2,505
- less than 5%	6.2	0.9	4.8	4.8	12.5
- 5 – 33%	75.9	75.6	54.5	59.9	61.6
- 33 – 50%	6.5	18.5	20.2	3.0	15.4
- over 50%	11.4	5.0	20.5	32.4	10.5
Global risk index	3.58	4.37	3.8	4.05	3.70

Note: The risk index is calculated according to instructions set by the Securities Commission. Its range of values is from “0”, low risk, to 5, high risk. Source: BSE and annual reports.

companies in which they hold shares, but to a different degree. In 1993, each fund was allocated shares in 1,100 to 1,300 companies. SIF1 (Banat-Crisana) has cut the number to 724, and SIF 5 (Oltenia) has reduced its holdings to 301. SIF 4 (Muntenia) has over 32% of its portfolio in companies where it holds a majority (over 50%) position, while SIF 2 (Moldova) prefers to remain a significant

shareholder, without taking majority positions (only 5% of its portfolio is placed in companies where it holds more than 50%). There is also a certain differentiation by industrial sectors – SIF 1 is dominant in sectors like wood, furniture, pulp and paper, SIF 2 in textiles, SIF 3 in machine building, transports and tourism, SIF 4 in building materials and petrochemicals, SIF 5 in electronics and electrical equipment.

Apart from reducing the number of participating firms to more manageable numbers, the SIFs' policy has also aimed at improving the quality of their portfolios and lowering their risk. However, the SIFs still hold very heterogeneous portfolios, which include a large number of unlisted companies. The SIFs' are also known to take controlling, or even majority positions, and to behave like strategic investors.

While SIFs have a focus on former state companies, some foreign VENTURE CAPITAL FUNDS have made a policy of investing in private (not listed) companies that have a great potential for growth over the next few years. The listed companies rarely offer the 30% return (in dollar terms) that the venture capital funds take as a minimum when considering opportunities that should match Romanian risk. It is estimated that approximately USD 500mn. are invested by the venture-capital funds, most of it in private projects. There are 15 venture capital funds, all of them foreign-owned (table 9).

Table 7: The venture capital funds active in Romania

Name of the fund	Main investments
■ Global Finance	■ Delta România, Neoset, Germanos Telecom, Titan/Moara Loulis, Chipita Romania, Sicomed
■ AIG New Europe Fund	■ MobilRom, Luxten, Astral Telecom
■ Societe Generale Investment Fund	■ Luxten, Arctic Gaesti , MobilRom
■ Baring Private Equity	■ Topway Industries
■ Advent International	■ Euromedia, Monopoly, Europlakat
■ Oresa Ventures	■ Flanco, Medicover
■ Enterprise Investor	■ MobilRom
■ CCP Overseas Equity Partners	■ Mobifon
■ Fondul Romano-American Romania Post Privatisation Fund	■ Banca Agricola, Policolor
■ Foreign & Colonial Romania Investment	■ PCNet
■ Romanian Investment Fund Limited	■ Compa, Sanex, Stirom
■ Romania Fund Limited	■ Policolor , TEC, ComtelRom, CMC Magnetics Corp.
■ Romanian Growth Fund PLC	■ Luxten, Conterra, Policolor
	■ Romcim, Olchim

Note: Public companies (listed) are evidenced in bold letters.

Source: *Capital no. 18, 3 May 2001*

Not all funds are dedicated to Romania. The Danube Fund, promoted by the Greek Alpha Bank, has USD 30mn. Of capital invested not only in Romania, but in Moldova, Bulgaria, the former Yugoslav Republic of Macedonia, and Albania. On Western markets the Société Générale Romania Fund has raised USD 50mn. for investments in Romania; EBRD and the IFC have contributed to the capital of Global Finance; the Romanian American Enterprise Fund is sponsored by the US government and by private investors. The Romanian Investment Fund has raised USD 65mn. from European and American investors.

Exit is not always easy for the funds. The stock exchange is depressed and does not pay the returns fund managers are seeking. Therefore, funds prefer selling to strategic investors ready to pay the premium for taking control.

Since the first Romanian MUTUAL FUNDS were created in 1993, crisis and scandal have plagued the industry. Today, the Romanian mutual funds industry is small, and dominated by money market funds. [See the box on the next page.]

Hence, along with the “strategic investors”, the SIFs are currently the most important corporate governance agents, followed by the foreign venture capital funds. No other institutional investor is likely to become in the near future a significant presence in corporate governance.

Mutual Funds in Romania: A Turbulent History

The first mutual funds were created in 1993-1994, when no specific regulation regarding the investments industry existed. All of them were "open ended funds" with a diversified portfolio of investments, part of it risky, venture capital type of businesses. With no regulations and no supervision, the funds were able to post consistently high increases in the net asset value of their portfolio, attracting a large number of investors.

In March 1996, the newly created National Securities Commission issued instruction no.6 regarding the calculation of the net asset value for the investment funds. Most funds had to drastically correct the value of their assets. An outburst of panic prompted investors to immediately redeem their titles, leading to the collapse of the largest fund of the time, FMOA (USD 200mn.). Confidence in the funds was undermined and it took years until the number of investors reached pre-crisis levels. Although confronted with difficulties, the industry progressed significantly in terms of organization and regulations. The UNOPC (the National Union of Collective Placement Organizations) was created as a Self Regulated body, under the supervision of the National Securities Commission. Weekly reporting requirements were imposed and, since 2000, funds must report the detailed structure of their assets. Related to the structure of their placements, a risk evaluation index was established and each fund is compelled to notify the public about its risk profile.

By the end of 1999, the funds looked again like a promising industry -- the number of investors was over 230,000 and the net asset value of their portfolio reached USD 150mn. In April 2000, a new scandal erupted when the FNI, the largest and most dynamic fund, lacked liquidity and subsequently collapsed, generating protests and demonstrations. An investigation was initiated, several persons arrested -- among them the president of the Securities Commission -- and a court case was initiated by the tens of thousands of victims. Fraud and negligence contributed to the denouement of the FNI case and the experience was once again devastating for the market. The number of investors and capital placed through the mutual funds fell ten-fold compared to the pre-FNI scandal levels. In March 2001, there were less than 50,000 investors and the net assets value less than USD 10mn. Another consequence of the FNI collapse was the change in the asset structure of the funds. In order to lower their risk index, funds reduced placements in listed and unlisted shares to only 8% of total assets.

Table 8: The mutual funds' industry evolution

	Apr. 96	Dec. 1998	Dec. 1999	Dec. 2000	Mar. 2001
Number of funds	10	10	15	17	20
Number of investors	77,723	116,286	239,382	46,736	44,720
Net Assets Value, ROL thou.	190610	664,424	2,880,603	197,062	276,464
Assets' Structure, %					
cash		21,2	39,9	1,20	1,1%
T-bills		0,5	3,7	71,70	60,4%
bonds		-	-	15,80	31,3%
bank deposits		5,7	0,7	0,30	0,0%
listed		8,3	9,1	0,40	0,6%
unlisted		50,9	37,2	0,30	0,2%
other assets		13,3	9,3	11,30	6,5%
Average risk index		3,007	2,23	0,759	0,67

Source: UNOPC reports

1.2.5. SHAREHOLDER ACTIVISM

Only a few years ago, “shareholder” was a word very few people in Romania had heard. Suddenly, through the mass privatisation program, virtually every Romanian adult citizen became a “shareholder”. The extremely dispersed ownership structure that resulted from the mass privatisation program was a recipe for lack of involvement.

Why are Shareholders so Passive?

- most shareholders are not familiar with their rights as shareholders and do not fully understand the corporate governance system in their companies;
- it is practically impossible for shareholders to organize themselves because of the large number and variety of persons involved;
- the free distribution of shares may have fostered a passive attitude among shareholders that tend to be grateful or indifferent, not incisive and demanding as people tend to be when they invest their own resources;
- in many companies the state was still a dominant stakeholder, having an intimidating effect on the activism of other shareholders;
- but above all, **the lack of shareholder activism is a perfectly rational decision from a cost-benefit point of view.** the costs for small individual shareholders to get involved in corporate governance is much higher than the benefits they would eventually derive from their activism.

The companies privatised through MEBO (Management and Employees Buy Out) were the first to experience some form of shareholder activism. Employee shareholders quickly learned that they could influence the boards’ decisions and could eventually change the boards. The power held by the employee shareholders was not always good for the companies and many tough decisions related to restructuring and cost reduction tended to be postponed and overall financial performance subordinated to the benefit of job security. Frequently, insiders’ interests proved to be in conflict with outsider shareholders’ interests.

In 1999, and especially 2000, shareholders’ activism evolved towards an organized, institutional form. Shareholders’ activism tended to be organized mainly around the protection of minority shareholders, in large part in reaction to a number of high profile cases of abuse, some of which are discussed in Section 2.2.2.. The year 2000 was also the debut of involvement of professional and non-government organizations in corporate governance affairs.

The **Corporate Governance Initiative for Economic Democracy in Romania** was the first large-scale systematic effort to bring corporate governance issues into public debate. The project was conducted by the International Center for Entrepreneurial Studies (CISA) in collaboration with the Strategic Alliance of the Business Associations (ASAA)¹⁹ and it was sponsored by the Center for International Private Enterprise (CIPE), an affiliate of the US Chamber of Commerce. Through conferences, debates and studies prepared by high-caliber Romanian professionals, the Corporate Governance Initiative had a significant impact on the business community. In January and February 2000, workshops were organized in different cities, where board members from local companies,

¹⁹ The Association includes a number of 37 entities – chambers of commerce and industry, business centers, professional associations and employers’ organisations.

executive directors, researchers and public administration officials all shared their experience and expressed views on practical aspects of corporate governance topics. In the end, a **Code of Corporate Governance** was elaborated²⁰.

The Code is a collection of best practice recommendations and is aimed at setting standards for corporate governance applicable to “any commercial company, but principally to the companies listed on the stock exchange or traded on the RASDAQ”, no matter where their capital originates from, state or private sources. The 6 chapters and 27 articles of the Code cover the main issues typically related to corporate governance:

- Structure of the board – the Code recommends boards composed of executive and non-executive directors or, if shareholders so decide, only non-executive boards (art. 4). The Code specifies (art.9) that the board should include two non-executive and three executive directors. For large companies, the number of directors may be increased to seven, while in small companies a board structure is not needed.
- The Code specifies professional and moral standards for selecting members of the boards. The Code is also more restrictive than the existing Romanian legislation on appointing board members – a person should not be appointed to more than 2 boards (against the 3 admitted by law 31/1990) and officials (members of the parliament, ministers and other high rank officials) and their relatives should not be eligible for positions on the boards. A more curious provision of the Code is the preference given to directors that are not shareholders in the company. Another innovation is the recommendation to appoint creditors’ representatives to the board (art. 10.1).
- According to current practice, directors exercise their power in virtue of a legal mandate; the Code proposes to also have contracts concluded between shareholders’ representatives and board members.
- Stakeholders are given proper consideration by the Code: shareholders (especially institutional investors), clients, suppliers or employees representatives are to be invited to certain meetings of the board, while creditors and institutional investors may be given a “permanent invitee” statute.
- Every board should adopt a Code of ethics, setting rules of conduct for all employees of the company (art. 15.3).
- The Code promotes higher standards of transparency. For example, according to the Code, directors have to make public all elements of their remuneration – fees, bonuses, other benefits; managers are obliged to disclose transactions with shares of the company. Special and detailed provisions refer to the reports directors must present to shareholders.
- The Code suggests some minimal financial controls directors should consider in order to insure prudential management of the company.

The Corporate Governance Code was to be promoted through the business associations, especially the network of the Chambers of Commerce, and voluntarily adopted by the companies. We have no information on whether the principles of the Code have been used by a significant number of companies. In any case, both the Corporate Governance Initiative and the Code of Corporate Governance were well received by the media and by the business community.

In 2000, the activism shareholders increased with the creation of the “Romanian Shareholders’ Association” (AARO) initiated by the five SIFs plus one individual. The AARO mission statement specifies: “Our aim is to introduce and enforce the principles of corporate governance issued by the

²⁰ Dr. Ion Anton, Valentin M. Ionescu and Despina Pascal finalised the “Code” adopted by the business associations on 24 March 2000, including the workshops’ conclusions.

OECD within the Romanian economic environment.” The minority shareholders’ case was well presented and well covered in the media.

Another remarkable development is the increased activism of SIFs’ shareholders. By definition, the shareholders in the SIFs are small and very dispersed (one single shareholder cannot have more than 0.1% of the shares). However, shareholders succeeded in imposing a change of the board of SIF Oltenia in October 2000, before the expiration of the mandate of the board. In 2001, one shareholder of SIF Transilvania initiated a campaign in the press against decisions of the board that he deemed to be illegal. His position was supported by court decisions.

Court disputes are the most obvious manifestation of shareholders’ activism. Probably every company has had at least one court case involving shareholders. Although the process is slow, experience is growing.

1.3 CORPORATE GOVERNANCE AND THE PROCESS OF TRANSITION

In Romania, as in other transition economies, changes in the corporate governance landscape occurred not so much as a result of dedicated reform efforts, but rather as a by-product of the broader reforms aimed at re-shaping the whole economic system. Only recently has corporate governance emerged as a distinct policy issue. **Enterprise reform**, prompted by the collapse of the administrative controls prevailing under the communist regime, laid the basis for the creation of private enterprise. **Capital markets reform** allowed for trade in equity for the first time in several decades. **Privatisation** not only transferred state assets to the private sector, but led to the creation of thousands of publicly listed shareholder-owned companies. These reforms are the only reason that the phrase 'corporate governance' has any meaning in Romania.

1.3.1. ECONOMIC REFORM AND THE TRANSITION TO A MARKET ECONOMY

Over the past decade, Romania's political, economic and social life have been subordinated to one major objective: the transition from the pre-1990 centrally-planned economic system to a market economy. Though based on practically the same set of measures used in all reforming countries in Eastern Europe, the Romanian transition to a market economy distinguished itself through the pace and sequencing of these measures. The resulting reform profile reflects not only decisions of the moment but also, to a large extent, the constraints imposed by the initial conditions. Indeed, prior to 1990, Romania was one of the most tightly controlled centrally-planned economies. Unlike other Eastern European countries, it did not experience some form of "mild reforms". The violence of the December 1989 revolution forced a sudden collapse of basic institutions and undermined traditional sources of authority. Instead of enjoying a "consensus building" preliminary period, Romania's reforming authorities were confronted from the beginning with a tense, distrustful and sometimes hostile environment, to which they had to reply with hasty decisions and measures.

From an economic point of view, Romania was confronted with serious macroeconomic imbalances, mainly large excess demand, price distortions and reduced competitiveness due to forced compression of basic imported inputs in the 1980s, when huge efforts to repay the external debt were made. These imbalances were aggravated in 1990 by the collapse in output combined with the policy of boosting real incomes to improve living conditions in compensation for the suffering of previous years.

Institutional fragility and serious **imbalances in the economic system** greatly complicated the task of the Romanian authorities and has had a long-lasting effect on the course of economic reform. Although the programs of economic reform have evolved through time, influenced by internal and external factors as well as by experience and better understanding accumulated in the process, they were constantly struggling with the same two issues, institutional fragility and macroeconomic imbalances.

INSTITUTIONAL REFORM

The reconstruction of the whole legal infrastructure was the main instrument used to re-build the institutional system. Two stages may be distinguished in institution building: the 1990 – 1996 period, during which the fundamental institutions were put in place, and the period after 1997, when attention was focused on expanding, amending and fine-tuning the existing institutions.

A **new Constitution** was adopted through a referendum in December 1991, which set the groundwork for a democratic political system. A bicameral Parliament (the Chamber of Deputies and the Senate) is the supreme legislative power; members of the parliament are elected for a four-year term through direct universal vote. The President is also elected through direct vote. The President designates a candidate to the office of Prime Minister after consultation with the political party which has obtained a majority in the Parliament. Within ten days after being designated, the candidate seeks a vote of confidence of the Parliament on his government's program and cabinet. The Government is in charge of implementing domestic and foreign policy in accordance with the program accepted by the Parliament, and with managing the public administration system.

The Constitution explicitly asserts that "Romania's economy is a free market economy" (art. 134). However, in order for this proclamation to become a reality, comprehensive reforms had to be implemented. Hundreds of laws and thousands of other pieces of legislation completely changed the institutional framework of the economy .

The Romanian legal system resumes a pre-war continental tradition: apart from the old Romanian Commercial Code (a piece of legislation drawn itself from the French and Italian codes, which was never officially abrogated) the new laws took inspiration mainly from the regulations of EEC member countries.

A natural sequencing was imposed by the priorities of the moment:

Enterprise reform was among the first radical changes to be enacted. After the December 1990 collapse of the old regime, the whole system of economic relations based on planning and administrative enforcement disintegrated. The "socialist enterprise" had become a fictitious entity, with no legal status. The answer to this situation was **Law no.15/1990, On the Reorganization of State Enterprises**, a cornerstone of the economic reform passed in July 1990, which changed the legal status of state "socialist enterprises". Two types of economic entities were created: the "**autonomous organizations**", state-owned organizations on the French model of the "regies autonomes", dedicated to activities in "strategic sectors" (defense, energy, mining, railway etc.) and the "**commercial companies**", most of them joint stock companies having the state as unique shareholder. Commercial companies were granted great freedom to take decisions, but their legal status was still equivocal, as very few specialists were familiar with notions such as stocks and shareholders.

Consequently, **Law no.31/1990, The Commercial Companies Law**, instituted the general rules for creating and running different types of commercial companies, and granting non-discriminatory entry rights to all entrepreneurs and equal treatment for all entities, private or state-owned. One of the very basic requirements for the existence of competitive markets had thus been fulfilled. New institutions were established in order to create an adequate environment for private, independent economic entities, such as the **Trade Register**, instituted by **Law 26/1991**; the **Chambers of Commerce and Industry**, instituted by **Decree-Law 139/90**; and **Administrative Disputed Claims Office**, established by **Law 29/90**. The Commercial Companies Law was amended in 1997.

Privatisation was the logical extension of the enterprise reform which started with Law 15/1990,. The ideas presented there were fully developed in **Privatisation Law no.58/1991**, adopted in August 1991. The privatisation legislation was amended several times, the most important changes being in 1995 and 1997. In 1997, most of the "regies autonomes" were transformed into commercial companies or "national companies" falling under the provisions of the Privatisation legislation.

The reform of **agricultural enterprises** deserves a special mention in this context. Reform in agriculture was triggered by the adoption of **Land Law no.18/1991**, which provided for the restitution of lands held by cooperative farms to former owners or heirs. There was a transfer of 80% of the arable land in the country to 5 million private owners and cooperatives were dismantled. State farms, reorganized as joint-stock commercial companies and holding about 16% of the land, were supposed to be privatised under the general provisions of the privatisation law.

Market reform evolved independently for different markets. The markets for goods and services were the first to be liberalized in 1990, but it was only in 1996 when **Law 21 -- the Competition Law --** was adopted that the market institutional framework was achieved. The most important markets liberalization measure was the **liberalization of prices**, which was gradual and hesitant. The large discrepancy between the money in circulation and the goods available on the market (estimated at 10 to 1) prompted fears that untenable price rises might occur if prices were suddenly liberalized. For many consumer goods, prices were liberalized in October 1990 but different controls and subsidies were maintained for a relatively large number of products. it was only in 1997 that price controls and price subsidies were completely

removed for all food items. Price liberalization for energy and some intermediary products took even longer.

The gradualism in the liberalization of the prices had two major negative consequences: it created persistent inflationary expectations and induced distortions for the business sector. Many state-owned companies went practically bankrupt as prices for their inputs were liberalized, while prices for their final products were kept fixed.

The labor market was deregulated through Law 13 (on collective labor contracts),¹⁴ (on wages and salaries) and Law 15 (on labor conflicts settlement) all adopted in early 1991. Restrictions on hiring and laying off were removed, and salaries and wages in all commercial companies were to be settled through individual or collective negotiations, subject to a national minimum wage. However, in state-owned companies rules for setting wages were introduced. The Unemployment Law no.1/1991 supplemented the legislative framework of the labor markets with a hitherto missing piece of the social safety net.

Financial markets. The reform of the banking system resulted in the creation of a two-tier system in 1991 and the de-monopolization of banking activities. Under Law 33/1991 concerning banking, commercial banks are granted permission to operate as universal banks under the supervision of the National Bank of Romania. Conditions for setting up new banks were established by law and the National Bank was given responsibility to check compliance and grant licenses. The legislation concerning the banking system was augmented and amended with Law 66/1996 (by which CEC, the traditional savings house, was given the status of a bank) and Law 58/1998 which amended Law 33/1991. The insurance sector was also de-monopolized in 1991, when Law 47/1991 on insurance companies was adopted. The capital market was completely recreated with Law 52/1994 concerning securities and stock exchanges.

Opening the economy was a natural complement of the liberalization of the markets. In February 1990, **foreign trade** was liberalized. The monopoly of the fifty or so foreign trade dedicated organizations on import and export operations was abolished. Any company, state-owned or private, was given the right to carry out transactions with foreign partners, subject to a licensing system. A new customs tariff became effective in 1992. However, the licensing system and the customs tariffs were significant barriers to trade, especially in "sensitive" products like energy or agricultural products. It was only in 1997 that most of these barriers were removed. After 1992 the foreign trade regime was increasingly influenced by agreements concluded with the European Union and CEFTA.

Positive discrimination was the dominant policy with respect to **foreign investment**. A company controlled by foreign capital enjoys the same rights and obligations as a Romanian company. For a good part of the 1990s, foreign companies were extended different fiscal incentives such as profit tax holidays, import duty exemptions for machinery and raw materials etc.. Investors were granted the right to repatriate net profits (dividends) and capital invested. After 1996, the regime of fiscal facilities for foreign investments was modified, then suspended, becoming quite unpredictable.

In November 1991, **internal convertibility** of the national currency, leu (pl. lei), was declared and a two-tier exchange rate system was initiated. An inter-bank auction system controlled by the National Bank established an "official" exchange rate, while an increasing volume of transactions took place at the much higher "market" exchange rate. It was only after 1997 that the auction system was completely liberalized and the market for foreign currencies started to work smoothly.

In 1991, the construction of a completely new system of **economic management** was initiated, based on two pillars: the National Bank of Romania, in charge of monetary policy, and the Ministry of Finance, in charge of fiscal policy.

The National Bank uses credit controls and the refinancing rate as the main instruments of its **monetary policy** aimed at "ensuring the stability of the domestic currency in order to contribute to price stability", as stated in the Statute of the National Bank adopted through law 34/1991 (amended in 1998). A floating

exchange rate regime was finally adopted, given the high rates of inflation and small foreign reserves of the National Bank.

Law no. 10/91, On Public Finances was the initial attempt to rebuild the fiscal system in line with the independent status of economic agents and with the new role of the state. The state and social security budgets are approved yearly by the Parliament. Taxes on profits, salaries and wages (complemented by the global income tax, which began in 2000) and the value added tax are the main sources of public revenue. They can only be modified by law. Public finance was an area of permanent change during the last decade. The frequent modifications of the existing legislation, the introduction of new taxes and the increasing number of regulations created a system difficult to administer and prone to abuses. Hence, it is not surprising that it is constantly mentioned as among the first obstacles to business in all surveys.

Reconstruction of **public administration** and of the **social safety net** were other areas of institutional reform initiated in the early 1990s, and are still evolving. The reform of the pensions system is the latest major reform measure, enacted in 2000, which may have a significant impact on the capital market as pension funds become investors.

ECONOMIC POLICY

Decisions regarding economic policies in Romania were difficult as no model nor established path for transition existed and conditions are very specific for each country. Some errors were probably inevitable, but many analysts think that policy blunders aggravated the situation and hindered Romania's progress towards a stable and business-friendly economic environment. The most obvious economic policy deficiencies noted are²¹:

- A "pathological gradualism"²², meaning not only that "shock therapy" was constantly rejected by Romanian policy-makers, but that the gradualist approach was generalized into becoming the standard approach to all reform measures. The best illustration is offered by the succession of price liberalization measures. The attempt to keep some prices under control for the sake of "social protection" proved to be disastrous -- the amount of subsidies required ballooned to unsustainable levels and structural distortions were aggravated. Price liberalization, in the absence of interest rate liberalization, caused the decapitalization of the banking system. Though a bonanza for the industrial companies that could obtain cheap credit, the interest rate controls of the first half of the 1990s led to bank failures. The bill was paid in 1997-2000 when about 8% of GDP had to be spent on cleaning up the banking system. The attempt to avoid the consequences of full liberalization of the exchange rate through a "multiple exchange rates" regime that prevailed until 1997 resulted in the depletion of the National Bank's foreign reserves.
- The "mirage of the industrial model" is related to the prevailing (although usually implicit) assumption that Romania's industrial infrastructure is an asset that has to be preserved at any cost. All macroeconomic stabilization efforts stumbled at the gates of the large industrial enterprises that continued to produce losses and to absorb, in one way or another, public money. Policy-makers failed to understand, and/or to accept, that the state did not have the resources to restructure and modernize the entire industrial system and that the market is the ultimate force in picking winners and re-shaping industries.

²¹ After Ilie Serbanescu, *Can the vicious circle be broken?* in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000.

²² The term was coined by Costea Munteanu in a paper produced in 1995.

Four periods may be distinguished in Romania's reforming policies²³:

"The first transformational recession" of the early years (1990 – 1993) was characterized by a severe decline in economic activity (more than a 26% drop in GDP) and extremely high inflation (300% in 1993). Incoherence in economic policies, with the first signs of "pathological gradualism", as well as the "institutional interregnum" situation, contributed to creating a fuzzy and volatile economic environment. The economy was deteriorating rapidly when a stabilization plan supported by the International Monetary Fund was adopted in 1991. But the gradualistic approach of the program failed to stop inflation and to restore macroeconomic equilibrium.

"The interest rate shock" (1993 – 1994). Rising inflation forced a reconsideration of policies; by the end of 1993, the National Bank increased the refinancing rate more than two times, pushing interest rates in the economy to positive levels for the first time. The effects appeared promptly: the flight from the currency was stopped, which permitted a substantial devaluation of the "official" exchange rate to levels close to the market rate. In 1994, inflation was down to 62% and the trade deficit reduced substantially.

"Fragile growth and relapse into inflation" (1995-1996). With inflation of only 28% and economic growth of 7.1%, 1995 looked like the best year of the decade. But clouds were already accumulating on the horizon: the current account deficit increased three-fold and the quasi-fiscal deficit was increasing rapidly because of growing subsidies to agriculture and loss-making *regies autonomes*. Approximately USD 400mn. were injected into two ailing banks (CREDIT BANK and DACIA FELIX). By the end of 1996, the monthly inflation rate was again in the double-digit zone, the current account deficit was rising and, in spite of borrowing on the international capital markets (USD 1.5bn.) the National Bank's foreign exchange reserves were running low.

"The second transformational recession" (1997-1999). As result of the liberalization of the foreign exchange market and of other prices (food, energy -- whose prices were, in fact, administratively adjusted towards market-clearing levels) initiated by the new government after the 1996 elections, inflation in 1997 bounced back to 151%. The corrections had some immediate positive consequences -- the budget deficit was reduced, as well as the current account deficit, while the National Bank's foreign exchange reserves soared to about USD 2.6bn. However, GDP fell by 6.6% in 1997 and continued its slippage until 2000. As monetary policy was prematurely relaxed towards the end of 1997, and the restructuring in the real sector was slow and inadequate, prospects for 1998 were not good. Although the budget deficit remained low and inflation continued to decline, the foreign trade deficit was higher than ever and the National Bank's reserves were declining again. This seriously increased the risk of external payment default in 1999, when more than USD 2.9bn. was due, especially considering that, after the Asian and Russian crises, the attitude of international capital markets towards Romania was very severe.

Romanian authorities were left with very little room for maneuver but, after avoiding payment default in 1999, things started to improve in 2000. Exports soared to the highest levels of the decade, the National Bank reserves were restored and, above all, a moderate 1.6% output growth was achieved -- in spite of a very bad agricultural year. Inflation was still high, at over 40%, but the budget deficit was under 3.5%.

Romania had a mixed record in achieving the targets agreed upon in the accords concluded with the international financial institutions, the IMF and the World Bank. Although, technically none of the agreements concluded during the decade were finalized, they were of extreme importance for the country, providing several important benefits:

²³ After Daniel Daianu, *Structure, Strain and Macroeconomic Dynamic in Romania*, in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000.

- money, in times when no other external financing sources would have been available;
- technical expertise in the field of macroeconomic policy and instruments which were not familiar to Romanian experts;
- increased credibility on the international capital markets;
- a firm stance on macroeconomic policy decisions which helped to keep on track some stabilization and structural adjustment programs.

After 1999, when Romania was officially invited to start negotiations for accession, the EU's influence over economic policy matters has been growing. A "Strategy for the Integration in the European Union" was elaborated in 2000, providing a detailed blueprint for action. All political parties endorsed the strategy, proving that the European idea is one of the strongest consensus-building political objectives of the moment.

1.3.2 THE PRIVATISATION PROCESS

In the year 2000, over 60% of Romanian GDP was produced by the private sector. Although agriculture, construction and services generate, respectively, 90%, 71% and 72% per cent of value added, industry is still dominated by state-owned companies which produce 55% of value added. The expansion of the private sector was achieved through two major avenues: the creation of new economic entities and the transfer to private ownership of state assets through privatisation.

In Romania, the importance of privatisation was recognized very soon in the debates on economic reform. The "Outline of a Strategy for Transition to a Market Economy in Romania", the first blueprint for reform published by the provisional authorities in May 1990, mentioned not only the need for privatisation, but also drew up an ambitious calendar. While privatisation was generally accepted, passionate disputes were engaged over the "best" privatisation method. Law 15/1990 on the reorganization of state enterprises into commercial companies and "regies autonomes" touched the issue and outlined the idea of a privatisation scheme combining a free-distribution program with a more conventional sale of assets and stocks.

The preparation of Privatisation Law no. 58/1991 took another year and was adopted by the Parliament in June 1991, after fierce controversies and contestation. In the meantime, some collateral privatisation was already initiated:

- the sale of housing stock was not regarded as a "privatisation" measure, but more like social protection/compensation – approved early in 1990 and extended in 1992 to houses owned by state companies;
- the restitution of agricultural land (Law 18/1991) which resulted in the collapse of the collective farm system. Over 80% of the arable land was returned to former owners or heirs.

The **privatisation of state enterprises** was, however the centerpiece of the privatisation program. Although, over time the initial privatisation scheme was altered, it remains essential for understanding the results and current configuration of the capital markets.

THE INITIAL PRIVATISATION SCHEME

In essence, the Romanian privatisation program proposed by Law 58/1991 was a combination of two basic schemes: a **free-distribution scheme**, aimed at speeding up the process and satisfying political objectives and a more conventional **sale of assets and stock scheme**, aimed at providing effective control over productive assets. The **National Agency for Privatisation** had been already set up by Law 15/1990 to prepare, coordinate and control the privatisation program.

The privatisation law was applicable to the approximately 6,300 commercial companies that resulted from the reorganization of socialist enterprises following Law 15/90. It was estimated that these companies were holding approximately 55% of the productive assets in the economy, the rest being held by the "regies autonomes" and excluded from the privatisation process.

Most commercial companies subject to the privatisation law were organized as joint-stock ventures with the state as the initial single shareholder. The privatisation law stipulated that the stock in each of these companies was to be transferred to two types of newly created legal entities: the State Ownership Fund, which was allotted 70% of the stock in each commercial company, and five Private Ownership Funds which received the other 30%.

The State Ownership Fund (SOF) was created as a "public institution acting on commercial grounds". It was subordinated directly to Parliament and controlled by a 17-member Board of Administrators appointed by the government, by the two chambers of Parliament and by the President. The SOF's main task was to reduce its portfolio through selling shares at a planned rate of 10% a year: in seven years it was to sell off its initial 70% stock in every company and disappear. A Privatisation Program was to be presented to the Parliament every year, with concrete measures proposed in order to secure that the 10% target be met.

The SOF had an independent budget and it could use the proceeds from sales for preparing new companies for privatization. In that context, the SOF also had responsibilities for restructuring the commercial companies.

The five Private Ownership Funds (POFs) were created as commercial companies of a "financial nature", which for the first five years of their existence were to be regulated under the special provisions of Law 58/91; after that, they would become common "mutual funds"²⁴. Each POF was governed by a 7 member Board of Administrators, appointed by Parliament for the first five years.

Each POF was endowed with 30% of the shares in companies allocated to it (around 1,200 companies per POF). At the same time, each POF had to issue **Certificates of Ownership (COs)** to be distributed free of charge to qualified Romanian citizens. Thus each Romanian citizen over 18 years old received five COs at the end of 1990 -- one for each of the five POFs -- and became a shareholder in the POFs.

The CO holders had several choices: to sell their COs to other Romanian citizens (foreigners were denied the right to possess COs); to buy, in exchange of their COs, shares in commercial companies put up for sale by the appropriate POF; to convert their remaining COs into common shares of the POFs when they transformed into regular mutual funds. As any stock, the CO gives the right to receive dividends from the POFs as well as the (theoretical) right to control the actions of the Board.

The POFs were allocated companies in certain industrial sectors and the original industrial profile is still discernible in the portfolio of their descendents, the five Financial Investment Companies (SIF):

- POF I – now SIF1 Banat-Crisana: companies in wood processing; non-ferrous metals;
- POF II – now SIF2 Moldova: textile and clothing;
- POF III – now SIF3 Transilvania: naval transport; fishing; tourism and catering;
- POF IV – now SIF4 Muntenia: glass and ceramics; construction materials; cosmetics; pharmaceuticals;

²⁴ They were in fact renamed "Societati de Investitii Financiare" (Financial Investment Companies) – better known under their Stock Exchange symbol SIF.

- POF V – now SIF5 Oltenia: electronics and electrotechnics; footwear and leather;

The "critical industries" (those in a difficult economic situation and in need of global restructuring -- metallurgy, machine building, petrochemicals and chemicals; and those enjoying monopoly or vital positions -- banks and insurance) were distributed among the five Funds in order to spread the risk, improve prospects for restructuring and avoid dominance of one POF over the others. Finally, other industries were assigned according to regional criteria (trade, construction and agriculture).

According to the law, the stock held by the State Ownership Fund, and by the Private Ownership Funds, was subject to sale to Romanian or foreign legal entities or natural persons, through one or several methods specified by the law: public offer for sale; sale of shares through open cry auction or auction with pre-selected bidders; sale of shares through direct negotiation.

THE EVOLUTION OF THE PRIVATISATION PROCESS²⁵

The experience of the "pilot privatisations" carried out by the National Agency for Privatisation in 1992 and 1993, as well as the first sales concluded by the State Ownership Fund, showed that serious difficulties confronted the process, which advanced much slower than expected. Only one privatisation method was an unexpected success: the sale to managers and employees. Initially devised as a standard procedure applicable only to small companies, MEBO became the dominant method of privatisation when a special law (no. 77/1994) granted substantial facilities to the employees who wanted to buy shares. This explains the relatively large number of PAS (employees associations) that are listed among the significant shareholders in companies on the Stock Exchange and especially on the RASDAQ.

²⁵ A detailed presentation, including many comments and critical observations, in Dragos Negrescu, *A decade of Privatisation in Romania*, in *Economic Transition in Romania – Past, Present and Future*, Proceedings of the Conference: Romania 2000. 10 Years of Transition, edited by Christof Ruhl and Daniel Daianu, published by the World Bank and the Romanian Center for Economic Policies, 2000.

Table 9: Evolution of the privatisation process

	1993	1994	1995	1996	1997	1998	1999	2000
No. of companies in SOF portfolio, beginning of the year	5,937	6,291	7,602	9,010		5,554	4,330	3,149
No. of companies privatised during the year, of which	265	604	648	1,388	1,304	1,267	1,772	1,341
■ MEBO	261	519	43	14				
■ Direct negotiations	4	85	605	1,006	1,064	244		
■ Auctions				455	231	991		
■ Sales on the capital market					9	32	64	108
Companies sold to foreign investors	1	1	5	4	44	96	83	38
Proceeds from sale to foreign investors – USD mn.	2.0	3.9	15.0	15.5	403.8	608.1	57.1	7.0

Note: The number of companies in SOF's portfolio was increasing mainly as result of reorganizations – some companies were split into several smaller units. Several privatisation methods may be used concurrently so numbers do not necessarily add up.

Source: *The State Ownership Fund*

Growing criticism (coming not only from domestic political opponents but also from the international financial institutions) prompted the government to try to instill new life into the privatisation program. In 1995 a new law (no. 55/1995) for “accelerating privatisation” was adopted. The new law in fact modified some of the provisions of Law 58/1991 and, thereby, set in motion the Mass Privatisation Program. Basically, new vouchers (named “privatisation coupons”) were distributed which, along with the old Certificates of Ownership, gave Romanian citizens an option to subscribe their vouchers either for one of approximately 4,000 companies targeted by the program, or to subscribe to one of the five POFs. Although, globally the 30% stake to be distributed freely was maintained, in individual companies up to 60% of the shares were put up for exchange against “coupons”. Although a logistical nightmare, the program was eventually finalized, and resulted in a dramatic shift in ownership structure characterized by an extremely dispersed ownership, with some companies having hundreds of thousands of small shareholders. The mass privatisation program created the ownership pattern that can be easily recognized on Romanian stock exchanges today.

By the end of 1996 a special law (no. 133/1996) was adopted for the transformation of the five Private Investment Funds into “regular mutual funds”, as recommended by the initial privatisation law. The most complicated and convoluted technical solutions were adopted. For example, not only did approximately 500,000 citizens who subscribed their “coupons” with each POF become shareholders,

but also over 10 million individuals were entitled to receive dividends from previous years more than two years until different “compensations” and “regularization” were achieved. The Financial Investment Company (SIF) had a complete list of all its 10mn. shareholders!

At the conclusion of the Mass Privatisation Program and the “regularization” exercise, the Ownership Fund was still in control of most of the companies in its portfolio. After the 1999 elections, a new approach to the privatisation process was promoted through several changes in the legislation. Although the new legislation was intended to simplify, render more transparent and accelerate the process, for a period of 25 months (from May 1997 to June 1999) no less than 15 additional reshuffles of the legislative framework were adopted. Of course, the volatility in legislation had negative consequences on the capacity to effectively finalize the deals. However, the new approach to privatisation during the period 1997-2000 produced some remarkable results:

- The scope of the privatisation process was substantially enlarged with the reorganization of the non-privatizable “regies autonomes” into “national companies”. The corporatisation of the large utilities opened new opportunities for privatisation. In 1998, 35% of ROMTELECOM – the national telephone company – was acquired by the Greek operator OTE. The gas and electricity monopolies were split into several operational units and regulated markets started to be organized as a step towards the utilities’ privatisation.
- Other previously “taboo” sectors were addressed: the ROMANIAN BANK FOR DEVELOPMENT was sold to the French SOCIETE GENERALE, and another retail bank, BANKPOST, was sold to a consortium formed by GE CAPITAL and BANCO PORTUGESE. Sales of large state farms were also initiated in 1999.
- The number of large companies that were privatised increased.
- Many of the large sales involved foreign investors – the number of contracts concluded with foreign investors and the hard currency proceeds increased several times as compared to the previous period.
- As a consequence, the percentage of total equity divested was more than double of that achieved in the previous years.
- The privatisation methods were diversified, including also sales on the capital markets. However, capital markets were used mainly for sales of the “residual” participations the SOF was left with in a number of companies after the Mass Privatisation Program.
- The SOF was no longer the only institution in charge with the privatisation – most “national companies” fell under the ministries’ responsibility.

At the beginning of 2001, the State Ownership Fund (transformed into the Authority for Privatisation and Administration of State Property) still had 1,135 companies in its portfolio and several projects underway. A group of 64 companies was selected for privatisation with investment banks under the World Bank PSAL agreement:

- Four large individual companies: TAROM (airlines), SIDEX (steel), ALRO/ALPROM (aluminum).
- Five medium sized companies, among which the most important is the pharmaceutical company ANTIBIOTICE.
- Fifty small- and medium-sized companies pooled into 5 groups of 10.

In spite of some delays incurred in 2000, the program now looks poised to take off. Negotiations for SIDEX, the largest company in Romania and a very difficult transaction, are quite advanced, with the international group ISPAT as the only bidder²⁶. The privatisation of BANCA AGRICOLA, which had been dragging on for more than one year, was concluded in April 2001. If the momentum is maintained, privatisation in the classical sense of the original Law 58/1991 should be concluded in 2001 – not too far off from the initial target! Privatisation of some large “national companies” like the oil company PETROM SA, the tobacco company SNTR, the airlines TAROM (all of them unsuccessfully offered for sale in 2000) as well as the utilities (electricity and gas) may take longer²⁷.

1.3.3. THE ROLE OF FOREIGN INVESTMENT

At USD 6.4bn, the stock of foreign investment in Romania is low compared to Poland, which attracted more than USD 30 bn. in foreign investment, or with the smaller Hungary and the Czech Republic, which have each around USD 20 bn. of foreign investments.

Greenfield foreign direct investment contributed 80% to the total stock of foreign capital in Romania (table 7); the proceeds from privatisation make for another 17%, while the quite volatile portfolio investments on the capital markets are currently over USD 200mn. It should be noted that privatisation’s contribution to attracting foreign investment became relevant only after 1997, while in other CEE countries it was the driving force for structural changes in the economy.

Table 10: Evolution of foreign direct investment

	No. of companies foreign participation	with Capital subscribed in hard currency, USD mn.
1991	5,526	376.6
1992	10,827	280.7
1993	9,858	343.5
1994	10,717	840.1
1995	4,249	213.5
1996	4,449	493.3
1997	5,864	347.1
1998	8,978	547.0
1999	7,776	602.0
2000	9,090	958.0
Total	77,334	5,001.9

Source: Chamber of Commerce and Industry, Foreign Investments in Romania, bulletin no. 35,

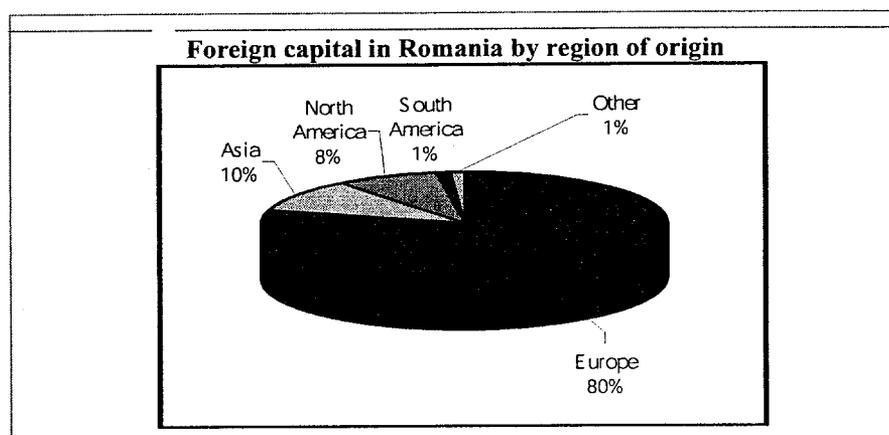
²⁶ The privatisation of Sidex has now been finalized.

²⁷ Petrom was listed in September 2001 when 4% of the company was sold to the public. Technically, the listing nearly doubled the capitalization of the market, including the shares still held by the state.

Lagging reforms and poor macroeconomic performance, a volatile and frustrating legislative framework especially in the area of taxes, a bloated bureaucracy and delays in privatisation are the main factors that have deterred foreign investors.

Moreover, statistics show that:

- Only 7.7% of foreign investors are legal persons, but
- 81.1% of the foreign capital invested in companies with foreign participation belongs to legal persons;
- 1% of the companies with foreign participation own over 80% of the invested capital, while the last 95% own only 12%.



Source: Trade registry

The analysis of FDI indicates two distinct periods:

1990-1996. Privatisation was confined to small- and medium-sized companies; foreign investors, consisting mainly of small companies or individuals, brought in around USD 35mn. The only large FDI investments during this period were in infrastructure projects (energy-ABB, telecommunications-Siemens), or driven by the size of the market in the consumer goods industry (Coca Cola, Colgate Palmolive) or the special incentives offered to some large investors (Daewoo, Unilever, Kraft Jacobs Suchard).

1997-2000. The recession, as well as the sense of political and legislative instability inspired by the continuous tensions within the ruling coalition of the time, were discouraging factors for foreign investors. On the other hand, the privatisation of large companies increased considerably and several significant transactions were concluded:

- **Romanian Bank for Development.** Initially SOF sold a 42.1% stake to Societe Generale for USD 135mn or USD 20.15/share. This was followed by a 20% share capital increase bringing SG's stake to 51% at a total cost of USD 200mn. 8.33% was acquired by the bank's employees and management and 4.99% was sold to the EBRD. A 9.86% stake was subject to a public offering, of which 25.7% was taken up and followed by listing on the BSE (as of 15 January 2000).
- **Bank Post.** The value of the 45% stake was USD 42.7mn, to which USD 50mn were added as direct investments. An additional 8% were sold to the employees and management and the bank is

under negotiations for the conditions of a debt equity swap for its two subordinated loans from the EBRD and the IFC. The remaining shares are to be sold via a private placement and followed by a listing on the BSE.

- **Dacia.** On 2 July 1999 a privatisation agreement for USD 269.7mn was signed, of which USD 50mn represented the price of the 50.96% stake (USD 0.14/share), USD 68.4mn share capital increase (Renault's obligation) and USD 151.3mn investment to be made by Renault over the next five years.

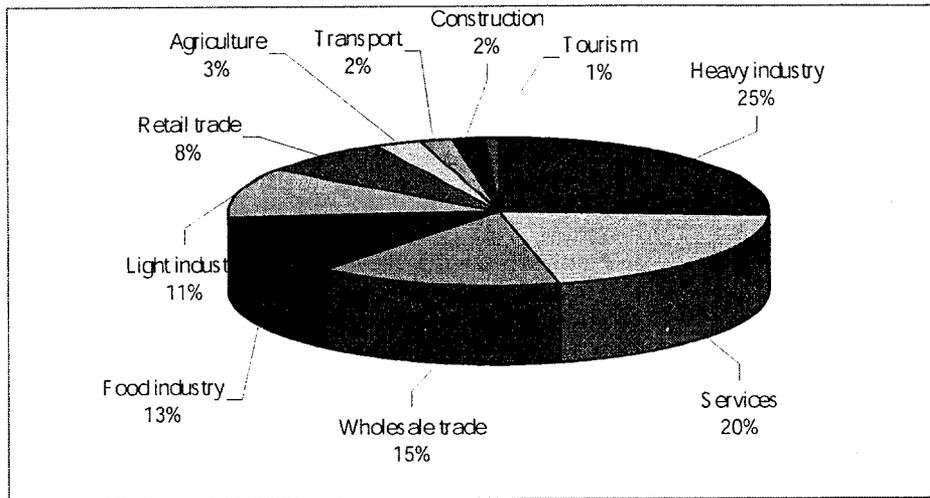
Table 11: Some major foreign investments via privatisation

Company name	Investor	Stake (%)	Amount (USD mn)
Automobile Craiova	Daewoo	51%	150
Romanian Bank for Development	Societe Generale	51%	200
Bank Post	General Electric	35%	92.7
	Banco Portuguese de Investimento	10%	
Dacia	Renault	51%	269.7
Astra Vagoane Arad	Trinity Industries	81.9%	50
Galati Shipyard	Group of four investors	40.9%	25
Silcotub Zalau	Tubman International Ltd	71.96%	6.8
Artrom Slatina	Staro Stahl- Und Rohrenhandel Gmbh	57.82%	6.2
Banca Agricola	Reiffeisen Bank	90%	15+37
	Romanian American Investment Fund		

Note: The amount of investments includes also the investment commitment.

Source: SOF.

FDI breakdown by sector as at October 2000

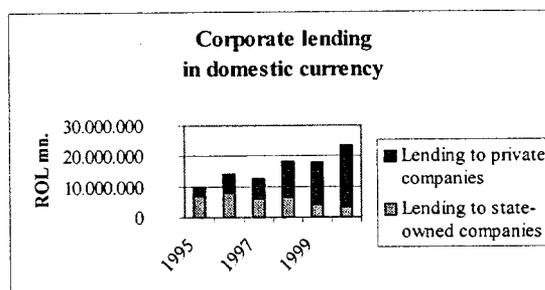
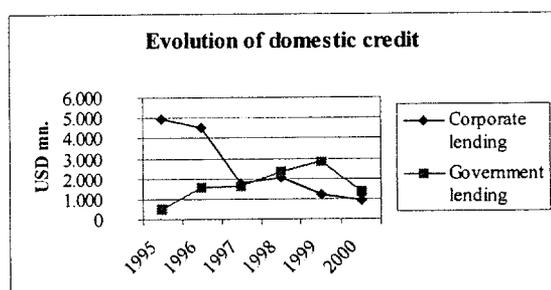


Source: Invest Romania

1.4. CONCLUSION: CORPORATE BEHAVIOUR, FINANCE AND RESTRUCTURING

According to the national accounts statistics²⁸, in 1997 the Romanian corporate sector had an operating surplus of 54% of the gross added value. 37.9% of the gross operating surplus was directed towards savings; the self-financing ratio (gross savings/gross fixed capital formation) was, therefore, 58.4% or, if net capital transfers and changes in inventories are included, 64.6%. This shows that Romanian companies used external sources for financing 35-40% of their capital needs. The net lending of the corporate sector in 1997 was ROL 15,663.5bn.

Lending in Romania



Although shrinking substantially in real terms, domestic credit remains the most important source of external finance: in 1997, bank lending to companies in domestic currency was ROL

12,479.1bn., that is 80% of the net lending (financing needs) of the corporate sector. While in 1995, 72% of bank lending was directed towards state-owned companies, in 2000 the state-owned companies were absorbing only 13% of the lending in domestic currency²⁹. In spite of the deteriorating macroeconomic conditions prevailing after 1996, every year the corporate sector has absorbed important funds – almost USD 1bn in 2000 (down from USD 6bn. in 1995). Romanian companies make very little use of the stock market as a source of new capital.

The very partial, anecdotal information available³⁰ suggests that companies' economic behaviour is correlated with the ownership structure that prevails in individual firms. Several situations may be distinguished from a corporate governance perspective:

- Because of the multiple and inevitably conflicting objectives the state has as owner of commercial companies (profit maximization, maintaining jobs, increasing tax revenues, serving political interests etc.), **state-owned firms** are rarely focused on economic performance. The interests of directors and managers of state firms are poorly aligned with shareholders' interests. The agency problem in state firms is aggravated by the limited capacity of the state institutions to effectively monitor managerial performance and behaviour³¹ and sometimes by conflicts between different

²⁸ National Commission for Statistics/National Bank of Romania, *National Accounts 1996 – 1997*, issued August 2000,

²⁹ According to data included in the National Bank of Romania *Monthly Bulletin no. 12/2000*.

³⁰ Studies based on surveys at a microeconomic level aimed at identifying patterns of managerial behaviour and corporate governance practice are missing. Opinions expressed occasionally by different authors on corporate governance are based on personal observation and on cases brought up by the media.

³¹ The agency problem was chronic for the Romanian State Ownership Fund since its inception in 1992. The legislation was modified several times with an aim to improving state representation in the general shareholders' assemblies and boards of directors (see 2.2 and 2.3 below), but with little success. The task is of daunting dimensions – the SOF had to appoint and monitor the activity of tens of thousands of representatives in the over 9000 companies it was holding in its portfolio at one time! The selection of state representatives was largely influenced by political motivations – each ruling party's specialists were better qualified for the job than their predecessors! Very frequently the state representatives – supposed to monitor the performance of the companies' managers – were, in fact, colluding with managers for different personal benefits.

institutions trying to impose their own bureaucratic objectives³². As a result, different forms of company assets stripping are frequent in state firms. Restructuring is slow in state companies as managers hesitate in taking responsibility for unpleasant tasks. When initiated, restructuring tends to be merely cosmetic³³ and driven from the outside (ministries and government agencies, different forms of financing granted in the event that restructuring programs are adopted etc.). Rent seeking through political lobbying is a much more rewarding managerial policy than cost cutting. Running a high volume of arrears, especially to the state budget, is also regarded as good managerial policy.

- **New private firms** are, in general, closely held by their founders, who are also involved in the current management of the company. The agency problem is therefore reduced. Instead, conflicts between associates are quite frequent, also resulting in court cases and split-offs. As companies grow and professional management is hired, agency may become an issue, but in general it is less severe than in the case of state-owned firms. Although economic rationality prevails in decision making, performance is not necessarily related to profit maximization but rather to company expansion. As a result, diversified and poorly structured business empires have appeared. Marred by financial problems, many of these empires tend to adopt the financing tactics of state-owned companies, such as building up arrears to the state budget. Restructuring eventually occurs but is rather slow.
- **Privatised companies** provide the widest variety of situations, with, at one extreme, firms having an extremely dispersed ownership or, at the other extreme, companies having a strong controlling ownership. The main corporate governance problem here is the conflict between insiders (controlling owners) and outsiders, minority shareholders. Because the minority shareholders usually resulted from the mass privatisation program, the controlling owners rarely think of them as investors and useful partners that could eventually contribute funds in the future. Although foreign investors³⁴ bring in better organizational and incentive systems that can improve corporate governance, their attitude towards minority shareholders is not much different. Many large strategic investors tried, and sometimes succeeded, in buying out minority shareholders' interests and delisting their companies from the stock exchange. The situation is very much improved in cases where minority shareholders are genuine investors who provide funds directly to the company. Most venture capital funds succeeded in building good relations with their controlling partners. Restructuring is slow in companies controlled by employees and most effective in companies controlled by foreign strategic investors.

In conclusion, the behaviour of companies is very much influenced by their ownership structure and privatisation is the main factor determining change in corporate behaviour. Although closely held private companies have their own specific corporate governance problems, these are most obvious in privatised and state-owned companies. Because stock exchanges have themselves been set up through political decision, as a complement and fulfillment of the privatisation process, they play a very limited role in financing the economy. As a result, companies have little incentive to get listed and to rigorously comply with all listing requirements. For the same reason, controlling owners are not motivated to keep minority shareholders satisfied, and conflicting relations tend to develop.

³² The most evident are the conflicts between the branch ministries (Ministry of Industries, Ministry of Agriculture etc.) which propose restructuring and development strategies for industrial sectors and the State Ownership Fund which is the nominal "owner" of the companies, having its own restructuring programmes.

³³ For many managers, restructuring is equivalent with and limited to staff reductions.

³⁴ A good analysis of the economic performance of foreign firms compared with domestic ones (state owned and private), in Voicu Boscaiu, Costea Munteanu, Daniela Liusnea, Lucia Puscoi, *Impact of the FDI on Productivity in Romanian Manufacturing Industry*, at www.ceroge.ro

PART II: THE REGULATORY FRAMEWORK AND THE ROLE OF POLICY

Laws and other regulations provide the foundation for any corporate governance system. In practice however, corporate governance standards depend not only on the provisions of the laws but also on their effective application, which is related to the functioning of the institutions aimed at monitoring compliance and enforcing the law. Part II of the report is dedicated to presenting the main provisions of the Romanian legislation relevant to corporate governance and provides some discussion of actual practice. Chapter 2.1 introduces the main laws and institutions, while 2.2. through 2.5 examine in detail the regulations, practices and policies covering all essential elements of corporate governance, following the structure of the OECD Principles.

2.1. THE LEGAL AND REGULATORY FRAMEWORK

The current system of corporate law in Romania is rooted in the Continental European tradition of civil law. The centerpiece of corporate legislation is the **Commercial Companies' Law** no. 31/1990, amended in 1997 by government ordinance no.32. Law 31/1990 draws on the Romanian Commercial Code of 1938, which, while never enacted, was an attempt to modernize and update the old 1887 Commercial Code. The Code was heavily inspired by the French legal tradition – although the 1938 Commercial Code also draws on the Italian Commercial Code, considered at the time the most advanced piece of legislation.

The second pillar of corporate legislation is more specific: the **Securities and Stock Exchanges Law** no.52/1994. This law contains special provisions for “public companies” (“open companies” in Romanian legal parlance), which are in general more constraining than the standards imposed by law 31/1990. The Securities and Exchanges Law is a modern piece of legislation, inspired not only by European tradition but also by Canadian and American experience.

As a candidate for EU membership, Romania is engaged in a comprehensive process of legal harmonization. One of the major objectives of the 1997 amendments to the Law 31/1990 was to bring Romanian legislation in line with EU regulations. Specialists consider corporate regulations to now be harmonized with respect to: the publicity of commercial companies; the validity of social commitments; the voidability of the incorporated company, protection of associates and third parties, mergers and divisions of commercial companies. Romanian legislation still differs on the minimum level of share capital (EUROS 25,000)³⁵.

However, analysts have observed that “fulfilling EU membership requirements will not do much to improve corporate governance regulatory standards because EU directives on company law are generally vague, reflecting the varying standards and practices of existing member states. EU directives are almost entirely for public companies, but do not distinguish between listed companies and offer little consistency with regard to takeovers.”³⁶ Although some EU rules do have great relevance on specific issues -- like accounting and auditing, transfer pricing, insider dealing, protection of creditors and other stakeholders, etc. -- assimilation of the EU regulations cannot be expected to induce major changes in the corporate regulatory framework.

2.1.1. THE COMPANY LAW

The Company Law is a comprehensive piece of legislation, drafted to produce a self-sufficient corpus of regulations governing the creation, organization, functioning, modification and liquidation of all types of commercial companies. Although for some interpretations of the law's provisions, reference should be made to the Commercial Code, the 287 articles of Law 31/1990 are the ultimate source for

³⁵ Elena Cârcei, *Societatile comerciale pe actiuni (The Joint-Stock Companies)*, ALL BECK Publishing House, 1999.

³⁶ SG Emerging Markets Equity Research – *Standards of Corporate Governance*, London, February 2000, p.2.

corporate legislation in Romania. Special provisions may apply to companies dedicated to specific commercial activities (banks, insurance companies, investment funds, etc.) or to companies in special conditions (companies listed on the stock exchange, companies in liquidation, etc.) but these provisions are always complementary to the Company Law. On the other hand, Law 31/1990 does not cover individual or collective businesses that are not organized into a distinct legal entity – a company. Here we will succinctly present the main provisions of the law, focusing on aspects that are relevant to “corporate governance”. Specific issues, such as the role and functioning of the board, shareholders’ rights and protections, accounting and disclosure requirements etc. are treated in the following chapters.

FORMS OF COMPANIES

Under the Romanian Company Law (art.2 and 3) five forms of corporate business organization are defined, each of them representing a specific mix of capital and persons, and differentiated by the extent the associates assume, in subsidiary, the company’s liabilities:

- general partnership (societate în nume colectiv – SNC) is the most “personal” type of organization, where partners are jointly and severally liable for their company’s obligations (each of them is liable for any claim against the company with all his possessions);
- limited partnership (societate în comandita simpla - SCS) – a first step towards a more depersonalized organization: there are simple contributing partners, liable up to the extent of their contribution, and committed partners that are jointly and severally liable for the company’s obligations;
- limited partnership by shares (societate în comandita pe actiuni – SCA), where the entire capital is divided into shares and the simple partners are liable only with their shares, while committed partners are jointly and severally liable;
- joint-stock companies (societate pe actiuni – SA), a completely depersonalized organization, where shareholders are only liable to the extent of their shares;
- limited liability companies (societate cu raspundere limitata – SRL), where partners are liable only to the extent of their contribution to the capital.

As a rule, at least two partners are required to set up a company (art.4). A minimum of five partners is required to set up a joint-stock company. Sole partnerships are admitted as an exception for limited liability companies, which cannot have more than fifty partners. Both natural and/or legal persons may become partners in a commercial company.

For some forms of companies, a minimum level of share capital is required (art. 10 and 11); currently, the limit is ROL 2mn. for limited liability companies and ROL 25mn. (approx. USD 800) for joint stock companies and limited partnerships by shares. Contributions in cash and contributions in kind to the share capital are accepted, but at least some contribution in cash is required.

The limited liability company is the most common form of organization for business entities in Romania. However, the joint stock company is the most complex organization and the one which is relevant for large corporate entities, where ownership and management are usually separated. Apart from general provisions, applicable to all forms of business entities, the Company Law treats extensively the special situations with which joint stock companies are confronted.

INCORPORATION

The incorporation of a company is a four-step process: (a) preparation of the association documents (contract of association and by-laws, which can be unified into a single document called a

“constitutive act”); (b) a hearing before a judge delegated by the Court to the Trade Registry; (c) the matriculation with the Trade Registry; (d.) public notification of the incorporation in the Official Gazette. For some businesses (banking, insurance, brokerage, etc.) a prior approval from the competent regulatory authority is required.

The Trade Registry is the key institution for the incorporation process. Organized on the basis of Law 26/1990, the Trade Registry is affiliated with the Chamber of Commerce and Industry. Its role is to keep public records on all businesses. The information recorded by the Trade Registry is quite extensive and mirrors the information required to be specified in the constitutive act³⁷: identification data on all associates or founders; information on the company (name, headquarters' address, subsidiaries or branches, legal form of organization, object of business); information on the capital (share capital, associates' contribution, in-kind capital, nominal value of shares and shares' distribution among associates, types of shares); information on the administrators/directors and censors; the conditions required for the validity of general shareholders meetings; the commitments assumed by the founders; clauses on the dissolution and liquidation of the company. Changes in any of these elements during the lifetime of a company also have to be recorded with the Trade Registry. Records are publicly available – for a fee, anyone can obtain information on a given company.

CREATION OF A JOINT-STOCK COMPANY

There are two ways to set up a joint-stock company as specified in article 9 of the Company Law: by integral and concomitant subscription by the founders or by public subscription. Public subscription, which implies raising money from third parties, is regulated in detail by the law. As public subscription is equivalent to a public offer as defined by the Securities and Stock Exchanges Law (no. 52/1994), the provisions of the company law are supplemented with the relevant provisions of Law 52/1994. The public subscription is based on a prospectus approved by the National Securities Commission and then presented to a judge delegated by the Trade Registry. The prospectus includes the information required for the “constitutive act”. Fifteen days after the closing of the public subscription, the founders have to call for the “constitutive meeting”, which checks whether the subscribed capital was effectively paid in, validates the report presented by the experts designated to evaluate the in-kind contributions (as the case may be), approves the operations previously carried out by the founders, adopts the constitutive act and appoints the directors and censors. The incorporation process is then continued by the persons designated.

SHARES AND SOCIAL PARTS

The capital of a Romanian corporate vehicle is divided into "shares" (for a joint-stock company or a limited partnership by shares) or "social parts" (for limited liability companies). Basically, both shares and social parts give their holders the same rights, including, but not limited to, the right to dividends and voting rights. However, some differences do apply.

All shares are of equal (nominal) value and grant equal rights to their holders. In particular, every share gives one vote – multiple voting shares are not allowed under Romanian legislation. However, the associates may decide, through the constitutive act, to issue *non-voting shares* (which give preferential dividends).

Two forms of shares may be issued by a company: *bearer shares* and/or *nominal shares*. The general shareholders meeting may decide to convert one form into the other. However, shares that are not paid up can only be nominal.

While ownership over bearer shares can be transferred through simple trading of the (paper) note (Art.99 of the law), the ownership transfer for nominal shares has to be recorded in the shareholders' registry kept either by the company, or by an independent specialized registry. Although nominal

³⁷ The information requirements are slightly different for different types of companies.

shares can have a material (paper) form like the bearer shares, they usually take a *dematerialized form*, being represented only by a record in the shareholders' registry. Only securities having a dematerialized form can be listed on a stock exchange.

As a result of the 1997 amendment to Law 31/1990, companies were granted the right to redeem their shares if there was agreement among shareholders assembled in a general meeting. The operation is limited to 10% of the paid-up capital, subject to certain restrictions.

Social parts in SRLs are not negotiable instruments (art.11). As a matter of law, social parts should not be transferred to third parties unless agreed to by associates holding at least three-quarters of the capital. The existing holders have preemption rights over the social parts. The assignment of social parts has to be registered not only in the company's books but also with the Trade Registry.

THE FUNCTIONING OF THE COMPANY

The functioning of a company is based on three bodies that have specific roles and powers defined by the law and by the constitutive act: the general shareholders meeting, a collective body that expresses the volition of the shareholders; the directors – administrators in Romanian legal parlance³⁸ – which form a body mandated with implementing the decisions of the shareholders and overseeing management; and the censors, a body dedicated to the financial supervision of the company. For small companies (i.e. limited liability) the three bodies are not necessarily distinct.

THE GENERAL SHAREHOLDERS MEETING

The general shareholders meeting is the supreme decision-making body in a company and all companies are supposed to hold general meetings on a regular basis. However the law gives special attention to the joint stock companies. There are four categories of general meetings:

- the constitutive general meeting – which adopts the constitutive act that initiate the incorporation process; unlike all the other general meetings, where every share gives one vote, in the constitutive meeting every person has one vote.
- the ordinary general meeting – which, in essence, sanctions the operations of the company and adopts decisions that do not modify the constitutive act;
- the extraordinary meeting – which, in principle, is the only meeting authorized to make changes in the constitutive act;
- special shareholders meetings – addressed to some shareholders, for example non-voting preferential shareholders.

The general shareholders meeting is normally convened by the directors (administrators), but in certain situations may be called: (a) by the administrators at the request of shareholders representing 10% of the share capital; (b) by the censors, if they deem well-founded and urgent a request by shareholders representing 25% of the share capital to verify certain facts; (c) by the liquidators that assume the administrators' functions during liquidation.

General shareholders meetings are called whenever necessary. An ordinary general meeting has to be organized at least once a year, within three months of the conclusion of the fiscal year. Notification of the meeting is to be published in the Official Gazette and in one local newspaper, at least 15 days before the meeting. The notification of the meeting has to specify: (a) the date and the place the meeting is held (the place must be where the company is headquartered); (b) the agenda of the

³⁸ "Director" designates, in Romanian, strictly an executive position; members of the board are called "administrators" and the board itself is called "administrators' council" – on the French model "conseil d'administration".

meeting; (c) the full text of proposed amendments to the constitutive act, when such an issue is included on the agenda; (d) when shares that certify a person is a shareholder are to be presented.

All issues on the agenda have to be explicitly stated in the notification. After publication, the agenda becomes mandatory for all shareholders and no other topics may be brought into discussion during the meeting – with one exception. According to art. 150 of the Commercial Companies Law, the decision to take action against administrators, censors or executives of the company may be discussed in the general shareholders meeting even if it was not on the agenda.

Shareholders can be represented in the general meetings by proxies. Only another shareholder can represent a shareholder in the general meeting, unless the constitutive act provides otherwise. The quorum for the validity of a general meeting and the majority required to adopt decisions in a general meeting differ for various types of meetings.

- for an ordinary meeting the quorum required in accordance with art. 112 of the law is shareholders representing at least half the share capital. If the quorum is not met, a second meeting is convened – this time the law does not impose any quorum. Decisions are adopted by absolute majority in the first meeting and by simple majority in the second meeting that takes place when the quorum was not met the first time.
- for extraordinary meetings, the quorum required by the law (art. 115) for the first meeting is three-fourths of the capital, while for the second meeting convoked, in case the first one did not meet the quorum, half of the capital is required. The majority required for adopting decisions is at least half the share capital in the first meeting and at least one-third of the share capital in the second meeting.

By law, the **ordinary general meeting** has as core competencies:

- to discuss, adopt or modify the annual financial statements, after hearing the directors/administrators and the censors report, and to decide on the distribution of profits and on dividends;
- to elect administrators and censors;
- to establish the remuneration for the administrators and censors, if it was not established in the constitutive act;
- to ratify directors' activity;
- to establish the income and expenses budget and the program of activity for the next fiscal year;
- to decide on mortgaging, leasing or dissolving one or several units of the company.

Other competencies of the ordinary meeting may be set by the constitutive act.

The **extraordinary general meeting** has as core competencies:

- change of the legal form of the company;
- moving the headquarters of the company;
- change of the statutory object of business;
- extension of the duration of the company;
- increase of the share capital;

- reduction of the share capital or to make up for incomplete capital by issue of new shares;
- mergers with other companies or division of the company into several entities;
- anticipated dissolution of the company;
- conversion of shares from one category into another;
- issue of bonds;
- any other change in the constitutive act.

Some of the competencies of the general shareholders meeting can be transferred to the administrators (change of headquarters' address, change of the object of business, increase or reduction of the share capital and conversion of the shares from one class to another).

As a rule (art. 129 of the Law 31/1990), the vote is open, but secret ballot is required for the selection and repeal of the directors/administrators. Conventions among shareholders to vote in a certain way are prohibited.

The decisions of the general meeting become valid only after having been submitted to the Trade Registry in order to be recorded and published in the Official Gazette. The decisions can be contested in court by shareholders that have voted against a certain decision (and their opposition mentioned in the minutes of the meeting) or by shareholders who were not present at the general meeting, within 15 days of publication. Creditors can also oppose decisions involving changes in the constitutive act.

DEBT INSTRUMENTS

Only joint-stock companies can issue debentures -- corporate bonds -- up to 75% of paid share capital. Limited liability companies cannot issue debt instruments.

Bonds are in many respects similar to shares. They may be issued in *nominal* or *bearer* form. Trades of nominal bonds have to be recorded in the company's bond register, while trades of bearer bonds are simply transfers of the title deeds. All bonds in an issue have the same characteristics. *Convertible bonds* have to be issued at a face value equal to the value of the shares.

Bonds issued through a public offer are also subject to the provisions of Law 52/1994: a public offer prospectus has to be approved by the Securities Commission prior to its publication.

According to art. 166 of the Company Law, bondholders may gather themselves "in a general meeting, in order to deliberate on their interests." The meeting is convened by bondholders representing a quarter of the securities or by bondholders' representatives -- if they have been appointed. The organization of bondholders' general meeting is very similar to a general shareholders meeting (publication of the meeting's notice, period, voting etc.). The company has the obligation to bear the costs entailed by the organization of the meeting.

The main competencies of the general meeting are:

- to appoint a representative of the bondholders and one or several substitutes, and to establish their remuneration. The bondholders' representative has the right to participate in the general shareholders meeting and to represent bondholders in relation with the company and in court.
- to carry out all activities aimed at monitoring and defending bondholders' rights;
- to establish a fund designated to cover expenses incurred by activities aimed at monitoring and defending bondholders' rights;

- to oppose modifications in the company's by-laws or in the terms of the loan which would be harmful for bondholders;
- to accept or to reject proposals on issuing new bonds.

MODIFICATION OF A COMPANY

Any change in one of the basic elements that define a company is similar to a re-creation of the company, involving an intervention in the constitutive act. In principle, any such change is subject to the same formal requirements imposed by the law for the creation of the company – approval of the general shareholders meeting, hearing before a judge, registration with the Trade Registry and public notification in the Official Gazette. While some changes are trivial (the address of a company's headquarters) others seriously affect the company and the interests of its owners, creditors or stakeholders. Changes in the share capital, mergers and divisions are the most important modifications.

An **increase of capital** can only be decided by the shareholders' extraordinary meeting if the previously issued shares have been fully paid in. The decision for increasing capital is taken by the shareholders based on a report presented by the directors/administrators, which motivates the operation and justifies the proposed value of the shares. There are two ways to increase capital: from internal sources or from external sources.

- An increase of capital from internal sources supposes capitalization of reserves, differences resulted from revaluation of assets or profits/dividends. This is mainly an accounting operation and takes place by either increasing the face value of the existing shares or by issuing new shares allocated proportionally to all shareholders.
- An increase from external sources brings in new capital from either the existing shareholders or through a public subscription. An increase of capital based exclusively on the contribution of the existing shareholders can only be decided by a unanimous decision of the extraordinary shareholders meeting -- which makes it a quite rare solution. If a public subscription takes place, the existing shareholders have preemption rights which allow them to subscribe new shares proportional to the number of shares they actually hold. The preemption right is negotiable -- a shareholder may buy or sell preemption rights. The preemption right does not apply when the increase of capital is achieved through an in-kind contribution (art.213 of Law 31/1990)³⁹. The general meeting may vote for giving up the preemption rights in favor of a third party.

The law provides for a third way of increasing the capital of a company that represents a combination of the internal/external sources: increase of capital by conversion of debt to equity. Although it is an accounting operation, the conversion changes the exiting shareholders' structure so that former creditors become shareholders⁴⁰.

A **reduction in the capital** of a company is required by law if: a) some shareholders have not fully paid in their contribution; b) when the company had losses representing half the share capital (or less, if the constitutive act so provides); c) some shareholders that voted against certain decisions in the general shareholders meeting decide to withdraw from the company under provisions of art. 133 of the law. In this case, the company has to redeem their shares and to reduce the capital. Apart from that, shareholders may decide to reduce capital for business considerations.

³⁹ This is frequently a source of abuse and litigation because many majority shareholders used in-kind contributions to increase the capital and dilute other shareholders.

⁴⁰ The Ministry of Finance has extensively used the conversion for recovering bad debts.

In practice, a reduction is operated by either lowering the face value of the shares or by reducing the number of shares. The shareholders' decision to reduce capital has to be published in the Official Gazette and the reduction is effectively operated only two months after publication. During that period, creditors have the right to file opposition with the court to the reduction of the capital.

With the 1997 amendments to the Company Law, **mergers and divisions** received special attention, being treated in a dedicated chapter – articles 233 – 245. The new provisions on mergers are in line with EU directives no. III and VI.

Two types of mergers are defined: a) absorption, by which a company integrates another company that ceases to exist; b) unification, by which two or several companies put together their resources in order to create a new company – the initial companies all cease to exist. Similarly, division may consist in: a) splitting part of a company to create a new company (the initial company continues to exist) or b) separating one company into two or several new entities (the initial company ceases to exist). It is important to note that the liabilities of companies involved in merger or division operations are transferred to the successors and creditors may claim settlement from any of the successors, unless merger/division documents have specified which successor assumes a specific claim.

The merger or division has to be approved by each of the involved companies' shareholders meeting. The directors/administrators are mandated to prepare a merger (or division) proposal that is presented to the Trade Register and, after approval by the delegate judge, is published in the Official Gazette. Creditors have the right to file opposition to the proposal with the court within 30 days of publication. After that period elapses, the shareholders in each of the companies involved take the final decision on the operation in an extraordinary meeting. Shareholders have the right to be informed about the documents related to the merger or division.

DISSOLVING AND LIQUIDATING THE COMPANY

Dissolving a company is either a decision of the shareholders, or has causes provided for in the law. Among the general causes specified by the law are: (a) expiration of the duration the company was created for; (b) impossibility to achieve the objective for which the company was created; (c) the court has declared the nullity of the company⁴¹; (d) by decision of the court, at the request of some of the shareholders; (e) as result of bankruptcy; (f) other causes make it impossible for the company to continue to exist (capital has fallen under the minimum level required by the law and shareholders did not take measures to replenish it; the number of shareholders has fallen under five, the minimum required for a joint-stock company, etc.).

Once the decision is taken by the extraordinary general shareholders meeting, it is published in the Official Gazette. Creditors have 30 days to file opposition to the decision.

As result of the dissolution, a liquidation procedure is initiated, by which liquidators take over the administration of the company.

2.1.2. THE LAW ON SECURITIES AND STOCK EXCHANGES

The Law on Securities and Stock Exchanges no. 52/1994 is the second pillar of the corporate governance system in Romania, dealing with the specific situation of the "public companies" -- business entities that raise capital through public subscription or whose securities have been subject of a public offer. The law was drafted in the context of preparing for opening a stock exchange in Romania after more than 50 years of abolition of transactions in securities (and securities themselves for that matter). Unlike the Company Law, which was inspired directly by the Romanian Commercial Code, the Law on Securities and Stock Exchanges was a completely new piece of legislation, drawing on contemporary legislation. The assistance received from Canadian and British experts produced a modern piece of law, with a touch of common law that is not always congruent with the Romanian legal tradition⁴².

Being the first regulatory act⁴³ dealing with securities and capital markets in Romania after 1952 (when the old stock exchanges law was abolished), the law covers several different topics:

- the creation and organization of the National Securities Commission as the regulatory and supervisory authority for the capital market;
- the public offer as the most complex and important operation on the capital markets;
- the securities' brokers organization and activities;
- the organization, functions and operations of the stock exchange;

⁴¹ The provisions concerning the nullity of a company were introduced through the 1997 amendments to the Company Law and are in line with the first EU directive.

⁴² For example, the classification of the National Securities Commission acts is not in line with Romanian administrative law. According to the Securities Act, the Securities Commission may grant "exemptions" which are not provided for by Romanian administrative law. Not once has the Securities Commission granted such exemptions for public offerings or for investment funds. Another example are the "ordinances". The Securities and Stock Exchanges law states that the Securities Commission issues "ordinances". According to the Romanian Constitution, the term ordinance is defined as an act having the power of law, which the Government is authorized to issue during Parliamentary recess or in cases of emergency (and here, Romania's constitutional system is similar to that of France, Spain and Italy, where the term is also 'ordinance' or decrees of the Council of Ministers)

⁴³ In 1993, the Romanian Government had issued Ordinance No. 13/1993, meant to create the legal background for trading securities and for licensing brokers. However, the Ordinance did not deal with stock exchanges as institutions, and did not establish any rules regarding self-regulatory bodies and public offering procedures. Also in 1993, the Government created the legal framework for investment funds (Ordinance 24/1993).

- auxiliary provisions regarding investors protection, external independent auditors, consultation on placement and the compensation and depository systems.

Law 52/1994 governs not only corporate shares but also bonds and all securities issued by the government or local authorities. The intention of the law is to facilitate the financing of business corporations and to provide public access to accurate, safe and exhaustive information regarding the securities traded on the market and the issuing companies.

Based on the Securities and Stock Exchange law, and complementary to it, the National Securities Commission -- a supervisory and regulatory authority -- issues explanatory rules and directives, which deal in detail with every chapter of the law.

2.1.3. OTHER SPECIFIC REGULATIONS

There are many regulations that may create a special legal regime for certain companies, activities or situations, with an impact on corporate governance. State-owned companies, for example, are subject to a legal regime that differs in certain aspects from the general corporate legislation – the “regies autonomes” are business organizations that do not fall under the provisions of the law 31/1990, but are organized and function under the provisions of Law 15/1990. Even the state-owned commercial companies, which in principle are subject to the general regime instituted by the Company Law, are granted an exceptional treatment for the incorporation procedures, for the transfer of their shares and even for the organization of management (see 2.3.4 below). We will briefly review some of the most relevant special regulations concerning the financial institutions.

BANKING

Banking in Romania is governed by the Banking Law, under which banks are organized as joint stock companies according to the common rules of the Company Law, but cannot conduct specific banking operations unless licensed by the National Bank (BNR). Banks may also act as brokers, clearinghouses, and originators of deposit money. There are two types of transactions in which banks may not deal: leasing, and the sale and/or purchase of securities. If they wish to handle such transactions, they must set up leasing and/or brokerage companies.

The management of banks is subject to some special rules that augment the general rules of corporate governance laid out in the Company Law. Such rules regard the eligibility criteria (professional and reputation-wise) for the managers, powers of representation, and conflicts of interests.

Under Art. 25 of the Banking Law, "the managers of the bank" must be residents of Romania, confine their activity strictly to that deriving from their position in the bank, and, for at least one of the banks managers, be a Romanian citizen. Also, they must hold an academic degree, have a minimum of five-years experience in a banking or financial institution, and prove that their previous activity had led no business corporation into bankruptcy. Appointees to managing positions in banks must be approved by BNR prior to the assumption of duties.

Supplemental to the provisions of the Company Law, the Banking Law sets forth that a person may not be elected to the office of member of a bank's board or, if elected, such person forfeits membership, if he/she is an employee of that particular bank, acts as the auditor or board member of another bank, or, within a period of five (5) years prior to such election, was replaced by the bank, as a remedial measure.

Under the Banking Law, "managers of the bank", must be construed as a member of the Board of Directors or a member of the Directors' Committee⁴⁴, according to the structure permitted by the Company Law, with the difference that, in a bank, only natural persons may be directors. Another

⁴⁴ Art. 26, Banking Law.

distinction between ordinary business corporations and banks is that the board of a bank may not exceed eleven members⁴⁵.

Under the Banking Law, a bank is committed by the signature of at least two "managers", whose limits of competence are specified by each bank's internal regulations, in conformity with the relevant rules of the BNR. Therefore, a bank is always represented by two directors and, as a rule, these are the president and one of the vice-presidents, and by two other persons who must be members of the Board of Directors and, at the same time, members of the Directors' Committee. Which means that not all the members of the board may represent their bank, but such members will perform as supervisors.

Unlike the Corporation Act, which addresses the issue of conflict of interests in a perfunctory manner, the Banking Law deals at length with the conflicts of interests that may appear between directors or between directors and shareholders⁴⁶, although some of the provisions are just a repetition of the similar provisions in the Company Law. For example, a bank director has the following duties:

- to inform the bank, in writing, of the nature and extent of his/her interest therein, whether he/she is a party to an agreement with the bank, is a director in an corporate entity which is a party to an agreement with the bank, or has a material interest or relationship with a person who is a party to an agreement with the bank, other than deposit agreements or valuables custody agreements.
- to report, in writing, to the bank's board of directors, at least once a year, the name and location of his/her associates, and information regarding the material interests of a financial, commercial, agricultural, industrial or other nature of such director and his family;
- to abstain from attending and voting at the meetings of the board devoted to a transaction in which he/she has a material interest or relationship directly concerning his/her estate or business or his/her family's estate or business; for quorum purposes only, when passing a resolution on such transaction, the director concerned will be deemed present.

When a director fails to report the occurrence or existence of a conflict of interests, the bank, a shareholder, or the BNR may petition a court for the annulment of any transaction if such director has a material interest that he/she failed to declare, as detailed above. Another remedy available to the BNR in such a situation is to direct the bank to suspend the defaulting director (for not more than one year) or to replace him/her.

INSURANCE LEGISLATION

Insurance and reinsurance, and the operation of insurance companies are subject to two regulatory acts: Law No.135/1995 (insurance and reinsurance) and Law No. 32/2000 (insurance companies and surveillance of insurance).

Viewed from the perspective of corporate governance, Law 32/2000 covers: types of companies that may conduct insurance and reinsurance activities (only joint stock companies), shareholding (where the terminology is 'significant shareholders, not majority shareholders), financial discipline, and the measures that may be imposed on the management of an insurance company by the competent authority on the insurance market.

For Law No. 32/2000, which is of a recent date and replaces the older Law No. 47/1991, the administrative rules for its application have not yet been issued.

INVESTMENT FUND LEGISLATION

⁴⁵ Art. 27, Banking Law.

⁴⁶ Arts. 29 – 34, Banking Law.

In Romania, investment funds are regulated by Government Ordinance No. 24/1993 ("GO 24"), regarding open end and closed end investment companies, and Government Ordinance No. 20/1998 ("GO 20"), regarding venture capital funds.

Open-end and Closed-end Investment Companies. GO 24 provides that open-end and closed-end investment funds must be managed by asset management companies incorporated as joint stock companies. Such management companies must have a minimum level of capital as determined by the Securities Commission and may only issue nominative shares. Securities dealers cannot hold more than 5% of the shares of a management company, and banks not more than 20%. Likewise, no management company may be a shareholder in another management company. The interdiction also affects the directors and the managers of such management companies.

The internal structure of management companies is governed by GO 24, which does not institute rules different from the Corporation Act. But the relationship between investors and the management company with regard to the investment fund⁴⁷ is amply dealt with both by the law and the Securities Commission regulations, particularly with respect to management contracts and reporting lines.

Venture Capital Funds. In Romania, the operation of venture capital is regulated by GO 20/1998, approved by Parliament in 2000, as distinct from other investment funds, due to their special nature. Romania was the first Central European country to regulate venture capital funds, and to encourage the diversification of investments on the capital market and in the productive sector. Shortly thereafter, Hungary issued similar legislation. The ordinance provides the legal form such ventures may assume (in the form of agreements/unincorporated companies or joint stock companies), and institutes rules for the relationships arising between them and management companies. Compared to EU legislation, the Romanian law on risk capital ventures drew inspiration exclusively from North American experience with an emphasis on investments in securities, with or without assumption of management, starting from the idea that the IPO involve high risk.

2.1.4. THE NATIONAL SECURITIES COMMISSION

The National Securities Commission (in Romanian: Comisia Națională a Valorilor Mobiliare – CNVM) was established through the Securities and Stock Exchanges Law 52/1994 as a legal “autonomous administrative authority”. Under Romanian public law, the CNVM is not subordinated to the government, it is subject only to parliamentary control. The five members of the Commission (including the President and the Vice-president) are appointed by the Parliamentary for a five-year term.

The purpose of the Securities Commission as set by law (art.6) is:

- to promote a well functioning securities market;
- to protect investors against unfair, abusive and fraudulent practices;
- to insure proper information to securities holders and the public at large on securities issuers;
- to establish a proper framework for the activities of securities brokers and dealers, the regime of their professional associations and the bodies in charge of running the securities market.

The CNVM performs three main functions: monitoring, regulation, and representation.

On the **monitoring** side, the CNVM acts directly, or through its employees, including the Commissioner of the Stock Exchange. By delegation of competence, the monitoring function may also be exercised by self-regulatory bodies.

⁴⁷ An investment fund may be established as a joint stock company or as an agreement. In the latter case, it is not a legal entity.

The **regulatory** side of its activities includes the general organization of securities markets, the licensing of market operators, and the related public filing. In exercising this function, the CNVM may issue regulations and directives, all having normative power.

CNVM regulations cover aspects such as:

- organization and operation of securities markets;
- licensing and operation of investment funds and of the companies that manage such funds;
- organization and operation of collective deposits of securities;
- organization of the Securities Records Office;
- licensing and operation of brokers, independent auditors, and investment advisors;
- sale or purchase of public offerings;
- approval of regulations regarding transactions conducted on the stock exchange or the OTC market;
- operations of clearing houses.

The CNVM directives (currently known in Romania as 'instructions') lay out rules with regard to:

- formation and operation of professional security broker corporations and brokers;
- reports, data, and information to be communicated to the CNVM and reports, data, and information to be communicated to the public by issuers, owners of securities and brokers; bookkeeping procedures, circumstances and deadlines for communication and/or filing;
- confidential and privileged information;
- transactions involving significant shareholders, and direct transactions with securities;
- transfer of controlling and majority positions;
- exemptions that may be granted by the CNVM.

CNVM issues individual decisions on the establishment or dissolution of institutions, issues or revokes licenses to market operators (including securities companies and individual brokers), cancels or confirms acts performed by its representatives, grants exemptions, revokes powers, issues ordinances, confirmations and approvals.

The three principles by which CNVM conducts its operations are:

Transparency: CNVM publishes in the Official Gazette of Romania all the regulations and directives issued. CNVM often co-operates with the professional associations in the elaboration of regulations and instructions.

Communication: , There are no rules providing for the CNVM to promptly and completely inform investors. There are some directives for regularly informing investors about the status of issuers of securities, confidential and privileged information, public offerings, etc. As a result of its rather limited capacity to handle communication, the CNVM prefers to pass its obligation to inform the public towards the issuers themselves, the stock exchange or the OTC market. In other words, communication is mainly provided in an indirect way, from the issuer to the investor, and not directly

from the CNVM to investors. An example is the Code of Ethics of the CNVM personnel, under which their obligations are mainly directed to market operators rather than to investors. This has led, in the past, to conflicts regarding the access permitted to individual investors to the incorporation documents of mutual funds, of the companies managing such funds, and to their financial statements.

Proportionality: Under the Securities Law, the CNVM has been vested with limited regulatory powers. It is for this reason that the CNVM may authorize professional bodies to issue their own regulations regarding the conduct of market operators, trading mechanisms, accounting rules, or it may delegate part of its monitoring prerogatives. Sometimes, however, the boundary between the competence of the CNVM and the professional bodies is crossed.

2.2. THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS

OECD Principles of Corporate Governance

I. The corporate governance framework should protect shareholders' rights.

II. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. .

2.2.1. THE LEGAL RIGHTS OF SHAREHOLDERS

The Company Law sets the two general principles that govern shareholders treatment: the principle of equality among shareholders in the same class and the principle of indivisibility of the shares. We have seen that the Romanian legislation provides for only two classes of shares – regular/voting shares and preferential/nonvoting shares. There are extremely few cases when companies have issued preferential shares.

Many of the legal provisions have, in one way or another, an impact on shareholders' rights and treatment, including the provisions regarding the rules and the quorum for different types of shareholders meetings, those protecting minority shareholders, the rules regarding corporate disclosure, the rules on shares registry and the compensation and depository system that secures shareholders' ownership rights etc. In this section we will focus only on the specific rights mentioned as such by law.

The law grants shareholders two types of rights: patrimonial and non-patrimonial⁴⁸.

The **non-patrimonial rights** refer to:

- The right to participate in the general shareholders meetings. Shareholders have the right to participate in meetings even if on a certain matter they have interests that diverge from the interests of the company – but in this case they must abstain from voting. Holders of non-voting shares do not participate in the regular shareholders meetings but meetings dedicated to preferential shareholders.
- The right to vote. Every shareholder has the right to vote in proportion to the number of shares he/she holds. Limitations on the number of votes that can be cast by a single shareholder are only possible if they have been included in the Constitutive Act of the company. In special situations (such as conflicts of interest) certain shareholders have to abstain from voting. Agreements among shareholders to vote in a certain, concerted way, as well as transfers of voting rights not related to the transfer of shares, are illegal.
- The right to information. Shareholders have the right to examine the shareholders' registry and the register of the minutes of shareholders meetings. They can also examine the financial statements before the annual meetings, as well as the administrators and the censors' reports. Shareholders may ask for excerpts or copies from these documents. Between the general shareholders meetings, but not more than twice a year, shareholders have the right to review certain documents specified in the Constitutive Act.
- Special minority rights:

⁴⁸ In practice it may be very well-argued that all rights are, directly or indirectly, patrimonial.

- shareholders representing 10% of the voting rights (or less if the Constitutive Act so provides) may ask directors/administrators to convene a general meeting;
- every individual shareholder has the right to notify the censors on certain facts he deems they should investigate. Censors are supposed to consider such notifications and include them in the annual report. When shareholders representing 25% of the shares (or less if the Constitutive Act so provides) complain to the censors, censors are required to present their conclusions and, if necessary, to call for an immediate shareholders meeting.
- shareholders representing more than 10% of the shares have the right to ask the court to appoint experts for investigating certain operations of the company. A copy of the experts' report is presented to the claimants and another copy to the censors of the company. The fees for the experts are supported by the company.
- shareholders have the right to contest in court the decisions of the general shareholders meeting and to ask for redress.

The shareholders' **patrimonial** rights are:

- The right to dividends. Dividends are paid in proportion to each shareholders' contribution to the paid-in capital, unless the Constitutive Act establishes different distribution criteria.
- The right over the reserves. According to the law, shareholders that leave the company have the right to reclaim not only their paid-in share capital, but their share in the equity of the company.
- The preemption right. In case a company increases its capital through public subscription, the existing shareholders have a preferential right to subscribe to new shares in proportion to the shares they already have. The preemption right is to be exercised during a limited period of time.
- The right to the proceeds from the liquidation of the company – again proportional to the contribution to the capital.
- The right to sell shares. Unlike the social parts, shares are freely transferable.

The main shareholders' **duties** with respect to the company are:

- To pay for the shares subscribed;
- To comply with the provisions of the Constitutive Act and with the decisions of the general shareholders meetings.
- To bear the losses of the company up to the value of their shares.

2.2.2. ABUSES OF SHAREHOLDERS RIGHTS'

In the last part of 2000, Law 52/1994, concerning securities and stock exchanges, was amended through government ordinance no. 229/2000⁴⁹. Among other things, the ordinance provided for enhanced protection of minority shareholders. The adoption of the ordinance was the result of an intense campaign promoted by some investment funds, which were complaining of violations of minority shareholders' rights.

The main criticism of the minority shareholders refers in general to the declining financial performance in companies controlled by strategic investors. Gross profits of the 26 largest companies listed on the BSE and the RASDAQ were plotted since 1998, before privatisation, to June 2000, to show how profits of USD 20-30mn. turned into losses of USD 30mn. during the period. In one of the most famous cases, BROADHURST investment funds brought to court RENAULT, the majority shareholder of DACIA Pitesti, showing that sales of DACIA cars declined dramatically immediately after the privatisation.

According to AARO, one of the main explanations for the deterioration in performance is related to abuses of majority shareholders and lack of sufficient monitoring and control from other stakeholders. An inventory of the most important forms of abuse compiled mainly by the SIFs includes⁵⁰.

■ Diluting minority shareholders of companies through:

- Capital increases without prior revaluation of existing capital. The "nominal" capital of companies has eroded because of the high inflation prevailing in Romania. As the Romanian Accounting System does not provide for automatic corrections, periodical "revaluations" are done. If a majority shareholder decides in the general assembly to increase the capital without performing such revaluations, shareholders which do not use their option to participate in the capital increase are diluted by much more than normally allowed. This would not be true if the correct value of the initial capital had been used. Dozens of such operations have been documented by the SIFs. One recent example is the decision taken in April 2001 by RENAULT (holding 80% of the shares in DACIA Pitesti) to increase the capital of DACIA from 2,500 to 5,800bn. ROL, without first adjusting the capital of the company which had not been revalued for 7 years. This is the third similar operation performed in the last two years, and for the first two, Broadhurst Investment, which holds 7.% of the shares in DACIA, opened court cases.
- Capital increases through in-kind contribution of the majority shareholder. Minority shareholders are confronted with three forms of abuse: for in-kind contribution, the legislation does not provide preemption rights for the existing shareholders, which are necessarily diluted; the in-kind contribution is usually over-valued and sometimes has nothing to do with the activity of the company; the in-kind contribution is performed without prior revaluation of the existing capital. In COMET Bucuresti, a retail trading company having a registered share capital of ROL 8.6bn (less than USD 300,000) the majority shareholder decided to increase the capital with the contribution of a non-functioning helicopter evaluated at USD 550,000. CONDEM Bucuresti, a company where the majority shareholder is a Romanian natural person, the share capital was doubled by including as in-kind contribution six patents held by the majority shareholder. CHIMCOM SA Bucuresti, the majority shareholder in ROMAQUA Group increased the capital by transferring the intellectual property rights on a patent it was

⁴⁹ The provisions of Ordinance 229/2000 will be examined in 2.2.3. below.

⁵⁰ Many newspapers presented extensively the arguments brought by both minority and majority shareholders. See for example *Bursa* issues no 20, 21, 24, 29, 30 in January and February 2001; *Adevarul Economic* no.7, 8, February 2001; *Ziarul Financiar* in January and February 2001 etc.

holding and which was evaluated at more than the existing share capital. Afterwards, an increase of capital through revaluation of the existing assets was performed.

- Transferring profits outside the company. Koyo Seiko, majority shareholder in KOYO Alexandria (producer of bearings, listed on the RASDAQ), was said to have extended loans to its Romanian subsidiary, at interest rates much higher than the market average. The company GAVAZZI STEEL Otelul Rosu, controlled by an Italian natural person, was acquired for USD 10,000 the Virgin Islands firm GAVAZZI STEEL CONSULTANTS, belonging to the same person. Against a commission it was supposed to assist the Romanian company in marketing and sales. The majority shareholder in ZIMBRUL Suceava, a Romanian natural person, required the company to purchase all supplies and sales through a firm held by his daughter.
- The “empty shell” tactic, by which the assets of a company are transferred to other parties by:
 - abusive sale of critical assets of a company. SC - SUMEL MASINI DE CALCUL Târgu Mures sold all its productive assets; in order to continue operations, the company had to rent the same assets from the new owners. SC DECEBAL Drobeta Turnu Severin sold the main three assets to firms where the majority shareholder of DECEBAL had a stake, at prices representing 10-15% of the 1994 book value.
 - use of the assets of a company as collateral for credits obtained by the majority shareholders.
 - transfer, through mergers and divisions, of the assets of a company to new entities controlled by some of the existing shareholders, directors or executives.
- Abusive allocation of profits. The employees associations, majority shareholders in companies privatised through MEBO, decide in the general shareholders meeting to distribute to employees more than half of the profits as “employee profit sharing”. Not much is left for the dividends to which outsiders are entitled.
- Delays in the payment of dividends. Although the decision is taken in the general shareholders meeting on the distribution of the dividends, companies postpone for years the effective payment.
- Limited access to information for minority shareholders, who only rarely have a seat on the board or the censors’ committee.

The Foreign Investors Council, an association of 81 large foreign investors in Romania, took the lead as representative of “strategic investors” who consider some of the provisions of ordinance 229/2000 to be excessive.. Although certain individual companies, like Koyo and Renault, offered explanations on some of the particular accusations brought against them, the majority shareholders were in general less specific as to the solutions they endorsed.

The Romanian Chamber of Commerce and Industry also intervened in the debate in favor of rational and balanced solutions. After two months of intense debates, Ordinance 229/2000 was abrogated in February 2001. The government committed itself to issue new, more comprehensive and balanced legislation for improving the minority shareholders protection.

2.2.3. INITIATIVES TO PROTECT MINORITY SHAREHOLDERS

Apart from the amendments to the Company Law already mentioned, the most important attempt to reform the corporate governance legal framework was made in 2000 when the government issued Emergency Ordinance no. 229/2000 amending Law 52/1994 on the Securities and Stock Exchanges. Ordinance 229/2000 became popular as the “law for minority investors’ protection” and is one of the pieces of legislation that generated fierce debates and an intense coverage in the media. It was one of the rare occasions when prestigious international publications like The Economist or Financial Times

mentioned a rather technical dispute in Romania. In February 2001, four months after it was adopted, during which major foreign investors having controlling positions in different Romanian companies were crying foul, Ordinance 229/2000 was revoked by the new government after the general elections. However, the government promised to soon issue new, more balanced regulations, taking equally into consideration the interests of minority and majority shareholders.

Although Ordinance 229/2000 is not in force anymore, we will briefly present its main provisions, which reveal some of the problems and provides a rough idea of potential solutions that may be considered for improving the corporate governance legal framework in Romania⁵¹.

SHAREHOLDERS' INFORMATION

- To provide better information to shareholders, Ordinance 229 proposed new reports to be prepared and presented by the directors/administrators at the annual general meeting or, if requested by shareholders holding at least 10% of the share capital, on a quarterly basis. The Securities Commission was supposed to issue detailed regulations regarding the form and content of the reports. They were supposed to include "all useful and material information" and, at a minimum, the reports should provide shareholders with the financial and patrimonial situation of the company, the adopted or planned economic and competition policy and the projected evolution of the company.
- A new claim and answer procedure for publicly traded companies was proposed, whereby shareholders holding individually or collectively 10% of the share capital may file a claim with the directors and/or auditors regarding any particular issue, operation or transaction. Within fifteen business days, the directors and/or auditors must review the operation in question and issue a report. If unsatisfied by the report, the filing shareholders have the right, at their own expense, to have one or more experts appointed by the court to review the operation in cause and prepare a report. Once this report is delivered to the directors/auditors, they must analyze it and propose appropriate corrective measures.

SHAREHOLDERS' CONSENT

- Under the amendments proposed by Ordinance 229, any time a director, employee, shareholder or "involved person" intends to execute an agreement with a company whose value is at least 1% of a company's share capital, the directors are required to convene a general meeting of shareholders in order to approve (or disapprove) the proposed transaction. Any person who has an interest in the transaction must abstain from voting.
- Any transaction that involves acquiring, disposing of, exchanging or executing a security on fixed assets in the patrimony of the company, whose value exceeds 10% of the share capital, must be approved by an extraordinary general meeting of the shareholders. Similar approvals are required for leasing for more than one year company's assets if the value of the transaction exceeds 10% of the book value of the assets of the company, and for associations entered into by the company for more than one year. Failure to obtain such approval may result in the court annulling the legal act at the request of any shareholder, as well as legal proceedings against the directors and/or manager for any prejudice caused to the company.

CUMULATIVE VOTING

- A new voting procedure is proposed for the election of board members in publicly traded companies if requested by shareholders who hold, individually or collectively, shares representing at least 15% of the share capital or at least 15% of the voting rights in the general meeting. If

⁵¹ See Victor Paduraru, Todd Shollenbarger, *Minority Shareholders' Rights – Romania*, in the Linklaters&Alliance bulletin "Central & Eastern European News, Issue 4, January 2001.

cumulative voting does not result in minority shareholder representation at the directors' level, then minority shareholders at least have the possibility to appoint one of the auditors.

PURCHASE OF MAJORITY SHARES

- Currently, the law permits acquisition of a majority share position only through a public offer. The Ordinance proposed to authorize the acquisition of a majority position in publicly traded companies through means other than a public tender, provided such acquisition is followed by a public offer within sixty days for all remaining shares.

CAPITAL INCREASE

- Any capital increase in a publicly traded company must be approved by the Securities Commission, which should ensure that shareholders have the ability to exercise their preemption rights. The capital increase cannot be registered with the relevant independent registry without having the consent of the Securities Commission and the Securities Registration Office will only register shares that have been subscribed, and paid in full as of the date of the subscription.
- Prior to registering any capital increase the company must revalue the fixed assets in its patrimony if the inflation rate was over 10% since its last revaluation, taking into consideration the usefulness and market value of the respective assets. New shares will be distributed pro rata among existing shareholders for any increase.
- If the share capital is to be increased thorough in-kind contribution, the Ordinance requires that such contribution first be appraised by an expert appointed by the general shareholders meeting. Shareholders holding, individually or collectively, at least 5% of the registered share capital may ask the court to appoint an independent expert appraiser, at their own expense. If the minority shareholders' expert's valuation differs by more than 10% from the valuation made by the general assembly's expert, the directors and the minority shareholders must jointly appoint an expert to reconcile the difference. At the same time, Ordinance 229 gives shareholders which do not participate in the in-kind contribution a right of preemption by means of pro-rata cash contributions, thereby avoiding any dilution.

OTHER PROTECTIONS

- For any merger between publicly traded companies, the Ordinance provides that the exchange rate for the shares participating in the merger be determined by reference to the market value of the shares of the relevant companies – which is to be calculated by averaging the value of the shares for the last three transactions, plus the inflation rate.
- The Ordinance expressly forbids shareholders, directors or employees with a “dominant position” from “abusing” such a position by using unfair or fraudulent acts whose purpose or possible effects would jeopardize and affect shareholders' rights.
- The Ordinance makes express the right of shareholders to attend the general meeting⁵², provided identity is substantiated. Failure to provide access leaves open the possibility to have a court suspend or annul a resolution at the request of the shareholders whose access was restricted – providing their shares represent at least 5% of the share capital.
- According to the Romanian Company Law, the extraordinary general meeting of the shareholders may delegate certain functions to the directors (art. 114). The Ordinance proposes that, at the

⁵² Abuses occurred by which shareholders were denied physical access to general meetings; in some cases, access was restricted based on a decision of the general shareholders meeting. However, such abuses are forbidden even by current legislation and shareholders may ask for redress in courts. But because the court procedure is quite complicated, it is hoped that clearer legal provisions can prevent such abuses.

request and at the expense of any shareholder, the directors will be required to release copies of those minutes and decisions that include on their agenda the duties delegated to the directors by the general meeting. Any shareholder has the right to attack in court any decision made by the directors pursuant to delegation, if such decision infringes upon any shareholders' rights recognized by the law.

- Any shareholder has the right to attack in court any decision made by the general assembly of shareholders, if such decision infringes upon any shareholders' rights recognized by the law.
- According to current provision of the Company Law, shareholders having 10% of the share capital in a company have the right to ask the directors to call a general meeting. An abuse developed in practice, whereby the directors would call the general meeting but would not place shareholders' issues on the agenda – thereby effectively precluding consideration of the issue or issues. The Ordinance make explicit in this context the right of such minority shareholders to have their issues placed on the agenda for the general meeting of shareholders, provided they are within the powers of the general assembly of shareholders.
- In addition to the other notification vehicles provided by the law, the Ordinance requires that notices be sent through registered mail to “significant shareholders” (more than 5%).
- The Ordinance also clarified two issues related to the “reference date” which determines the identity of shareholders entitled to participate in the general meeting and to receive dividends. It is also specified that dividends should be paid to all shareholders within 60 days of the date of the general meeting approving the distribution of dividends.
- The Ordinance makes clear that a person cannot be appointed as the “independent censor” required by Law 52/1994 to certify the financial statements of publicly traded companies if he has a “special business relationship” or any other relationship with any shareholder, director or manager of the company.

Many of the provisions of Ordinance 229/2000 address practical situations, when directors or majority shareholders abused their position. However, in most cases, the existing legal framework has solutions for such abuses. The real problem is that many shareholders feel frustrated by the long and costly court procedures they have to initiate for redress. Although clearer legal provisions may help, increasing the capabilities and competence of the judiciary is the best way to protect shareholder rights.

2.2.4. INSIDER TRADING AND MARKET MANIPULATION

According to art. 86 of Law 52/1994 on the securities and stock exchanges “any person which is in a position to obtain confidential and/or privileged information is forbidden to make use of such information nor to make it public or to facilitate disclosure to its own or to third parties' advantage.” The same law defines (in art. 2) confidential and privileged information:

- *Confidential information* is information of any nature regarding an issuer or any of the securities thereof, that are not accessible to the public or have not been disclosed yet which, if disclosed, could influence the price or other aspects of the transactions with the respective issuer's securities or its associated companies, as well as of companies where the issuer has a majority position;
- *Privileged information* is information of any nature regarding an issuer or any of the securities thereof that is not known to the public and is susceptible to influence the decision of a reasonable investor.

An “insider” that has access to confidential information is defined as someone who:

- a) has access to information:

- as a member of the management, supervision or assimilated structures of the issuer;
- during the period he is employed by the issuer;
- as an investor in the securities of an issuer.

b) has access to such information by virtue of a position or relation identical to the ones specified under point a) above with a legal entity having itself access to such information;

c) has obtained such information from any of the above mentioned persons or in any other way.

The Securities Commission has also set norms of conduct for brokers and brokerage companies aimed at preventing insider trading and market manipulation. Regulation no. 3/1996 regarding the licensing of brokerage companies provides⁵³:

- Brokerage companies are forbidden to carry out transactions aimed at artificially influencing the price of securities or creating the impression of a high volume of transactions;
- Brokerage companies are forbidden to post quotations or place orders that may create a misleading perception regarding the real market price for a given security;
- Brokerage companies and their employees are forbidden to operate trades in a certain security based on confidential or privileged information, or to disclose such information to a person that may obtain benefits from trading.

Failure to comply with insider trading rules is sanctioned with fines for the brokerage company and/or the broker.

In practice, insider trading and market manipulation is difficult to prove. Sometimes, certain transactions suggest that confidential information may have leaked and rumors are frequently the main driving force on the market, especially for the RASDAQ.

2.2.5. THE STATE AS SHAREHOLDER

Ever since the adoption of Law 15/1990 regarding the reorganization of the state economic units into “regies autonomes” and commercial companies, successive governments have tried to identify ways for improving the effectiveness of corporate governance in state-controlled enterprises. Law 15/1990 itself allowed for a major separation between the “commercial companies”, which were supposed to be organized and function under the general regime put in place through the Company Law and the so-called “regies autonomes” whose legal regime was sketched in Law 15/1990.

For the “regies autonomes” the corporate governance structure was built around a board whose members are appointed by the ministry or public institution having a certain regie under its direct authority. In many cases, the members of such boards are managers of the regie and civil servants in a ministry, usually the Ministry of Industry or the Ministry of Finance, but outsiders may also be appointed. The members of the board have the same broad responsibilities as the administrators in a commercial company. The whole system is strictly bureaucratic, based on bureaucratic incentives and controls.

The state-owned commercial companies, most of them organized as joint-stock corporations, were supposed to adhere to the corporate governance structures recommended by the Company Law. As a surrogate of a General Shareholders meeting the single shareholder – the state represented by the State Ownership Fund – appointed representatives in a Council of State Trustees, which in turn made

⁵³ Art. 28. Regulation no. 3/1996 was supplanted by Regulation no. 3/1998, amended by Regulation no. 1/2001.

nominations for the board of administrators. The system mimicked the regular corporate governance structure but was evidently quite artificial. Instead of adopting profit maximization as an objective, these politically sensitive boards and the managers of state companies tended naturally to espouse a bureaucratic attitude. The weakness of the State Ownership Fund and its limited capacity to properly monitor its representatives at shareholders meetings and in the boards of administrators contributed to the distortion of the corporate governance system in state-owned companies. Instead of producing profit for the shareholders, state companies focused primarily on producing material and/or political benefits for the managers, the board members and other stakeholders.

The privatisation of the state companies was supposed to be the solution for better alignment of the interests of directors/managers with profit maximization. But privatisation advanced slowly while the economic performance of state companies deteriorated abruptly. This is why some analysts proposed intermediate solutions⁵⁴ that would better align interests of managers/directors with economic performance. A practical attempt was Law 66/1993 – the management contract law.

Law 66/1993 was applicable only to companies or “regies autonomes” where the state holds more than 50% of the shares. The Law was an attempt to set forth objective criteria for selecting “professional” managers, to give them enough power to run the companies, with a better, performance-related incentives system which would align their interests with profit maximization. For the first time, managers would get shares in their companies as compensation for good performance.

Unfortunately, the legal implementation of the law was a setback. Law 66/1993 created a legal hybrid by assimilating the manager with the members in a Board of Directors. The manager has the same responsibilities as the Board of Directors, but is employed by the company if he/she is a natural person. The manager can also be a legal person, but in this case the legal person has to appoint a representative who must be a natural person.

The nature of this contractual relationship is inconsistent. If the manager is a natural person, the contractual relations with the company are set under the provisions of the Labor Code. If the manager is a legal person, the contractual relations are not clear, because an agency contract between the legal person (manager) and the company is required, along with a contract with the representative of the manager, the natural person. It is not clear who concludes the contract with the representative of the manager and on what law the contract is grounded (mandate or labor contract?)

If, in addition to management performance, one considers the supplementary cost incurred from incoherent structuring of authority levels which do not allow real separation between the control function and the management function, then it is possible to conclude that agency costs for state-controlled companies went up as a consequence of management contract law.

From the beginning, Law 66/1993 was controversial and inconsistently applied. It was modified by Emergency Ordinance 39/1997, but this Ordinance was short-lived, being rejected the same year by the Parliament. The EO 39/1997 was an attempt to restore the board of administrators, giving managers a role subordinated to the board. This difference was necessary, although its purpose was also political, as there were no clear-cut criteria with regard to the nomination of the members of the Board of Directors. Besides, the executive managers were members of the board of directors/administrators with no voting right, so to some extent they were assimilated to the Directors' Committee provided for by Law 31/1990, except that the rights were not similar. The objective was to restore the distinction between the control function and the management function, but it did so in a quite incoherent manner.

⁵⁴ Aurelian Dochia, *Conducerea unităților economice cu capital de stat în perioada de tranziție (The Management of State-owned Economic Entities during Transition)*, in *Tribuna Economică* nr.2/1992;

Another Emergency Ordinance (no. 49/1999) was set forth in 1999, which abrogated Law 66/1993. The new regulation introduced the management contract, while maintaining the legal jargon of Law 31/1990. Consequently, no confusion was possible between a management contract and a contract concluded with the executive managers, but it is strange that all the management contracts concluded before the effectual date of this law were maintained until their termination.

In April 2000 this Ordinance was also rejected by the Parliament, so that now the simultaneous application of Law 66/1993 (considering its abrogation by O.U. 49/1999, also rejected by the Parliament) and Law 31/1990 is debatable.

2.3. THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

The OECD Principles of Corporate Governance

III. The corporate governance framework should recognize the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

“Stakeholders” is a notion that barely exists in Romania’s emerging corporate governance culture. This should not be a surprise, considering the context in which the new corporate governance system was instituted. From the corporate governance point of view, the transition is mainly a reassertion of the owners’ rights over a company. This is a revolutionary change compared to the situation which prevailed under communist rule, when “public” or “collective” ownership theoretically gave everyone a stake in the “socialist enterprise”. In many ways, the transition is a struggle aimed at limiting the influence of different stakeholders and strengthening the position of the owners. This basic fact (which has not been emphasized in previous works on transition and corporate governance) places the whole discussion related to stakeholders in a context that is distinct from the one prevailing in the advanced market economies.

In Romania there are only two categories of stakeholders that seem to be widely accepted as having legitimate interests in companies’ corporate governance: employees and creditors. However, neither of them is systematically treated as a legitimate stakeholder by the boards.

Employees derive their stakeholder rights from the constitution, as well as from labor and trade-union legislation. In addition to rights granted by law, such as a minimum wage and social protection rights, employees have the right to be informed and to express their opinion to the board on issues like restructuring plans and reductions in the labor force. However, the rights vary in their practical applications. In large state-owned, or formerly state-owned companies, employees tend to have more influence, mainly on decisions related to wages, work conditions or protection of social rights. In the smaller and private companies, employees rarely have a say when critical decisions are made. Cases where employees are systematically informed about the financial performance of their company, or are consulted on important decisions, are exceptional. There are some cases where trade union leaders or other employees’ representatives are appointed to the boards of their company (or another company), but these are exceptions. Except for wage negotiations, it is rare that employees’ representatives are systematically invited to the meetings of the board.

The rights of workers to contact authorities, board members, and shareholders on illegal and unethical behavior by management and other parties have also been violated. It should be noted that much controversy surrounds the various allegations, which include stories of intimidation, physical abuse and even one murder case. Protection of ‘whistle-blowers’ is poor and should receive serious attention from the criminal authorities.

Workers also have the right to collective representation, whether or not they belong to a union. This right is generally respected. Overall, trade unions are strong in Romania, especially in state-controlled companies. Strikes and similar labor actions have been common in Romania, a situation that would have probably been made worse if procedures for moderation and arbitration were not in place. Union opposition to restructuring and privatisation has been one particular area of conflict (see box). While there have been problems in the privatisation process that have affected labor, union opposition to restructuring has at times seemed myopic and counterproductive. Unions have also used their political influence to put governmental pressure on private companies experiencing labor disputes.

While employees have means to make their voice heard by the boards if necessary, bank creditors are in a weaker position. During the normal course of the business, creditors have limited possibilities to intervene in defending their rights. It is exceptional for banks to have representatives on the boards of companies, and when it happens it is either because of special personal relations among directors, or

because the bank is itself a shareholder in that company. For prudential reasons, the banking law provides that a bank cannot hold more than 20% of the shares in a specific company – usually, the stake is much lower – which does not necessarily grant banks a seat on the board.

Apart from banks, there are few other creditors, as the bond market is still in its infancy. Very few corporate bonds have been sold to the public until now and there are no corporate bonds listed on the stock exchange. According to the law, bondholders may hold general meetings where they can appoint representatives to the company. Representatives have the right to participate in the general shareholders meetings and can also challenge in court certain decisions of the board.

Creditors are given more power when a company defaults on its debt, and insolvency and liquidation procedures are initiated under the provisions of Law 64/1996 regarding bankruptcy and liquidation. Although a syndic judge is appointed to run the procedures, major decisions are to be approved by the creditors. Creditors decide whether they accept a reorganization plan, which gives the company a second chance to continue its business, or go directly into liquidation.

In practice, however, it is generally acknowledged that creditors' legitimate interests in companies are insufficiently protected in the current institutional arrangements. This is especially true during bankruptcy proceedings, which are extremely long and generally conducted with a bias towards management and other 'corporate incumbents'. Considering the abuses many creditors have been confronted with over the years, and the many fraudulent schemes banks that creditors have been victims of, it is no surprise that the cost of credit continues to remain very high and that most banks prefer to lend to the government.

Privatisation and Labor Conflict in Romania

ALRO Inc. is a major producer of aluminum in Romania. Sixty percent of production is exported and its products are traded on the London Metal Exchange. Since 1997 ALRO shares have been listed and traded on the first tier of the official listing of the Bucharest Stock Exchange. Though the state still holds over 50% of the paid-in capital of ALRO, the economic performance of the company is strong. Over the last year, ALRO paid net dividends of over 17 million US\$, a great amount by Romanian standards.

In 1999, at the request of FPS and the Ministry of Industries and Commerce, a study for the privatisation of ALRO and ALPROM, another company in the aluminum industry located in the same region as ALRO, was made by foreign experts. They suggested a merger, then privatisation of the new company. In October 2000, another foreign advisor advocated privatising ALRO and ALPROM as a "package deal" with a strategic investor, without a previous merger of the two companies. This new decision by FPS provoked a massive protest of the trade unions in the two companies involved. Their leaders have declared the following:

"ALRO and ALPROM have created together, on the industrial platform of Slatina town, an economic microsystem, with more than 10,000 employees and with another 16,000 employees in the 60 economic agents, upstream and downstream Slatina. In this context, the privatisation of the two companies has to be made in the interest of Romania, otherwise we all shall watch the biggest transfer of the national wealth abroad. We are not against the privatisation of the two companies, but this should be done in the general interest of the Romanian metallurgical sector and national economy."

The protest meetings that followed these allegations stopped the privatisation process.

In March this year, APAPS made an attempt to increase capital by a public offering, preceded by the exercise of pre-emptive rights. According to privatisation law, the state is not entitled to participate in any capital increase, hence the proposed operation meant, in an obscure way, a masked privatisation (this episode is described in more detail in section 2.4.1.).

This initiative provoked the protest of the trade unions. They again organized protest meetings and made incendiary allegations: "The method chosen by APAPS is, practically, a masked privatisation aiming to satisfy mean interests". Union opposition has for all intents and purposes suspended the privatisation of either company, in spite of their profitability and potential value to outside investors.

The privatisation of CS Resita was considered a success story. The American strategic investor committed itself to invest approximately 60 million USD until the end of 2000 and another 62 million USD in the four next years.

However, they have not fulfilled their investment commitments, nor their promises regarding repayment of certain debts to the state. The trade unions initiated a strike, claiming that the American company, Noble Ventures, had not observed its contractual obligations, that the steel mill's economic performance was disastrous due to bad management, that production was interrupted and that wages were paid with long delays. The Resita steel mill has so many debts that any of its creditors may ask the Court to start judicial reorganization and restructuring of the company, or even its winding-up.

In June, the labor dispute was at its peak. 220 employees of CS Resita were on hunger strike and another 2,000 were gathered into protest meetings in front of the County Hall. A local court obliged the management of the company to pay the pending wages and to accept the presence of trade union leaders at the meetings of the Board of Administration.

At the end of June 2001, a Governmental delegation led by the Minister of Privatisation started negotiations with the trade unions. The result of the negotiations was the judicial reorganization of the company, preserving, however, the present shareholding structure. At the same time, the Resita Downhill signed a protocol with the trade unions, undertaking to pay emergency unemployment indemnities from the local budget; the amounts to be distributed to be reimbursed by the employees when resuming their activity.

2.4. THE BOARD OF DIRECTORS AND THE OVERSIGHT OF MANAGEMENT

OECD Principles of Corporate Governance

V. The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The board of directors is the cornerstone of the corporate governance system. In most jurisdictions, the board is the interface between the shareholders and the executive managers of the company in charge of day to day operations. The Romanian Company Law sets forth solutions for the appointment of the board of directors/administrators and for the organization and effective functioning of the board that are in line with the European continental tradition. One of the most criticized characteristics of the board system in Romania is the presence of a large number of politically appointed members. After parliamentary elections, a wave of change regularly sweeps through thousands of companies, with representatives of the new political majority replacing members of the board who do not enjoy political support anymore⁵⁵. The Financial Investment Companies (SIFs), although private, still have boards with a large number of political figures – seven out of the eleven members of the newly elected board of SIF IV Muntenia are Members of Parliament. What is more curious is that sometimes genuinely private companies invite politicians to take a seat on their boards: the Daewoo Magnolia Heavy Industries Company (a shipyard controlled by Daewoo) recently appointed two PDSR MBPS to its board – and the case is not singular.

2.4.1. BOARD NOMINATION AND STRUCTURES

BOARD NOMINATION

In accordance with Law 31/1990, the nomination of the directors/administrators, or of the sole administrator, is made exclusively by the general assembly of the shareholders⁵⁶. The director/administrator⁵⁷ can be either a natural or a legal person. In limited companies by shares, the administrator shall be a partner⁵⁸, while in joint stock companies any person, shareholder or non-shareholder, can be an administrator.

If the administrator is a legal person, he is bound to nominate a natural person as permanent representative. The representative has the same obligations as the administrator and is accountable both under civil and criminal law, just like any other administrator-natural person. Moreover, the legal person that designates a representative is severely liable⁵⁹. The nomination of the representative shall not occur before an administrative contract (which has to be in a written form) is signed by the parties -- the legal person and the business corporation -- through a shareholder.⁶⁰ If the administrator is a natural person, the law makes no specific provision, although it does not rule out the possibility of having an explicit written contract. In practice, however, there are very few cases where the natural

⁵⁵ See for example Adrian Barbulescu, *PDSR se infiltreaza in consiliile de administratie ale firmelor de stat (The SDPR is infiltrating in the boards of administrators of the state firms)*, in Curentul, April 25; *APAPS a schimbat conducerea a peste 1000 de societati (APASP has changed the management structure in over 1000 companies)* in Curentul, May 14.

⁵⁶ Art. 111 par. (2) (b), art. 113 (l) (implicit provision), art. 134, par. (4)

⁵⁷ We should emphasize again that in the Romanian legal discourse the members of the board are called "administrators", while the term "director" is reserved for executive managerial positions.

⁵⁸ Art. 183 of law 31/1990 on commercial companies, republished.

⁵⁹ Art. 136 par. (2) of law 31/1990

⁶⁰ Art. 136 par. (2) of Law 31/1990

persons appointed as directors/administrators have concluded such a contract – except for state-owned companies that were examined separately in 2.2.5 The State as Shareholder. In most cases, the contractual relations between the administrators and the company are implicitly derived from Law 31/1990 and from the Constitutive Act.

Romania requires that the sole administrator, or at least half of the administrators, should be Romanian citizens⁶¹, unless the Constitutive Act provides otherwise⁶². In other words, the law complies with the principle of contractual freedom and gives shareholders the right to decide on the nomination of foreign citizens to the Board⁶³.

For the election of the members of the board the law specifically requires a secret ballot procedure. In spite of the secret ballot, elections rarely bring out surprises in the nomination of the board – the majority shareholder, the existing members of the board and the executive managers all have a decisive role in promoting certain candidates.

There are no special provisions to ensure representation on the board of different stakeholders, including minority shareholders. In practice, however, in companies controlled by the state, different stakeholders -- such as financial investors -- generally have a seat as result of agreements with the majority shareholder. Such arrangements tend to be continued after privatization and the new majority shareholder is usually willing to establish good relations with the other partners.

ELIGIBILITY OF BOARD MEMBERS

With regard to the selection criteria for the directors/administrators, Law 31/1990 establishes a quite restrictive regime, although this regime is not always supported by severe sanctions. The requirements specified by the law refer to respectability and legal capacity. Conflicts of interest situations are also disqualifying in the selection of board members. Some supplementary requirements refer to the members of the boards in banks and other financial institutions.

A first category of general requirements refers to respectability or to legal capacity. In this respect, Law 31/1990 stipulates that persons who cannot be founders cannot be administrators either. The persons who cannot be founders are persons that have no legal capacity or persons convicted for fraudulent management, abuse of trust, forgery, use of forgery, fraud, embezzlement, false testimony, bribery, as well as other criminal acts specified by Law 31/1990⁶⁴.

The second category of requirements refers to cases of conflict of interest. Therefore, Law 31/1990 provides that the administrators cannot be censors. The interdiction is valid because the cumulated functions eliminate the distinction between internal and external financial control. At the same time, the law provides that a person cannot sit on more than three Boards of Directors concomitantly⁶⁵,

⁶¹ Citizenship in the case of the natural persons and nationality in the case of legal persons

⁶² Art. 134 par. (3) of Law 31/1990.

⁶³ This is in contrast to the situation before 1940, which made it compulsory to appoint Romanian citizens for at least half of the seats on the board.

⁶⁴ Art. 6 par. (2) of Law 31/1990. When it refers to “founders”, the text of the law is intended to the business corporations set up through public subscription. However, the wording of art. 135 of Law 31/1990 shall be corroborated with art. 6 par. (2) of the same law, as it regulates the management of the stock companies in general.

⁶⁵ Law 31/1990, art 142: “(1) no one can operate in more than three Boards of Directors concomitantly. (2) The interdiction mentioned on par. (1) does not refer to cases when the person elected to the Board of Directors is the owner of at least one fourth of the aggregate stock or takes the office of administrator of a business corporation that owns the one fourth”.

cannot be an administrator, censor or shareholder/general partner in a competing company, or carry out the same kind of trade on his own account⁶⁶.

In order for a nomination to the board to become legally valid, the administrator is required to constitute a guarantee – either double their monthly remuneration or the nominal value of 10 shares⁶⁷. The administrators are also bound to register their signature specimen with the Trade Registry.

Banking Law no. 58/1998 sets special rules for the nomination of directors/administrators in a bank that are complementary to the provisions of Law 31/1990. Only natural persons can be appointed as administrators in a bank and the board of a bank can have a maximum number of 11 members. The administrators of a bank must be residents of Romania, fulfill exclusively the function for which they were appointed, and at least one of them should be a Romanian citizen. Moreover, the administrators must hold a university degree, have at least 5 years experience in financial-banking activity and should not be liable for the bankruptcy of a business corporation. The banking law specifies that a person is excluded from the position of administrator if he or she has violated the banking laws, either in a previous similar position or as an executive manager or censor. These situations of misconduct are specified by Law 58/1998. The administrators of a bank must get the clearance of the central bank before taking office⁶⁸.

Similar special provisions are in place for other financial institutions – insurance companies or investment funds.

REVOCAION OF THE MEMBERS OF THE BOARD

The members of the Board can be revoked by the shareholders convened in the general assembly at any time. The revocation does not need to be motivated.

In the case of the banks that have problems, the Board of the National Bank has the right to replace the existing board of directors/administrators with a “special administrator”⁶⁹ and a special management regime. During special management, the shareholders of the bank cannot appoint other administrators.

Revocation is not frequent in practice – usually members of the board resign if they feel they have conflicts with the majority shareholder that could eventually lead to revocation.

BOARD REMUNERATION

The directors/administrators are entitled to be compensated for their work as members of the board. Art. 148 of Law 31/1990 specifies that “fixed fees and any other pay or benefits can be granted to administrators and censors only based on a decision of the general meeting (of shareholders)”. Directors’ may also take a share of the benefits of the company – but only if such remuneration was decided by an extraordinary general shareholders meeting or was written in the Constitutive Act of the company. Although it is legally possible, it is not customary to compensate members of the board in shares.

⁶⁶ Art. 142 par. (5) of Law 31/1990: “The members of the Directors’ Committee and the executives of a joint stock company cannot be, without the approval of the Board of Directors, administrators, members of the Directors’ Committee, censors or associates with unlimited responsibility of other competing companies or having the same line of business and cannot carry out the same trade or a competing trade in its own account or in the account of another person, as such cases are liable to be sanctioned by revocation and charged to pay damages”.

⁶⁷ Art. 137 par. (1) of Law 31/1990.

⁶⁸ Art. 25 of Law 58/1998. These requirements are detailed in the Norms No. 2/1999 issued by the National Bank of Romania, modified by Norms 10/1999.

⁶⁹ Art. 80 of Law 58/1998

Board members who assume extra responsibilities, such as the chairman/president of the board or members of the Directors' Committee, receive compensation proportional to their supplementary tasks. The remuneration of the members of the Directors' Committee is established by the other members of the board within the limits set by the Constitutive Act. If no such limits are defined in the Constitutive Act, then the general assembly has to decide.

In state-owned companies the remuneration of the members of the board was frequently established in relation to the general manager's salary. This created incentives for the members of the board to approve high salaries for the executives, in order to raise their own remuneration.

In practice, although formally the provision of the law is respected in the sense that shareholders approve the remuneration of the boards, there are ways to go beyond the approved remuneration either by "adjusting to inflation" the amount approved, or by granting "bonuses" that were not explicitly submitted to shareholders' approval.

THE STRUCTURE OF THE BOARD

According to art. 134 of Law 31/1990, the company is administered "by one or several administrators, that are temporary and revocable". When several administrators are appointed, they form a "board of administrators" headed by a chairman/president of the board appointed among the members of the board. At the same time, art. 140 of the Law provides that "the board of administrators can delegate part of its powers to a Directors' Committee composed of members selected among the administrators". The president of the board can at the same time be the general manager or manager of the company, in which case he also heads the Directors' Committee. The board selects and hires the managers and other employees of the company.

Thus, Romania has adopted the "unitary" structure of the board. But in many large companies the existence of a Directors' Committee is made up of administrators who assume an executive role, suggesting a hybrid structure. The hybrid structure does not explicitly include a surveillance council -- all members of the board have the same broad responsibilities and are still equally accountable -- but in practice the non-executive members of the board tend to assume more of a surveillance role.

In practice, most large companies have at least one independent (non-executive) member on the board⁷⁰. The companies listed on RASDAQ tend to have the unitary type structure of the board while the companies on the Bucharest Stock Exchange are more frequently organized under the hybrid structure. Also, in small- and medium-sized companies there are less non-executive members of the board than in larger companies. Private companies also more frequently adopt the unitary type of structure, where the main shareholder also holds the position of president/chairman and director-general (chief executive officer). Affiliates of foreign companies prefer to maintain a dual structure, where one of the top positions -- chairman of the board or general manager -- is held by the representative of the foreign owner while the other position is given to a local "specialist".

It should be mentioned that for certain types of companies, such as investment funds, an organizational structure that specifically provides for a "surveillance board" completely separate from the executive tasks is required. The five Financial Investment Companies can choose to organize themselves either as "self-managed" entities or they can separate the portfolio management functions (entrusted to a specialized assets management firm) from the other functions. Currently, only SIF IV Muntenia has adopted the split structure.

Romanian companies rarely use specialized committees outside the directors committee. Part of this may reflect the existence of the censors, who would seem to serve some of the functions of an audit or

⁷⁰ There are no empirical studies on the structure and effective functioning of the boards in Romania; therefore, the estimates in the text should be considered an "educated guess".

censors committee. In practice, however, the lack of specialized committees greatly reduces the effectiveness of the typical board.

2.4.2. BOARD FUNCTIONS

Romanian legislation is rather general regarding the functions of the board. In accordance with the provisions of art.70 par. (1) of Law 31/1990, the administrators "can carry out all the operations required in order to achieve the objectives of the company, within the limits specified in the Constitutive Act". Art. 72 stipulates that "The duties and liability of the administrators are regulated by the provisions concerning the mandate and those specified in the present law." The main limitations to the powers of the board refer to the scope of business (administrators cannot undertake actions that are not within the scope of the company's business) and the decisions reserved by the law to the shareholders meetings. The law does not clearly specify the administrator's duty of care and loyalty to *all* shareholders.

In practice, the effective functions assumed by a board depend to a large degree on the structure of the board, the professional and human qualities of board members and on the position and personality of the general manager-chief executive officer. Large companies, as well as financial institutions, tend to have strong boards, actively involved in corporate strategy decision-making and in monitoring corporate performance. In many other companies, however, including private companies, boards have a formal role of "stamping" managers' decisions. Theoretically, boards have power in nominating the key executives and in establishing their remuneration; but, in practice, boards tend to follow the majority shareholder's choice.

LIABILITY OF ADMINISTRATORS

If the rights and obligations of the administrators are set by a legal proxy contract, their liability is derived from the contract⁷¹. However, Romanian law also includes a liability for torts in the case of prejudices, as well as criminal liability for perpetration of deeds considered criminal offences.

Civil liability. The administrators are liable if they do not fulfil their mandate in compliance with the administration contract, the statutory act and/or the law. Administrators are also held responsible for wrongdoing perpetrated by their predecessors, in the case that they neglected to inform the censors whenever they discovered such wrongdoing.

The administrators are jointly, severally and subsidiary liable. The liability is not extended to the administrators who can prove (based on the minutes of the board meetings and written notification of the censors) that they disapproved a certain decision. Bringing an action for liability belongs to the general assembly of the shareholders that appoint a representative⁷². It is very difficult for shareholders to sue board members directly. The action can also be brought by creditors, but only in the case when the company is undergoing bankruptcy procedures.

The law specifies that administrators are jointly liable for: (a) the effective existence of payments made by subscribers; (b) for the reality of dividends actually paid; (c) for the existence of the registers required by the law and for correct and fair bookkeeping; for the truthful fulfillment of the decisions of the General Assemblies⁷³.

⁷¹ Prof. dr. Stanciu D. Carpenaru: "Management of companies under the provisions of Law 31/1990", Commercial Law Journal no. 2/1993, pg. 40, Bucharest, 1993.

⁷² Art. 150 of Law 31/1990. The provision is taken over by art. 154 of the Romanian Commercial Code, except that in this law, the action against the administrators is brought by the censors. The text was liable to criticism from the very beginning, because other persons had no right to take action in Court (such as creditors, or other persons taking an interest)

⁷³ Art. 73 and 144 of Law 31/1990.

In all the other cases, administrators are severely liable. It is obvious that such cases refer to bad management where the responsibility of an individual member of the board can be identified. Although, in terms of procedure, action brought against all administrators is not ruled out. Moreover, the administrators' liability can be subsidiary when it pertains to deeds perpetrated by executive managers or by other employees of the company. In the last case, liability's role is that of a "guarantee that does not replace the responsibility of the person who committed the deed resulting in damages..."⁷⁴, but is grounded on the administrators' failure to perform the control function.

Criminal liability. Under criminal law administrators are held responsible for prejudice brought to a company or bankruptcy caused by fraud. Law 31/1990 enumerates about 22 criminal offences that administrators may be liable for, including: (a) the use of the company's assets or credit for their own benefit or for an end that is contrary to the company's interests; (b) spreading false information or using other fraudulent means in order to obtain a benefit to the detriment of the company; (c) payment of dividends out of fictive benefits, without proper financial statements or based on false financial statements etc. Prosecutors may initiate criminal action against administrators.

2.4.3. MANAGERIAL ENTRENCHMENT

In most companies, managers have a strong position in their relations with the board, derived from different sources:

- Both in state-controlled and private companies, managers tend to learn they owe their position not primarily to the board of directors/administrators, but directly to the controlling shareholder. As a result, managers are frequently in a position to influence nominations for board seats, reversing normal authority;
- Managers have access to and control over the information in the company, which gives them an advantage over the other members of the board;
- The structure of the board also favors managerial entrenchment. In companies where the president of the board is also general manager/chief executive officer, the board of administrators has a weaker position in monitoring management. The same applies when the board is dominated by executive directors; The lack of specialized committees also weakens the position of the board relative to management.
- The process for nominating board members is not well-defined in the law and offers shareholders few protections. For example, it does not require any information on nominees to be distributed directly to share holders. When combined with dispersed ownership structures, managers have ample room for maneuvering in the process of nominating members of the board and subsequently in the organization and functioning of the board;
- The weakness and passive/bureaucratic attitude of the board members appointed by the ministries or other public institutions in state controlled companies encourages managers to assume broader responsibilities and to intervene in board decisions.
- Perhaps most seriously, the absence of independent board members in either state controlled or private companies ensures that all board members have close ties to management and controlling shareholders. Currently there are no requirements, either in company law or listing requirements, that companies have independent members.

⁷⁴ Prof. dr. Stanciu D. Carpenaru: "Management of companies under the provisions of Law 31/1990", Commercial Law Journal no. 2/1993, pg. 40, Bucharest, 1993.

The current situation of the balance of power between managers and the board is in line with the prevailing view that during transition, when companies are confronted with so many changes and uncertainties, strong management is needed in order to improve effectiveness in decision-making. The experience of the first half of the 1990s, when managers were frequently removed at the demand of the trade unions, reinforced the idea that managers should be given proper powers and defenses if they are to generate economic performance.

2.4.5. THE ROLE OF THE CENSORS

The censors are part of the Romanian structure of corporate governance. While the general shareholders' assembly serves as an instrument for formulating the resolution of the company, and the administrators are in charge of the execution of the resolution, the censors' role is to monitor the administrators, provide financial oversight, and check compliance with legislation. The censors monitor not only the company, but also the activity and the decisions of the board. The censors do not have a role in the decision making process, though they usually participate in the meetings of the board of administrators and eventually express their opinion on different current matters.

Romanian legislation has adopted the internal auditing system. According to Law 31/1990, the general shareholders meeting appoints three censors and three substitutes (if the Constitutive Act does not set a higher number), of which at least one is required to be a certified or expert accountant. The censors are elected among the shareholders -- with the exception of the certified or expert accountants -- for a term of three years. In companies where the state holds more than 20% of the shares, the Ministry of Finance has the right to recommend one of the censors⁷⁵.

It should be noted that in public companies the internal censors system is supplemented by external censors. The financial reports of public companies have to be certified by external censors authorized by the National Securities Commission.

In fulfilling their role, the censors have two main duties: to monitor the administration of the company and to check financial statements. The conclusions of the censors' inspection are presented in a report submitted to the general shareholders meeting. The general shareholders meeting cannot approve the yearly financial statements unless the censors' report is presented.

Other duties of the censors specified by law are:

- to check every month the cash in the company as well as the securities belonging to the company;
- to call for the ordinary or extraordinary shareholders' general meeting, when the administrators fail to do so;
- to participate in the general meetings and to demand for certain issues considered by them to be important enough to be included on the agenda;
- to check whether the administrators have fulfilled their obligation to deposit a guarantee;
- to check whether the administrators or liquidators comply with the law and the Constitutive Act;
- to appoint, together with the administrators, a temporary administrator in case of vacancy, and to call for a general shareholders meeting for a definitive nomination;
- to call for a general shareholders meeting when they find the request of shareholders representing 25% of the share capital is justified.

⁷⁵ Art. 154 of the Law 31/1990.

Censors also have an obligation to inform shareholders and directors/administrators on irregularities they have uncovered.

While the censors would seem to have the potential to ensure good corporate practices, in reality they are largely ineffective in their assigned roles. They tend to follow the lead of management and the controlling shareholder. Their relationship with the board is ambiguous, and their existence seems to prevent the board from (or provides an excuse not to) engaging in certain core competencies, such as supervising internal audits.

2.5. TRANSPARENCY AND DISCLOSURE

OECD Principles of Corporate Governance

IV. "The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company."

Company Law no. 31/1990 as amended in 1997 specifies the records a joint-stock company is required to keep, as well as the minimal disclosure requirements to shareholders and other interested parties. Higher disclosure standards are applicable for the companies listed on the Stock Exchange, these standards being imposed by Law 52/1994 on the Securities and Stock Exchanges and by Stock Exchange regulations. Accounting rules and procedures are set by Accounting Law no.82/1991.

It should be mentioned that, along with the legislation, the media has proved to be one of the most important forces and vehicles for promoting transparency and disclosure with regard to corporate governance. Apart from publishing the different announcements required by law (notice of the meetings, important events, changes in ownership etc.) all major newspapers have regular comments and analysis on capital markets and on companies. All major Internet portals have links to the institutions of Romanian capital markets and there are several specialized sites full of informative content.

But the most important contribution of the media came from investigative reporting. In fact, most of the "scandals" showing frauds, abuses or cases of mishandling of a situation by the authorities were initiated by the media.

2.5.1. CORPORATE FINANCIAL AND OPERATIONAL DISCLOSURE

Art. 172 of the Law 31/1990 enumerates six "registers" a joint stock company is required to keep, "in addition to the records provided by the law"⁷⁶:

- a) the shareholders register that records the name and the address of the nominal shares owners, as well as the payments made for shares. The shareholders' register has to be updated prior to every general shareholders meeting, but not less than once a year⁷⁷. The company can have the shareholders register maintained by an independent specialized registry. The companies listed on a stock exchange are compelled by Law 52/1994 to keep their shareholders register with an independent registry authorized by the Securities Commission.
- b) a register of the general shareholders meetings, which is a collection of the minutes of the meetings;
- c) the register of the board of directors/administrators meetings – recording the minutes of the discussions of the boards, the decisions and the votes;
- d) the register of the directors' committee meetings – recording the minutes of the discussions in the directors' committee;
- e) the register of the discussions and conclusions of the censors;

⁷⁶ The "records provided by the law" are the accounting books treated below at 2.4.2.

⁷⁷ Regulated through Government Decision no.855/1995.

- f) the bonds register, similar to the shareholders register, records all bonds issued and settled, as well as the identification of bondholders, when bonds are nominal. The register for dematerialized bonds and for bonds listed on a stock exchange is subject to the provisions of law 52/1994.

The registers mentioned under (a), (b), (c) and (f) are the duty of the board to keep, the register under (d) is the duty of the directors' committee and the register (e) under the censors' duty.

The directors/administrators have an obligation to put at the shareholders' disposal the registers under (a) and (b) and to issue copies of the records in these registers at their own expense. The same applies to the bonds' register, which should be made available to bondholders.

Shareholders' access to information was extended in 1999⁷⁸ through provisions aimed specifically at minority shareholders. According to the new art. 133¹ and 133², between the general meetings, but not more than twice during a fiscal year, shareholders have the right to consult documents specified in the constitutive act. Consequently, shareholders may notify the board of directors/administrators in writing, which have an obligation to answer within 15 days from the date the notification was filed. Shareholders representing more than 10% of the capital may ask the court to appoint experts to check certain operations of the company and to present a report. The fees of the experts are to be paid by the company – unless the request was ill-intentioned.

The most comprehensive document by which shareholders are informed about the evolution of the company is the annual report of the directors/administrators, accompanied by the report of the censors. Both reports have to be presented every year at the general shareholders meeting and constitute the basis for the decisions made by shareholders.

Art. 176 of the Company Law specifies that “the administrators have to present to the censors, at least one month in advance of the general meeting, the balance sheet for the previous fiscal exercise, with the profit and loss account, accompanied by their report and by supporting documents”. The censors have an obligation “to check whether the balance sheet and the profit and loss account are prepared in line with the law and correspond to the registers, whether the registers are regularly updated and whether the evaluation of the patrimony was performed in conformity with accounting rules.” (art. 158). The censors' review is presented in a report to the general meeting.

As a general rule, there are no specific provisions regarding the structure or the content of the administrators' annual report, except the requirement that it should be presented in written form. The report should present clearly and in a concise form the situation and the evolution of the company in the previous fiscal year; the performance, the difficulties and problems that have confronted the company; the most important events, the activity of the subsidiaries, the evolution of the transactions with shares – for listed companies – and comparisons of the performance indicators with previous years.

In practice, the quality of the administrators' reports vary substantially. They tend to be good for the large companies listed on the Stock Exchange and for financial institutions, but mediocre and formal for many small- and medium-sized companies, or for companies that are not exposed to public scrutiny.

The administrators report, together with the other documents to be submitted for the shareholders' attention and vote in the general meeting have to be deposited at the company's headquarters and subsidiaries 15 days before the meeting in order to be reviewed by shareholders. Shareholders may obtain, at their own expense, copies of the balance sheet and of the administrators' and censors' reports.

⁷⁸ Law 99/1999 concerning measures for the acceleration of the economic reform. art. viii.

Sometimes companies discourage shareholders from asking for copies of the reports by establishing relatively high costs for the copies. For example, ALRO, one of the blue chips of the BSE, fixed a ROL 1mn. (approx. USD 40) price for its year 2000 reports – well above the cost of producing a copy of the report. The same company produced a long and a short form of the report – the long form being reserved for “significant shareholders”.

Within 15 days after the general meeting, the financial statements and the reports approved by the shareholders are presented to the territorial office of the fiscal administration. One copy of the same documents with the visa of the fiscal administration is lodged with the Trade Registry, where the public can consult it. While most companies comply with the legal requirement of presenting the documents to the fiscal authorities, an important number of companies fail to submit their annual reports to the Trade Registry, or they are very late in doing so.

Law 52/1994 sets higher disclosure standards for the companies listed on the stock exchange. The annual reports of such companies are prepared in accordance with instructions of the securities commission that specify the minimal content, the form and the moment the report is to be made public. Listed companies are also required to publish a summary of the annual report in the press. Half-year financial statements have to be made public and the securities commission may decide to ask for quarterly reports (art.82). Listed companies send “current reports” to the Securities Commission and to the Stock Exchange in which they have to announce any important event that may influence investors’ decisions.

Failure to comply with reporting requirements was a chronic problem for the BSE. Starting with the year 2000, both the BSE and the Securities Commission sanctioned many companies and discipline improved. But surprises continued to happen – the latest being the saga of ALRO’s decision to proceed to increase capital through revaluation of assets and issue of new shares. Rumors about such an increase were circulating in the market and hesitantly denied by the company officials. Then on 14 May 2001 ALRO was suspended from trading. The next day the call for an extraordinary meeting of the shareholders was published. The increase of capital was on the agenda of the meeting. But the details on the increase (the sequencing of the two operations, the price for the new shares etc.) were missing. The strong reaction of the press and the trade unions obliged the authorities (the privatisation agency, APAPS, is the majority shareholder in ALRO) to give some explanations, but ALRO shares started to fluctuate on the stock exchange (up 14.8% on May 15, down 6.8% on May 16 and up 7.5% again on the next two days). The Stock Exchange General Commissioner asked the Securities Commission to sanction the company and the members of ALRO’s board, but the Securities Commission decided it had no legal ground to apply sanctions⁷⁹. In fact, the whole operation was a covert privatisation of one of the “crown jewels” of the Romanian economy and the lack of transparency for such an important transaction risk to seriously undermine the credibility of the Securities Commission and weaken the BSE.

On the occasion of the ordinary general shareholders meeting, administrators presented another important document – the budget for the subsequent fiscal year and the program of activity of the company. Although the Company Law specifies that the program of activity is presented “as the case may be”, most large listed companies do prepare the document. The content of the document is, however, variable from company to company – sometimes specific objectives are set, as well as the measures envisaged to meet the targets, at other times only a general indication is provided as to the revenues and main categories of expenses. The budget and the program of activities are the only documents giving shareholders the possibility to discuss and take position *ex ante* on the managers’ intentions. By setting numerical targets, the document establishes a benchmark against which the performance of the administrators may be measured. However, because of the volatility of the macroeconomic environment (high and unpredictable inflation), in most cases the general shareholders

⁷⁹ For a critical overview of the operation see Teodor Ion, “Lovitura de stat” de la “ALRO” Slatina (A “coup d’etat” in ALRO Slatina), *Adevarul Economic* nr.21, May 2001.

meetings entrust administrators with the power to adjust the initial provisions of the budget. The “benchmark function” of the budget is thus weakened as the boards adjust targets according to their interest to show good performance.

2.5.2. ACCOUNTING PROCEDURES AND AUDITING REQUIREMENTS

The legislation is more specific on the financial statements a company is required to prepare and present to shareholders and to third parties. The provisions of the Company Law are augmented by the provisions of Accounting Law no. 82/1991. According to art. 27 of the Accounting Law, the financial statement of a company is composed of three documents: the balance sheet, the profit and loss account -- both with the corresponding annexes -- and the administration report.

All three corporate governance bodies have a role in the preparation of the financial statement. The effective drafting of the financial statement is done by the directors/administrators (in practice, based on managers' input). The censors check the information included in the financial statement with the company's books and signal irregularities in their report. Finally, the general assembly of the shareholders approves the document or requires changes.

In drafting the financial statement the directors/administrators have to observe some basic rules set through the Accounting Law: a) all entries in the balance sheet have to be in line with the data recorded in the company's books and should reflect the real situation of the assets and liabilities; b) no compensations are allowed between different accounts that are consolidated in the balance sheet, as well as between different revenues and expenses positions included in the profit and loss account; c) share capital is a constant amount on the books. The directors/administrators are legally liable for the organization of bookkeeping and for compliance with the legal norms.

Traditionally, the Ministry of Finance sets accounting rules. Directed primarily towards providing information to the tax authorities and to the government, the Romanian accounting system allows very little scope for judgmental accounting entries, provides limited disclosure and, therefore, is of little help for users like managers and shareholders. A “chart of accounts” is set by law that includes all accounts and account numbers to be used by all entities (with the exception of the banks and not-for-profit institutions, which have different charts of accounts). The principle of the chart of accounts is that all companies will record the same item in the same account irrespective of the business activity⁸⁰.

A first attempt to improve the accounting regulations was made in 1994, when a new “chart of accounts” was introduced. The system then adopted allowed the measurement of a company's assets and liabilities in a manner broadly consistent with International Accounting Standards, but still failed to include certain essential information such as the cash flow statement and proper disclosures, including notes to the financial statements. While the new system allowed for a degree of judgmental accounting entries, in practice those which do not have any tax consequences are rarely made, reflecting the unwillingness of most accountants to record entries other than those that are required to calculate taxable profit.

Only certified or expert accountants have the right to oversee preparation and to sign the financial statements of a company. The accounting profession was organized into an independent professional organization – the Body of Certified and Expert Accountants⁸¹ – with the purpose of establishing professional standards, monitoring compliance and sanctioning members. However, the Ministry of Finance maintained a role in both the accountants' certification process and in setting professional standards, causing the Body of Certified and Expert Accountants to complain repeatedly about interference.

⁸⁰ See *A comparison of International Accounting Standards and Romanian Accounting Regulations*, prepared by Pricewaterhouse Coopers Romania, on the site www.majorcompanies.ro

⁸¹ Government Ordinance no. 50/1997

In April 1999, the Ministry of Finance issued the first two public documents directed at harmonizing the presentation of the Romanian financial statements with the formats prescribed by the EU IVth Directive and setting up a conceptual framework for the future development of accounting standards in accordance with IAS. Subsequently, in the year 2000, detailed accounting standards which are IAS compliant were published. Regulations on the preparation of group accounts, in accordance with the EU VIIth Directive have also been published. All these new accounting regulations began to apply in the year 2000 to companies that meet two of the three criteria set by the EU IVth Directive: turnover, total assets and number of employees. In February 2001 the latest piece of legislation was issued⁸², which establishes the principles and the basic accounting rules, the form and the content of the financial statements.

Thirteen companies, most of them listed on the Bucharest Stock Exchange, prepared year 2000 financial statements in accordance with the new regulations⁸³; another 197 companies started in 2001 and 600 will start in 2002. All large-sized public companies will apply the new accounting standards in 2005; for small companies a simplified accounting system will be put in place.

Auditing is also changing. Traditionally, censors were entrusted with the role of auditors, according to the Company Law. Censors are shareholders' representatives. they are elected among the shareholders – although one of the three censors has to be a certified accountant and, therefore, may be an outsider. Censors oversee the administration, check compliance of the financial statements with the books and make sure records are properly maintained.

A first step towards the professionalisation of the censors' function was made through Law 52/1994, which requires public companies to have their books certified by an independent censor selected from a pool of censors authorized by the Securities Commission⁸⁴. The external/independent censor, whose report is addressed to the Securities Commission and to the Stock exchange, does not substitute for the internal censors committee.

⁸² Order of the Ministry of Finance no. 94/2001. See Maria Manolescu, Georgeta Petre *In plina actualitate, implementarea reglementarilor contabile armonizate cu Directiva a IV-a a UE si cu Standardele Internationale de Contabilitate (Implementation of the Accounting Regulations harmonised with the EU IVth Directive and with the International Accounting Standards)*.in *Adevarul Economic* no.21/2001.

⁸³ However, for tax purposes, the old regulations will be applied. Under the IAS, part of the current profits turn into losses, having a negative impact on budget revenues.

⁸⁴ Chapter VII of the Law 52/1994, on the external censors.

Main Differences between Romanian and International Accounting Standards

Procedures for restating RAR into IAS compliant statements have been developed. In fact, many foreign companies, or companies that have relations with foreign partners, currently keep their books simultaneously in compliance with RAR (for tax purposes) and with IAS (for managerial purposes). There are four differences from IAS that impact most on the Romanian companies' financial statements:

Hyperinflation

- IAS 29 requires that the financial statements of any entity that reports in the currency of a hyperinflationary economy should be adjusted to take into account the effects of inflation. The financial statements are restated in terms of the measuring unit current on the balance sheet date, and the net loss on the net monetary position is included in the income statement and disclosed separately as the restatement adjustment. IAS standards suggest that economies should be regarded as hyperinflationary if the cumulative inflation rate over a period of three years exceeds 100%.
- RAR does not address the issue of hyperinflation. To date, the only adjustments that have been made in this area are a number of revaluations of fixed assets based initially on government decisions. However, these revaluations did not necessarily result in assets being assessed at fair market value and extreme care should be taken when relying on such revaluations.

Foreign exchange

- IAS – Foreign currency transactions should be translated into the company's reporting currency using the exchange rate on the transaction date. The average rate for a defined period may be used as an approximation, providing the exchange rates have not fluctuated significantly during that period. All monetary assets and liabilities should be translated at the closing rate on the balance sheet date. Non-monetary assets and liabilities carried at cost should be translated at historical rates, while those carried at fair value should be translated at rates applicable when the fair values were determined. Foreign exchange gains or losses should be reported as part of the profit or loss for the year. Those that relate to the revaluation of monetary items that form part of, or are used to hedge the company's net investment in a foreign equity, should be recognized within shareholders' equity.
- RAR – Foreign currency transactions should be translated into the company's reporting currency using the official National Bank rate on the transaction date. All monetary assets and liabilities should be translated at the closing rate on the balance sheet date. Non-monetary assets and liabilities carried at cost should be translated at historical rates and the difference should be presented in specific balance sheet accounts. Foreign exchange gains or losses, should be reported as part of the profit or loss for the year.

Depreciation

- IAS – Depreciation should be provided on all depreciable assets. No specific method of depreciation is specified, although the methods used should be disclosed and applied consistently by management.
- RAR – Depreciation should be provided on all depreciable assets, on both intangible and tangible assets, with the exception of freehold land. The law sets compulsory useful lives to be used when depreciating the assets that are usually longer than the generally accepted useful lives under IAS.

Equity reserves

- IAS – No specific guidelines exist regarding the appropriation of profit to retained earnings.
- RAR – A legal reserve of a maximum two times the par value of share capital must be maintained by annual appropriation of 20% of the net profit, until it reaches the amount of the share capital, and 10% yearly afterwards, until the maximum amount is achieved. Statutory reserves are constituted annually from the net profit in accordance with the company's articles of incorporation. Other reserves may be constituted from the net profit for covering losses, or other reasons in accordance with the shareholders meeting decision.

External auditing was not required, except for banks. However, some large companies, especially foreign-owned, occasionally asked one of the “big five” auditing firms to scrutinize their books and prepare auditing reports. Parts of these reports were eventually circulated to shareholders or to a larger audience, according to the board’s decision and interests.

In the context of reform of the accounting system, new provisions were issued on the auditing profession and activities. Audit reports prepared by external independent auditors will become compulsory for all public companies, following the same phased implementation extended until 2005. Based on Government Ordinance 75/1999, the Chamber of Auditors was created as a professional organization, a first step to integrating the EU VIIIth Directive. The Chamber already has around 500 members and has adopted the IFAC handbook as the local standard for auditors.

In spite of these important reforms, significant efforts are still required for Romania to achieve adequate standards of auditing and accounting. Currently, investors and the public feel that important information is not disclosed, or disclosed late, and what is disclosed is sometimes not trusted. Successful reform will require both companies and the accounting and auditing professions to make significant improvements in their standards and practices.

2.5.3. INFORMATION ON SHARE OWNERSHIP

According to the Company Law, shareholders and third parties have the right to be informed on the ownership structure of a company. To that effect, the Company Law has put in place a two-tier mechanism:

- the shareholders’ registry each company is required to keep – where every shareholder can check not only their own position but also other shareholders’ stakes. Companies may delegate the task of keeping the shareholders’ register to an independent specialized registry.
- the Trade Registry, which keeps public records on shareholders.

According to the Securities and Stock Exchange Law, public (open) companies are also required to register their securities with the Securities Record Office set up by the National Securities Commission and to conclude a contract with an independent specialized registry for keeping updated and accurate evidence on the shareholders’ ownership. For each new entry in the central shareholders’ file, the independent registry has to record at least the following information:

- the name and address of the company;
- the company’s unique registration number with the Trade Registry;
- shareholder-related information: name and address, identity document number, the number of shares held (or the value of the principal in the case of bonds), series of the shares (if any) and nominal value. A registration number with the independent registry is assigned to each entry.
- details on any limitation on the company’s liability or conditions affecting transferability.

Public companies are required⁸⁵ to submit to the National Securities Commission reports on any change in their ownership structure within 15 days from the occurrence of such a change. The change in ownership structure is defined by the law as a situation where a shareholder, alone or together with associated parties as defined by the law, reaches 5% of the voting shares in a company, thus becoming a “significant shareholder”. Shareholders having over 5% of the voting shares are required to disclose every single transaction. A shareholder aiming to take a “controlling stake” (over one-third of the voting shares), is required to make a public offer for the acquisition and a shareholder reaching a

⁸⁵ Article 88 and 89 of the Law 52/1994.

majority position (over 50% of the voting shares) shall make a public offer for all the shares on the market.

According to National Securities Commission Regulation no.2/1996, the current reports should include information on:

- changes in shareholding structures;
- the identity of the person or the entity that takes control of the company as well as, if necessary, the identity of the person controlling that entity;
- the existing form of control;
- the degree of control or the reason for which it is believed that the company will be controlled;
- the amount paid in exchange of, or the ways through which control is achieved;
- the description of the transaction under which the person or entity took control, including the identity of the person waiving control;
- details on the source and conditions under which financing was assured in the transaction;
- description of any issues related to the transaction which might determine it to be temporary, or of any anticipated potential changes in the control position.

The current reports are also submitted to the information department of the stock exchange and are made available to investors through publication in at least one national newspaper. Failure to comply with the obligation to submit timely and current reports is sanctioned with fines and repeated breaches may result in delisting. It was only in 2000 and 2001 that the Securities Commission and the BSE became more rigorous in enforcing the provisions concerning current reporting. Now, information on “significant shareholders” is regularly published in the media.

It is known that investors sometimes use different stratagems in order to circumvent the obligation to report when they reach the 5% threshold – the most common being the use of nominees for buying blocks of shares of less than 5%. It is quite difficult for the Securities Commission to check such arrangements, and almost impossible when foreign-based intermediaries are used. Foreign-based intermediaries also make it difficult to know in practice who the ultimate owner of a block of shares is.

2.5.4. DIRECTORS, MANAGERS AND RELATED PARTIES DISCLOSURES

Romanian legislation has only one provision specifically regarding directors’ disclosure obligations. Law 31/1990 specifies (art. 145) that a member of the board is required to inform the other members of the board and the censors, when he has, directly or indirectly, a personal interest in a certain transaction that is opposed to the interests of the company. The same applies when the director/administrator has knowledge of any of his relatives having an interest in a transaction that is opposed to the interests of the company. The directors/administrators that fail to disclose such interests are liable for the eventual damages incurred to the company.

ANNEX: CAPITAL MARKETS IN ROMANIA

ORGANIZATION AND FUNCTIONING

Although shares started to be occasionally traded soon after the Company Law no. 31/1991 set the legal ground in 1991, it was only in 1994 that the Law on Securities and Stock Exchanges no. 52/1994 created the conditions for an institutional capital market to exist. In April 1995, the National Securities Commission decided (Decision no. 20/1995) on the creation of the Bucharest Stock Exchange. After an intense preparation period, during which Canadian technical assistance played an important role, on 20 November 1995 the Bucharest Stock Exchange resumed operations⁸⁶ with six companies listed and one trading session per week.

The Bucharest Stock Exchange is organized as a non-profit, self-financing "public institution". As a self-regulated body under the supervision of the Securities Commission, the BSE issues its own regulations and rules regarding membership, listing and trading, clearing, settlement and registry activities. The BSE also monitors and enforces compliance.

The Stock Exchange Association is the highest decision-making body of the Stock Exchange. It was set up in June 1995 by the 24 securities firms licensed to operate on the Stock Exchange. Now, around 120 securities firms are members of the BSE. According to its Charter, the Exchange Association is aimed at properly administering the Stock Exchange system in order to ensure continuity of trading on the BSE in an efficient, transparent and law-abiding way, and offering adequate protection to investors. The Exchange Association is also in charge of the functioning of the registry and the clearing and settlement system that is part of the Stock Exchange infrastructure.

The Exchange Association elects among its members the 9 members Exchange Committee -- the executive body of the Stock Exchange. In its turn, the Exchange Committee appoints the General Manager of the Stock Exchange who is responsible for implementation of its strategies and the day-to-day operation of the Exchange. Both members of the Exchange Committee and the General Manager have to be confirmed by the National Securities Commission. The National Securities Commission also designates a General Commissioner as its permanent representative on the Stock Exchange. Although the General Commissioner has a role of observer (with no voting or decision-making power), he can propose that the Securities Commission cancel certain decisions of the Exchange Committee or of the General Manager.

Two permanent committees support the Exchange Committee: the Ethics and Conduct Committee, in charge of monitoring stock exchange discipline and sanctioning breaches of regulations, and the Listing Committee, in charge of admission to listings on the stock exchange.

The Bucharest Stock Exchange has all the traditional departments of similar institutions -- trading, listing and membership. In addition, the BSE has departments dedicated to auxiliary services -- the registry department, a clearing and settlement department, the IT department and the public relations and market development departments.

The BSE has three separate listings for different securities, submitted to different listing requirements:

- Securities issued by Romanian legal entities.
- Bonds and other securities issued by the state, by the central and local administrations and by other authorities.
- Foreign securities.

⁸⁶ The first Stock Exchange in Romania was established in 1882, but it was closed in 1948.

No listings have ever been recorded on the state bonds and foreign securities sectors. Listing of the treasury bills was long expected by market players in anticipation that the volume of trades and the liquidity on the stock exchange would be greatly improved. However, the Ministry of Finance was reluctant to let treasury bills be traded on the stock exchange and only now a solution seems to have emerged that would create a market for treasury bonds.

A company is listed on the BSE upon request, provided that it meets certain criteria. Two sets of listing criteria have been established: for **high-grade** companies, listed on the first tier of the Stock Exchange and for **lower-grade** companies, listed on the second tier of the exchange.

General requirements for listing on the second (base) tier of the Bucharest Stock Exchange

- The issuer must have lodged the respective securities with the National Securities Commission Registration Office;
- The securities to be listed must be freely transferable and dematerialized. The BSE only lists securities represented by an entry in an electronic register and securities in paper form that have been immobilized according to BSE procedures;
- The issuer has to conclude with the Exchange a Registry Contract (by which the Exchange will provide depository, registrar and transfer agent functions) as well as Listing and Maintenance contracts;
- The issuer must prove it has the capacity to provide securities holders with adequate services and appropriate information flows. Disclosure shall be made by the issuer in accordance with the provisions set out in the "Disclosure" chapter of the Stock Exchange regulations and procedures, in order to insure equal access of all securities holders to the information needed to make investment decisions. Periodic disclosure refers to the annual and semi-annual financial reports and other statements required by the Exchange on a regular basis, according to the maintenance procedures;
- The issuer's minimum share capital must be the equivalent in ROL of Euro 2 million;
- The issuer has to pay the listing fees set out in the Exchange's procedures;
- The issuer has to have appointed a Liaison Officer in charge of keeping permanent contact with the Stock Exchange;
- The annual financial statements of the issuer have to be audited by an external independent auditor.

Companies that do not meet the criteria for listing on the second (base) tier of the stock exchange have the option to have their securities traded on the "unlisted" sector of the BSE. There are currently 13 companies traded on the "unlisted" sector of the stock exchange – most of them formerly listed companies.

For the services provided, the Bucharest Stock Exchange charges fees which constitute the basis of its revenues (Stock Exchange Association membership contributions provide for another share of revenues). In general, the BSE charges 0.3% of the value of a trade on the seller and 0.22% of the value of a trade on the buyer. For large transactions (over USD 100,000) the fees are lower. Apart from trading fees, the BSE charges other fees for listing, for registry services provided to issuers, etc.

In order to track market performance, the Bucharest Stock Exchange has devised a set of indices⁸⁷. The BET index (Bucharest Exchange Trading) was launched on 22 September 1997 and is built on the ten most liquid securities listed on the first tier of the BSE. Since September 2000, a limit has been introduced on the weight of a stock in the index, which cannot be more than 25%; two securities, ALRO and the ROMANIAN BANK FOR DEVELOPMENT, are currently subjected to the 25% threshold.

In April 1998 a new index was launched – the BET-C (composite), which includes all securities traded on the BSE. When in December 1999 the five Financial Investment Companies were listed on the BSE, a decision was taken not to include them in the composition of the BET and BET-C indices because of the special character of these securities. Instead, a dedicated “financial” index, BET-FI, was launched in November 2000, after one year of trading when SIFs prices had stabilized.

The BSE is responsible for monitoring all market activities in order to ensure compliance with the law and regulations, minimize market volatility and protect investors. In order to enforce discipline and assure investors’ protection, the BSE disposes of several instruments to prevent market volatility, to ensure discipline of issuers and brokers:

- Trade suspension to prevent market volatility. Initially, trade in a particular security was suspended when its price fluctuated by more than 15% during a trading session. Currently, monitoring of market volatility is based on the negative variation of the BET index from its closing value of the preceding trading day. A warning message appears when the index falls by 10%, a 30-minute trading suspension is applied when the index falls by 12%, whereas a 15% fall triggers definitive suspension for the rest of the session.
- Temporary suspension from trade as a sanction for companies that do not observe listing requirements and BSE regulations. This is the most frequent sanction and is normally triggered by a failure to comply with disclosure requirements.
- Downgrading from tier I listing to tier II – applicable when a company ceases to meet the tier I listing requirements. Several such downgrades occurred in past years, especially in 2000 – most frequently for companies that did not observe reporting and disclosure requirements.
- De-listing is applied when a company repeatedly fails to comply with BSE rules and requirements.
- Brokers may be suspended from performing trade for various reasons. The most serious violations, like price manipulation or insider trading, are reported and sanctioned also by the Securities commission, which may decide to withdraw the operating license of the person or the brokerage house involved.

Until recently, the Stock Exchange was hesitant in imposing sanctions and many violations of the rules and regulations were disregarded. This attitude was motivated by the fear that a tougher approach would discourage market players and would further contribute to weakening the stock exchange. However, after serious frauds were discovered, such as theft of shares initiated by, or having the complicity of, some brokers⁸⁸, the Exchange Committee decided to take a firmer stance. In 2000 a “cleaning” operation was initiated, aimed at improving the standards and making the BSE an investor-friendly and trustworthy environment.

From a technical perspective, the Bucharest Stock Exchange is based on an advanced software platform -- the HORIZON trading system and the EQUATOR clearing -- settlement and registry

⁸⁷ A complete presentation of the indices system may be found on the BSE web site, www.bvb.ro

⁸⁸ In 2000, over 300 cases were submitted to the Securities commission, some of them being also being investigated by the police. See George Vulcanescu, *Miliarde in ancheta* (Billions under investigation) in *Piata Financiara* no. 10/2000.

system – that integrates trading with clearing and settlement⁸⁹. All brokers are connected to the BSE by remote terminals (although booths on the trading floor are also available). The system is order-driven and it automatically matches orders. When sell orders are entered, the actual existence of securities is automatically checked. The settlement cycle is T+3. While the Stock Exchange acts as a counterpart for all trades, it also carries out clearing and settlement. The broker receives clearing and settlement reports that indicate only the net position on funds and securities. Each broker has settlement accounts with an authorized settlement bank; on T+3 all settlement banks settle their net position on funds through the National Bank of Romania, paying to, or receiving funds from, the Stock Exchange. The securities are electronically settled by the system, as each client has an open account with the stock exchange register⁹⁰.

TRADING AND PERFORMANCE

In December 2000, the market capitalization of the Bucharest Stock Exchange (BSE) stood at less than USD 400mn. or 1.4% of GDP; after adding the newly listed Romanian Bank for Development the market capitalization becomes 2.9% of the GDP. This is among the lowest market capitalization in Central and Eastern European countries, where Slovenia has a market capitalization of 8.2% of GDP, Hungary 21%, Poland 19.8% and the Global Emerging Markets average is 52%. Bulgaria, with a capitalization of 1.2% of GDP, is the only country in the region comparable to Romania.⁹¹

Table A1: Bucharest Stock Exchange trading statistics

Year	No. of companies listed	No. of shares traded	No. of trades	Total turnover, USD
1995	9	42,761	379	964,374
1996	17	1,141,738	17,772	5,279,372
1997	75	568,152,039	607,318	251,927,242
1998	126	889,576,015	506,497	193,705,492
1999	127	829,974,047	404,017	67,952,185
2000	115	1,779,900,757	429,949	86,245,986

Source: BSE

Since its inception in 1995, the BSE has progressed in terms of volume of activity: the number of companies listed increased from the initial 6 to 127 at the end of 1999 and the number of shares traded in 2000 was 1,500 times higher than the shares traded in 1996. The total turnover remains low however – after the 1997 peak of USD 251mn. the turnover fell to USD 68mn. in 1999, recovering to USD 86mn. in 2000.

⁸⁹ For technical details, see article *The Bucharest Stock Exchange at millenium crossroads* prepared by BSE and published on the web site www.majorcompanies.ro

⁹⁰ A more detailed presentation of the clearing – settlement procedures, in *Romanian capital markets review*, prepared by Alpha Finance Romania and published on the web site www.majorcompanies.ro

⁹¹ Source: SG Emerging Markets Equity Research. It should be noted that sometimes statistics present consolidate figures for different classes of securities and/or listing requirements, making comparisons difficult. For example in Bulgaria the Official Market has three segments, A, B (Parallel market) and C (Provisional market) which do not really match the structure of the Bucharest Stock Exchange – some of the segments are closer to the over-the-counter conditions which in Romania fall under the RASDAQ trading system.

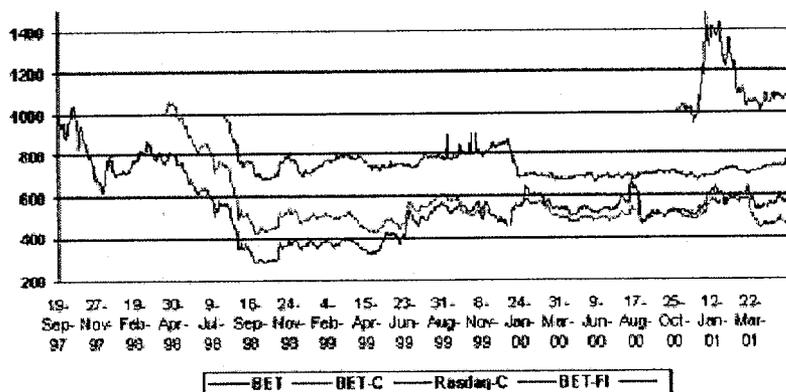
Table A2: Bucharest Stock Exchange performance indicators

Indicator	1995	1996	1997	1998	1999	2000
Market capitalization (USD mn., end of period)	100.4	60.8	632.4	357.1	316.8	363.2
Total turnover (USD mn.)	0.9	5.3	251.9	193.7	67.9	86.2
Liquidity	0.96%	8.68%	41.18%	54.15%	39.45%	23.85%
Turnover ratio		6.19%				
Market P/E ratio			72.51%	36.94%	20.17%	25.48%
P/BV			10.7	8.22	8.82	3.98
Dividend yield				0.38	0.62	0.41
				10,66%	7.84%	7.48%

Source: www.bvb.ro

The valuation of shares on The Bucharest Stock Exchange seems low compared with other markets, at least by some measures. The price/book value ratio is less than 0.5, while in Poland shares are traded at 1.5 – 1.6 their book value, in Hungary at 2.2, or in Greece at 2.8. The price earnings ratio of 4 in 2000 is by far the lowest in the region (it is 10.9 in Poland, 10.2 in Hungary, 10 in Turkey and 14.3 in Greece) and the dividend yield of 7.5% on the BSE stands well against 2.8% in Greece. At the same time, both market capitalization and liquidity are lower on the BSE than on the neighboring markets. What more is, the dominant market trend has been decline in the last few years, as market indices reveal. Launched at 1000, the BET index is currently around 550; in dollar terms, the fall is even more severe – current BET/USD is 143 points.

Romanian Share Indices through Time



Trading has been the most important contribution to the total volume of transactions. In 1999 and 2000 Eight primary offerings and private placements were carried out through the BSE. In spite of the

diversification that was taking place over the years in the transactions carried through the BSE, the exchange remains predominantly a trading place, not a capital-raising instrument (Table 7). The BSE also plays a role in the privatisation process since the State Ownership Fund, the privatisation authority, sometimes uses the stock exchange for placing some of the residual blocks of shares it holds. At the end of 2000, 9% of the shares of BANCA ROMÂNĂ PENTRU DEZVOLTARE-Groupe Societe Generale, was offered on a secondary public offer. As a result, BANCA ROMÂNĂ PENTRU DEZVOLTARE (BRD) was listed on the BSE, increasing the market capitalization from USD 400 to almost USD 800mn.

Table A3: Structure of transactions on the Bucharest Stock Exchange

Year	Total value (USD)	of which, %			
		Normal trading	Primary public offerings	Secondary public offerings	Private placements
2000	83,774,384	68.2	0.0	6.6	25.1
1999	92,261,593	81.1	12.2	6.7	
1998	208,041,460	90.1		9.9	
1997	271,464,565	98.8	0.1	1.1	
1996	4,919,559	100.0			
1995	1,210,811	100.0			

Source: BSE

Analysts⁹² distinguish three phases in the evolution of the stock exchange. The first, between the fall of 1995 and the spring of 1997, was characterized by slow and hesitant growth. Few companies were listed and their quality was poor. As credit was cheap, raising capital on the stock exchange was not an attractive alternative for the companies.

The second stage was the most spectacular and full of promise, but it lasted only two trimesters in 1997. The radical economic reform program announced in February by the new government issued after the election and the strong support manifested by the international financial institutions were sufficient reason for foreign institutional investors to buy shares that looked undervalued and with huge growth potential. Both turnover and market capitalization skyrocketed.

In October, the backlash on the market was already evident, inaugurating the third stage in the evolution of the BSE. Disappointment over the pace of reform and the outbreak of crisis in southeast Asia and Russia rendered investors much more nervous about the Romanian market; most of them quit, driving down prices and the volume of transactions. In spite of the growth recorded in 2000, the stock exchange did not completely recover. Proposals were made in 2000 to reduce the number of trading days in an attempt to cut costs for both brokers and the BSE itself.

The year 2000 was when the first takeover battle was engaged on the BSE. The majority shareholder Samsung Deutchland and Lindsell Enterprises fund fought over OTELINOX Targoviste, driving up its market share price more than 80% up in two months.

⁹² Florin Pogonaru, Camil Apostol, *Romanian Capital Markets: a Decade of Transition*, in *Economic Transition in Romania*, Proceedings of the Conference "Romania 2000. 10 Years of Transition", World Bank / The Romanian Center for Economic Policies.

A big step forward was made in 2000 with the two bond issues that took place on the exchange. One, made by INTERNATIONAL LEASING, enjoyed a full success while the other, made by local wine producer BACHUS Buzau, was eventually annulled as the minimum of 60% of the total amount hadn't been subscribed. INTERNATIONAL LEASING's request that the bonds issued be listed was denied, so in the end there were no bond listings on the BSE.

THE COMPANIES LISTED ON THE BSE

There are 115 companies currently (April 2001) listed on the Bucharest Stock Exchange. One of them (BTR -- the Turkish-Romanian Bank) has been suspended from trade since November 2000⁹³, so BSE statistics actually include only 114 companies, 23 on the first tier (blue chips) and 91 on the second tier.

The average market capitalization is USD 7.5mn per company, but the market is very concentrated: the largest 10 companies account for 80% of the market capitalization, while the last ten make up only 0.2% of the market cap – due mainly to the Romanian Bank for Development which accounts for half of the capitalization⁹⁴. Turnover is also unevenly distributed – the most heavily traded 10 companies account for 72% of the turnover in the market.

With one exception (the automobile producer DACIA), the ten largest companies on the BSE also achieve a much better performance (Table 8) than the market average, which is 70% for debt/equity ratio, 8.5% for the return on equity (ROE) and 2.6% for the return on assets (ROA).

The aluminum smelter ALRO, two pharmaceutical companies (TERAPIA and SICOMED) and the automobile producer DACIA are the only non-financial companies listed in the top ten.

Table A4: BSE largest ten companies' performance

Company	Market cap, USD	PER	ROE %	ROA %	Debt/Equity %
Banca Romana De Dezvoltare (Brd)	394,252,751	3.9	26.7	3.6	0.0
Alro (Alr)	114,482,197	2.0	77.7	49.3	31.6
Automobile Dacia (Dac)	52,857,911	-1.7	-237.8	-29.1	62.0
Banca Turco-Romana (Btr)	29,002,558	*	*	*	*
Terapia (Ter)	20,134,063	3.7	26.6	21.9	5.5
Banca Transilvania (Tlv)	16,935,316	2.1	58.2	9.9	0.0
Sicomed	15,716,184	3.4	18.3	15.4	5.4
Sif Trasilvania (Sif 3)	15,653,244	1.9	6.9	6.8	0.1
Sif Banat-Crisana(Sif 1)	14,097,475	0.9	15.1	14.4	0.0
Sif Muntenia (Sif 4)	13,914,715	2.7	5.7	5.4	0.0
Average	68,704,641				

Source: BSE

The equipment (42 companies) and consumer goods (26 companies) industries are the best represented on the stock exchange; in terms of market capitalization, the materials and financial sectors have the heaviest presence (Table 8). It is evident that the structure of the companies listed on the stock exchange do not mirror the structure of the economy as a whole, especially in terms of market capitalization. It is also interesting to note that there are wide variations in the "quality" of the companies listed – the price/earnings ratio ranges from 2 (companies in the chemicals sector) to 8.67

⁹³ In May 2001 the trade of BTR shares was resumed, but on the unlisted category of the stock exchange.

⁹⁴ In the last few weeks, the price of BRD shares dropped to half the initial value. As a result, market capitalization was drastically reduced and some of the calculations based on earlier data should be revised accordingly.

(service companies). The chemicals companies are, however, very indebted – their debt-to-equity ratio is 110%, while the pharmaceutical companies' debt represents only 7% of their equity. The energy sector has a unique performance – a negative debt/equity ratio, due to the fact that four companies in the sector have a negative equity (RAFO Onesti in the first place)!

Table A5: Sectoral structure of the companies listed on the Bucharest Stock Exchange

Sector / no. of companies	Market capitalization	Biggest	Smallest	Average	PER	Debt/Equity %
	USD					
Pharmaceuticals / 3	37,927,372	15,716,184	5,156,297	12,624,457	5,45	7
Energy / 5	15,291,498	11,167,679	384,653	3,058,299	5,95	-22
Materials / 10	121,143,392	114,482,197	77,160	12,114,339	6,88	35
Equipment / 42	40,355,793	6,191,415	14,412	960,376	3,65	45
Consumer goods / 26	76,477,037	52,957,811	86,609	2,941,424	3,51	42
Services / 7	10,541,241	2,746,724	85,971	1,505,891	8,67	26
Financial / 9	105,892,926	394,252,751	1,984,677	11,765,880	2,77	*
Chemicals / 11	27,933,389	8,860,761	142,847	2,539,399	2,00	110

Source: BSE. Sectors defined according to BSE classification.

The financial sector is clearly dominant on the stock exchange. Two banks and the five Financial Investment Companies (SIFs) are among the largest and most traded companies on the stock exchange. While the BRD (the ROMANIAN BANK FOR DEVELOPMENT) has a free float of only approximately 10% (shares acquired by the employees and the 2.5% placed on the public offer), BANCA TRANSILVANIA and the SIFs are also among the most liquid securities – they have a free float close to 100%. Because of special provisions in their statutes which limit the number of shares held by a single investor to 5% of total shares in the case of BANCA TRANSILVANIA and to 0.1% in case of the SIFs, these companies have a dispersed ownership that favors high liquidity.

In fact, the five SIFs are some of the most notable actors on the Bucharest Stock Exchange, both as significant shareholders in many of the companies listed and as companies listed themselves – some of the largest, most liquid and attractive placements. Since November 1999, when the five SIFs were listed on the first tier of the BSE, the capitalization and liquidity of the market improved substantially; almost half of the number of shares traded on the BSE in 2000 were SIF shares, contributing 22% to the market turnover.

The FINANCIAL INVESTMENT COMPANIES are the result of the Romanian mass privatisation program, which provided for a free distribution of 30% of the share capital in state-owned companies to all adult citizens⁹⁵. At the end of 2000, each of the five SIFs had over 9 million shareholders. At the same time, each SIF has assets including listed and non-listed companies, as well as financial placements (bank deposits etc.) (Table 10 and Appendix 2).

⁹⁵ For details, see chapter 1.3.2. below.

Table A6: The Financial Investment Companies' holdings

Indicator	SIF 1	SIF 2	SIF 3	SIF 4	SIF 5
Market capitalization, ROL bn.	373	247	415	369	342
Assets, book value, (ROL bn. 31.12.2000), of which	2,184	3,308	3,233	2,664	2,927
- - shares	2,469	2,950	2,833	2,237	2,505

Source: BSE and annual reports.

The market capitalization for the SIFs varies between USD 9.3mn. for SIF 2 and 15.6mn. for SIF 3. With a large discrepancy between their net asset values and market capitalization, SIF's shares make a very interesting speculative placement, in spite of their relatively high risk.

One of the distinguishing features of the SIFs is that they regularly pay dividends. Indeed, many of the companies listed on the Stock Exchange do not distribute dividends and sometimes, although a decision to distribute dividends is taken, companies do not pay or defer payment for months or years. According to information available in mid-April 2001 (April is the month when General Shareholders Meetings take place to approve the previous year's financial results), approximately one-third of the companies listed on the BSE will distribute dividends. The others will reinvest profits or have to cover previous years' losses. A number of companies systematically capitalizing dividends by issuing new shares, a solution that has merits for the company (which does not risk a reduction in liquidity) and for shareholders (for fiscal reasons). One company (OLTCHIM) has proposed that shareholders distribute newly issued bonds in exchange for dividends due since 1994!

Non-payment of dividends is one of the most frequent complains of investors. Apart from cases of abuse (to be dealt with in chapter 1.4.4.), companies are frequently victims of the Romanian accounting system, which creates illusory profits.

In any case, low level of dividends and payment problems both contribute to making investment in BSE securities unattractive. Analysts⁹⁶ have calculated that, with just a few exceptions, the return on investments in BSE listed securities is inferior to the return on a bank deposit. This is a telling observation on the actual state of the capital market in Romania.

⁹⁶ Carol Popa, *Doar o treime din societatile listate la bursa platesc dividende* (Only one-third of the companies listed on the BSE pay dividends), published in the weekly Capital, no. 16, April 19, 2001. (in Romania)

The Registry, Depository and Compensation System

The depository and compensation system is regulated by Law 52/1994 on the securities and stock exchanges. The Law establishes that:

- All operations auxiliary to the securities trading – registry, depository and compensation – have to be carried out exclusively by legal entities authorized and working under the supervision of the Securities Commission.
- These legal entities dedicated to servicing the securities transactions should be organized as joint-stock companies having as shareholders only banks, stock exchanges, brokerage houses, insurance companies, or other legal entities authorized by the Securities Commission.
- The depository and compensation companies should adopt a management structure granting them operational and administrative independence from the interests of their shareholders.
- The depository and compensation companies operate through compensating and depository agents – stock exchanges, brokerage houses, banks etc. - authorized by the Securities Commission.

The National Securities Commission has issued detailed regulations concerning the organization and functioning of the registry, depository and compensation companies.

THE "RASDAQ" OVER-THE-COUNTER TRANSACTION SYSTEM

ORGANIZATION AND FUNCTIONING

By 1996, the Romanian Mass Privatisation Program (MPP) had created a huge number of shareholders in all state-owned companies. Millions of these shareholders were locked into many obscure companies. Selling stock was difficult and inefficient, as only local, non-transparent and fragmented markets were available. The issue had a political dimension too: the risk of falling prices, cheating and fraud because of imperfect markets for MPP-resulted securities was undermining one of the main objectives of the privatisation which is fair and equitable distribution to all citizens. The need for an operational market capable to support large-scale transactions was obvious and urgent.

The technical specifications for building such a market were, however, daunting. About 16 million Romanian citizens (the entire adult population) had received privatisation vouchers, many of them exchanged against shares in some of the 4,000 companies included in the MPP. All shares were issued in a dematerialized form. That Romania succeeded in rapidly putting in place an over-the-counter transaction system called RASDAQ (the Romanian Association of Securities Dealers Automated Quotation) is to a great extent due to the substantial financial and technical support received by the National Association of Securities Dealers (NASD) from the United States Agency for International Development (USAID),.

The NASD, a professional organization of brokerage houses created in January 1995 by 25 founding members, established the institutional framework (rules and regulations) needed to support RASDAQ trading, drawing on the fair trading and customer protection practices of the US market and on the NASDAQ organizational model. In September 1996, the National Securities Commission granted the NASD a Self-Regulated Organization statute, i.e. it delegated the responsibility for regulating the market and monitoring compliance by the brokerage houses with its Rules of Fair Practice.

In order to operate the electronic trading system based on a customized version of the PORTAL software platform used by the American NASDAQ, the NASD has set up a fully owned subsidiary organized as a limited liability partnership – the RASDAQ SRL.

The PORTAL technology, which accommodates trading in around 6,000 companies, allows for a delocalized market consisting of a network of computer terminals. By using their personal computers as trading terminals with direct access, the dealers enter bids and offer quotations for securities. Once entered into the system, they are available in real time to all other users. Trades can be subsequently negotiated by telephone or through the system. Interested investors may follow the evolution of the market by using the “view only” facility of the system. The system also enables the NASD Monitoring and Surveillance Department to supervise trading activities on the RASDAQ and to intervene with a “message” function every time there is a reason to believe that the Rules of Fair Practice have been violated. Important violations are reported to the NASD Disciplinary Committee for investigation and sanctioning, if necessary.

Apart from the NASD and the RASDAQ SRL, other organizations contribute to the functioning of the OTC market: the National Company for Securities Clearing, Settlement and Depository (NCSCSD) and the independent registries⁹⁷ and custodian banks.

The NCSCSD provides the brokers and banks with services related to securities transactions like trade recording, trade settlement and custody. Functioning in a dematerialized environment, the NCSCSD imports trades at the end of each trading day, validates and processes them for settlement on a settlement cycle of T+3. Registered as a “clearing house” with the National Bank of Romania, the NCSCSD processes all money movements for transactions through an account at the National Bank, providing efficiency and protection in settlement operations.

Set up in August 1996, the NCSCSD is organized as a joint-stock company owned by more than 160 Romanian financial organizations such as banks, brokerage houses, the Bucharest Stock Exchange and the NASD. The NCSCSD was granted Self-Regulatory Organization status by the National Securities Commission. It has a 5-member Board of Administrators, while day-to-day operations are ensured by an Executive Manager and a staff of 18 employees.

The RASDAQ-listed companies hold their shareholder registry with one of the eleven authorized registry service providers. Most of them still use the services of the Romanian Shareholder Registry, a joint venture set up in 1996 by eight Romanian banks, which was initially the sole beneficiary of the listings of shareholders in all the Romanian companies privatised through the MPP. The shareholders’ registries usually offer on-line access so that trades may be checked and settled through the electronic system of the exchange.

As a general rule, securities that are actively traded on the market are registered with the NCSCSD, due to a faster processing of the orders. However, at the client’s request, securities can be registered with another registry.

RASDAQ provides three products:

- the regular securities market – on which stocks and bonds can be traded;
- the Public Offerings market, which can accommodate any kind of public offering;
- the electronic auction market – a trading system specifically designed for selling the residual shares held by the State Ownership Fund in line with the provisions of the privatisation legislation.

⁹⁷ Further details on the organisation of the OTC market may be found on the RASDAQ web site www.rasd.ro

The RASDAQ trading system is quote driven, enabling brokers to input and negotiate orders on their computer screen. Trading is limited to the members of NASD, which are supposed to have a minimum share capital level, different for brokers, dealers and market makers. At the same time, brokers as individuals have to be licensed and must be employed by a NASD member.

The revenues of the RASDAQ are derived mainly from transaction fees. Currently, the buyer pays a fee of 0.07% on the transaction value, while the seller pays 0.15%. For each terminal connected to the RASDAQ system, brokerage houses pay a USD 50 monthly subscription. RASDAQ ended the 2000 financial year with losses. In order to correct the situation, the NASD planned to increase fees starting in May 2001⁹⁸.

Companies do not pay listing or other fees. A company may decide to list its shares on the RASDAQ OTC market without any prior conditions or requirements to be fulfilled. There are no disclosure requirements. Most companies have been actually listed on the RASDAQ because of a legal provision imposing listing to all companies included in the mass privatisation program. Therefore the RASDAQ was perceived as the “exchange of the MPP”.

As the RASDAQ is based on loose regulation, there are not many sanctions provided. The National Securities Commission or the NASD may decide to temporarily suspend transactions in a particular security in order to protect investors and to maintain the confidence of the public in the market. But usually suspensions occur only when companies transfer their share register from one independent registry to another.

The RASDAQ Composite is the official market index, launched in July 1998. It is a market capitalization index, monitoring all stocks listed.

As opposed to the BSE, on the RASDAQ there are no prevention rules for failed trades. No limits are imposed on the number of shares brokerage houses can buy and no instrument is in place to check whether the shares offered for sale are effectively available. Failed trades are therefore more frequent.

Fraudulent transactions are, however, a much more serious problem of the RASDAQ market. Many cases of theft of shares have been reported, where brokers took advantage of the weaknesses in the security systems of the independent registries and operated trades on behalf of unsuspecting shareholders. The securities commission has asked the registries to improve protection by assigning an extra individual code/password to each investor who has shares deposited with a registry.

Some brokers took advantage of an ambiguity in the regulation: trades with settlement periods longer than the usual T+3 became disguised lending operations among market participants (repo contracts), which, if unregulated, distort prices and competition in the market. Several brokerage houses were confronted with serious financial problems and some were suspended in the last part of 2000, when the Securities Commission explicitly banned such operations⁹⁹.

Because of the growing number of problems the RASDAQ was confronted with, the National Securities Commission decided to temporarily recall NASD’s statute of Self-Regulated Organization. A sense of “crisis” prevails¹⁰⁰ and NASD members seem incapable of agreeing on solutions. Eight restructuring proposals were presented in NASD’s General Meeting in April 2001, but no decision

⁹⁸ Carol POPA, *ANSYM a majorat taxele pe piata RASDAQ*, in *Capital*, no.17/2001

⁹⁹ See George Vulcanescu, *CNVM a stopat tranzactiile la termen pe piata extrabursiera (The NSC has stopped the terms transactions on the OTC market)*, *Piata Financiara* no. 11/2000

¹⁰⁰ RASDAQ is “short of time, ideas and money” as a journalist depicts the situation – see Laurentiu Ispir, *Piata RASDAQ isi cauta perlele ingropate (The RASDAQ market is looking for its buried pearls)*, in *Ziarul Financiar* of April 3, 2001

was taken¹⁰¹. Merging the Bucharest Stock Exchange and the RASDAQ market is one of the most radical reform ideas, but no investigation was made to evaluate the technical compatibility of the two systems, the costs and the implications. Most brokers however seem to prefer an alternative solution – to split the market into several tiers, where the best companies would be admitted to listing on the first tier, with strict trading rules, disclosure and other investor protection requirements.

TRADING AND PERFORMANCE

There are currently (April 2001) 5427 companies listed on the RASDAQ OTC market. Almost half of them are not actively traded and around 1500 companies have never been traded since they were listed for the first time. Even among companies that are recorded by statistics as having been traded in a particular year, many are traded only occasionally. Under these circumstances, statistics regarding the market capitalization for the RASDAQ as a whole should be treated cautiously. However, it should be

Table A7: **RASDAQ trade statistics**

Year	Number of trades	Number of shares traded	Trade value ROL bn.	Trade value (USD)	No. of companies traded	No. of active brokerage houses
1996	3.072	7.009.584	4	969.454	224	n/a
1997	447.099	796.387.743	2.830	386.099.048	2.427	127
1998	542.026	1.400.620.770	3.790	419.296.270	3.337	197
1999	272.276	2.133.810.745	3.620	242.225.310	3.267	184
2000	122.462	943.196.609	2.360	116.597.930	2.978	150
Total	1.386.935	5.281.025.451	12.604	1.165.188.011		

Source: *Piata RASDAQ 1996-2000*, on www.kmarket.ro

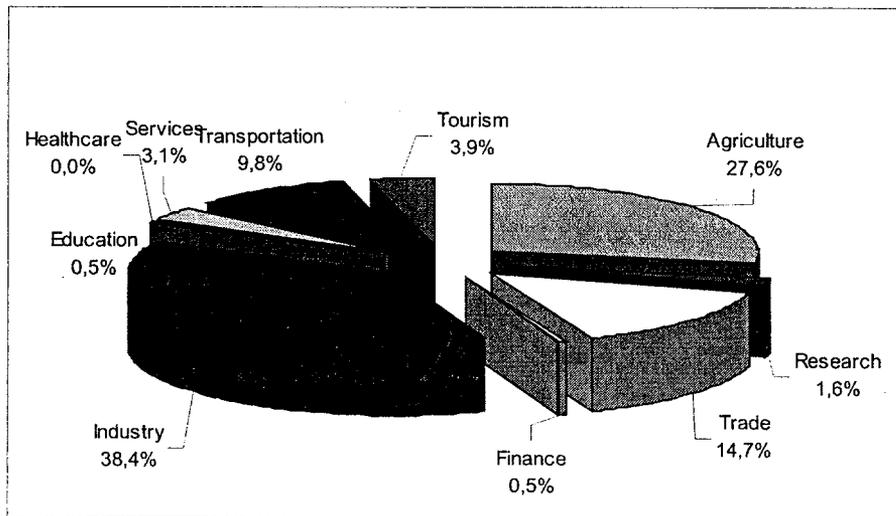
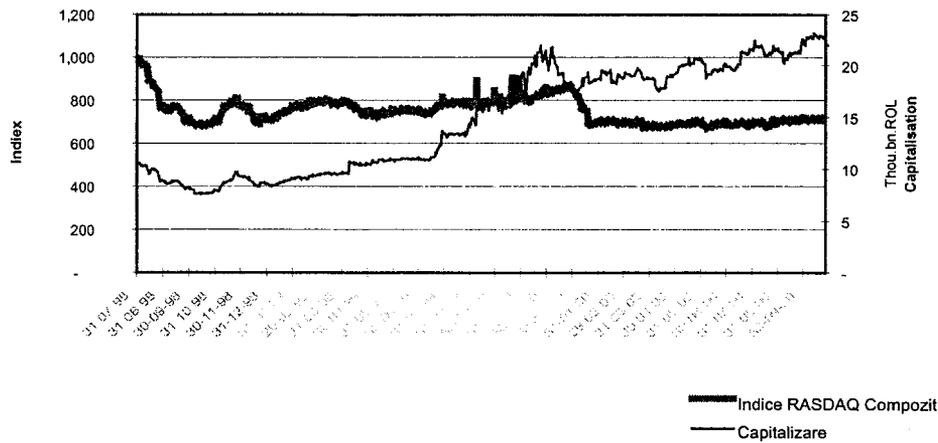
noted that the market capitalization for the RASDAQ was, in general, higher than the market capitalization of the Bucharest Stock Exchange. Currently, the RASDAQ market capitalization stands at around USD 900mn., down from a maximum of over USD 2bn. reached in July 1997. Historically, the RASDAQ's evolution has been similar to that of the Bucharest Stock Exchange, with a peak in 1997 followed by a prolonged decline.

¹⁰¹ Laurentiu Gheorghe, *Reformarea RASDAQ este doar în faza de intenție (The RASDAQ reform is only at the intention stage)*, in Capital no. 16/2001

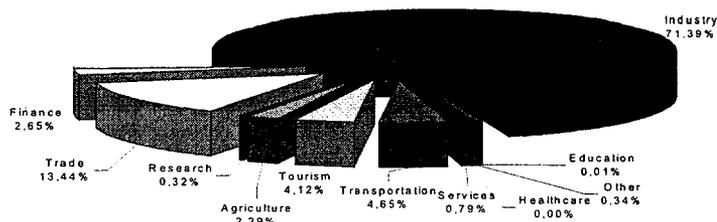
Because the RASDAQ was essentially a trading platform for the companies included in the mass privatisation program, the number of companies listed did not significantly change, while the sectoral structure of the companies listed on RASDAQ closely mirrors the structure of the economy in general (see chart). However, trades are concentrated in industry, which makes up over 70% of the total volume of trades since the beginning of the OTC market.

The RASDAQ is considered to be the instrument of choice for investors aiming to take control over target companies. Buying and selling public offers contribute 30-40% to the total volume of trades. Another 10% (USD 11mn.) was achieved in 2000 in sales of the residual shares held by the privatisation authority through the dedicated auction procedures.

Value And Market Capitalization of The RASDAQ through Time, and Breakdown of Listed Companies and Trades by Sector.



**Distribution by sector of the trades concluded on RASDAQ
since inception**
Total ROL: 12,6 thou.bn.
Total USD: 1,16 bn.



Like the BSE, the RASDAQ is equipped for trading not only shares but also fixed income instruments. In 2000, Certificates of Deposit of one bank (BANCA ROMÂNĂ DE SCONT) were traded for the first time and listing of corporate bonds is envisaged for another company (International Leasing). But it is hard to believe diversification is the solution to the slump of the OTC market.

THE COMPANIES LISTED ON RASDAQ

The large number of companies and their huge diversity in terms of size, quality and, most importantly, frequency of trades makes it very difficult to compile statistics on the RASDAQ as a whole. Instead, we will focus on the Top 100 companies by market capitalization, which represent almost half the volume of the OTC market (Appendix 3).

The RASDAQ does not have a sectoral classification of its own. We have used the sectors defined by the Bucharest Stock Exchange for a breakdown of the top 100 list. According to this criterion, the RASDAQ is dominated by the service companies. There are 35 companies from trade, tourism, restaurants, agriculture and geological research. Thirty-four companies are involved in production of materials, from stone, gravel and marble to pulp and paper, synthetic materials and steel. There are 12 equipment producers, 9 consumer goods producers and 4 energy-related companies. Three insurance companies and a mutual fund represent the financial sector. The chemical and pharmaceutical sectors are represented by one company each.

The largest company on the RASDAQ, SIDEX Galati (steel), has a market capitalization of over USD 32 mil. The ten largest companies on the RASDAQ represent approximately 13% of the total market capitalization. In spite of their similar size, the ten largest companies are very different from a point of view of performance (table 12).

Table A8: RASDAQ largest ten companies' performance

Company	Market cap, USD	PER	ROE %	ROA %	Debt/Equity %
Combinatul Siderurgic Sidex Galati (Coer)	32,377,989	10.6	1.0	0.2	308
Asigurarea Romaneasca					
Asirom (Asra)	19,351,760	24.5	0.8	0.8	4
Romcim Bucuresti (Romb)	17,633,073	-2.12	-5.7	-3.8	48
Neptun Olimp (Neol)	16,077,226	-9.75	-17.7	-12.4	41
Romcif Fieni (Romc)	15,744,677	-20.0	-7.4	-2.4	180
Brau Union Romania (Buro)	15,373,614	*	*	*	*
Santierul Naval Damen Galati (Asti)	15,043,989	1.6	59.1	22.5	153
Carom Onesti (Carz)	12,944,631	-2.49	-63.3	-18.9	-435
Socp Constanta (Socp)	10,146,601	4.33	23.9	20.2	16
Petrotel Lukoil Sa (Pely)	9,903,020	3.23	8.5	4.4	94
Average	16,459,658				

Source: Calculations based on RASDAQ information.

Based on the year 2000 first semester financial data, performance indicators of the ten largest companies on the RASDAQ give a good example of the very mixed nature of the OTC market. More than 30% of the companies traded on RASDAQ are suffering losses – their performance indicators are sometimes impressive in a negative sense. Some of the companies listed are not only having losses, but do also carry huge debts in their balance sheets. Many are technically bankrupt, having debt several times higher than their equity.

The vast majority of the companies listed on the RASDAQ market are sporadically traded. Only around 15 companies are traded regularly, that is, more than half of the time. Some of the largest and most attractive companies have a free float of less than 10% of the shares. In fact, some analysts identified a correlation between the size of a company and the free float – large companies have a smaller free float¹⁰². While for companies with an average share capital of USD 200,000 the free float is over 30%, for companies with a share capital of more than USD 1mn. the free float is typically less than 10%.

RASDAQ is an ideal place for speculative operations. Every week and month a new star is born, an obscure company that for a short period of time is intensely traded, with price increases that make some sellers gain two or three times what they invested a few weeks before. Usually, such an event is driven by a takeover attempt. The rallies on certain companies increase the volatility of the market and, because of the unexpected character of the operation¹⁰³, give RASDAQ investments an air of gambling. The limited information available to investors, the opacity on some operations (like the off-market trades that take place directly between buyer and seller) and fraud cases have also make their contribution to undermining the RASDAQ's credibility.

CONCLUSIONS: WHAT KIND OF REFORM FOR THE CAPITAL MARKET?

The dragging slump in the Romanian capital markets has prompted a lot of criticism and many proposals for solutions to revitalize the BSE and the RASDAQ. At the beginning of April 2001,

¹⁰² Madalina Mocanu, *Societatile cu capital social redus au si multe actiuni ramase neconcentrate (Companies with small share capital have more free shares)*, in Bursa no. 55/2001

¹⁰³ In the sense that it cannot be anticipated by changes in the "fundamentals" of a company.

authorities initiated a systematic analysis of the situation the objective of which was to identify solutions for reviving the market. Prime Minister Adrian NASTASE stated: "After the FNI scandal¹⁰⁴, the confidence in the capital market and in RASDAQ, has declined very much. It is our duty to find solutions. It is clear that without a legislative decision trust cannot be restored."¹⁰⁵ In the context of the expected negotiations with the World Bank for a new PSAL (Private Sector Adjustment Loan) agreement, improving the legal and regulatory environment for the capital markets is given special emphasis. Mrs. Gabriela ANGHELACHE, vice-president of the Securities Commission, mentioned that new, unitary legislation, in line with the EU directives, was to be prepared before October 31¹⁰⁶. A liberal party legislative initiative was submitted to the Senate in March 2001, which proposed a complete overhaul of Law 52/1994 on securities and stock exchanges¹⁰⁷.

This is the first time since the inception of the capital market that it has received so much attention from the authorities and that reform projects are seriously considered. However, from what has been revealed until now, no definite conclusion can be drawn on the direction and chances of success of the initiative. In fact, it seems that a global perspective is missing, with different constituencies having different views and priorities. Authorities focus on improving the legislative framework. Brokers active in the market have insisted for years that the listing of better quality companies could improve the attractiveness of the Romanian exchanges. Those who nostalgically recall the 1997 upsurge maintain that only an infusion of foreign capital can revive the markets, while others rightly point out that no stock exchange can properly function without domestic capital¹⁰⁸.

Each of these positions is based on factual observation and therefore hardly disputable. Like any other market, the capital market is made up of three elements: supply, demand and the transaction mechanism. The dimension, evolution and effectiveness of the capital market is determined not only by the characteristics and dynamics of each individual component but, to a significant degree, by the proper equilibrium among these components. An effective reform should be based on an accurate diagnostic, which identifies the "laggard" among the three components of the market and specifies measures addressed to bringing the failing element in line with the others. If misdirected, reform efforts result in only marginal improvements, or even worse, in a waste of resources.

- A. The current focus of the Romanian authorities on improving the legislative framework of the capital market is based on the (implicit) assumption that the imperfections in the **transaction system** are the main cause of the markets' decline. The quality of the transaction system is important because it determines **transaction costs**. Better transaction systems induce lower transaction costs, allowing the markets to function more efficiently. It is important to point out that "transaction costs" are not limited to direct costs (like the fees associated with a trade on the exchange) but include indirect costs like the expense required to obtain information in order to make an investment decision, the cost required to monitor an investment, the cost incurred when losses happen etc.

There are many arguments which, in my opinion, demonstrate that the legislative framework and the transaction system in general cannot be held responsible as the main source for the current poor condition of the capital markets. The Romanian transaction system (including the legislative

¹⁰⁴ The collapse of the largest investment fund in April 2000 – see chapter 1.2.2.

¹⁰⁵ Ziarul Financiar,

¹⁰⁶ I.Z. *Programul Bancii Mondiale PSAL-2 prevede termene pentru restructurarea pietei românești de capital (The World Bank PSAL-2 sets deadlines for the restructuring of the Romanian capital market)*, in Bursa no.77/2001

¹⁰⁷ The project (in Romanian) is posted on www.kmarket.ro

¹⁰⁸ Under the signature of its director, the "Bursa" started on April 25 to publish daily a "Program for stimulating the Romanian capital market" built around the idea that domestic capital is the critical factor needed to turn around the exchange. However, the solution envisaged for attracting domestic capital, i.e. a non-regulated market based on bearer shares, is not credible in our opinion.

framework) compares well with other emerging markets and, under certain technical aspects, is in line with some of the most advanced systems. It is exactly the same transaction system that was in place during the 1997 boom of the markets – and at that time nobody complained about its adequacy.

This is not to say that the institutional infrastructure of the capital market cannot or should not be reformed. On the contrary, amendments are needed. But the best legislation and the most efficient institutions cannot supplant the strong demand and the expansive supply that make buoyant capital markets.

- B. The **demand for capital** is clearly the weakest component of the Romanian capital market and it is surprising to see how most analysts ignore such an easily observable fact. Listing more, or even better quality, companies on the stock exchange cannot solve the problem¹⁰⁹. The Romanian economy was confronted with a long and severe recession – between 1997 and 2000, industrial production fell by more than 20%. During recessions, companies tend to focus on restructuring measures and this reduces their investments and demand for capital. An economic recession prompts a worldwide fall in the capital market and there is no reason to expect the Romanian capital market could have done better than the economy in general.

During recessions, the financial performance of companies deteriorates, making investment in corporate securities less attractive than alternative placements. Because the state budget was permanently running a deficit financed mainly through the domestic market, it pushed up interest rates on the money market to levels the stock exchange could not match. Therefore, in the last few years the treasury bills, and even the bank deposits, systematically had offered better returns than average corporate securities¹¹⁰. No wonder that many investors deserted the stock exchange in favor of the less risky and better remunerated placements.

- C. The **offer of capital** was, in general, simply adjusting to the conditions in the economy – reduced demand of capital from the corporate sector and the eviction effect of the budget deficit¹¹¹. Except for a distortion induced by the taxation system in 2000 (when a 10% withholding tax was applied on the stock exchange trades at the transaction value, not at the capital gain), no major institutional obstacles hindered the offer of capital. The scandal related to the collapse of the FNI investment fund in 2000 was the most important event that significantly influenced the offer of capital. Investors' confidence hit record low levels and the capital market experienced a new setback, only partially offset by the mild economic recovery.

In conclusion, the best policy for reviving the BSE and the RASDAQ is to promote economic growth and stabilization. In parallel, a careful and well-targeted capital market institutional reform may contribute to a better business environment. Several measures appear as being the most urgent:

- Strengthening the monitoring and enforcement capacity of the market regulators (The National Securities Commission¹¹² and the Self-Regulated Organizations);

¹⁰⁹ Listing of some companies (the five SIFs in 1999, the Romanian Bank for Development in 2000) stirred hopes that the BSE would attract more capital, but they were short-lived.

¹¹⁰ The Activity Report for year 2000 presented by the National Securities Commission to the Parliament correctly insists on the distorting effect the high interest rates have on the capital market.

¹¹¹ "Lack of capital" is one of the recurrent laments and excuses for the slump in the capital markets. Because of their low revenues, the justification goes, Romanians cannot save and invest sufficiently, so the offer of capital is weak. However, the population has almost USD 3bn. of bank deposits and the huge success of some investment funds demonstrate that Romanians can mobilise savings.

¹¹² The National Securities Commission should be a priority, starting with basics like appropriate premises and staffing.

- Improved and more rigorous standards for brokers should prompt consolidation in a very fragmented profession – the Romanian market cannot sustain the 120-150 brokerage houses¹¹³ that are now struggling for survival¹¹⁴.
- Standards for listing companies on the BSE should be more consistently applied. The sanctions for infringement of the regulations by the companies listed have to be diversified and reinforced.
- Better defined and enforced disclosure requirements, improved accounting and auditing standards and wider and better specified minority protection provisions are among the measures the most awaited for by the participants in the market.
- A decision has to be taken on the future of the RASDAQ trading system and reforms need to be rapidly implemented. The OTC market is an essential part of the Romanian capital market, and under one form or another, it should continue to exist and improve its functionality. The alternative reform solutions advanced until now should be critically examined in order to select one which is viable, not only technically, but also financially.

The existing reform initiatives already address the main problems and gaps in the capital market regulatory framework and the public debate of these initiatives should contribute to further improvements.

¹¹³ The Polish market, ten times bigger than the Romanian one, has around 40 brokerage houses.

¹¹⁴ Stere Farmache, the General Manager of the Bucharest Stock Exchange, was suggesting in an interview that many of the small brokerage houses could become “retail brokers” which do not trade on the BSE but collect orders from small clients.

APPENDIX 1 Companies listed on the Bucharest Stock Exchange

Ranked by market capitalization

March 2001

Symb ol	Company Name	Total number of shares	Share capital ROL mn	Market Capitalizatio n USD	Sector
BRD	Banca Romana De Dezvoltare	348.450.670	1.742.253	394.252.751	Financial
ALR*	Alro Slatina	158.458.182	792.290	114.482.197	Materials
DAC	Automobile Dacia Pitesti	1.919.755.874	685.139	52.857.911	Consumer goods
BTR	Banca Turco-Romana Bucuresti	345.600.000	345.600	29.002.558	Financial
TER*	Terapia Cluj Napoca	306.613.680	306.614	20.134.063	Pharmaceuticals
TLV*	Banca Transilvania Cluj Napoca	173.696.726	173.697	16.935.316	Financial
SCD	Sicomed Bucuresti	138.987.050	138.987	15.716.184	Pharmaceuticals
SIF3	S.I.F. Transilvania Brasov	546.071.666	546.072	15.653.244	Financial
SIF1	S.I.F. Banat-Crisana Arad	548.849.268	548.849	14.097.475	Financial
SIF4	S.I.F. Muntenia Bucuresti	628.485.262	628.485	13.914.715	Financial
SIF5	S.I.F. Oltenia Craiova	580.165.714	580.166	12.910.564	Financial
INX	Otelinox Targoviste	6.100.246	152.506	12.654.680	Materials
ASP*	Rafinaria Astra Romana Ploiesti	219.650.344	132.470	11.167.679	Energy
SIF2	S.I.F. Moldova Bacau	519.089.588	519.090	9.319.452	Financial
OLT*	Oltchim Rm. Valcea	323.588.641	323.589	8.860.761	Chemicals
AZO*	Azomures Tg. Mures	230.458.309	230.458	7.588.357	Chemicals
ARC*	Arctic Gaiesti	228.744.000	228.744	7.160.922	Consumer goods
ELJ*	Electroaparataj Bucuresti	131.427.536	131.428	6.191.415	Equipment
ATB*	Antibiotice Iasi	68.836.310	68.836	5.156.297	Pharmaceuticals
PCL	Policolor Bucuresti	48.925.250	53.742	4.611.481	Chemicals

SNT	Aker Tulcea	4.776.809	119.420	4.157.047	Equipment
NVR	C. N. F. R. Navrom Galati	6.891.551	172.289	3.076.803	Equipment
COS	Cos Targoviste	38.234.558	946.764	2.958.214	Materials
OIL	Oil Terminal Constanta	152.759.924	152.760	2.875.088	Energy
TBM	Turbomecanica Bucuresti	1.980.634	49.516	2.838.762	Equipment
ASV	Astra Vagoane Arad	93.446.703	93.447	2.816.125	Equipment
TRS	Turism Transilvania Cluj Napoca	1.387.122	34.678	2.746.724	Services
IMS	Imsat Bucuresti	35.247.654	35.248	2.652.249	Services
EXC	Excelent Bucuresti	93.857.625	93.858	2.587.784	Consumer goods
RLS	Rolast Pitesti	80.458.243	80.458	2.433.806	Chemicals
AMO	Amonil Slobozia	223.445.352	86.313	2.358.820	Chemicals
BRM	Bermas Suceava	9.492.656	66.448	1.970.998	Consumer goods
ASA	Agras Bucuresti	22.256.000	22.256	1.984.677	Financial
SNO	Santierul Naval Orsova	4.328.630	108.215	1.895.083	Equipments
CMP	Compa Sibiu	74.494.229	74.494	1.756.078	Equipments
IMP	Impact Bucuresti	22.684.207	22.684	1.625.617	Equipments
AMP	Amp American Packaging Tecuci	36.056.042	48.240	1.625.126	Equipments
MPF	Mopaf Vrancea Focsani	21.832.675	22.648	1.450.132	Consumer goods
INT	International Sinaia	11.958.999	11.959	1.398.291	Services
PEI	Petrolexportimport Bucuresti	254.650	38.197	1.349.694	Services
SRT	Siretul Pascani	24.735.853	61.839	1.255.779	Consumer goods
RBR	Rulmentul Brasov	149.664.550	149.665	1.145.925	Equipment
SNC	Santierul Naval Constanta	6.899.522	205.214	1.118.996	Equipment
EPT	Electroputere Craiova	122.978.031	122.978	1.103.940	Equipment
PPL	Prodplast Bucuresti	685.668	17.141	1.034.463	Chemicals
MPR	Mopariv Ramnicu Valcea	23.593.071	23.593	1.096.561	Consumer goods
ARS	Aerostar Bacau	3.403.000	18.679	1.028.174	Equipment

SLC	Silcotub Zalau	4.993.311	12.833	942.276	Materials
PTS	Petrolsub Suplacu De Barcau	19.070.162	19.070	870.882	Energy
GRX	Grimex Targu Jiu	994.465	24.862	862.022	Equipment
ALM	Alimentara Cluj Napoca	56.964.325	56.969	883.442	Services
CIP	Ciprom Ploiesti	46.983.582	46.984	852.378	Equipment
APC	Vae Apcarom Buzau	73.796.185	73.796	852.266	Equipment
ARM	Armatura Cluj Napoca	15.235.039	15.235	832.057	Equipment
UCM	U.C.M. Resita	6.047.949	151.199	823.037	Equipment
MEF	Mefin Sinaia	2.176.319	54.408	820.850	Equipment
ZIM	Zimtub Zimnicea	1.812.578	45.314	820.914	Materials
FAU	Faur Bucuresti	8.691.018	217.275	1.129.743	Equipment
RAF	Rafo Onesti	8.304.100	207.602	754.090	Energy
CRB	Carbid-Fox Tarnaveni	23.544.050	23.544	722.848	Chemicals
DOR	Dorobantul Ploiesti	10.277.394	30.832	700.458	Consumer goods
FTN	Fortuna Bucuresti	1.491.790	37.295	620.897	Equipment
BRC	Berceni Bucuresti	14.186.693	14.187	596.084	Consumer goods
CPR	Chimopar Bucuresti	1.278.550	31.964	579.053	Chemicals
MPN	Mopan Mures	19.374.300	19.374	577.290	Consumer goods
EPN	Ema Piatra Neamt	7.117.950	7.118	562.714	Consumer goods
SOF	Sofert Bacau	87.561.866	87.562	567.392	Chemicals
VAC	Prodvinalco Cluj Napoca	9.066.650	9.067	547.503	Consumer goods
STZ	Sinteza Oradea	44.075.060	44.075	531.966	Chemicals
NVL	Navol Oltenita	52.325.452	52.325	514.274	Equipment
AUR	Aurora Targu-Frumos Iasi	182.996	4.575	513.430	Consumer goods
APS	Apsa Baia Mare	10.314.425		493.683	Equipment
ELN	Allied Deals Elcond Zalau	31.389.650	31.390	485.413	Equipment
CBC	Carbochim Cluj Napoca	1.371.632	34.291	466.281	Materials
ETN	Electrotehnica Bucuresti	510.808	12.770	462.688	Equipment

VES	Ves Sighisoara	19.518.005	19.518	419.615	Consumer goods
CPL	Carmetaplast Deva	497.938	12.448	446.357	Materials
FOR	Foraj Sonde Craiova	16.528.850	16.529	384.653	Energy
UAM	Uamt Oradea	22.567.125	101.552	378.772	Equipment
RCR	Rocar Bucuresti	32.275.280	32.275	372.178	Equipment
STR	Stratusmob Blaj	30.221.408	30.221	342.724	Consumer goods
TMR	Tomiris Iasi	1.033.201	25.830	331.454	Consumer goods
AER	Aeroteh Bucuresti	748.976	18.678	325.076	Equipment
MCN	Mecanica Ceahlau Piatra Neamt	884.943	22.123	317.507	Equipment
FRL	Frial Constanta	483.016	12.075	318.207	Services
ART	Artrom Slatina	5.654.474	141.927	303.538	Equipment
NCL	Nicolina Iasi	2.662.263	66.557	290.184	Equipment
HTR	Hitrom Vaslui	1.206.093	30.152	282.415	Equipment
ABR	Abrom Barlad	2.515.164	62.879	272.452	Materials
VAP	Cramele Prahova	10.303.150	15.389	233.314	Consumer goods
CAS	Casirom Turda	27.532.236	27.532	229.496	Materials
MOL	Moldomobila Iasi	25.138.150	25.138	247.730	Consumer goods
UTN	Uton Onesti	802.480	20.062	218.411	Equipment
UZC	Uzuc Ploiesti	1.226.261	30.656	208.264	Equipment
PTR	Petros Ploiesti	927.303	19.070	192.794	Equipment
AMC	Amco Otopeni	310.586	7.764	194.926	Equipment
UZT	Uztel Ploiesti	1.170.800	29.270	176.751	Equipment
MDS	Moldosin Vaslui	2.224.885	55.622	142.847	Chemicals
ALF	Mobila Alfa Oradea	15.295.725	15.296	138.211	Consumer goods
CMF	Comelf Bistrita	2.094.285	7.567	138.100	Equipment
ALB	Albapam Alba Iulia	10.070.600	10.070	114.830	Consumer goods
ROB	Robinete Industriale Bacau	812.197	20.305	113.418	Equipment
FEL	Feleacul Cluj Napoca	6.180.525	6.180	108.059	Consumer goods

ENP	Comp. Energopetrol Campina	436.931	10.923	107.188	Equipment
CRN	Carne Arad	1.235.635	30.891	100.606	Consumer goods
AMY	Amylon Sibiu	3.763.500	3.763	88.205	Consumer goods
SDT	Sidertrans Calarasi	6.074.371	6.074	85.971	Services
NTX	Netex Bistrita	8.638.400	8.638	81.454	Consumer goods
ELC	Electroceramica Turda	339.181	8.479	77.160	Materials
IRS	M. P. Iris Barlad	5.250.125	5.250	73.651	Consumer goods
ASM	Asam Iasi	683.903	17.097	71.307	Equipment
CRT	Ciorapi Timisoara	4.725.115	4.725	86.609	Consumer goods
ECT	Electrocontact Botosani	258.010	8.479	14.412	Equipment
	Total	9.571.187.663	13.560.936	854.423.759	

APPENDIX 2 MAIN ECONOMIC INDICATORS FOR THE FIVE SIFS

Financial Investment Companies (SIF)

billion ROL

INDICATOR		1997	1998	1999	2000
Share capital, end of period,	SIF1	482	482	549	549
	SIF2	522	522	519	519
	SIF3	550	546	546	546
	SIF4	520	565	628	696
	SIF5	563	563	580	580
Total assets, end of period,	SIF1	2,038	2,302	2,596	2,184
	SIF2	2,768	3,035	3,083	3,308
	SIF3	2,443	2,555	2,947	3,233
	SIF4	1,957	1,854	2,216	2,664
	SIF5	1,769	2,145	2,400	2,927
Shareholders' equity end of period,	SIF1	1,956	2,194	2,485	2,782
	SIF2	2,703	2,914	2,992	3,123
	SIF3	2,236	2,431	2,805	3,054
	SIF4	1,797	1,688	2,046	2,420
	SIF5	1,696	2,045	2,298	2,752
Net assets, end of period,	SIF1		1,652	1,536	2,019
	SIF2		1,087	804	1,020
	SIF3		1,263	1,770	2,513
	SIF4		1,252	1,925	2,415
	SIF5		980	1,426	1,990
Net assets per share, end of period, ROL	SIF1		3,428	2,800	3,679
	SIF2		2,083	1,550	1,965
	SIF3		2,312	3,241	4,602

	SIF4		2,217	3,409	3,842
	SIF5		1,740	2,458	3,430
Revenues, total	SIF1	97	144	198	476
	SIF2	64	134	127	248
	SIF3	135	173	258	314
	SIF4	159	193	232	354
	SIF5	95	201	252	339
Expenses, total	SIF1	9	25	67	226
	SIF2	18	30	46	84
	SIF3	42	60	108	131
	SIF4	23	61	85	114
	SIF5	33	53	120	142
Profit before tax	SIF1	88	120	131	250
	SIF2	46	104	81	164
	SIF3	93	112	150	183
	SIF4	136	131	148	240
	SIF5	96	148	132	197
Dividends, total	SIF1	55	58	71	132
	SIF2	38	66	57	113
	SIF3	61	78	87	109
	SIF4	81	94	112	161
	SIF5	63	63	64	122

Source: Annual reports

APPENDIX 3 THE TOP 100 COMPANIES LISTED ON THE RASDAQ

by market capitalization

Symbol	Company Name	No. of shares	Share capital ROL	Market cap USD	Sector
COER	Combinatul Siderurgic Sidex	252.319.761	6.307.994.025.000	32.377.989	Metals (steel)
ASRA	Asigurarea Romaneasca Asiom	29.177.900	29.177.900.000	19.351.760	Insurance
ROMB	Romcim Bucuresti	15.583.522	389.588.050.000	17.633.073	Construction materials (cement)
NEOL	Neptun-Olimp	8.357.951	208.948.775.000	16.077.226	Tourism (hotels and restaurants)
ROMC	Romcif Fieni	126.496.550	126.496.550.000	15.744.677	Construction materials (cement)
BURO	Brau Union Romania Sa	43.799.921	1.094.998.025.000	15.373.614	Brewery
ASTI	Santierul Naval Damen Galati	6.122.672	153.066.800.000	15.043.989	Shipyard
CARZ	Carom Onesti	8.552.841	213.821.025.000	12.944.631	Chemicals (Synthetic rubber)
SOCP	Socep Constanta	114.475.248	114.475.248.000	10.146.601	Handlings
PELY	Petrotel-Lukoil S.A.	43.759.796	1.093.994.900.000	9.903.020	Refinery
STRV	Pcc Sterom Sa	5.710.167	142.754.175.000	8.286.349	Drilling and oil well exploration equipment
BACR	Banca Carpatica Sa Sibiu	1.000.000	100.000.000.000	8.341.277	Bank
PTRM	Petromidia	36.268.400	906.710.000.000	7.523.713	Refinery
MLCM	Moldocim	15.357.686	383.942.150.000	7.240.639	Construction materials (cement)

MINE	Minerva Bucuresti	2.931.717	73.292.925.000	6.592.890	Food, beverage and tobacco wholesale trade
ALPO	Alprom Slatina	6.817.649	170.441.225.000	6.042.875	Aluminum processing
IMEP	Ana-Imep Pitesti	79.847.078	79.847.078.000	6.023.240	Production of electric motors, generators and transformers
RLMP	Timken-Romania	10.181.061	254.526.525.000	5.952.040	Bearings
CSIA	Casial Deva	128.224.798	128.224.798.000	5.803.559	Construction materials (cement)
AMRO	Ambro	7.646.140	191.153.500.000	5.767.842	Pulp and paper
HEBI	Hermes Bistrita	309.537	7.738.425.000	5.310.510	Retail trade with textiles
COIB	Comtex Arad	293.605	7.340.125.000	5.207.810	Wholesale trade with textiles
VICQ	Victoria Prahova	7.174.978	179.374.450.000	4.465.249	Tyres
REGA	Romaqua Group Borsec	72.557.104	264.787.405.000	4.378.658	Mineral water production
BUTU	Bucuresti Turism	2.207.751	55.193.775.000	4.291.729	Tourism (hotels and restaurants)
METE	Metex Galati	2.967.639	74.190.975.000	4.199.706	Retail trade with garments
DUCL	Ductil	77.000.000	77.000.000.000	4.065.930	Methalurgical products
ICEZ	Icme Electroizolante	65.665.912	65.665.912.000	3.962.790	Electrical wires
TUFE	Turism Felix Baile Felix	2.785.747	69.643.675.000	3.782.555	Tourism (hotels and restaurants)
COLH	Comcereal Galati	197.507.556	197.507.556.000	3.724.730	Services for the agriculture mechanization, fertilization and phytosanitary protection

CITU	Cimentul Turda	2.111.621	52.790.525.000	3.584.013	Construction materials (cement)
ATRA	Astra Bucuresti	2.016.000	50.400.000.000	3.579.928	Insurance
ICMB	Icme Ecab Bucuresti	151.580.126	151.580.126.000	3.487.492	Electrical wires
FREX	Forex Suceava	27.899.778	27.899.778.000	3.509.406	Wood processing
MARN	Marmosim	42.197.255	42.197.255.000	3.342.294	Marble processing
GECM	Generalcom Bucuresti	14.919.050	14.919.050.000	3.098.979	Retail trade
ELMA	Electromagnetica	19.994.127	45.986.492.100	3.016.502	Production of radio-television transmitters, telephones and telegraphs
SANE	Sanex	140.119.718	280.239.436.000	3.052.951	Sanitary items
SOMR	Sometra Copsa Mica	15.909.435	397.735.875.000	2.403.419	Lead, zinc and tin production
AMBU	Amco Buftea	63.089.097	63.089.097.000	2.397.913	Light metals packaging materials
NAPP	Napolact	9.699.011	9.699.011.000	2.304.672	Cheese and milk production
BARU	Bad Rulmenti Brasov	27.315.573	27.315.573.000	2.164.957	Wholesale trade with equipment for industry
ROFU	Romarc Fuel	93.675.225	93.675.225.000	2.124.637	Trade with various products
HIOT	Hidrotehnica Galati	2.805.336	70.133.400.000	2.203.410	Hydrotechnical constructions
MAIA	Mamaia Constanta	4.545.733	113.643.325.000	2.057.436	Tourism (hotels and restaurants)
ROMT	Romportmet	33.859.850	33.859.850.000	2.044.677	Handlings
CMVX	Comvex	3.337.683	83.442.075.000	2.014.217	Warehousing
SCDM	S.C.D.M.A.I.Unirea Bucuresti	2.082.921	13.606.816.600	2.004.623	Retail trade

MOEX	Mobitex Bucuresti	378.585	9.464.625.000	2.000.374	Retail trade with furniture and other household items
UZIN	Uzinexport	14.693.750	14.693.750.000	1.995.153	Retail trade with equipment for industry, trade and navigation
SOCA	Socalp	2.088.139	2.088.139.000	2.154.142	Restaurants
GRIA	Grupul Iatsa	4.339.887	108.497.175.000	1.964.268	Maintenance and repairs of vehicles
PACY	Palace Sinaia	19.952.470	19.952.470.000	2.011.338	Tourism agency
ARMD	Armedica	67.011.403	67.011.403.000	1.950.510	Pharmaceuticals
FORD	Foradex	2.051.359	51.283.975.000	2.104.735	Activities of geological research, exploitation, prospecting and cartography
ATPA	Athenee Palace	8.474.025	60.792.655.350	1.917.706	Tourisms (hotels and restaurants)
ERCA	Hercules Baile Herculane	56.120.064	56.120.064.000	1.906.252	Tourism agency
SIDG	Siderurgica	24.924.723	623.118.075.000	1.890.026	Metals (steel)
SIVN	Silvania Zalau	3.006.330	75.158.250.000	1.870.948	Tyres
CNMP	Cnm Petromin	22.487.571	562.189.275.000	1.938.964	Sea transports
BRCR	Braiconf	7.469.250	7.469.250.000	1.845.268	Garments
TRUX	Tractorul-Utb	392.335.249	392.612.857.000	1.786.387	Tractors production
ONZV	Ont Carpati	1.166.259	29.156.475.000	1.759.528	Tourism agency
TITA	Titan	15.484.175	15.484.175.000	1.757.635	Bakery products

COCR	Cocor	301.691	30.169.100.000	1.706.848	Retail trade with food, beverage and tobacco mainly
XFOA	Fondul Oamenilor De Afaceri	6.450.744	175.079.642.904	1.703.135	Mutual Fund
CMCR	Comcereal Slobozia	29.845.594	29.845.594.000	1.717.831	Services for the agriculture mechanization, fertilization and phytosanitary protection
BBGA	Bbg Alum	5.783.311	344.581.236.002	1.638.146	Metallurgy (alumina)
AGAL	Agromec Albesti	725.400	725.400.000	1.562.505	Services for the agriculture mecanization, fertilization and phytosanitary protection
OPTX	Optimex	20.908.226	20.908.226.000	1.499.307	Retail trade
PTRO	Petrotub Roman	14.554.139	363.853.475.000	1.482.147	Steel and cast iron production
STIB	Stirom Bucuresti	6.837.203	170.930.075.000	1.477.614	Glass manufacturing
GRND	Grandemar	7.621.649	7.621.649.000	1.438.264	Construction (extraction of stone)
DANA	Danubiana Bucuresti	6.652.354	166.308.850.000	1.380.886	Tyres
INOR	Intfor	1.354.842	33.871.050.000	1.382.805	Metals
VAOX	Varotex	405.525	10.138.125.000	1.376.579	Garments
AMIC	Amic	352.332	8.808.300.000	1.375.414	Extraction of stone and gravel
SROY	Combinatul Siderurgic Resita	12.153.289	303.832.225.000	1.385.780	Metallurgy (steel)
IPRU	Iproeb Bistrita	36.234.500	109.790.535.000	1.366.669	Electrical wires and cables
BUCU	Bucur Obor	13.375.750	13.375.750.000	1.654.656	Trade with various products

ROAT	Romarta Bucuresti	15.591.472	15.591.472.000	1.421.452	Trade with various products
CHOB	Chimcomplex Borzesti	7.155.984	178.899.600.000	1.359.936	Chemicals (Inorganic products)
TPRO	Tepro - Iasi	5.361.928	134.048.200.000	1.351.292	Manufacturing of steel tubes and pipes
FBRX	Fibrexyon	7.733.172	40.212.494.400	1.312.536	Synthetic fibres manufacturing
STNM	Santierul Naval 2 Mai Magnolia	8.465.949	211.648.725.000	1.310.914	Shipyard
ERCN	Euroconstruct	68.223.728	68.223.728.000	1.426.201	Construction materials (concrete)
SCPH	Scpi Hameroc	1.355.570	33.889.250.000	1.278.213	Extraction of stone and gravel
MEBY	Luceafarul (Meta-Tex Combac)	271.273	6.781.825.000	1.317.612	Retail trade with textiles
ARCC	Ardealul Carei	12.496.825	12.496.825.000	1.231.915	Refined oils and grease manufacturing
MEVE	Meva	1.613.153	40.328.825.000	1.216.877	Production and repair of materials for railways
SMOB	Samobil	26.737.500	26.737.500.000	1.210.161	Furniture production
AROA	Aro	10.562.666	264.066.650.000	1.195.187	Automotive
SEOM	Semrom Muntenia	7.727.199	193.179.975.000	1.201.195	Wholesale trade with cereals, seeds and forage
FILD	Filatura De Bumbac Gura Humorului	1.126.781	28.169.525.000	1.192.631	Cotton fibres manufacturing
RLAL	Koyo Romania (Rulmenti Alexandria)	6.148.424	153.710.600.000	1.159.511	Bearings
SNBB	Santierul Naval	2.279.280	56.982.000.000	1.117.589	Shipyard

	Braila				
ZADR	Zahar Arad	9.844.281	138.863.427.786	1.156.609	Sugar production
IAME	Iame	910.658	68.299.350.000	1.132.967	Electrical components for engines
TRMP	Trivale M.Pitesti	145.670	3.641.750.000	1.129.575	Retail trade with textiles
TOMI	Tomiris Constanta	1.072.400	26.810.000.000	1.092.098	Miscellaneous retail trade in non-specialized shops
	Total	3.028.621.927	20.321.622.450.142	403.768.487	

APPENDIX 4 Main Legislation Relevant to Corporate Governance

Core Legislation		
<ul style="list-style-type: none"> • Law 31/1990, The Company Law. Last amended in 1997 		The basic piece of corporate legislation, setting the rules for the creation, organization, functioning and dissolution of commercial organizations and the key rules and procedures for corporate governance.
<ul style="list-style-type: none"> • Law 26/1990, on The Trade Register. Last amended in 1998. 		Complements Law 31/1990, setting grounds for the national system of companies' registration, through which basic information on companies is made available to the public.
<ul style="list-style-type: none"> • Law 52/1994, The Securities and Stock Exchanges Law. 		Establishes the rules for the organization and functioning of the National Securities Commission, for brokerage houses, the stock exchanges and stock exchange operations, sets standards for investors' protection and guidelines for the organization of the compensation and depository systems.
<ul style="list-style-type: none"> • Law 15/1990 on the re-organization of economic units as regies autonomes or commercial companies. 		The debut of the enterprise reform. Establishes special rules for corporate governance in state-owned entities
<ul style="list-style-type: none"> • Ordinance 49/1999 concerning the management of companies in which the state or local administration has a majority position. (replaces Law 66/1993 on the management contract). 		Special provisions regarding corporate governance in state-owned companies.
Subsidiary Regulations of the National Securities Commission		
Regulation no.7/2000 on the organization of the National Securities Commission.		
Regulation no.5./000 concerning the clearing of securities' trades on the organized markets.		
Regulation no.2/1999 on the organization of the unlisted securities market.		
Regulation no.13/1999 on the electronic auctions on the RASDAQ market.		
Regulation no. 11/1999 on trading fixed income instruments on the RASDAQ market.		
Regulation no. 6/1998 concerning the organization and functioning of the self-regulatory organizations for regulated securities markets.		

Regulation no. 3/1998 concerning the licensing and operations of the securities brokerage houses.	
Regulation no.9/1997 concerning the requirements, registering criteria and licensing procedures for independent registrar companies.	
Regulation no. 1/1996 concerning the statute of the general commissioner of the Stock Exchange.	
Regulation no.2/1996 concerning the periodic and continuous information that securities issuers have to observe.	
Regulation no. 15/1996 concerning private placement.	
Regulation no. 16/1996 concerning the public offer for acquisition of securities.	
Regulation no. 2/1995 concerning the activity of the independent external auditors.	
Regulation no. 4/1995 concerning the activity of the securities placement consultants.	
Regulation no. 5/1995 on the code of ethics and conduct of the members and staff of the National Securities Commission.	
Regulation no. 6/1995 concerning the public offer for sale of securities.	
Special Legislation	
<ul style="list-style-type: none"> • Law 58/1998 on banking (update of the initial Law 33/1991) 	Stipulates special conditions for the organization and functioning of banks, including corporate governance related provisions.
<ul style="list-style-type: none"> • Law no. 32/2000 on insurance and reinsurance (update of Law 47/1991) 	Stipulates special conditions for the organization and functioning of the insurance companies.
<ul style="list-style-type: none"> • Ordinance 24/1993 on the creation and functioning of the open investment funds and of the investment companies as financial intermediaries. 	Organization, functioning and supervision of investment funds.
<ul style="list-style-type: none"> • Law no. 64/1995 on the liquidation and bankruptcy procedures. 	Special rules concerning corporate governance during liquidation and bankruptcy procedures.
<ul style="list-style-type: none"> • Law no. 133/1996 on the transformation of the Private Ownership Funds into Financial Investment Companies. 	The birth certificate of the SIFs.
<ul style="list-style-type: none"> • Ordinance 20/1998 concerning the venture 	Another group of players on the capital market.

capital funds.	
<ul style="list-style-type: none"> • Law no.36/1991 on agricultural companies and other forms of associations in agriculture. 	Particular rules for the organization and operations of agricultural entities.
Reform-related Legislation	
<ul style="list-style-type: none"> • Law 58/1991 on the privatisation of commercial companies 	The original legislation establishing the framework of the privatisation process.
<ul style="list-style-type: none"> • Law 77/1994 on the creation of employees and managers associations in companies targeted for privatisation. 	The MEBO law, which has a significant impact on the ownership structure of listed companies.
<ul style="list-style-type: none"> • Law 55/1995 on the acceleration of the privatisation process. 	The law that sets in motion the mass privatisation program; a long term effect on the ownership structure.
<ul style="list-style-type: none"> • Emergency Ordinance no.88/1997 	Latest major reshuffle of the privatisation legislation.
<ul style="list-style-type: none"> • Law 18/1991 on land restitution. 	Dismantling of the cooperative farms system and restitution of land to private owners.
<ul style="list-style-type: none"> • Law no.82/1991 on accounting; Ordinance no. 50/1997 concerning the activity of the expert and licensed accountants. 	Sets the framework for accounting and financial reporting and standards for the accounting profession.
<ul style="list-style-type: none"> • Ordinance no. 75/1999 on auditing. 	Auditing becomes compulsory for public companies.
<ul style="list-style-type: none"> • Law no. 13/1991, on the collective labor contracts; Law no. 15/1991 on collective labor disputes resolution. 	Some of the basic rights of employees.
<ul style="list-style-type: none"> • Emergency Ordinance no. 230/2000 concerning the universal pension funds. 	An important potential influence on the capital market in the future.

EXHIBIT K



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Openness to Foreign Investment

Since 1990, Romania's stated policy has been to encourage foreign direct investment. In general, the debate in the government has been not over whether to promote a market economy that is open to foreign investment, but over how to achieve that objective. To give a positive signal regarding its interest in foreign investment, the current Romanian government has created two new interfaces with foreign investors: the National Council for Foreign Investment, under the Ministry of Development and Prognosis, for investments in excess of \$1 million, and the Office for Foreign Investment, directly subordinated to the Prime Minister, for investments in excess of \$10 million. The government has also expressed its openness to suggestions coming from foreign investors in Romania to help improve the investment climate.

There remains resistance to foreign investment in some quarters, including representatives of the nationalist political parties and from some managers of state-owned enterprises who fear that foreigners' purchases of state-owned companies will give them too much influence in the economy. Others fear losing the only job they know how to do in an economy with a 10 percent unemployment rate. This mentality has led, for example, to managers and employees of state-owned enterprises designated for liquidation or privatization initiating legal and other procedural challenges that have slowed or stopped the process.

Like other countries in the region, Romania has worked to create a legal framework consistent with a market economy and investment promotion. Gradually it is moving to strengthen tax administration, enhance transparency and create legal means to reach expeditious resolution of contract disputes. In spite of progress, the unpredictability of the legal framework continues to undermine investor confidence. It is, therefore, recommended that any prospective U.S. investor consult appropriate legal counsel to get the most up-to-date information.

Successful U.S. companies tend to share a common approach to investing in Romania. Firstly, they establish themselves in Romania so that they are able to analyze the local situation and develop the most effective corporate strategy. Secondly, they come with a strategy that communicates long-term commitment to

the Romanian market and government. This often paves the way for successful negotiations with economic ministries, the Privatization Authority, labor unions, and local partners.

Investments that involve the government of Romania, either through sovereign guarantees or by the involvement of entities such as the Privatization Authority, are generally more complicated than greenfield investments or joint ventures with private Romanian companies. Large deals involving the government of Romania frequently become stymied by vested political and economic interests and bogged down by indecision within governmental ministries. Greater success has been encountered with less complex deals involving small to medium-sized private and state enterprises.

The legal framework for foreign investment in Romania is provided by the following laws:

Commercial Register Law (No. 26/1990; revised 1998)
 Commercial Company Law (No. 31/1990; revised 1997, 1999)
 Accountancy Law (No. 82/1991, revised 1999)
 Free Trade Zones Law (No. 84/1992)
 Local Taxes (Law No. 27/1994; revised 1999, 2000)
 Government Ordinance Regarding Tax on Profit (No. 70/1994; revised 1996, 1997, 1999, 2000)
 Bankruptcy Law (No. 64/1995; revised 1997, 1999)
 Petroleum Law (No. 134/1995)
 Copyrights and Neighboring Rights Law (No. 8/1996)
 Competition Law (No. 21/1996)
 Government Ordinance on Leasing (No. 51/1997, revised 2000)
 Bank Privatization Law (No. 83/1997, revised 1999);
 Government Ordinance on Privatization (No. 88/1997; revised 1999, 2001);
 Stimulation of Direct Investments (Government Ordinance No. 92/1997; revised 2000)
 Stimulation of Private SMEs (Law No. 133/1999, revised 2000, 2001)
 State Aid Law (No. 143/1999)
 Value Added Tax (Emergency Ordinance No. 17/2000)
 Privatization of Tourism Companies (Government Ordinance 52/2001)
 Public Procurements (Emergency Ordinance 60/2001 and secondary legislation)
 Privatization of Agricultural Companies (Law 268/2001)

This body of legislation provides that foreign investors are granted national treatment, have free access to domestic markets, and are allowed to participate in privatizations. There is no limit on foreign participation in commercial companies. Foreign investors are entitled to establish wholly foreign-owned enterprises in Romania (although joint ventures are the normal pattern) and to convert and repatriate 100 percent of after-tax profits. They are allowed to participate in the management and administration of the investment, as well as to assign their contractual obligations and their rights to other Romanian or foreign investors. Foreign investments are governed by the provisions established by the foreign investment law in force at the time of incorporation, unless a subsequent law contains more favorable provisions.

Foreign investors may engage in business activities in Romania in any of the following ways:

- setting up new commercial companies, subsidiaries or branches, either wholly-owned or in partnership with Romanian natural or legal persons;
- participating in the increase of the registered capital of an existing company or the acquisition of shares, bonds, or other securities of such companies;
- acquiring concessions, leases or agreements to manage economic activities, public services, or the production of sub-units belonging to commercial companies or state-owned public corporations;
- acquiring ownership rights over non-residential real estate improvements, including land, via establishment of a Romanian company;
- acquiring industrial or other intellectual property rights;
- concluding exploration and production-sharing agreements related to the development of natural resources.

Foreign investor participation can take the form of: foreign capital, equipment, means of transport, spare parts and other goods, services, intellectual property rights, know-how and management expertise, or proceeds and profits from other businesses carried out in Romania.

Foreign investment must comply with environmental protection regulations and must not negatively affect Romania's national security, defense interests, public order, or public health. The regulatory norms generally require the publication of environmental balance sheets for privatizations involving the sale of a majority of a company's shares. Such balance sheets are also required for the sale of any company's assets that, under applicable environmental laws and regulations, are considered to have a negative environmental impact. In practice, these regulations can be difficult to comply with. There are few environmental engineering or consulting companies present in Romania and in many cases the clean-up of past environmental damage will be cost-prohibitive to foreign investors.

At present, if a public institution is selling a majority stake in a company, the company must submit a report to the local environmental agency office. This office then issues an assessment as to whether or not additional environmental reviews/audits are necessary. Given the level of damage inflicted by the state sector in the past, sales of several major enterprises could be difficult if the purchasers are forced to pay for clean up of past damage. Under the 1999 Privatization Law, the buyer of shares has to pledge environment investment to clean up past damages and upgrade the technology to make it environmentally friendly. To mitigate investors' environmental risk, the law provides that public institutions which sell companies on which environmental damages are eventually assessed are liable to indemnify the purchaser from any environmental damage not listed in the environmental balance sheet at the time of the sale. However, notwithstanding the new law, the Privatization Authority typically endeavors to exclude itself from this liability by requesting inclusion in the sales contract of language holding buyers liable for environmental damage revealed after the sale.

Under current law, the government body that has authority over a company (the Privatization Authority, an economic ministry, or the local administration) also has the authority to privatize it. The government authority can hire an agent to handle the project from the restructuring to the final privatization. Sales of shares take one of the following forms: public offering on the Bucharest Stock Exchange or RASDAQ, negotiation, auction, depositary receipts issued by investment banks on the international capital markets (GDR, ADR, EDR) or a combination of these

methods. Public institutions may, at their discretion, agree to accept payment over time for shares being sold through negotiation or auction. As of January 2001, buyers of state companies are subject to new requirements and restrictions concerning company's object of activity, turnover, and social protection. The law also stipulates that the Ministry of Finance must issue a certificate listing all debts of an enterprise upon request and that the company will not be liable for any debts not listed in this certificate.

In cases where former owners win title to an asset in the patrimony of a company that has been privatized, the asset will be restituted in kind and the company compensated by the public institution that has privatized it. If restitution is not possible in kind, the public institution will compensate former owners.

Conversion and Transfer Policies

Romanian legislation does not put any restrictions on converting or transferring funds associated with direct investment. All profits made by foreign investors in Romania may be converted into hard currency, and transferred abroad, after payment of taxes. Proceeds from the sale of shares, bonds, or other securities, as well as from winding-up an investment can also be repatriated. There is no limitation on the inflow or outflow of funds for remittances of profits, debt service, capital gains, returns on intellectual property or imported inputs.

In February 1998, the Romanian government implemented new regulations that liberalized the foreign exchange market on the current account. In early 2001, the National Bank of Romania decided to proceed to the gradual liberalization of capital account transactions. However, due to the fragility of Romanian economic fundamentals, the NBR will proceed cautiously, and full implementation is not expected before 2004. The central bank is also concerned about "hot money", that is, about potentially large inflows of short-term portfolio investment that should be sterilized in ROL in order to reduce impact on inflation and exchange rate stability.

Expropriation and Compensation

The law on direct investment includes a guarantee against nationalization and expropriation and other equivalent actions. The law also allows investors to choose the court or arbitrary body they want to settle any potential litigation. Since 1989 there have been no cases involving expropriation of U.S. property, although there are many unresolved cases involving property nationalized during the communist era.

Dispute Settlement

Property and contractual rights are recognized, but enforcement through Romanian courts is difficult. Foreign companies engaged in trade or investment in Romania often express concern regarding the international commercial experience of Romanian courts. Judges generally have little experience in the functioning of a market economy, international business methods, or the application of new Romanian commercial laws.

Many agreements involving international companies and Romanian counterparts provide for the resolution of such disputes through third-party arbitration. Arbitration offers an effective means of dispute resolution which avoids long trials before non-specialized legal courts. The parties may choose one or more

arbitrators who are specialists in international commerce or a particular industry.

Romania recognizes the importance of arbitration in the settlement of commercial disputes. It is a signatory to the New York convention of 1958 regarding the recognition and execution of foreign arbitration awards. Romania is also a party to the European convention on international commercial arbitration concluded in Geneva in 1961 and a member of the International Center for the settlement of investment disputes. Romanian law and practice recognize applications to other internationally renowned arbitration institutions, such as the ICC Paris Court of Arbitration. Arbitration awards are enforceable through the Romanian courts under circumstances similar to those in western countries.

In addition, Romania has an International Commerce Arbitration Court administered by the Chamber of Commerce and Industry of Romania (The "Arbitration Court"). The regulations and procedural rules provide for the Arbitration Court to be a permanent non-governmental arbitration institution. The Arbitration Court is independent financially, administratively and organizationally. The Chamber of Commerce and Industry of Romania is also non-governmental, and is a self-governing, public interest organization, which organizes arbitration proceedings through the Arbitration Court. The Arbitration Court has cooperation agreements with arbitration institutions in the United States, Austria, Switzerland, India, South Korea, and other countries.

Romania's bankruptcy law contains provisions for liquidation and reorganization that are generally consistent with western legal standards. It emphasizes enterprise restructuring and job preservation. Legal education and the training of existing judges and lawyers has lagged behind law making, making it difficult to bring bankruptcy cases to court with consistent outcomes. To deal with this and mitigate the time and financial costs, the Law No. 99/1999 provides for administrative liquidation as an alternative to bankruptcy. Thus, the company and its creditors no longer have to go through a lengthy and costly judicial process.

Performance Requirements/Incentives

There are no performance requirements imposed as a condition for establishing, maintaining or expanding an investment. Since 1991, Romania's legislation has seesawed between granting, amending and suspending investment incentives, while creating or ending special treatment for FDI. In late 1999-early 2000, Romania revised its tax system to bring it closer to EU models and more in line with the recommendations of the World Bank and IMF. Two new emergency ordinances brought significant changes to the business and investment environment. The ordinances lowered the corporate income tax to 25 percent from 38 percent and reduced the value added tax (VAT) to 19 percent from 22 percent while expanding the tax base. An investment tax credit of 10 percent was introduced for machinery and equipment only, and a lower tax rate of 10 percent was set on reinvested profits. The measures also aimed to enhance exports by providing VAT exemption for exported goods and a corporate profit tax rate of 5 percent for profits made from export. Generally, exported goods are eligible for VAT exemption if the sale proceeds are cashed in a Romanian bank. As an exception to the rule, goods exported under barter agreements are also eligible for VAT exemption. Also, imported raw materials designed exclusively for the manufacturing of finished products that are exported within 45 days from importation are eligible for VAT exemption. A new ordinance passed in May 2000 makes it possible for importers and exporters to get customs clearance on site

rather than at the border.

To compensate for the budget revenue losses from such fiscal relaxation, in 2000 the government abrogated most of the incentives granted under previous legislation, which resulted in a business and investment environment with few incentives. After the abrogation of the ordinance providing tax incentives for companies investing in excess of \$50 million, only the French carmaker Renault and the German tire manufacturer Continental continue to enjoy tax incentives under the ordinance, benefiting from a grandfathering clause. Otherwise the changes do not grandfather any other past incentives – many of which were due to expire in any case.

Currently, customs and tax incentives are available for operators in the six free trade zones and for investments in the 29 economically disadvantaged regions of the country. Customs duty and VAT-related incentives for private SMEs have been reinstated. Starting June 2001, investments in excess of \$1 million are eligible for tax incentives including: customs duty exemption for imported equipment and software, deferred payment of VAT, 20 percent tax deduction of the investment value, and accelerated depreciation.

However, the availability of incentives is dependent on the economic situation, and the government has frequently suspended incentives in order to tighten fiscal policy. Investors are encouraged to check with the embassy to determine the current status of investor incentives.

Like other Central and Eastern European countries, Romania provides tariff preferences for EU goods under its association agreement with the EU.

Right to Private Ownership and Establishment of Enterprises

The Romanian constitution, adopted in December 1991, guarantees the right to ownership of private property. Mineral rights, air rights, and similar attributes are excluded from private ownership.

Foreign investors involved with commercial companies having partial or full foreign capital may acquire land or property necessary for fulfilling or developing the company's corporate goals. If the company is dissolved or liquidated, the land must be sold within one year of the company's closure and may be sold only to a buyer(s) with the legal right to purchase such assets. Agricultural land cannot be purchased by foreign investors at this time. Under Law 268/2001, investors can buy shares in agricultural companies and can lease from State Land Agency land which is in the public domain.

The process of establishing a company in Romania, although recently streamlined, can be bureaucratic and time consuming. The Romanian Trade Registry is responsible for company registration. Although a one-stop-shop has been recently established to assist investors, the number of approvals required remains the same.

Protection of Property Rights

Romania is a signatory to international conventions concerning intellectual property rights, TRIPS included, and has enacted legislation protecting patents, trademarks, and copyrights. While the legal framework is generally good,

enforcement remains weak. Romania passed in 2000 border enforcement provisions required under the WTO. As the result of persistent problems in the enforcement of intellectual property rights, the International Intellectual Property Alliance (IIPA) has recommended that the Office of the Special Trade Representative (USTR) preserves Romania on its Special 301 Watch List for 2001. The IIPA has estimated that Romanian piracy of motion pictures, sound recordings, computer programs/software, and books cost U.S. industry \$25.9 million dollars in 2000.

Patents: Romania is a party to the Paris Convention for the protection of industrial property and has subscribed to all of its amendments. Foreign investors are therefore entitled to the same treatment as Romanian citizens. A modern Patent Law (No. 64/91) broadens and clarifies the basis on which a patent is granted. Several other laws (No. 129/92, on the protection of industrial drawings and designs; No. 16/95, on the protection of integrated circuit designs, etc.) have helped bring Romanian patent legislation up to international standards. Patents are valid for 20 years. The period for contesting a patent application is six months. Legislation providing for transitory ("pipeline") patent protection was enacted in early 1998.

Trademarks: In 1998 Romania passed a new law on trademarks which is generally consistent with international standards. Romania is a signatory to the Madrid Agreement relating to the international registration of trademarks. Trademark registrations are valid for 10 years from the date of application, being renewable for similar periods. The first applicant is entitled to the registration. The period for contesting a trademark is six months.

Copyrights: Romania is a member of the Bern Convention on copyrights. Its 1996 law on protection of copyrights and neighboring rights is among the most modern in this field. It is consistent with EU provisions and incorporates many suggestions made by U.S. experts. The Romanian parliament ratified the latest versions of the Bern and Rome conventions. A new Romanian Office for Copyright protection (ORDA), directly subordinated to the Romanian Government, was established in 1997. However, copyright law enforcement is not regarded as a high priority of prosecutors, judges, ORDA inspectors, and police officers. As a result, since 1996, there have been only very few convictions for IP law violations, although the Romanian market contains 65-90 percent pirated products. ORDA organized in March 2001 the first public mass destruction of counterfeited and seized audio material.

Credit security: The Law no. 99/1999 amended the secured transaction law and substantially improved the security interest system. The provisions refer to all movable, tangible or intangible assets, such as deposit accounts, bills of lading, shares, trademarks, patents, copyrights and other intellectual property rights, either industrial or commercial, lease of movable assets or object of leasing operations. Under the law, a secured claim originating in a foreign country is valid in Romania provided that is duly recorded. It is an improvement to credit security enforcement, since before the law became effective, the only way for a creditor to satisfy its claim was through court proceedings and judgement. The law also states that an easy to access electronic system (Electronic Security Records) has been created. In July 2001, a law on electronic signature was passed. Draft bills on electronic commerce and protection of personal data were debated in the Parliament. Work is in progress within pertaining ministries on cyber crime and digital payment systems.

Mortgages: The new Law No. 190/1999 on mortgage loans for real estate investments simplified certain mortgage loan requirements, allowing a debtor's receivables to be used as a guarantee, and specifically addressing the protection of both borrowers and creditors, in an effort to minimize the risk undertaken by the lender.

Semiconductor chip layout design: Law No. 16/1995 protects semiconductor chip layout design. In order to benefit of the provisions of this law, the designs have to be properly registered as per the government decision no. 535/1996.

Transparency of the Regulatory System

Cumbersome and non-transparent bureaucratic procedures are a major problem. Foreign investors point to the excessive time it takes to secure the necessary zoning permits, property titles, licenses, and utility hook-ups. Furthermore, regulations change frequently, sometimes literally overnight, and without advance notice. The government does not have an effective means of communicating with foreign investors or with Romanian private businesses about changes in the regulatory framework. These changes, which can significantly add to the costs of doing business, make it difficult for investors to develop effective business plans. Many successful foreign investors choose to work with a local Romanian partner to alleviate some of these problems.

Many foreign investors feel they are unfairly targeted by Romanian tax authorities for audits and reviews and that Romanian authorities view them as "cash cows" that can be milked to fill government coffers. Unlike most Romanian companies, foreign investors generally have good financial records that make them easier to investigate. Foreign investors also tend to be more conscious of the need to remain in compliance with local laws and regulations.

The presence of large state-owned government-subsidized enterprises in the economy is also a major impediment to the efficient mobilization and allocation of investment capital. A new EU-inspired law on state aid came into effect in January 2000, aiming to regulate and keep under control state aid in any form (as either direct state subsidies, debt rescheduling schemes, or discount prices). However, implementation of the law has been slow and preferential debt rescheduling by the Ministry of Finance and Ministry of Labor has resulted in major distortions on the market. Furthermore, state aid schemes continue to be non-transparent.

Capital Markets and Portfolio Investment

Romania seeks to develop efficient capital markets. However, because of the slow pace of privatization, capital markets have only recently become fully operational in Romania. Ordinance No. 18/93 and Government Decision No. 552/92 established a National Securities Commission (CNVM) charged with regulating the securities market in order to protect investors. The process principally provides for: registration and licensing of brokers and financial intermediaries, filing and approval of prospectuses, and approval of market mechanisms.

Romania officially opened the Bucharest Stock Exchange (BSE) on June 22, 1995. On November 20, 1995, the stock exchange made its first transactions

after a hiatus of 50 years. The BSE now operates a two-tier system that lists a total of 80 companies with 18 companies on the first tier. The official index, BET, is based on a basket of the 10 most active stocks listed on the first tier. The BSE has a home page at <http://www.bvb.ro>.

In September 1996, the Romanian over-the-counter stock market, RASDAQ, was inaugurated. It is supported by several independent registries and is a depository for Romanian securities. Over 5,500 companies are listed on the RASDAQ though typically around 600 companies are traded each day. RASDAQ has a home page at <http://www.rasd.ro>.

Given the trading volume and pace of privatization many brokers feel the broker/dealer industry is close to saturation. Tight competition has brought trading fees down and lack of liquidity among listed companies makes it difficult to place large purchase orders. Together with unsatisfactory disclosure and annual audit reports this lack of liquidity has tended to keep large institutional investors away. Country funds, hedge funds, and venture capital funds however continue to participate actively in the capital markets or through direct investment in private enterprises.

The Romanian mutual funds industry developed earlier than the rest of the capital market and initially concentrated on small commercial loans. Strong performance in 1993-1994 encouraged further growth of the industry. In late May 2000, the largest mutual fund (FNI) collapsed as a result of a fraudulent management by the managing company SOVINVEST and lack of supervision by CNVM. These recent problems with Romanian mutual funds and CNVM have had a negative impact on the capital markets.

Complaints continue to be aired by one of the largest U.S. investment funds present in Romania regarding the abuse of minority shareholder rights. The former Romanian government responded in 2000 to complaints by U.S. investment funds regarding the abuse of minority shareholder rights by issuing an emergency ordinance that sanctioned for the first time in Romania such things. In February 2001, at the pressure of several foreign direct investors gathered in the FIC, the current government repealed the ordinance on the grounds that increased powers granted to minority shareholders might have jeopardized strategic decision taking procedures.

Political Violence

There have been no incidents in Romania involving politically motivated damage to foreign investments (projects and/or installations). Major civil disturbances are not likely to occur in Romania in the near future.

Corruption

Romanian law and regulations contain provisions intended to prevent corruption, but enforcement is generally weak. Corruption is currently punishable under a variety of statutes in the penal code. A money laundering law was passed in February 1999 and an anti-corruption law was passed in May 2000. Prison sentences are sometimes imposed for white collar crimes, but powerful and influential individuals most often evade punishment.

The government is preparing to accede to the OECD convention on combating

bribery, but is not yet a signatory.

U.S. firms have complained of government corruption in Romania. The customs service, municipal zoning offices, local financial authorities, and other bodies are affected to some degree by this problem. In some cases, demands for payoffs by mid- to low-level officials can reach the point of harassment. According to Transparency International, Romania is among the third tier of countries in the world considered the most corrupt.

Bribery is punishable by fines or imprisonment, but not both. Fines permitted under the existing penal code are too low to be effective deterrents. There is no deduction for bribery in the tax code.

Romania is a member country of the Southeast European Cooperation Initiative (SECI), and it has signed and ratified the Agreement on Cooperation to Prevent and Combat Transborder Crime of May 1999. Bucharest hosts the SECI Regional Center for Combating Corruption and Organized Crime, Romania being one of the three members of the Joint Cooperation Committee.

According to the World Bank's "Diagnostic survey on corruption in Romania" (funded primarily with USAID money), released in early March, 2001, corruption in Romania is systemic: approximately 2/3 of the Romanian public believes that all or most officials are corrupt; half of the households surveyed believe that corruption is a part of daily life; 40 percent of businesses believe that corruption is a part of daily life; more than half of the respondents believe that officials in the Customs Authority and the Judiciary are corrupt.

The previous government attempted to tackle the problems of corruption by pursuing a "law enforcement" approach - - it focused on individual cases of corruption, rather than the overarching societal problem of corruption. This is especially problematic since there is a widespread belief that the police and judiciary are corrupt. In order to be effective, the current government must take a holistic approach and battle corruption as a societal problem.

In response to the World Bank diagnostic study, the Romanian Government has created an interagency team, whose operation is still embryonic.

Court System: The judicial system in Romania suffers from corruption and inefficiencies. Companies complain that commercial disputes take too long to resolve through the court system and that court orders often are not enforced. According to the World Bank survey, nearly two-thirds of enterprises believe that most judiciary officials are corrupt. One in five households that have been involved in a case reported paying a bribe. The vast majority of bribes were paid to attorneys, who act as intermediaries, rather than directly to a judge or clerk. The most common reason for paying a bribe was to speed up the trial or to assure a particular person was assigned to the case.

Cyber Crime: Romania has one of the highest cases of internet credit card fraud. The problem began in fall 1998, but has escalated to a steady stream of complaints, some of which involve U.S. companies being defrauded for millions of dollars. The most common problems result from the use of stolen credit card numbers for the purchase of goods on-line.

Romanian hackers also have gained notoriety for hacking into U.S. companies'

servers and stealing proprietary information, including customer credit card data. There have been cases where the Romanian hackers have then offered to sell the U.S. company the means by which they hacked the company's server (a form of extortion). During other occasions the hackers have threatened to release the sensitive data or the means to hack the system unless a specific amount of money is paid.

Bilateral Investment Agreements

Romania has concluded bilateral investment protection agreements or treaties with the following countries: Albania, Algeria, Argentina (1994), Armenia (1995), Australia (1994), Austria (1997), Bangladesh (1987), Belarus (1995), Belgium + Luxembourg (1997), Bolivia (1996), Bulgaria (1991), Cameroon (1981), Canada (1997), Chile (1995), China (1995), Croatia, Cuba (1997), Czech Republic (1985), Cyprus (1993), Denmark (1995), Egypt (1997), Finland (1993), France (1995), Gabon (1982), Germany (1981), Ghana, Greece (1997), Hungary (1991), Indonesia, Israel (1992), Italy (1991), Jordan (1995), Kazakhstan (1997), Kuwait (1992), Lebanon (1995), Lithuania, Malaysia (1997), Moldova (1994), Mauritania (1989), Mongolia (1996), Morocco, Nigeria, Norway (1991), Netherlands (1984), Pakistan (1979), Paraguay, Peru, Philippines, Poland (1991), Portugal, Qatar (1997), Russia (1992), Senegal (1984), Singapore, Slovakia, Slovenia (1996), South Korea (1997), Spain (1995), Sri Lanka (1982), Sudan, Switzerland (1994), Tunisia (1996), Turkey (1994), Turkmenistan (1995), Ukraine (1995), United Kingdom (1995), USA (1994), Uruguay (1993), Uzbekistan (1997), Yugoslavia (1996).

The U.S.-Romanian Treaty on the reciprocal encouragement and protection of investment (signed May 1992, ratified by the U.S. party in 1994) guarantees national treatment for U.S. and Romanian investors. It provides a workable dispute resolution mechanism, liberal capital transfer, prompt and adequate compensation in the event of an expropriation, and avoidance of trade-distorting performance requirements.

OPIC and Other Investment Insurance Programs

Following the signing of an investment incentive agreement in June 1992, the Overseas Private Investment Corporation (OPIC) began operations in Romania in late 1992.

Since 1992, Romania has been a member of the Multilateral Investment Guarantee Agency (MIGA).

Labor

Romania offers a large skilled labor force at comparatively low rates in most sectors. Annually, the university system matriculates a high percentage of technically oriented graduates and positive reports have been received from U.S. businesses that employ Romanian engineers and software designers. With appropriate on-the-job training, local labor can perform well with new technologies and more exacting quality requirements. However, there is a shortage of western-trained managers.

Since the revolution of December 1989, labor-management relations have occasionally been tense as a result of economic restructuring efforts and attendant personnel layoffs. Unemployment is officially 10 percent of the

country's active labor-force. Trade unions are vocal defenders of their prerogatives. The government adheres to the ILO convention protecting worker rights.

Many Romanian state enterprises maintain that the first priority for an enterprise is to preserve jobs rather than turn a profit. Individual dismissals for poor performance must be carefully documented and are subject to legal challenge by the affected employee. Some foreign investors have run into labor problems when they have tried to trim staff in loss-making product lines. For example, in early 2001, trade unions carried out demonstrations in connection with a privatization involving a U.S. company, which resulted in property damage as well as an attack on an American employee of the company.

Steep salary taxes may also generate problems. A new law on global income tax was passed in August 1999 and came into effect in January 2000, including non-cash benefits in the basis for calculating salary tax. Romania currently levies a maximum tax rate of 40 percent on gross salaries above \$250 per month.

The law makes it very costly to locate expatriate staff in Romania. Foreign companies often resort to expensive staff rotations, special consulting contracts, and non-cash benefits. A new law was passed in December 1999, describing the new legal requirements applicable to work permits required for foreigners employed in Romania. As a rule, such permits are issued for a period of six months for an equivalent fee of \$200, and may be renewed for subsequent six-month periods at \$100 per renewal.

Free Trade Zones

Free Trade Zones (FTZs) operate under Law No. 84/1992. General provisions include unrestricted entry and re-export of goods as well as exemption from customs duties and value added tax (for specific activities performed inside). They also include an exemption from profit taxes for the duration of a company's operations in the FTZ. The law further permits the leasing or transfer of buildings or lands for terms of up to 50 years to either legal person or natural persons, Romanian and non-Romanian.

Currently, there are six FTZs: Sulina (located at the mouth of the Danube); Constanta-Sud Agigea (located close to the port of Constanta, at the entrance to the Black Sea-Danube Canal); Galati (located about 100 km from the Danube mouth); Braila (located 30 km up the Danube from Galati); Curtici-Arad (located about 30 km from the cross border with Hungary); and Giurgiu (located on the Danube, 60 km south of Bucharest)

The administration of each FTZ is responsible for all activities performed within the zone. FTZs are under the authority of the Ministry of Public Works, Transportation and Housing.

Foreign Direct Investment Statistics

Despite some substantial gains in recent years, direct investment flows into Romania remain far below the levels that the economy needs to promote economic growth. According to data provided by the Trade Registry, cumulative foreign direct investment for the 1990-2000 period totaled only \$8.39 billion.

As of end-2000, the largest direct foreign investors in Romania were Holland (\$1,035.6 million), France (\$896.8 million), Italy (\$840.6 million), Germany (\$767.7 million), the U.S. (\$693.2 million), the U.K. (\$593.5 million), and Greece (\$534.8 million). These are pledged net figures, including amounts resulting from these countries' participation in the privatization of some Romanian enterprises. Offshore investments are included only by the source of registration, not by flag of original source of capital. Equity funds are not included.

The number of companies with foreign capital amounted to 77,481 at the end of 2000, representing about 9 percent of all companies registered in Romania. In 2000, FDI totaled \$2,039.7 million, which represented 5.5 percent of GDP for 2000. Since 1990, preferred areas for foreign investment have included oil exploration (Shell, Enterprise Oil, Occidental, Amoco), the automobile and automotive component industry (Renault, Daewoo, Siemens, Daimler Benz), banking and finance (Raiffeisen, Société Générale, Wasserstein Perella Group, ABN Amro Bank, ING Bank, Citibank, Creditanstalt/Bank of Austria, Volksbank, Banca di Roma, GE Capital), telecommunications (France Telecom, OTE, Telesystem International Wireless Services, Airtouch-Vodafone), commercial/hotel construction and development (Bouygues, Compagnie Immobiliere Phoenix, Ilbau Holding), and consumer products (Coca Cola, Procter and Gamble, Unilever, Henkel, Colgate Palmolive, Kraft Jacobs Suchard).

At the end of 2000, the U.S. ranked fifth among foreign direct investors to Romania, with a total direct investment of \$693.2 million, up 18.3 percent from \$586 million in 1999. Out of the total cumulative U.S. direct investment between 1990 and 2000, 52.9 percent was invested in joint ventures and greenfield projects, and the rest through sale contracts concluded with the State Ownership Fund.

In addition to direct investment, foreign portfolio cumulated investments with Romanian capital markets by the end of 2000 amounted to \$683.4 million for inflows, \$135.1 million for outflows, \$711.6 million for purchases, and \$307.2 million for sales. U.S. portfolio investments in Romania have roughly made 60 percent in all these categories, based on estimates by the National Securities Commission.

Americans invested capital in a wide variety of industries. Prominent investors include manufacturers in heavy industry and electronics - - Timken (bearings), Trinity Industries (freight cars), Solectron (computer and electronic components), Precision Castparts (gasfield exploration equipment), World Machinery Works (machine tools); engineering and design companies - - Washington Group International (engineering and design for the oil, chemical, energy, and industrial processes industries), Cambric Consulting (digital engineering), Search Corporation (road design); ICT companies -- IBM, Compaq, Hewlett-Packard, Harris, Lucent Technologies, Qualcomm, Microsoft, Oracle, Motorola, KPNQwest, Atomic TV, HBO; consumer goods companies -- Coca-Cola, Quadrant Amroq Beverages (Pepsi), McDonalds, Kraft Jacobs Suchard, Philip Morris, Procter and Gamble, Colgate-Palmolive; and banking and insurance companies -- Citibank, GE Capital, AIG.

Important investment in Romania has also been made by such private equity funds with U.S. capital as New Century Holding, Advent Central and Eastern Europe, AIG New Europe Fund, the Romanian-American Enterprise Fund, and the Romania and Moldova Direct Fund.

To the best of our knowledge, the information contained in this report is accurate as of the date published. However, the Department of Commerce does not take responsibility for actions readers may take based on the information contained herein. Readers should always conduct their own due diligence before entering into business ventures or other commercial arrangements. The Department of Commerce can assist companies in these endeavors.

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British Ambassador to Romania Says Investors Complain of Corruption

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[Unattributed report: "Romania Excels in Corruption -- Says the British Ambassador to Bucharest"]

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British investors complain about the "legislative nightmare" in Romania, which gives many headaches to those who wish to start a business in this country, says Sir Richard Ralph, British ambassador to Romania. He says he has heard this from the investors themselves, who "complained" about this "legislative nightmare," and warn against the seriousness of corruption, a scourge that is not specific to Romania, but which is a much more serious phenomenon in this country than in other European countries, reports RomNet.

[Description of Source: Bucharest Adevarul in Romanian -- large, influential, privately owned daily, with a centrist perspective]

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May 22, 2002

SECTION: No. 2685**LENGTH:** 2232 words**HEADLINE:** EU/ROMANIA: RELUCTANT REFORMERS CHASE ACCESSION CARROT**HIGHLIGHT:**

Romania at last appears to be recovering from the post-Communist meltdown of its economy. The European Commission says that economic growth of 4.6% in 2001 may be sustainable in the long-term. Commission officials in Romania say that a strong domestic market is developing as a middle class emerges. European Union membership beckons, perhaps by 2008. The extreme right, which gained over a third of the votes in late 2000, now appears a spent force, while the present ex-Communist government has surprised western observers with its support for economic liberalisation. Foreign investors in the country paint an almost glowing picture. However most observers agree that economic recovery needs sustained reform, and that this requires political will and nerve. Delivery is still awaited on some of the commitments to combating corruption and vested interests, and to closing firms that will never make a profit, even if the prospect of EU membership and the lack of any alternatives are underlying drivers of reform. In this special analysis of Romania's situation, European Report examines the prospects for reform and the prospects for foreign companies wishing to do business in the country.

BODY:

Some leading foreigners with a stake in Romanian firms offer a favourable assessment. Stephen Groningen, the Chief Executive Officer of Romania's Banca Agricola, which has been bought by Austria's Raiffeisen Bank, says that "the overall balance is certainly positive" for business in **Romania**. He adds that the country is "a mixture of fantastic opportunities, partly offset by... a number of risks". Among the strengths are "well educated people and a very European focus". Nalenda Chaudhary, the General Director of **Romania's** largest steel company, Sidex of Galati, admits there is "a substantial difference" between the business climates of **transition** countries like **Romania**, and developed ones. However he says "we do not encounter many problems doing business our way", either from the government, the

administration or the public. He adds that "the economic system is maturing". Dragos Negrescu, the chief economist of the European Commission's Delegation in Romania, is also positive, and see the growth since 2000 as sustainable, as long certain conditions are met - principally whether the present government of Prime Minister Adrian Nastase and President Ion Iliescu is prepared to maintain economic reform. Commission officials say the authorities need to "finalise privatisation, and stabilise legislation and rules for companies". They add that "the commitment of government" is "a primary condition for investment". This in turn is vital if the GDP is to keep growing at 4-5% in coming years, which "studies by the government and international donors" say is needed for a relatively smooth **transition**. Will the government stick to reform? Andre Lys, in charge of EU aid at the Commission's Bucharest delegation, says the country's ex-Communist leadership is "very much a mixed picture".

A question of politics.

According to the Commission officials, **Romania** in Mr Iliescu's first period in office, which end in late 1996, "was a command economy". Under the centre right government which followed, "1997 was the big moment of liberalisation", followed by "a dramatic drop in GDP and industrial production". Although there was an upturn in 2000, due, according to the Commission, to "restructuring linked to foreign competition", it came too late for the government of Emil Constantinescu. In elections at the end of 2000, the centre- right parties were obliterated - permanently, according to most observers. The ex-Communist Social Democrats under Mr Iliescu and Mr Nastase returned to power, challenged by the far-right Great Romania party of Vadim Tudor.

The present government appears to have pleased its electorate. A poll in February 2002 put the ruling party's support at 52.5%, compared to a vote of 37% in the elections two years ago. Mr Lys calls the far-right, with 17.5% in opinion polls, "not organised, just a protest vote". The "major risk" for the government, he says, "is social unrest". This is a left-wing government, and "does not want liberalisation at any price. It will not take a risk", adds Mr Negrescu. The risks of social unrest, of strikes and more violent protests like blockading roads, are ultimately the major obstacles to continued growth, say the Commission analysts. Mr Chaudhary of Sidex says social unrest ranks with obsolete business practices among the main challenges. For Mr Groningen too, the key is government support for reforms, though he also says business must organise better to lobby for its interests.

The "most important" problem, according to Mr Negrescu, is the burden of debts owed to electricity, water and gas suppliers, preventing them from investing. He says these are attacked by the press, and receive no support from politicians and the courts if they try to get the money they are owed from district heating companies and heavy industry. Many of these can only stave off bankruptcy by not paying their bills and taxes. If heating companies go bust, whole neighbourhoods could freeze in winter. And bankruptcy in massive Communist-era factories could throw entire towns out of work.

The EU membership carrot.

The prospect of EU membership is seen by many as the key to continuing and setting the agenda for reform. Mr Groningen says the government "cannot go entirely against European principles", and that these are "very, very important to give direction to reform". For Mr Chaudhary, reform legislation is driven by "desire to join the EU", though he adds that the government is also imitating western economies as the only successful model available. Commission officials describe EU membership as "the only anchor" and "the single driving force" of reforms. However, they warn that the present universal popularity of accession may be undermined if the government over-uses a technique popular among Member State governments - pinning responsibility for difficult reforms on Brussels. Mr Negrescu says he does "not know how long this will work", adding that giving in to pressure from bodies like

the International Monetary Fund is already "not socially acceptable".

Manuela Stefanescu, the President of the Romanian branch of the human rights organisation, the Helsinki Committee, says she believes that the present government has to be "pushed from outside" and is "not very keen on real reform". She adds that "their own instincts are to slow down as much as possible but they are forced by Brussels to move in the only direction possible". The Commission's men are only a little more positive, warning that the government is "willing to intervene at a national level to save social peace" in a particular labour dispute.

Corruption, vested interests and bureaucracy.

Cosy vested interests and corruption are cited as other problems. Mr Negreascu says the utility companies are "in some cases clearly directed not to call in debts by politicians. It is difficult to know what goes on behind closed doors". Meanwhile Banca Agricola's Mr Groningen complains of losing court cases where the evidence was overwhelmingly in his favour "for all sorts of mysterious reasons", and remains unconvinced that the courts will give "an impartial decision in due time". Tellingly, both the banker and Ms Stefanescu, the human rights activist, pose the identical question of why, in the latter's words, "very well known embezzlers are still at large". Ms Stefanescu says it is "not necessarily the case" that the courts are corrupt, "but it is a logical explanation", given the "very low salaries" of officials.

Nevertheless, the Banca Agricola boss warns that although there "definitely is corruption", one "should not over-dramatise". It's "more of a nuisance" than anything else and "it is possible to do business without resort to corruption". He adds that there now appears to be "more understanding and awareness" that corruption is a serious obstacle to development and the authorities "are more serious about dealing with it than in the past". However, he adds, "words are one thing, results are another".

For Mr Groningen, the process of exposing and rooting out corruption "must go on for a long, long, long time". But the press is seen as playing what he describes as "an important role". And Mr Chaudhary says Ispat's management of Sidex has "been very critically watched by the press".

Ms Stefanescu is more worried. She points to a series of laws mandating heavy punishments for journalists for vaguely defined crimes, as well as political manipulation of magistrates. There is a "culture of secrecy in Romania", she says, adding that there is "no culture of giving information by the authorities and no culture of asking for it by the citizens". She explains the present government's popularity by its "blackmail" of media companies, "in particular through their huge debts" to the state, and accuses state television of "worshipping" Mr Nastase.

Bureaucracy and disorganisation are identified by businessmen as other ingrained barriers to doing business in **Romania** - a common criticism of **transition** countries. Mr Groningen complains that "it is not so much the rules themselves" that are the problem for business as "the inconsistency and lack of application" of them.

Challenges in dealing with Romanian bureaucracy also confronted European Report, which found it impossible to speak to officials from the privatisation bureau, the foreign trade department of the Foreign Ministry, or the office of the Mayor of Bucharest. They were either unable to make concrete appointments or to keep them. One privatisation bureau representative admitted that officials only schedule the starting times of meetings, but not when they are meant to finish. She said officials were delighted in principle to speak to the press - even if in practice it proved impossible on this occasion. A relaxed approach to timekeeping and over-complex bureaucratic procedures strike even the most casual visitor to

Romania. For instance, a train ticket can consist of up to three hand-written pieces of paper, with predictable consequences for speed of service.

Both Mr Groningen and Mr Chaudhary indicate that the major problems in their sectors lie in the unhealthy business practices of the past. Raiffeisen has stopped Banca Agricola's bad habit of making bad loans, and is pursuing over a hundred debtors through the courts. Mr Groningen expects a return to profitability soon. He says there is a "very open business culture" in Romania, comparing the country's openness to foreign investors favourably with Russia and even Hungary. As soon as Mr Chaudhary's Anglo-Indian firm Ispa took over Sidex last year, it insisted on working in cash. Until then, Sidex had paid suppliers in steel and was paid by other companies in goods. The transformation took "diligence and determination", especially in the face of resistance from the well-connected middlemen who profited from the barter system, as well as demand for credit from partners in Romania. "Once we demanded change", says Mr Chaudhary, "there was change".

Disputes over privatisations.

Ilie Serbanescu, who was Minister for Reform until the elections, is bitter that the Social Democrats' electoral campaign accused the Constantinescu government of selling firms too cheaply. He accuses the Nastase government of selling even more cheaply. However, he says that in Romania, privatisation "opportunities for profit are not very attractive, and because of this, there are not too many buyers". The present Privatisation Minister, Ovidiu Musetescu, says he is pushing through a bill to allow "accelerated privatisation" of about 120 firms by the end of the year, including "about 40 large or very large firms". However, Commission officials agree with Mr Serbanescu that most of what remains are less interesting properties, even if the prices are low. The exceptions are the biggest bank, Banca Comerciala, which Commission officials call "a crown jewel" which should be sold "by the end of the year", and the oil company Petrom. Mr Lys describes Petrom as "a good investment opportunity" but "politically difficult" to sell.

Social impact of further sales.

Local Commission officials say privatisation of the industrial sector is slower, and that several large firms have such severe social problems that "there is no possible buyer". The government refuses to admit this, however. Mr Musetescu calls Roman Brasov, a track-making company, "extremely important for the Romanian economy and "successfully placed for any serious investor". Western diplomats privately use different descriptions, like "a sacred cow" and "a hopeless case". Nevertheless, the Commission views any privatisation as helpful, as it diminishes the relative weight of the state in the economy. In some areas, like gas and electricity utilities, Commission sources say "the environment is not yet ripe" for sale. Mr Chaudhary agrees that "businesses with a social impact are the hardest to privatise", putting steel, electricity and railways in this category. However, he argues that the privatisation of Sidex was the "greatest challenge". He says this "has been met and has been successful".

Some opportunities.

Mr Groningen defends Raiffeisen's decision to buy into the banking sector now and build up market share before the market consolidates. He says trends in Hungary and Poland suggest there is just a "maximum three years" before the mass banking market will be sewn up by the "top three or top five" banks. Newcomers will then have to look for niche markets. According to Mr Lys and Mr Negrescu from the Commission, a few domestic sectors, like supermarkets, insurance, beer and soft drinks, have already been opened up to foreign capital or even saturated, but Mr Lys says most other service sectors and consumer markets remain "underdeveloped". Mr Negrescu says Romania could have a bright future in high technology, as it is "known for the high level of its mathematicians and computer specialists".

Mr Negrescu says it is "hard to predict" which industrial products could become export earners for Romania, but that shipbuilding is "a possibility" and "Sidex could become an important player". Mr Chaudhary says he is still concentrating on the steel producer's traditional markets within Romania, including shipbuilding. However he thinks the country is in a "geographically good location" for exporting.

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Region: East Europe**Sub-Region: Balkan States****Country: Romania****Topic: DOMESTIC ECONOMIC, DOMESTIC POLITICAL, INTERNATIONAL ECONOMIC, LEADER****Source-Date: 05/21/2002****BNR Official, Foreign Investor View Romania's Business, Investment Climate***EUP20020521000215 Bucharest Romania Libera in Romanian 21 May 02 p 4***Reference:**

1. Romanian Leaders, European Bank Officials Discuss Privatization, Investment
EUP20020520000132 Bucharest Adevarul Romanian 20 May 02

[Report by Cristina Ciobanu: "Jean-Pierre Vigroux, Partner of PricewaterhouseCoopers Company: 'It Is Difficult To Attract Financing to a Country Affected by Corruption'"]

[FBIS Translated Text]

The EBRD's [European Bank for Reconstruction and Development] General Assembly, which is currently being held in Bucharest, offers an opportunity to conduct an assessment of Romania's economic situation and on the current **investment** environment. Despite the optimism displayed by the authorities, Romania continues to register the lowest rate of GDP per capita compared to neighboring countries. At the end of 2001, the inflation rate was quite high, amounting to 30.3 percent, compared to the average value of 9.8 percent registered in the countries transitioning to a market economy. Cristian Popa, the BNR's [National Bank of Romania] vice-governor, considers that efforts have to be made to curb the inflation rate. They must correspond to the increase of the labor productivity. This way it will be possible to achieve the forecast level of 22 percent by the end of 2002, or even a lower rate, of approximately 20 percent. For the time being, direct **foreign investments** are extremely low in Romania. Since the transition process started, they represented only \$7.9 billion, which translates to \$356/per capita, compared to the average value of \$600/per capita registered in the countries in transition. "In relation to structural reforms, there have been many obstacles

and Romania has even taken steps backward. It is not possible to change investors' perception unless privatization continues to develop at a steady pace," Cristian Popa thinks. He considers that the financial discipline in the state sector and even in the private sector is still a problem that will be solved only through privatization and through some companies' bankruptcy. In relation to the economic growth rate, the BNR's vice-governor thinks that the Romanian economy, which is grounded on domestic development and consumption, will still need huge imports. That is why a strategy is needed, aiming at keeping the money in the country. "The way the current account balance sheet looks, means that the **foreign** capital inflows have been represented by massive imports, not necessarily under the form of capital for **investments**," Cristian Popa says. In relation to exports, approximately 75 percent of the transactions are being carried out in the countries within the European Union. This might make the BNR endorse the euro as a reference currency, starting with 2003. Even if the national currency registered some increase at the end of April 2002, against the background of the euro's fluctuations compared to the US dollar and the inflation rate, the BNR does not aim at the leu's great appreciation. This way it wants to prevent problems from emerging in the Romanian exporters' activity. Regarding Romania's trumps, the BNR vice-governor listed the following. The public debt decreased to less than 30 percent of the GDP (of which 8 percent of the GDP represents the domestic debt), the current account's deficit fell to \$1.8-\$1.9 billion and the currency reserves increased to almost \$6 billion. The increase of the bank credits by 20 percent in 2001 was another positive thing, moreover since 25 percent of the loans were for the private sector (mainly in the industrial sector). The steps taken by the BNR last year led to the consolidation of the banking system, by curbing unsecured loans and by reaching an average solvency rate of 27-28 percent. In practice, at the end of May, 9 million euros will be in Romanian commercial banks' accounts. This money can ensure the necessary **investments** in the private sector. All these evolutions have brought about the improvement of Romania's country rates. Standard & Poors' lifted it to a B+. This rating can also be noticed in the fact that some loans could be obtained from the **foreign** markets in more advantageous conditions, such as the last issuance of bonds launched by the Finance Ministry. Their interest rate was 8.5 percent, which is 2 percent less than the previous one.

Despite these positive signs, **foreign** investors are still reticent when it comes to Romania. "It is difficult to attract financing to a country like Romania, which is affected by very many corruption-related scandals, where the system of credits granted to suppliers by compensation is being developed," said Jean-Pierre Vigroux. Vigroux is a partner of the PricewaterhouseCoopers Company. According to him, the great state sector currently existing in Romania continues to be an extremely heavy burden for the economy. This is reflected in the very great fiscal burden, which exceeds 40 percent of a company's income. There are very many cases of unfair competition, following which companies that pay all taxes in due time have to file for bankruptcy. "In relation to the fiscal policy, Romania was perceived as a country that breaks its commitments. There used to be some facilities granted to investors, which have vanished over time. It is true, in some cases they were canceled at the IMF's pressure," Jean-Pierre Vigroux says. Some major problems are also present in relation to VAT [Value Added Tax] refunds. There are great delays in recovering the money from the state. "The setting up of the One Stop Office was a good idea. However, the way in which the civil servants work has made things sometimes take longer than before regarding a company's licensing," Jean-Pierre Vigroux also added. **Foreign** investors think there are very many problems whose settlement continued to be postponed for too many years. It is out of question to change this perception only with the authorities' exaggerated optimism.

[Description of Source: Bucharest Romania Libera in Romanian -- respected, privately owned,

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[Report by Adina Sadeanu: "Without Giving Names or Providing Evidence, Nastase Accuses Multinational Companies in Romania of Tax Evasion"]

[FBIS Translated Text]

Foreign Investors Replied Angrily, Referring to the Bribes Protected by the Government

Having arrived in Bucharest to listen to messages from a government that keeps promising to make life easier for them, **foreign** businessmen had the opportunity to hear and see a prime minister [Adrian Nastase] who was harshly critical, but not of himself or the team he is leading. Rather, he criticized the large **foreign** companies in Romania. Without providing evidence or naming names, Nastase said yesterday, quoting a Finance Ministry report, "many of the large companies in Romania use various means to avoid paying the profit tax." As he told the press at the end of the conference organized by the prestigious *The Economist*, the head of government knows the names of the companies in question, but he would not reveal them. "If I had wanted to give examples, I would have done so," answered Nastase when journalists insisted that he publish the names of those incriminated.

Why did Nastase choose to launch such criticism against multinational companies at this time, and most of all at a meeting where they were waiting for encouraging signals from the government? Is the prime minister's reaction a form of defense against critics?

From the information gathered from the businessmen who attended the conferences (which

the press had no access to), we found out that the **foreign** investors burst out in front of the authorities, toughly criticizing the opaque policy of the government. "Some of the businessmen present were quite angry. They complained about the bribes they have to give, and about the fact that there are no equal conditions," say the sources. In fact, some of the criticism was put to the prime minister publicly by one of the organizers, who informed him that the **foreign** investors would like to know how he will solve the problem of imported smuggled goods, which distort the market. Nastase did not offer a clear answer.

Eventually, after the "treatment" he gave to the multinational companies, he said he hopes Romania will attract **foreign investment** worth over \$1 billion in 2002.

The Government Is Watching the Budgets of the Large Companies Through a Magnifying Glass

The **foreign** investors attended the roundtable with the Romanian Government to see whether or not it is worth investing in this country, and yesterday they were surprised to see Nastase pointing the finger at multinational companies because they do not pay the profit tax. "I asked the Finance Ministry for a report on taxes and fees paid by the large companies in Romania. I got a preliminary report identifying the surprising methods by which these companies report huge losses so as to avoid paying the profit tax," said Nastase, showing surprise. Asked later by journalists to give the names of those companies, Nastase said, "If I had wanted to give examples, I would have done so. They are companies currently in Romania." Although in this way those that pay were lumped together with those that do not pay, the head of government said he does not believe his assertions will discourage **foreign** investors, because, "We must talk to them very openly, to see exactly what is going on, based on honest evaluations." "We want this **investment** (*Adevarul* editor's note: made by large companies) to bring more profit taxes and fees in time, so we can use the money for social projects," added Nastase. Asked whether, in his opinion, tax dodging by multinational companies is due to the business environment or to loopholes in the legislation, Nastase said he did not want "to go too deeply into that," but "we are carefully watching the income and expenditures of the large companies in Romania, so the profit tax and fees in Romania will not only be paid by small- and medium-sized businesses."

Some participants in the conference opined that Nastase's criticism was launched as a to criticism by investors, except the latter voiced such things in private talks with Romanian officials. "I have seen many angry investors. They accused the government of opacity, of lack of equal conditions for all, as several competing companies accept and take advantage of their relations with state companies, which do not pay any taxes," said a participant.

Foreign Investors -- Different Opinions

The prime minister's message was not well received, as most **foreign** businessmen criticized the offensive manner of its presentation and the fact that, as no names were given, all companies were lumped together. "This matter is extremely debatable, because on the one hand, if you want greater **investment**, then you cannot expect those companies to make profits. Many come here, and at first they accept operating at a deficit, just to get in the market," the representative of a **foreign** bank told us. There were also some voices claiming they did not see Nastase's statements as a "major criticism." Admitting that there may be some large companies that do not "play" by the rules, investors opined that generally, when it comes to tax evasion, smaller companies are better equipped to do that, because "the big ones have so many eyes watching them, it would be hard enough for them to do something

weird."

Finance Minister Mihai Tanaescu Says There Is Nothing Illegal

Referring to Nastase's talk, Tanasescu tried to sweeten the message a little, promising clear and predictable fiscal laws to investors. Cornered by journalists, Tanasescu refused to give the names of tax-dodging large companies, but he explained this issue exists all over Europe, and it is called "transfer by price" [transfer prin pret]. Asked how much money the budget lost that way, he said "this is not about any loss," and "nobody said anything illegal was done, but, owing to a more permissive legislation on this 'transfer price,' certain opportunities have been created for certain funds to be taken out of the country without being taxed." Tanasescu claimed the new law on the profit tax "solves the problem of these dysfunctions" that exist on the market, especially with multinational companies.

[Description of Source: Bucharest Adevarul in Romanian -- large, influential, privately owned daily, with a centrist perspective]

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Romania: Ex-President's Book 'Toughly Critical' of Government Economic Policies

EUP20021004000216 Bucharest Ziua in Romanian 04 Oct 02 p 3

[Excerpt from book by former Romanian President Emil Constantinescu "Time To Demolish, Time To Build," volume 4: "Emil Constantinescu Is Launching Tomorrow His Book 'Time To Demolish, Time to Build.' In It, the Former President of Romania Also Analyzes the First 20 Months of the Social Democratic Party Governance -- Toughly Critical" -- first paragraph is introduction by Roland Catalin Pena; headline and subheads by Ziua]

[FBIS Translated Text]

After Former Prime Minister Radu Vasile and the former spokesman for the government and presidency, Rasvan Popescu, published early this fall their memoirs from the 1996-2000 Romanian administration, which they were witnesses to and part of, it is former President Emil Constantinescu's turn to come forward. Tomorrow at 1600 hours [1300 GMT], the former president will launch his book "Time To Demolish, Time To Build" [Timpul daramarii, timpul zidirii] at the Romanian Athenaeum, in the presence of former Moldovan President Petru Lucinschi and former Bulgarian President Petar Stoyanov. "After 10 years, I realize that many of the people I believed in could be blackmailed or bought; they were cowards, lazy, or plain villainous. Still, I have no regrets for what I have experienced. I have met the political, financial, and military decision-makers of our time. The world looks different when you are familiar with the mechanisms and mysteries of power. I saw my limitations, and what happened when you go beyond them," confesses Constantinescu in his book. The fourth volume of the book includes an analysis of the PSD [Social Democratic Party] government, from which we publish a significant excerpt.

[signed] Roland Catalin Pena

Public Administration

The government that took office following the 2000 election is made up for the most part of people who had privileges under the Communist regime.

--Prime Minister: Adrian Nastase.

Before 1989, he was sent to represent the Nicolae Ceasuescu regime at international human rights institutions. At a time when human rights were systematically violated in Romania, Nastase supported the policy of the Communist government, as vice president of the Association for International Law and International Relations, as a founding member of the Human Rights Information and Documentation System, as a member of the French International Law Society, and as an expert on "Eastern Europe" with the Human Rights International Institute in Strasbourg. In the 1980s, Nastase represented Ceausescu's regime in Oslo, at the Norwegian Institute for International Affairs.

--Minister in charge of coordinating the Government General Secretariat: Petru Serban Mihailescu.

Before 1989, he was a member of the Communist nomenklatura. In the 1984-1989 period, Mihailescu was an inspector and secretary of the Council of Ministers, being one of the people who cooperated most closely with the then prime Minister Constantin Dascalescu. Mihailescu serves today in exactly the same post he had in December 1989.

--Minister of industry and resources: Dan Ioan Popescu.

Before 1989 he was an inspector working within Dascalescu's apparatus.

--Minister of national defense: Ioan Mircea Pascu.

Before 1989 he worked for the Stefan Gheorghiu Academy, the school where Romanian Communist Party [PCR] activists were trained. In 1971-1986 Pascu was a researcher with this academy, and in 1986 he became a lecturer there.

--Minister of development and forecasting: Gheorghe Romeo Leonard Cazan.

Before 1989 he was a member of the Communist nomenklatura. Cazan was active for over 15 years, 1973-1989, in the State Council in Charge of [Economic] Planning, the institution that coordinated the Communist centralized economy. Cazan was deputy director of the Directorate for Long-Term Programs and of the Directorate in Charge of Coordinating the State Council in Charge of Planning.

--Public administration minister: Octav Cozmanca.

Before 1989 he was a member of the Communist nomenklatura. In 1983-1989, Cozmanca was chief of the coordination sector of the Communist government.

--Minister for relations with Parliament: Acsinte Gaspar.

Before 1989, he was a member of the Communist nomenklatura. For almost 25 years,

1965-1989, he was a councilor and sector chief with the State Council.

Although there are many question marks in connection with the biographies of some ministers, most of them refuse to disclose their professional activity and political posts they held before 1989. For example, the post and powers of Dan Matei Agathon, current tourism minister, at the UTC [Communist Youth Union] are still a subject for investigation.

The Trade Deficit

In the governing program dated 22 December 2000, the PSD pledged to achieve a equilibrium of the trade balance." The result of the first year in government was catastrophic: in 2001 Romania had the highest trade deficit in its entire history. The difference between imports and exports rose from \$2.68 billion in 2000 to \$4.16 billion in 2001. In one month only, December 2001, there was a \$590-million deficit. In 2001, imports rose by 19.1 percent compared with 2000.

The Current Account Deficit

Despite a conjunction of favorable factors, among which the prudent policy of the National Bank of Romania, good weather conditions in agriculture -- unlike in 2000 -- and the relatively low price of oil, the current account deficit rose from \$1.36 billion at the end of 2000 to \$2.35 billion at the end of 2001. In 2000, compared with 1999, the deficit of the current account for the balance of payments was reduced by 0.5 percent as a share of the GDP (from 4.2 percent in 1999 to 3.7 percent in 2000). In 2001, it reached 6.3 percent of GDP. Medium- and long-term foreign debt rose by 14 percent compared with the end of 2000, from \$10.2 billion to \$11.7 billion.

Unkept Promises

In the 2000 election campaign, the PSD promised to "cut the inflation rate to a one-digit number, to cut taxes, to cut the reinvested profit tax by 75 percent, to cut taxes for people who only have one house by 20 percent, and to levy a single VAT of 2-19 percent on basic products ("The Electoral Offer of the Social Democracy Party of Romania" [PDSR], page 21). Most of these promises have not been kept.

VAT levels for basic products have not been changed, and, further, the PSD government reintroduced a unique VAT on housing construction and on tourism services for foreigners, which stimulates tax evasion in those fields. Taxes on employer's expenditures to pay employees have risen -- due to increased taxation and to the introduction of the VAT on that fund. Also, the profit tax for exports and for underprivileged areas have risen. The PSD government has also added a 1-percent tax on the value of exports for the fund to promote Romania's image abroad; the functioning of that fund is completely hidden, and citizens have no control there. The unjustified tariff increases for utilities, the inability to cut arrears, and the insufficient adjustments to the economy have led to a continuous high inflation.

Back to the Tactics of the Nicolae Vacaroiu Government

The Adrian Nastase government has resumed the vicious economic practice of the Vacaroiu government: the stockpiled production has increased, the rate of tax collection has decreased, and bankrupt enterprises are being retained with the citizens' money.

The black holes in banks, which characterized the 1992-1996 period, have now been moved to the energy system. In the absence of state banks responding to political commands, large state enterprises and private companies that belong to the PSD clientele are subsidized in a hidden manner, by exempting them from paying what they owe to national companies and public corporations (Electrica, Petrom, Distrigaz, and so on). The latter ones keep accumulating enormous losses, which will be taken up by the public debt, one way or another.

In the 22 December 2000 governing program the PSD had pledged to attract "an annual volume of direct foreign investment worth over \$1.8 billion" (page 77). Actually, the Nastase government has blocked the privatization process. The 2000 election campaign mainly targeted a few recently privatized companies, especially the one in Resita, where the demagogical promises of the PSD and PRM [Greater Romania Party] have led to the current dramatic situation. Immediately after the election, the new government announced that privatization actions were suspended, giving a discouraging political signal to investors. In 2001, the APAPS [Privatization Authority and Management of State Shareholding] only privatized 127 enterprises. The rapid privatization of the Agricultural Bank was the result of the preparations for it made by the 1996-2000 government, and the privatization of Sidex, the only important one, is far from a success. In the election campaign, the PSDR pledged to obtain \$2-3 billion from the sale of Sidex, and then it sold it for only \$50 million. Overall, the price they received for the 127 enterprises is only 36 percent of the nominal value of their shares.

Fraud in Managing European Union Funds

The PSD government is unable to manage the grants the European Union offers to Romania. Mihai David, state secretary in the Development and Forecasting Ministry, admitted in June 2002 that, out of the \$125 million set aside for Romania under the PHARE [Economic Reconstruction Aid for Poland and Hungary] 2000 program, the PSD government has only managed to contract \$4 million.

The fraudulent management of these funds has perhaps an even more serious aspect. In early August 2002, a representative of the Delegation of the European Union in Romania said, "We have received signals about fraud from all over the country. This problem exists in 50 percent of the country. The European Union could decide to cut the financing for IMMs [small- and medium-sized businesses] as a means to slow down fraud. Local Mafias bury honest businessmen. Cases have been discovered in which the PHARE non-reimbursable grants did not reach the people they were supposed to." On 14 August 2002, the spokesman for the European Commission in Romania confirmed that problems had been found in using European funds. "If the investigation conducted by the European experts finds fraudulent manipulation of PHARE funds, Romania will have to give back the misappropriated money to the Commission, to the last cent." In turn, the charge d'affaires for foreign affairs of the European Commission Delegation in Bucharest said Romania is currently being investigated in several cases of misappropriation of community funds, put together by a European Union body -- the European Anti-Fraud Office [OLAF]." Several PSD leaders admitted that they have benefited from EU grant funds, sometimes used openly to finance PSD party actions.

Out of the desire to direct the European funds toward its political clientele, the PSD government took several measures that led to the loss or postponement of some grants the European Union had allocated to Romania. The SAPARD [Special Accession Program for Agriculture and Rural Development] program is meant to restructure agriculture in aspirant countries, among which Romania is the most complicated case, so it should have benefited

from the highest fund quota. Begun in 2000, this program was to unfold along seven years. As a first tranche, 150,636,000 euros were set aside for Romania, and this allocation could change according to the quality of the projects. At the end of 2000, Romania was ready to begin the SAPARD program. The national plan for agriculture and rural development had been passed by Parliament, which enacted it into law, and it was approved in Brussels; and the SAPARD Agency was established on 14 September 2000.

The fact that the PSD came to power blocked the SAPARD program. The management and officials of SAPARD, a team made up of people especially trained for this by the European Union, were victims of PSD-zation. The governing party removed them, and brought its own people to the Agency in order to control the European funds through them. The European Union was extremely critical, especially because important sums had been spent to train the SAPARD officials, and it refused for months on end to recognize the new PSD-ized agency. Therefore, Romania ended up being the last aspirant nation to receive accreditation for SAPARD, thus losing extremely consistent funds, which could have boosted the modernization of Romanian villages.

In fact, out of similar petty political considerations, the Nastase government refused the loan the Constantinescu administration had obtained from Kuwait to revamp rural localities (access roads and water supply).

Lying Statistics

The PSD government is trying to hide its incompetence in continuing the reform behind false statistics on restructuring. In the activity review presented after 100 days in office, Nastase announced, "For the first time in many years, the personnel employed in electric power, thermal energy, natural gas, and water supply have been cut considerably. During the first nine months, personnel levels were reduced by 14,900 people, or 8 percent out of the total number of employees in that branch of the economy." Actually, nothing but a few cosmetic changes had been made.

The 2001 white book of the PSD government mentions sale-purchase contracts signed in the first 10 months of the year for shares belonging to 121 commercial companies, with a sold social capital of 9.6 trillion lei, over 50 percent more than in 2000. It is true that at the end of 2001, 127 commercial companies with a social capital of 9.822 trillion lei had been privatized, but that capital was sold for 3.460 trillion lei, which is only one-third of the social capital.

The PSD local government took up the practice of the Communist regime, making it mandatory for people to report the achievement and over-achievement of tasks imposed from Bucharest. In early 2002, the prime minister said he was unhappy because some counties were slow in handing out property titles for land plots. Following that, the Maramures County prefect, who is also the local PSD leader, asked the chairman of the commission in charge of applying the land [law] to forge the previously reported data.

According to the census conducted in the early 2002, the National Statistics Institute communicated that Romania's population was 21,698,181 inhabitants. According to the same institute, Romania had 22,435,205 inhabitants on 1 July 2000. It is impossible for the Romanian population to have decreased by over 700,000 people in a year and a half. A significantly reduced population will make it possible for the Nastase government to fabricate statistics where several indicators will show better results than the real ones.

Equally, the debate in the press on the population's standard of living has proven that these calculations are done based on 2-year-old prices, especially for maintenance [water, natural gas, and heating] expenses, which grossly falsifies reality, as long as we are witnessing an explosion in the prices of utilities. The statistical evaluation based on which important indicators -- the cost of the "daily basket," the minimal salary, and the level of granting aids -- are established starts out from something false.

Impoverishing the Population

The PSD made numerous social promises in the 2000 election campaign. The PSD promised to cut the VAT for bread, milk, oil, and sugar to 3 percent, so the prices of these products would decrease significantly. Equally, the PSD had promised as early as in 1999, in the "Anti-Crisis Program," to "strictly regulate energy and fuel prices."

In its first 20 months in office, prices rose steeply, without any justification. In June 2002, consumer prices were 42.3 percent higher than in December 2000. Food goods became 40.2 percent more expensive, non-food goods 42 percent more expensive, and service tariffs rose by 50.1 percent. These were the highest price increases in that period: power, natural gas, and central heating -- 72.7 percent; urban transportation -- 72.2 percent; fruit and canned fruit -- 69.8 percent; oil, fat, and lard -- 63.4 percent; water, sewage, and sanitation -- 61.1 percent; vegetables and canned vegetables -- 59.5 percent; inter-city transportation -- 56.3 percent; meat, meat products, and canned meat -- 50.4 percent; and fish and canned fish -- 49.6 percent. In June 2002, potatoes were 2.3 times more expensive than in December 2000. Oil was more expensive by 69.6 percent, beef by 67.7 percent, pork by 52.7 percent, milk by 36 percent, poultry by 34.3 percent, cheese by 30.7 percent, sugar by 26.0 percent, and bread by 21.8 percent. In January 2001-June 2002, natural gas prices doubled, the price of power rose by 60 percent, and thermal energy prices rose by 60 percent. Transportation on the CFR [Romanian railroads] became 120 percent more expensive in that period, urban transportation was 70 percent more expensive, and telephone conversations were 40 percent more expensive.

The results of economic growth in 2000 should have been felt by 2001 in an increase in the standard of living. But reality is this: high salaries have increased further, while low salaries have stayed low. The salaries of people working in health and social assistance, agriculture, trade, construction, real estate, and other services have decreased by comparison with the average. In the healthcare sector, the difference between nominal net average monthly incomes and the overall country average rose from 371,033 thousand lei at the end of 2000 to 464,601 thousand lei at the end of June 2002. Therefore, today, the average salary in health and social assistance is lower than the average nationwide salary by 464,601 lei, after a year and a half of PSD governance. In agriculture, the negative difference increased from 606,204 thousand lei to 1,072,822 thousand lei, and in construction from 277,716 thousand lei to 478,136 thousand lei.

The PSD electoral offer won votes to the party with an aberrant promise. "Nine hundred eighty thousand jobs will be created." Considering that in December 2000 there were 1,007,000 unemployed people, keeping this promise made by the current governing party would mean a virtual elimination of unemployment. Actually, the number of employees in the economy dropped from 4.646 million people in December 2000 to 4.404 million people in June 2002, although in the PSD's first months in office the economy had experienced growth, following the policy of the Mugur Isarescu government. The economic policies of the PSD government have triggered, however, a significant decrease in the number of employed in the

economy: in June 2002 there were 242,000 fewer such people than in December 2000. In order to hide the real unemployment rate, the PSD government presents statistics where people who no longer receive unemployment or other financial benefits, because the period for such benefits has expired according to the law, are no longer considered unemployed. Economic growth in 2000 has triggered an increase in the job opportunities and a decrease in unemployment in the first half of 2001, but the PSD government has forced a decrease in that supply, little by little. At the end of 2001, job supply was only 14.7 thousand jobs, less than half of the number at the end of 2000. The job supply/demand ratio decreased from 1 to 25 in December 2000 to 1 to 41 in December 2001. The level of unemployment benefits decreased considerably, because a new calculation method was introduced, no longer making the level of the unemployment benefits dependent on the income the individual made on the most recent job.

[Description of Source: Bucharest Ziua in Romanian -- popular, privately owned daily; generally critical of the political establishment across the board]

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EXHIBIT Q



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Chapter: EXECUTIVE SUMMARY

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During the last ten years, trade relations between the United States and Romania have constantly improved. The U.S.-Romanian trade agreement (1993), a bilateral investment treaty (1994), and the granting of unconditional MFN treatment (1996) have all served to strengthen trade relations. In 2000, the United States ranked seventh in Romanian imports, sixth in Romanian exports, fifth among foreign direct investors in Romania, and accounted for about 60 percent of foreign portfolio investments on Romanian capital markets. About 53 percent of U.S. direct investment in Romania went into joint ventures with local companies and greenfield projects, while the remainder accounts for U.S. participation in the privatization of Romanian enterprises.

The Romanian marketplace has, however, not been an easy one for U.S. companies wishing to do business with this country. A complex, confusing, and constantly changing regulatory environment, erratic taxation, lack of transparency in major deals, pervasive bureaucracy, and widespread corruption have often discouraged and chased foreign investors away. Romania has thus paid a heavy price for a hesitant approach to economic reform and transition to a market economy by the successive governments that ruled the country between December 1989 and November 2000.

The completion of industrial restructuring and privatization and the creation of a healthy economy as a prerequisite for Romania's European Union accession and NATO integration is the dominant preoccupation of the country's current government (elected in late 2000). The government's reform package for 2001-2004 is daunting, and its implementation will be rendered even more difficult because of its many social implications. Among the most important components of economic reform are privatizing the country's industrial core (80 percent state owned), completing the privatization of state farms (10 percent of the country's agricultural land), completing the privatization of the banking system, and implementing tight fiscal and monetary policies to tame inflation. The whole process will have to be accompanied by strong measures to fight corrupt practices and implement good governance in the economic, social and political system.

During its first seven months in office, Romania's new government has given some positive signals regarding its commitment to reform and, especially,

regarding its determination to create a better environment for foreign business in this country. New legislation on direct investment has already been passed. A new Tax Code is expected to unify the myriad current taxation regulations by the end of 2002. The government has taken the first serious steps to enforce legislation regarding IPR infringement, and has also expressed its preparedness to deal with good governance issues.

A more stable and friendlier commercial and investment environment would allow U.S. businesses to play a larger role in Romania's economy. There are solid reasons to believe that with more U.S. companies discovering the Romanian marketplace to be a valuable asset for their development plans, a foundation will be laid for a durable trend in bilateral trade relations.

To the best of our knowledge, the information contained in this report is accurate as of the date published. However, the Department of Commerce does not take responsibility for actions readers may take based on the information contained herein. Readers should always conduct their own due diligence before entering into business ventures or other commercial arrangements. The Department of Commerce can assist companies in these endeavors.

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Region: East Europe**Sub-Region: Balkan States****Country: Romania****Topic: DOMESTIC ECONOMIC, DOMESTIC POLITICAL, INTERNATIONAL ECONOMIC****Source-Date: 09/25/2002****Romanian Daily Says OECD Report on Romania Contains 'Unpleasant' Truths***EUP20020925000213 Bucharest Adevarul in Romanian 25 Sep 02 p 7***Reference:**

1. OECD Report Warns Romanian Officials on Current Problems Due to Lack of Reforms
EUP20020923000360 Bucharest Evenimentul Zilei Romanian 23 Sep 02

[Report/commentary by Daniel Oanta: "The OECD Report on Romania -- Full of Unpleasant Truths About Our Domestic Economic Policy"]

[FBIS Translated Text]

Owing to its objectivity, the OECD report assessing Romania's economic situation distinguishes itself in a landscape dominated lately by the festive government communiques on macro-economic results. To sum it up, the report shows that the old flaws are being perpetuated by the current government in the economy. Some of those flaws are the lack of political will to take the loss-making enterprises off the market and the giant financial indiscipline that has brought the arrears to an estimated 40 percent of the GDP. Let us detail below some of the truths in that report, which the rulers do not like.

-- The business environment continues to be burdened, even though, as the report says, the regulation environment is now liberal, at least theoretically. Companies see the legal framework as uncertain and discouraging, both for domestic and for **foreign investments**.

-- It is unanimously admitted that the administrative "harassment" in connection with fiscal obligations is very strong and brings about micro-corruption. The government has proclaimed

its resolve to fight corruption, but the test of an actual implementation of that resolve is still in the future.

-- Another important element is the administrative capacity. The status of civil servants is bad. Their salaries are below the nation-wide average, and the managerial practice does not favor initiative or reward competence. Therefore, public services have a tendency to be inefficient and a source of corruption.

-- The legislative process continues to be "frantic" and overwhelming, and the adoption of the community acquis may increase this tendency even further.

-- Government meetings are excessively long, and they are not anchored by decision-making mechanisms [sentence as published]. There is an excessive number of state secretaries.

-- There are two agencies in charge of the competition policy (the Competition Office and the Competition Council). The application of the competition policy is weak (there are neither resources nor the political will for that).

-- As regards tax collection, there is a general accumulation of delays. The pension fund is the main source of delays for the state budget.

-- Limited progress has been made in privatizing large state enterprises. Very few large, loss-making enterprises have been liquidated.

-- The legal environment continues to be very unstable.

-- In 2001, a Ministry for Small and Medium-Sized Businesses was created, but with mixed results. On paper, the administrative delays in creating companies were reduced to 20 days. At least, they acknowledged the crucial role played by small and medium-sized businesses in the economy.

-- Although there are laws, the implementation of bankruptcy and the protection of creditors are weak.

For the most part, the government accepts the OECD criticism. At least this is what Eugen Dijmarescu, chief of the new Economic Policies Department, said. Let us wait for the next country report. . . .

[Description of Source: Bucharest Adevarul in Romanian -- large, influential, privately owned daily, with a centrist perspective]

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EXHIBIT S

January 2001

IMF Country Report No. 01/16

Romania: Selected Issues and Statistical Appendix

This Selected Issues and Statistical Appendix report on Romania was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with this member country. As such, the views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Romania or the Executive Board of the IMF. The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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ROMANIA

Selected Issues and Statistical Appendix

Prepared by Gerwin Bell, Stephane Cosse, Tao Wang, David Moore (all EU1),
and Ward Brown (PDR)

Approved by the European I Department

November 6, 2000

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INTRODUCTION

1. Romania's transition to a market-based economy has been painful. Living standards for large parts of the population have deteriorated over the past ten years, from already low levels under communism. This reflects the fact that the country's economic performance has been among the weakest of the transition economies in the region, owing to limited progress in structural reform and stop-go macroeconomic policies that contributed to low growth, high and variable rates of inflation, and several episodes of severe balance of payments pressures.

2. But there are now signs that recent stabilization efforts have started to bear fruit. An economic program launched in early 1999 has yielded improved external viability and financial stability, and—recently—signs of sustainable growth, although the inflation outcome was less favorable. Given the previous poor record of economic performance, the by-and-large encouraging recent experience provides an opportunity to identify policies which have worked well and those which have not.

3. Against this background, the following chapters review policy developments over the last ten years, with particular focus on the last three years. Chapter I discusses the determinants of inflation, which has been the highest among transition countries in central and eastern Europe. It establishes the key role of unit labor costs in driving inflation—a reflection of the unfinished state of restructuring in the economy—as well as of the exchange rate, which in turn has reflected monetary conditions. Chapter II reviews salient trends in public finance and finds that while important progress has been made—particularly in limiting the overall deficit as well as in tax policy—the fiscal situation remains precarious and calls for urgent measures in the area of expenditure policy. Chapter III takes a look at monetary policy, and finds that both the conduct and operational setting of monetary policy have recently improved—much of the improvements owing to the recent policies to clean up the financial sector outlined in Chapter IV. Nonetheless, a fundamental lack of policy credibility still needs to be overcome. Chapter V chronicles the balance of payments crisis in 1999 and looks at the recently improved external viability trends.

4. All of the chapters identify key policy issues and challenges for the immediate future and the medium-term. Within Romania, a broad-based consensus sees medium-term prospects intricately linked to the country's accession to the European Union. The relevant aspects of this process are discussed in Chapter VI.

I. INFLATION IN ROMANIA—DEVELOPMENTS AND DETERMINANTS¹

A. Overview

1. Inflation in Romania has been high and variable through the past decade, owing fundamentally to stop-go stabilization efforts and widespread financial indiscipline. This financial indiscipline has taken several forms over time, including large fiscal and quasi-fiscal deficits, accumulation of arrears, and outbreaks of wage growth well in excess of productivity.
2. **Econometric evidence highlights the role of unit labor costs, and to a lesser extent the exchange rate, in driving inflation.** Unit labor costs have been the leading proximate determinant of inflation, with deeply rooted financial indiscipline at the enterprise level being largely reflected in higher wages than justified by productivity, or than could even be paid in many enterprises in the absence of soft budget constraints. The influence of the exchange rate on inflation has also become increasingly clear over the past few years, in the wake of the full liberalization of the foreign exchange market.
3. **The role of money and credit growth in causing inflation has also been important, though harder to demonstrate empirically.** Episodes of excessive money growth led to a buildup of inflationary pressure, but the actual path of inflation was determined largely by policy decisions regarding the timing and magnitude of price liberalizations and exchange rate adjustments. The high rates of money growth in the mid-1990s are still the most plausible explanation for the magnitude of the inflationary spike following the last round of major price liberalization in 1997.
4. **This chapter reviews recent developments in inflation in Romania, and analyzes its key determinants.** Part B provides background on aggregate and sectoral price developments over the past decade, and the process of price liberalization. Part C reviews developments in several variables commonly identified in the literature as sources of price pressures, including wages, the exchange rate and monetary aggregates. Part D examines empirically the relationships among prices and wages, money and the exchange rate through the 1990s using vector autoregression (VAR) models. Part E concludes.

B. Price Developments

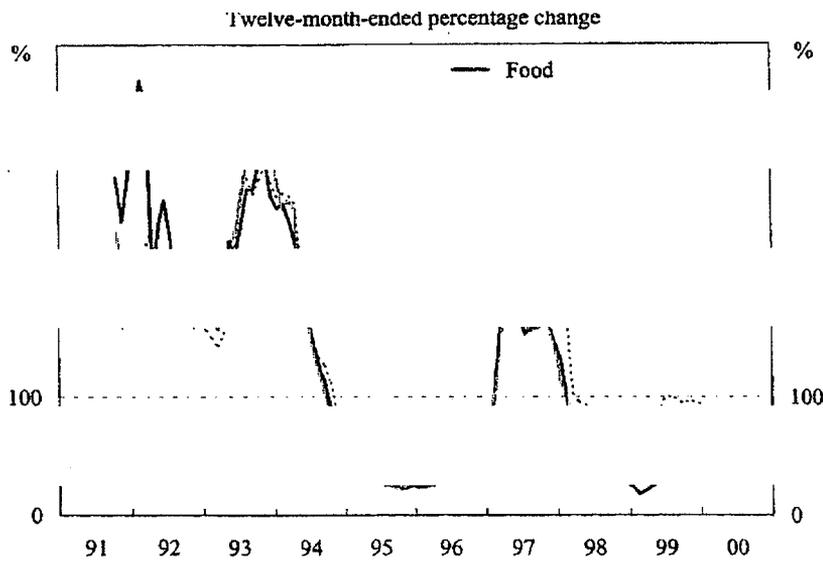
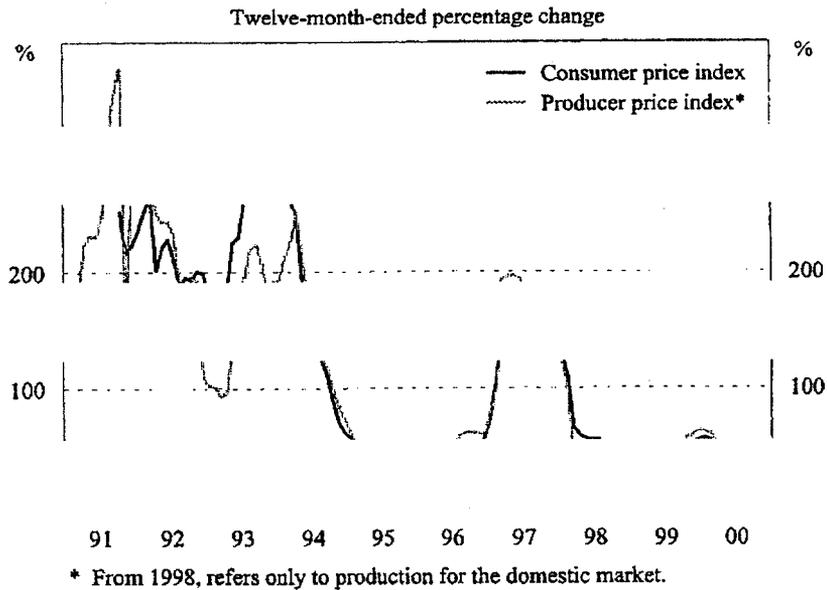
Price Outcomes

5. Inflation has been high and variable through the past decade. On a 12-month basis, inflation reached some 200-300 percent at the start of the transition. Inflation eased steadily between mid-1993 and mid-1995, reaching a low of 25 percent, but again accelerated from second half of 1995. The dramatic surge in early 1997 was associated with the liberalization

¹ This chapter was prepared by David Moore.

of agricultural and energy prices; 12-month inflation peaked just below 180 percent in mid-1997 and remained very high until 1998, but monthly rates fell swiftly after the initial surge.

Figure 1.1a. Consumer and Producer Prices



controls, which merely *released* inflationary pressures.

6. Although down from its high levels following the last round of price liberalization in 1997, inflation has remained volatile. Inflation slowed in 1998, with the 12-month rate bottoming out at 33 percent in February 1999, in response to tight monetary policy and a slower rate of depreciation of the leu. However, against a background of a large fiscal deficit and continuing rapid wage growth, this slowdown came at the cost of a large real appreciation and severe loss of competitiveness. The subsequent large corrective depreciation contributed to a renewed pickup in inflation through 1999, and consumer prices increased by 57 percent in the year to January 2000.

7. Aggregate prices are particularly strongly influenced by food prices, which account for around half of the CPI basket. The prices of food, non-food goods, and services increased at broadly similar rates during the mid-1990s, but have grown at increasingly divergent paces over the past couple of years (Figure I.1b). Services prices rose especially rapidly in 1999, in part reflecting the effects of large increases in administered prices (see below). In 2000, drought has caused a sharp rise in food prices and frustrated progress in disinflation. Notwithstanding the high weight of food in the CPI basket, most other measures of inflation, such as producer prices and the household consumption and GDP deflators, have mostly moved broadly in line with the CPI (Table I.1). A notable exception is 1998, when consumer prices increased by 59 percent but producer prices rose by only 33 percent (Figure I.1a).²

Price liberalization

8. Price liberalization in Romania was fitful and protracted, with the last major round of liberalization delayed until 1997. Moreover, estimates vary on the degree to which prices remained controlled during the mid-1990s; in many cases, consumer prices were liberalized but the raw and basic material prices were not; in others, "liberalized" prices were heavily distorted by subsidies, especially in the agricultural sector.

9. Initial progress in price liberalization seemed encouraging. Demekas and Khan (1991) reported that most prices were liberalized in three rounds, in November 1990, in April 1991, and in July 1991, after which the authorities claimed around 80 percent of consumer prices were market-determined. Price controls and subsidies for most other consumer goods were supposedly eliminated in 1993.

10. Nevertheless, formal and informal price controls persisted, or were reintroduced, during the mid-1990s; controls on food prices were especially pervasive. The OECD (1993) noted that prices on many consumer items, notably in state-owned retail stores, were still not market-determined, instead being subject to supervision based on strict mark-up limits. More formally, Government Decision 45/1994 declared a wide range of items as being of "national

² This is consistent with (and in fact may be regarded as one measure of) the real appreciation in 1998.

importance” and subject to review (and influence) by the Competition Office.³ The IMF (1997) reports that, in addition to an array of producer price controls, the government had maintained direct wholesale and retail price ceilings on a number of sensitive food items,⁴ which accounted for 28 percent in the total consumption basket. With energy, utility, transport and telecommunications prices also administered, this implied that nearly 40 percent of the consumer price basket was still controlled as at end-1996.

11. Most prices still subject to control were liberalized in early 1997. Agricultural prices were liberalized in February 1997; with the trade regime also substantially liberalized shortly afterwards, agricultural prices are now market-determined. In the industrial sector, most administered producer and retailer prices were liberalized by March 1997, although price controls were retained for a short list of goods supplied in monopoly markets, notably energy; these prices have subsequently been adjusted (in most cases by the Competition Office) in line with movements in the exchange rate and/or consumer price index.⁵ Fuel prices were deregulated in September 1998. Administered and regulated prices now account for about 14 percent of the CPI basket.⁶

12. Administered prices have grown sharply since 1997 (Table I.2). Large increases in electricity and heating prices reflect the phasing out of the dual pricing system, where low household prices were cross-subsidized by higher prices for other economic agents. Domestic thermal energy prices were increased sharply in 1999 to bring them closer to world prices.

³ These items included energy, iron and other ores, medicines, wood, bread, milk, railways, river and urban transport, post and telecommunications, other utilities, childcare, municipal services, and other government services and charges.

⁴ These items included milk and dairy products; wheat and (low quality) bread; pork, poultry and processed products; sugar; and sunflower oil. These items accounted for 55 percent of the food component of the household consumption basket.

⁵ The ordinance which provides for such increases is vaguely worded. In cases where the price is regulated by this ordinance but is not subject to review by the Competition Office—notably, telephone prices—the provider has taken full advantage of the weaknesses in the ordinance to increase prices.

⁶ This consists of 5 percent of prices regulated by ordinance (telecommunications, medicines, rents and radio and television subscriptions); 4 percent regulated by the Competition Office (railway, river and urban transport, post, and water); 4 percent by the independent electricity sector regulator ANRE (electric and thermal energy), and 1 percent by the independent natural gas sector regulator ANRGN. Responsibility for electricity pricing was transferred from the Competition Office to ANRE in mid-2000. Note that the share of administered prices in the CPI basket varies according to re-weightings of the basket; based on 1999 weights, this share would be about 10 percent.

C. Determinants of Inflation

13. Theoretical considerations suggest several variables to be included in an empirical study of inflation. Under certain stringent assumptions—notably, perfect wage and price flexibility, and a stable equilibrium real exchange rate—conventional economic theory suggests that money alone can explain inflation. However, relaxing each of these rather stringent assumptions introduces new potential explanators of inflation. Relaxing the assumptions of wage and price flexibility implies roles for unit labor costs and pricing policies respectively in explaining inflation; similarly, instability in the real exchange rate implies the exchange rate is also potentially relevant in explaining inflation.

14. Research on inflation in transition economies has highlighted both the role of traditional cost-push and demand-pull factors in generating and sustaining inflation, and also the effect of relative price adjustment in retarding disinflation.⁷ Each of these factors appears to have been present in Romania. Cost-push pressures have resulted from episodes of wage growth well in excess of productivity—owing fundamentally to a lack of financial discipline—as well as real depreciations of the leu. Demand-pull factors have included monetary accommodation of fiscal and/or quasi-fiscal deficits, again reflecting financial indiscipline and pervasive soft budget constraints at the enterprise level. Relative price adjustment has been especially protracted in Romania owing to the piecemeal and occasionally reversed process of price liberalization.

15. This section reviews the behavior of key variables associated with inflation in other transition economies: money and credit, wages and the exchange rate.

Money and credit

16. Figure I.2 shows the growth of M2, M2 including foreign currency deposits (M2X), and domestic credit. Growth in the monetary aggregates surged on a number of occasions in the 1990s when the National Bank of Romania (NBR) was forced to accommodate large fiscal and quasi-fiscal deficits, of loss-making state-owned enterprises in general and of the agriculture sector in particular. The most egregious case was the surge in money growth which peaked in late 1994, when the authorities launched a very large program of subsidized agricultural financing.⁸

17. Figure I.2 suggests that the relationship between money and prices was rather loose for much of the 1990s, though a positive correlation has become somewhat clearer over the past two years. Especially noteworthy is the low rate of inflation relative to money in the mid-1990s, and the much higher inflation rate in 1997. This would be consistent with the existence of a monetary overhang arising from the variety of price controls in effect through

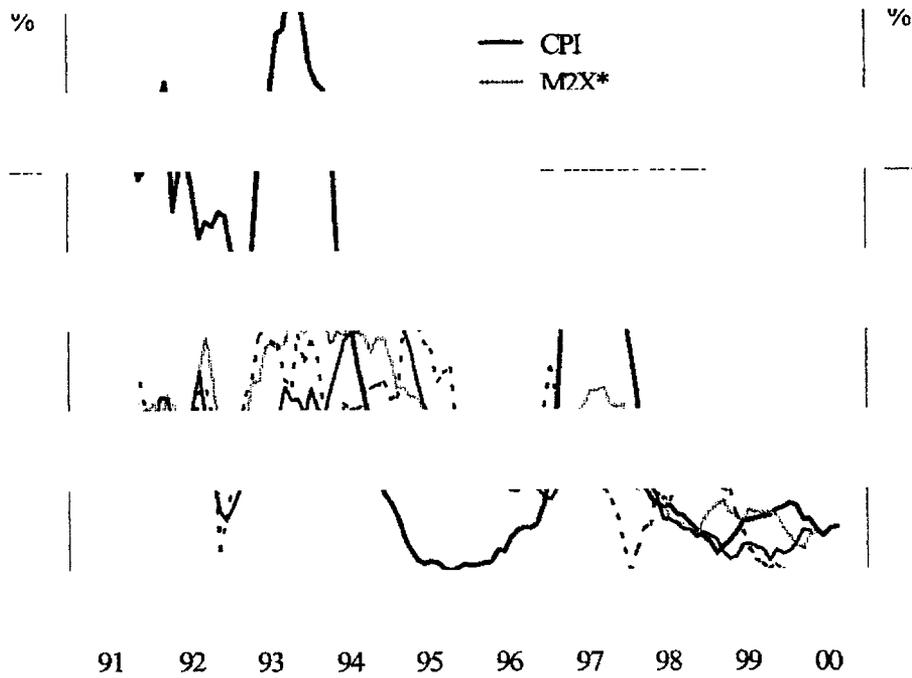
⁷ See for example Coorey, Mecagni and Offerdal (1998).

⁸ For further details see IMF (1997).

the mid-1990s, and which was apparently run down following the foreign exchange and price liberalizations in 1997.

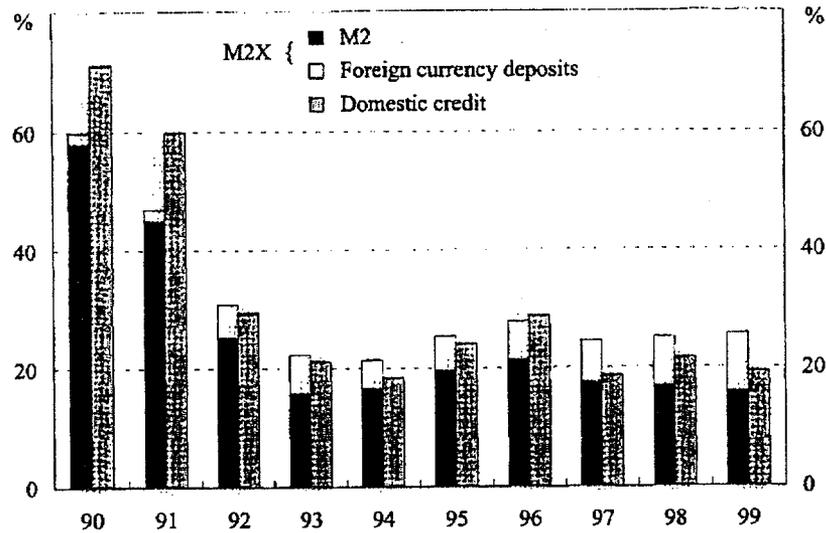
exchange rate movements had severed the links through which inflationary effects may pass. Episodes of excessive money growth over the past decade led to a buildup of inflationary pressure, but the actual path of inflation was determined largely by policy decisions

Figure 7.2 Money, Credit, and Prices



* M2 plus foreign currency deposits.

Figure I.3. Demonetization
Percent of GDP



19. The high inflation rates relative to money growth in the early 1990s imply significant demonetization of the Romanian economy since the start of the transition (Figure I.3). The increasing share of foreign currency deposits in the monetary aggregates, though significant in itself, has only modestly countered the overall trend of demonetization.

20. Some remonetization took place between 1994 and 1996, but with several undesirable features which rendered it unsustainable. The OECD (1998) observes that the remonetization process funneled subsidies to loss-making sectors of the economy, in particular the agriculture and energy sectors, using NBR credits, which undermined the attempts of the central bank attempts to reduce inflation.⁹ This policy was completely opposed to the authorities' stated intention of allowing market forces to determine the sectoral allocation of credit.

⁹ The OECD also notes that the remonetization enabled the authorities to inject special credits into two failed banks, Dacia Felix and Credit Bank, and thereby avoid having to resolve them.

Box I.1: Soft Budget Constraints and Inter-Enterprise Arrears

Soft budget constraints have taken a number of forms in Romania. One important form has been the soft credits extended to the agriculture sector, including NBR credits, especially in the mid-1990s. Another important manifestation of financial indiscipline, which has yet to be adequately addressed, has been inter-enterprise arrears. Inter-enterprise arrears were equivalent to 42 percent of GDP as at end-1999, and apart from a fall in 1997, have risen steadily each year from around 20 percent of GDP as at end-1994.

Some level of arrears might be inevitable in a demonetized economy such as Romania (Figure I.3), especially in the aftermath of demonetization in the early 1990s. Clearly there is a failure of financial intermediation in an economy in which credit is less than 20 percent of GDP, and the development of inter-enterprise credits is a natural response. Consequently, the question of when an inter-enterprise credit becomes an arrear is an important reporting issue, and the extent to which the arrears data include normal trade credits as well as overdue payments is not fully clear. Nevertheless the continuing increases in arrears since the mid-1990s reflect deeper financial indiscipline.

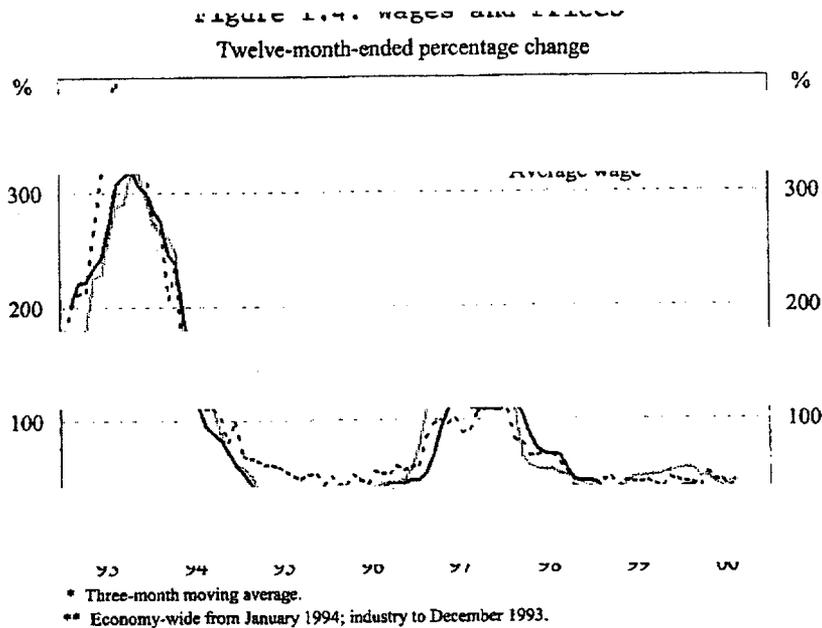
This problem has been particularly acute in the case of the major utilities – both in terms of the utilities' tax arrears to the government, and the arrears to the utilities of other enterprises such as nationally owned loss-making companies, and local utilities. Despite the scale of the utilities' losses and arrears, wages at the utilities remain some of the highest in Romania; in the December quarter of 1999, average wages at the three major utilities were 2.2 times the economy-wide average wage.

Soft budget constraints and weak corporate governance in the state sector have allowed episodes of faster wage growth, notably in 1995, 1996, and 1998. Consequently, wages in state-owned utilities and many loss-making companies are among the highest in the country. In the December quarter of 1999, average wages at the ten largest régies autonomes exceeded the economy-wide average wage by more than 60 percent.¹⁰ In turn, this complicates the process of restructuring. Workers with high-wage, low-productivity jobs – such as those in the mining and energy sectors – clearly face high opportunity costs from moving to higher productivity but lower wage jobs, and have strong incentives to resist restructuring.

Wages

21. Wage growth contributes to inflation in several ways. In general, wage increases which exceed increases in productivity *generate* inflationary pressures; large wage increases in response to an initial inflation shock contribute to inflationary inertia and hence *sustain* inflationary pressures. Additional effects operate when budget constraints are soft. Sahay and Végh (1996) note the role of wage bill increases in inducing monetary expansion via the expansion of credit to state enterprises and to the government.

¹⁰ A recent OECD study reported that Romanian employers facing competitive pressures were more likely to be concerned about controlling wage costs, and noted the apparent link between wage moderation and productivity across sectors (OECD, 2000).



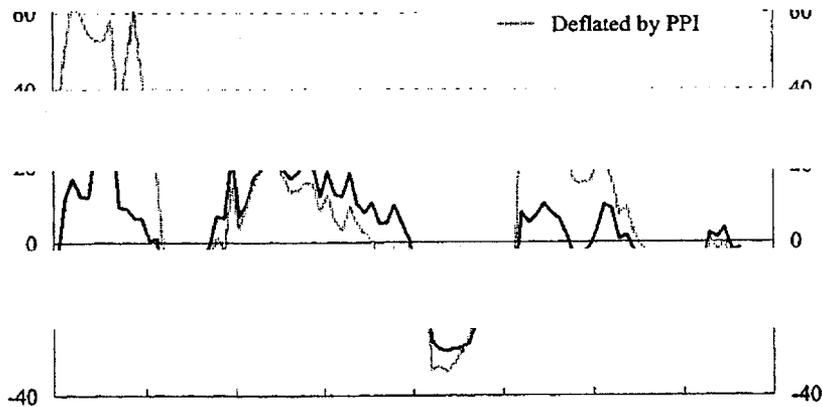
22. Figure 1.4 shows growth in nominal average wages, and smoothed growth in nominal unit labor costs in industry. The extremely close correlation between growth in unit labor

23. Figure 1.5 highlights the volatility in real wages. Real wage growth was particularly strongly in 1995 and 1996, with high wage increases recorded in the state-owned *régies autonomes* (RAs) and commercial companies, despite the large losses recorded in these

strongly in 1998, led by increases in the budgetary sector and RAs. Although wage growth in 1998 would appear only modest if deflated by the CPI, *U.S. dollar* wages increased by over

24. In between periods of rapid growth, real wages fell significantly in 1994, even more sharply in 1997 (owing to the unexpectedly high inflation outcome), and more modestly in

Figure I.5. Real Wages
 Twelve-month-ended percentage change



Box I.2: Wage Policies

incomes policies were abandoned in 1995, and no official wage policy was in place in 1996 (Oprescu, 2000).

In conjunction with the 1997 Stand-By Arrangement with the IMF, the authorities agreed to limit the growth of the average

August 1997, with the ceilings not observed in the budgetary sector or by the régies autonomes, and wage growth picked up in 1998.

nominal terms over the whole of 1999, implying a 9 percent real decline based on then-projected inflation. The target for end-December 1999 was breached by nearly 5 percent, in part as a result of the authorities' decision to increase the defense/security sector wage bill by 80 percent. For the rest of the state sector, nominal wage bills in 1999 were restricted to four times their level in the December quarter of 1998. In the case of the DA and national companies, this policy determined

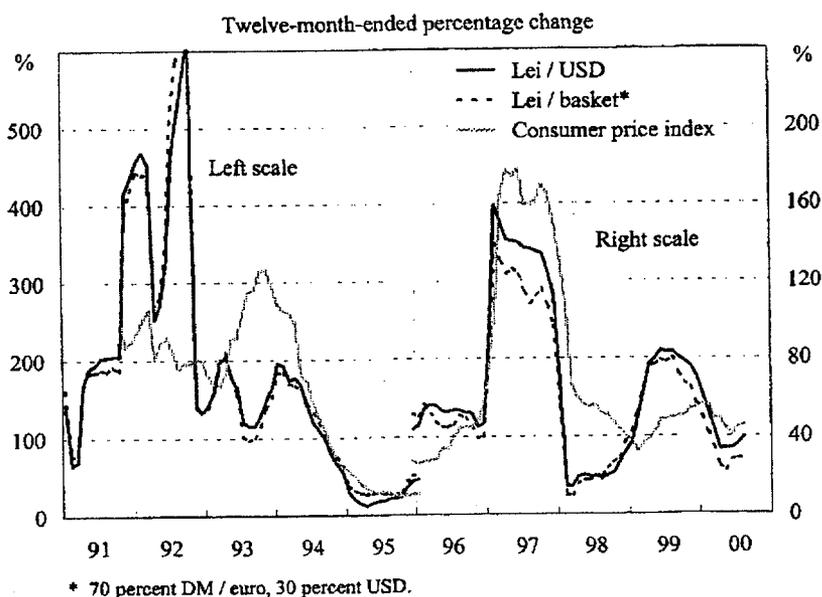
Under the extended Stand-by Arrangement, the authorities undertook to limit the increase in the nominal wage bill of the state sector to 40 percent in 2000, implying an increase of 1 percent in real terms on the basis of the originally targeted rate of inflation. Within this overall target, the real wage bill for the budgetary sector was envisaged to rise by 12 percent and

in wage policy imply that the state sector wage bill is now likely to increase by 58 percent in 2000.

Exchange rate

25. Figure I.6 shows the evolution of the leu / U.S. dollar exchange rate, a trade-weighted nominal exchange rate (70 percent deutsche mark/euro, 30 percent U.S. dollar), and consumer prices. Figure I.6 suggests that consumer prices are highly responsive to movements in the exchange rate, although with some lag.¹¹ The large depreciation through late 1998 and early 1999 appears to have contributed strongly to the more gradual pickup in inflation through 1999.

Figure I.6. Exchange Rate and Prices



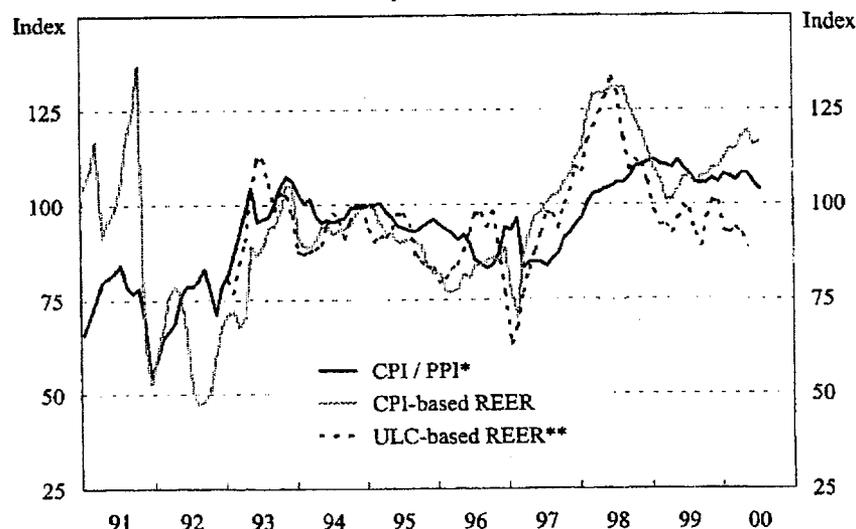
26. The erratic behavior of the exchange rate reflects a series of policy reversals, especially in the early to mid-1990s. The IMF (1997) reports that notwithstanding frequent commitments to a flexible exchange rate, the authorities repeatedly intervened to maintain the exchange rate at overvalued levels, effectively as a subsidy to energy-intensive enterprises, only to be forced into allowing periodic depreciations as reserves ran low. The foreign exchange market was subject to particularly severe distortions in 1996; in response to a sharp depreciation of the leu in early 1996, the authorities withdrew the licenses of all foreign exchange dealers except for four state-owned banks. Attempts to set the exchange

¹¹ For this reason, the *absence* of a lag in early 1997 between movements in the exchange rate and in consumer prices is noteworthy. The sharp depreciation coincides with an even sharper rise in inflation as a result of the near-simultaneous liberalizations of the foreign exchange market and of prices for staple goods, both of which had been distorted by the combination of administrative controls and the monetary overhang.

rate by administrative means were abandoned following the 1996 election, and the exchange rate is now a managed float.

27. Figure I.7 highlights the considerable volatility of Romania's real effective exchange rate.¹² Coorey et al. (1998) note that a real appreciation can have different implications for inflation depending on the nominal exchange rate regime: real appreciation associated with a stable nominal exchange rate generally implies capital inflows, monetary expansion and higher inflation; but when the nominal exchange rate is flexible, real appreciation is generally associated with nominal appreciation—or in the case of Romania, slower nominal depreciation—implying downward pressure on inflation.

Figure I.7. Measures of the Real Exchange Rate
January 1995 = 100



* From 1998, PPI refers only to production for the domestic market.

** Three-month centered moving average.

¹² The volatility of the real exchange rate implies that the influence of Balassa-Samuelson effects (i.e. changes in the relative prices of traded and non-traded goods arising from differential productivity growth in the traded and non-traded sectors of the economy) is likely to be second-order. Moreover, the CPI / PPI ratio shown in Figure I.7 is a poor proxy for the real exchange rate in the case of Romania. While this ratio is commonly used because traded goods typically account for a greater share of producer prices than of consumer prices, the Romanian PPI *excludes* exported production from January 1998 and hence has a disproportionately high share of non-traded production.

D. Empirical Analysis

28. While casual inspection yields considerable information on the relationships between inflation and its determinants, econometric analysis offers additional insights. The analysis uses vector autoregression (VAR) techniques, which are appealing in this context because they require no a priori assumptions about the exogeneity of the policy and other variables—exogeneity is instead *tested* below—and they avoid problems of simultaneity bias, given the potential for contemporaneous relationships among the variables. The analysis uses the variables described in section C, as well as an activity variable to complete the system:

Consumer price index—CPI
Industrial production—IP (proxy for activity)
Unit labor costs in industry—ULC
Nominal exchange rate—NER (lei /U.S. dollar), NTWI (weighted average of lei against U.S. dollar and DM/euro)
Monetary aggregates—M2, M2X (including foreign currency deposits), and CRED (domestic credit)

All variables have been logged and run from January 1991 to March 2000.¹³

29. The first step in the analysis is to determine the order of integration of the variables, in order to avoid misspecifying the model. Results from a variety of unit root tests (Appendix I) indicate on balance that each of the variables is $I(1)$, i.e. integrated of order 1.¹⁴

30. The non-stationarity of the data motivates the use of the multivariate Johansen procedure to detect the presence of long-run stationary (“cointegrating”) relationships among the non-stationary variables. An advantage of the Johansen procedure is that it also allows the researcher to investigate the speed of adjustment to long-run equilibrium, and so to test for (weak) exogeneity of the explanatory variables (if the speed of adjustment of a variable is not significantly different from zero, the variable is weakly exogenous).¹⁵ The procedure is briefly explained in Appendix II.

¹³ Owing to data limitations, a measure of relative price variability—potentially a very important variable—has not been included in the econometric analysis.

¹⁴ The results need to be interpreted with caution, owing to the low power of the tests, especially in the presence of structural breaks. Some results are contradictory. Several variables, including the CPI, unit labor costs and the money and credit variables, could be $I(2)$; the exchange rate variables could be $I(0)$ about a trend. On balance, however, the tests justify proceeding on the assumption that the variables are each $I(1)$.

¹⁵ Ericsson (1992) discusses the concepts of weak, strong and super exogeneity and their relationship to cointegration analysis.

centered seasonal dummies. The test results shown in Appendix II provide evidence for the existence of one cointegrating relationship across a range of specifications.

"exclusion" from the long-run relationship. In most cases, the CPI and ULC were found to be most strongly significant; also, weak exogeneity was usually rejected for the CPI, implying

unsurprisingly, activity) were not found to be significant; this is consistent with the interpretation that the linkages between prices and monetary aggregates have been weakened

35. To narrow the focus on the relationships between the CPI, ULC and exchange rate, three-variable VARs were estimated. The results are sensitive to the inclusion of the dummy in 1997, but are intuitively plausible when the dummy is included. All three variables are

labor costs does not imply that wages do not react to inflation in the short run; but it does imply that in the long run, wages are determined by real instead of nominal factors. This

$$LCPI = 0.156 LNTWI + 0.846 LULC$$

($R^2=0.672$). However, tests on the residual properties and the structural stability of the model (Figure I.9) point to problems with the parameters of the model in early 1997. This is not

short, and does not yet lend itself to reliable modeling.

35 Because of the susceptibility of the levels data to structural breaks it is also useful to

Figure I.8. Romania: Estimates of CPI Determinants, 1991-99

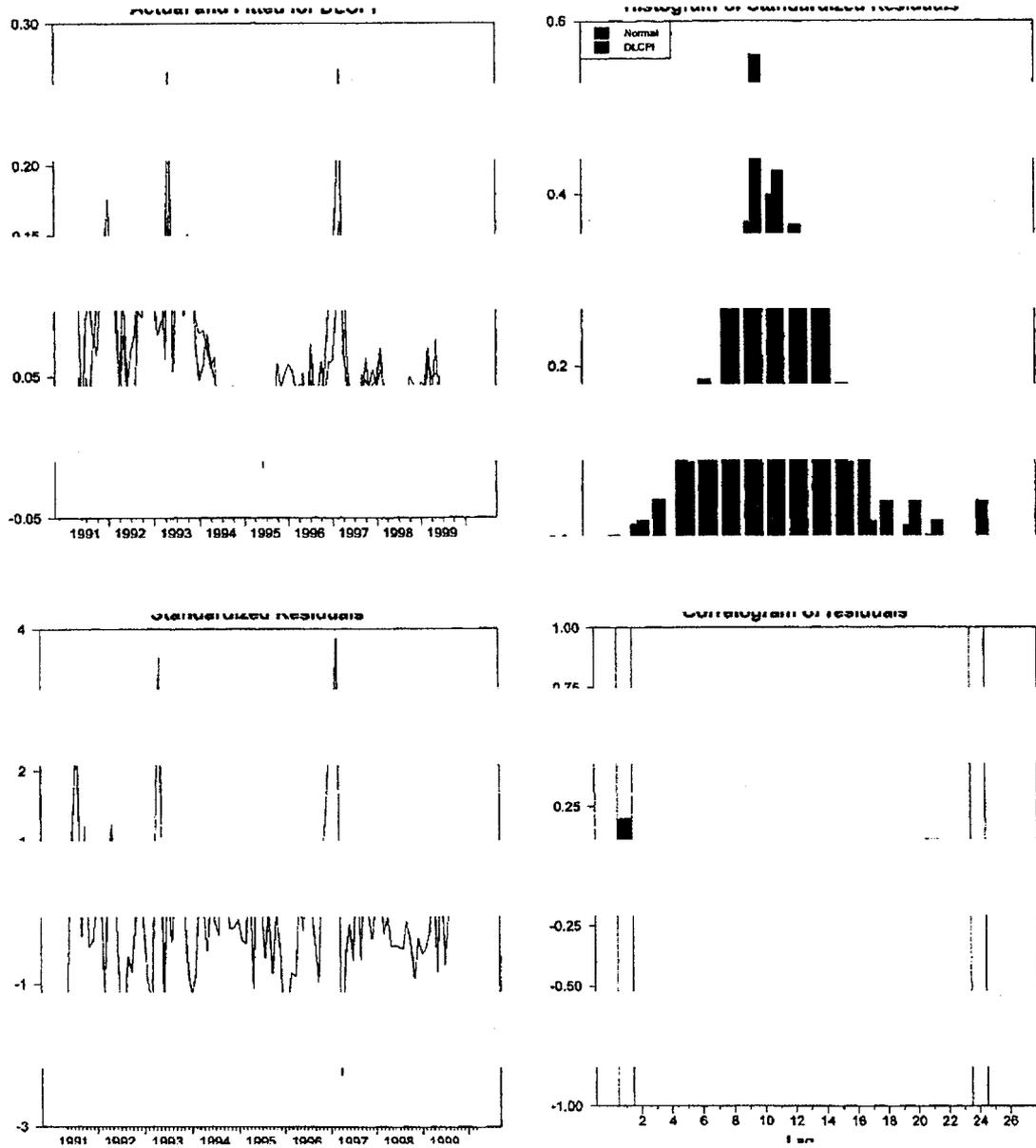
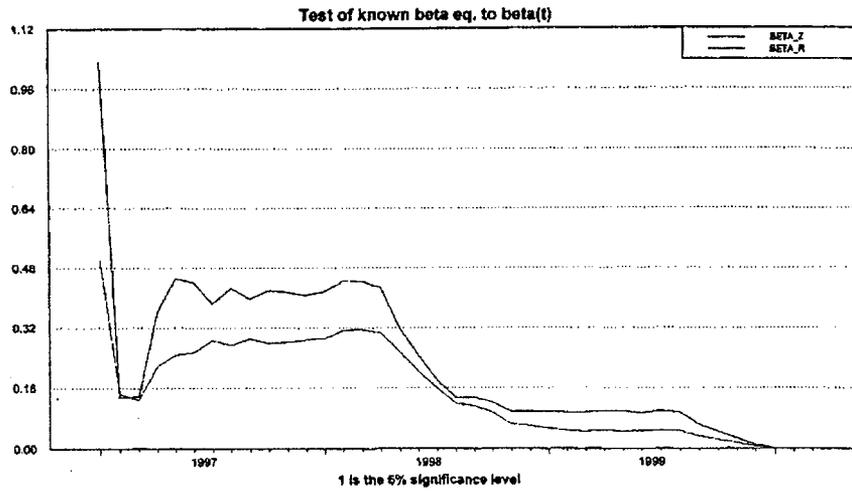
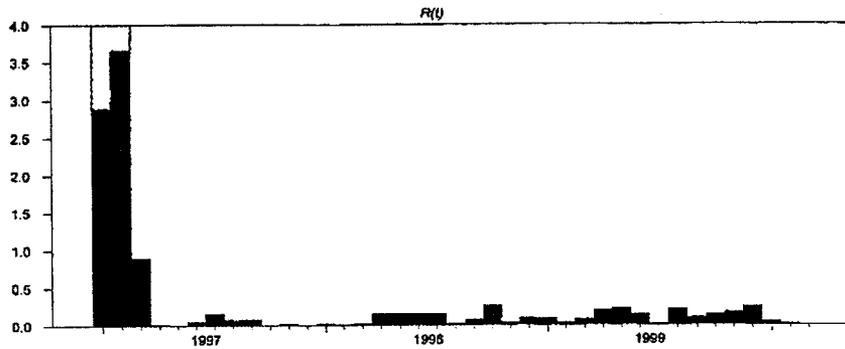
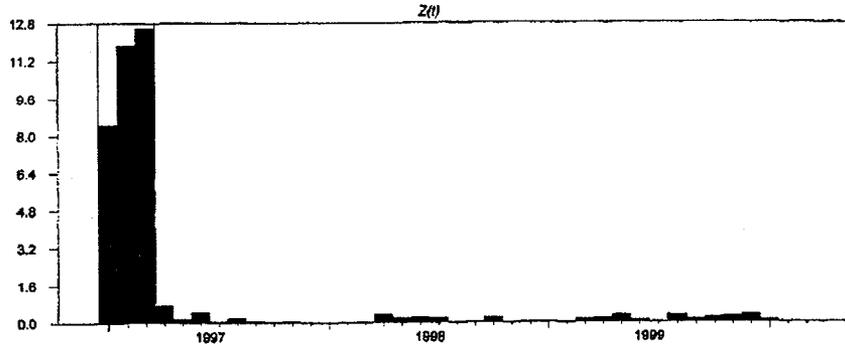


Figure I.9. Romania: Residual Properties of the CPI Estimate, 1997-99

1-step prediction test



36. Several results are particularly noteworthy, and hold up across most lags. First, there is strong evidence that unit labor costs growth and depreciation of the exchange rate both Granger cause inflation; also, while lei-only M2 does not appear to Granger cause inflation, there is strong evidence that broader monetary aggregates including foreign currency deposits do Granger cause inflation. Second, there is strong evidence that inflation Granger causes unit labor costs, confirming the bidirectional causality between wages and prices at least in the short run. Finally, there is also some evidence that unit labor costs Granger cause M2 and M2X, consistent with the hypothesis that money growth has accommodated growth in wages and prices.

37. Variance decompositions and impulse response functions have been obtained from a 4-lag unrestricted VAR. The VAR is identified using the Choleski decomposition, which implies—unlike in the Johansen procedure—that the ordering of the variables can affect the results significantly.¹⁷ The ordering shown here assumes that movements in the exchange rate and unit labor costs feed into inflation, which is then accommodated by money.

38. Table I.4 shows that substantial proportions of the forecast error variation in inflation can be attributed to innovations in unit labor costs, and that the reverse is also true, as expected on the basis of the Granger causality tests. Money also explains a significant proportion of the forecast error variance in inflation. These results appear relatively robust to the ordering of the VAR. However, results for the exchange rate do appear sensitive to the VAR ordering; the result that much of the forecast error variance in M2X is explained by the exchange rate but not vice versa is reversed when the VAR is reordered.

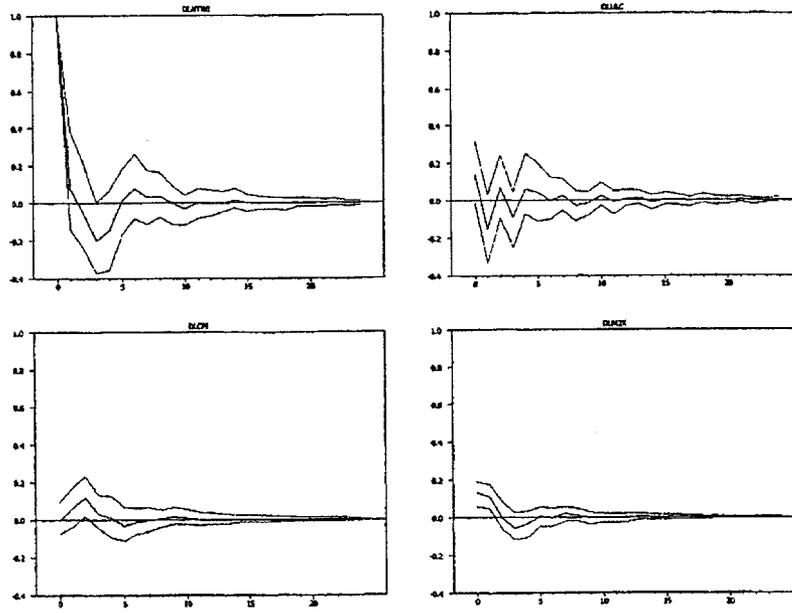
39. Figure I.10 shows impulse response functions (IRFs) to a one standard deviation structural shock, with bootstrapped standard error bands.¹⁸ Again, the clearest results appear to be for inflation and unit labor costs. Inflation responds to unit labor costs within one month, with the response persisting for over a year. Unit labor costs tend to respond sharply to innovations in inflation within about two months. Inflation also appears to respond to innovations in money with a lag of about two months, and to innovations in the exchange rate in about three months, though these responses decay more quickly than responses to unit labor costs.

¹⁷ The Choleski factorization eliminates the cross-equation residual correlations for a given innovation series, *and* prior series in the ordering.

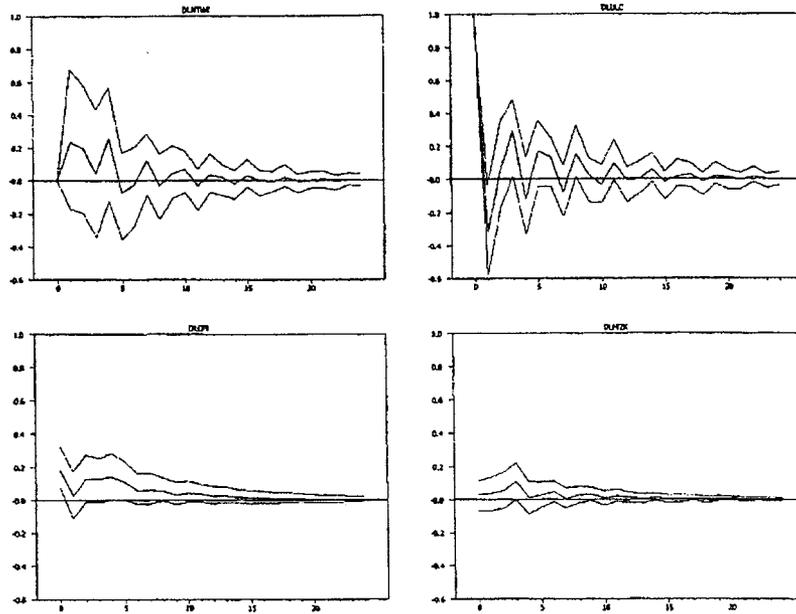
¹⁸ Some of the IRFs are quite jagged, notably for unit labor costs. Adding an activity variable (IP) did not greatly improve the properties of the IRFs.

Figure I.10. Impulse Response Functions
One standard-deviation structural shock, ± 2 S.E.

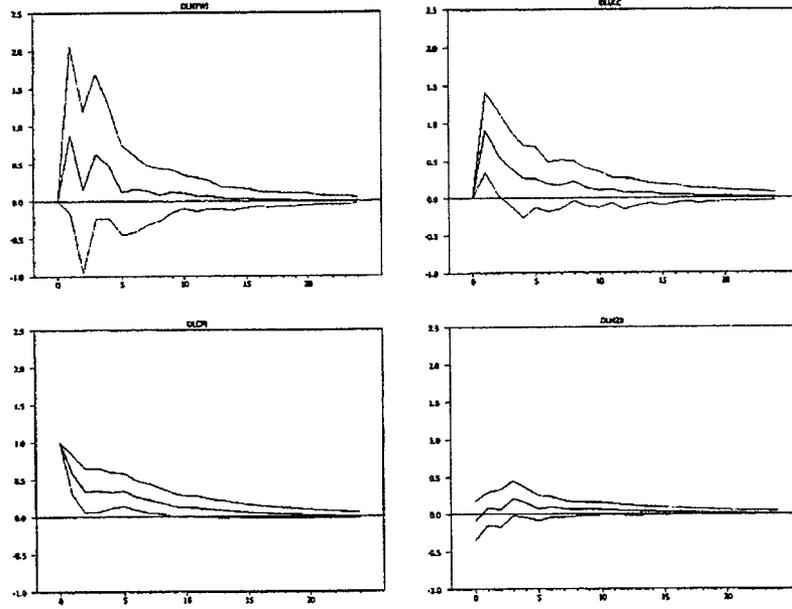
Effects of a Shock to DLNTWI



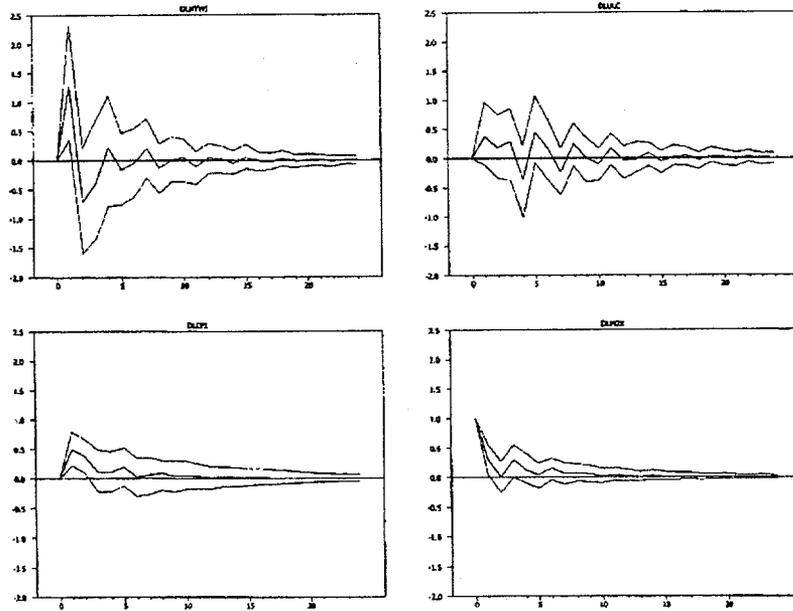
Effects of a Shock to DLULC



Effects of a Shock to DLCPI



Effects of a Shock to DLM2X



E. Conclusions

40. **Inflation in Romania has reflected a number of causes, the most fundamental of which have been lax macroeconomic policies and widespread financial indiscipline.** Inflation has been generated by monetary accommodation of large fiscal and quasi-fiscal deficits, and by rapid wage growth unsupported by productivity and financed by arrears; and it has been sustained by inflation inertia and protracted relative price adjustment.

41. **The econometric evidence points to the role of unit labor costs in driving inflation.** Reading through the statistical noise, unit labor costs emerge as the most plausible explanator of inflation in the long-run, at least in a proximate sense. It is clear that wages also respond to inflation in the shorter run, highlighting the role of inertia in sustaining inflation. But it is also true that in the long run, real wages are determined, whether efficiently or inefficiently, by real factors. The combination of wage levels well above those justified by productivity (even if those wages are low in absolute terms), especially in conjunction with widespread overstaffing—and more fundamentally, the failure to enforce financial discipline—has clearly done much to fuel inflation.

42. **There is also evidence of the increasing importance of the exchange rate for inflation.** Though somewhat sensitive to specification, the econometric evidence generally confirms the importance of the exchange rate for inflation—as does, perhaps even more persuasively, the pickup in inflation through 1999. This relationship should emerge even more clearly over the next few years, as more data becomes available for the period following the liberalizations of the exchange rate and of prices, and the Romanian economy continues to open up.

43. **The correlation between money growth and inflation is less visible, owing to price controls and fluctuations in the real exchange rate.** There is little statistical evidence of a stable relationship between money growth and inflation. However, a plausible reason for this is the monetary overhang present at the start of the 1990s, and which built up again in the mid-1990s ahead of the last round of price liberalization; another plausible reason is the fluctuation of the real exchange rate. With the major price distortions now eliminated, the increasing correlation between money growth and inflation over the past few years suggests that this traditional relationship is now be reasserting itself.

44. **Romania's experience highlights the need to unburden monetary policy as a prerequisite for a sustained reduction in inflation.** Although inflation is ultimately a monetary phenomenon, pressures for accommodating fiscal and quasi-fiscal deficits proved irresistible on several occasions through the past decade. If Romania is to make the progress in disinflation envisaged in its medium-term strategy, monetary policy needs greater support from incomes and fiscal policies, and greater progress in enforcing financial discipline.

Table I.1. Measures of Inflation, 1994–99						
(Percentage change, period average)						
	1994	1995	1996	1997	1998	1999
Consumer price index	136.7	32.3	38.8	154.8	59.1	45.8
Producer price index	140.5	35.1	49.9	156.5	33.2	42.2
GDP deflator	139.0	35.3	45.3	147.2	53.9	46.4
Private consumption deflator	141.8	36.7	43.6	156.8	49.7	45.8

Source: National Commission for Statistics.

Table I.2. Developments in Administered Prices, 1997–99				
Percentage change, end-period				
	1999 CPI weights	1997	1998	1999
Administered prices	9.3	227.6	77.6	88.1
<i>of which:</i>				
Electricity, gas and heating	3.6	209.2	88.5	108.3
Water and sewerage	2.1	198.1	62.6	63.9
Public transport	1.6	202.1	39.5	51.3
Post and telecommunications	2.1	345.6	98.2	112.8
“Core” prices	90.7	144.7	36.0	51.2
Total CPI	100.0	151.4	40.6	54.8

Source: National Commission for Statistics; and staff estimates.

Table I.3: Granger Causality Tests

	Lag length in number of months					
	1	2	3	4	5	6
CPI						
IP to CPI	1.25	3.20 **	0.87	0.86	1.44	1.09
ULC to CPI	7.00 *	6.50 *	3.50 **	2.87 **	2.44 **	2.08 ***
NER to CPI	2.77 ***	3.49 **	3.70 **	3.88 *	3.32 *	3.02 **
NTWI to CPI	2.38	3.27 **	3.61 **	3.43 **	2.85 **	2.65 **
M2 to CPI	0.13	2.27	2.28 ***	1.00	0.95	1.29
M2X to CPI	9.85 *	6.48 *	10.16 *	6.71 *	5.70 *	5.88 *
CRED to CPI	12.63 *	6.95 *	7.45 *	5.82 *	4.43 *	3.78 *
IP						
CPI to IP	1.33	0.82	2.04	1.42	1.34	1.12
ULC to IP	0.35	0.02	1.18	1.02	0.87	1.56
NER to IP	0.01	0.75	0.61	0.59	1.65	1.79
NTWI to IP	0.02	0.66	0.58	0.50	1.38	1.62
M2 to IP	5.02 **	4.55 **	3.21 **	2.77 **	2.35 **	2.18 ***
M2X to IP	5.37 **	2.34	1.66	1.20	1.38	1.30
CRED to IP	13.81 *	6.32 *	4.50 *	3.04 **	3.06 **	2.57 **
ULC						
CPI to ULC	37.51 *	19.56 *	9.74 *	6.85 *	5.83 *	2.97 **
IP to ULC	2.98 ***	1.73	2.29 ***	3.67 *	3.30 *	2.57 **
NER to ULC	0.76	0.66	1.98	2.42 ***	2.24 ***	0.97
NTWI to ULC	0.29	0.50	1.68	2.19 ***	2.10 ***	0.90
M2 to ULC	3.99 **	2.17	1.22	1.37	1.18	1.39
M2X to ULC	0.31	0.84	0.15	0.16	0.71	0.35
CRED to ULC	0.09	0.01	0.38	0.68	1.15	0.46
NER						
CPI to NER	1.56	1.15	1.66	1.84	2.05 ***	1.57
IP to NER	0.66	1.25	1.60	1.42	1.14	0.87
ULC to NER	0.69	2.34	2.43 ***	2.38 ***	2.55 **	2.87 **
M2 to NER	0.00	1.39	2.48 ***	1.87	2.57 **	3.63 *
M2X to NER	1.02	2.09	3.73 **	2.66 **	2.62 **	3.60 *
CRED to NER	2.18	2.53 ***	2.06	1.46	1.15	0.97
NTWI						
CPI to NTWI	1.21	0.83	1.40	1.66	1.86	1.46
IP to NTWI	0.92	1.54	1.68	1.43	1.13	0.83
ULC to NTWI	0.86	2.20	2.19 ***	2.22 ***	2.58 **	2.84 **

Table I.3: Granger Causality Tests

	Lag length in number of months					
	1	2	3	4	5	6
M2 to NTWI	0.03	1.87	2.86 **	2.11 ***	2.81 **	3.97 *
M2X to NTWI	1.29	2.66 ***	3.96 **	2.71 **	2.68 **	3.73 *
CRED to NTWI	2.14	2.56 ***	2.08	1.39	1.07	0.92
M2						
CPI to M2	1.87	1.04	2.56 ***	1.88	3.03 **	3.04 **
IP to M2	0.31	0.90	1.29	1.13	0.48	0.62
ULC to M2	0.19	0.56	2.19 ***	1.65	2.49 **	2.93 **
NER to M2	4.94 **	2.23	2.31 ***	1.35	0.99	1.37
NTWI to M2	4.61 **	2.12	2.17 ***	1.25	0.97	1.31
CRED to M2	0.02	1.00	2.04	2.09 ***	1.98 ***	1.88 ***
M2X						
CPI to M2X	3.52 ***	2.74 ***	3.39 **	2.91 **	1.83	1.67
IP to M2X	1.48	1.36	1.78	1.40	0.80	0.70
ULC to M2X	1.28	0.92	2.95 **	2.08 ***	2.27 ***	2.59 **
NER to M2X	6.40 **	2.74 ***	3.90 **	2.74 **	1.84	2.46 **
NTWI to M2X	5.75 **	2.52 ***	3.80 **	2.66 **	1.82	2.32 **
CRED to M2X	0.13	0.88	0.88	0.95	0.89	0.84
CRED						
CPI to CRED	0.00	0.55	0.42	0.52	0.29	0.40
IP to CRED	5.64 **	2.97 ***	2.35 ***	1.66	1.20	1.17
ULC to CRED	2.40	1.40	2.02	2.35 ***	1.81	1.56
NER to CRED	32.70 *	21.23 *	14.99 *	20.01 *	15.39 *	12.46 *
NTWI to CRED	34.85 *	21.74 *	15.28 *	19.13 *	14.96 *	12.07 *
M2 to CRED	7.91 *	4.31 **	3.85 **	3.19 **	4.29 *	3.59 *
M2X to CRED	9.66 *	5.54 *	4.28 *	5.36 *	5.27 *	4.27 *

Standard F-tests; (*), (**), (***) indicate rejection of the null hypothesis at significance levels of 1, 5, and 10 percent, respectively. The null hypothesis is "no Granger causality".

Table I.4: Variance Decompositions					
Variable	Lags	DLNTWI	dLULC	dLCPI	DLM2X
dLNTWI	1	86.6	1.5	4.9	7.0
	6	79.5	3.8	7.9	8.8
	12	78.7	4.3	8.1	8.9
	18	78.6	4.4	8.1	8.9
	24	78.6	4.4	8.1	8.9
dLULC	1	9.6	75.4	13.4	1.6
	6	10.5	65.8	18.5	5.2
	12	10.3	64.5	19.0	6.2
	18	10.3	64.3	19.1	6.2
	24	10.3	64.3	19.1	6.3
dLCPI	1	3.2	8.6	78.3	9.9
	6	9.5	15.1	64.6	10.8
	12	9.1	15.6	64.8	10.5
	18	9.0	15.7	64.9	10.4
	24	9.0	15.7	64.9	10.4
dLM2X	1	33.9	0.7	1.4	64.0
	6	31.4	5.6	6.6	56.5
	12	30.8	6.1	7.7	55.5
	18	30.7	6.2	7.9	55.3
	24	30.7	6.2	7.9	55.3

Unit Root Tests

Variable	ADF Tests			KPSS Tests		Result
	Lags	ADF(t)	ADF(Z)	4 lags		
LCPI	1 TC	-2.02	-3.97	τ	0.43 *	I(1), possibly I(2)
	1 C	-3.25 **	-1.50	μ	2.23 *	
DLCPI	0 TC	-6.51 *	-62.32 *	τ	0.12	
	1 C	-4.05 *	-33.90 *	μ	0.83 *	
LIP	12 TC	-2.36	-39.35 *	τ	0.26 *	I(1)
	12 C	-2.20	-26.67 *	μ	0.64 **	
DLIP	11 TC	-2.06	-16.50	τ	0.09	
	20 C	-2.63 ***	824.49	μ	0.10	
LULC	18 TC	-2.37	-8.48	τ	0.46 *	I(1), possibly I(2)
	18 C	-2.45	-1.88	μ	2.20 *	
DLULC	17 TC	-2.67	34.49	τ	0.11	
	14 C	-1.41	-6.88	μ	0.86 *	
LWAG	20 TC	-4.58 *	-13.59	τ	0.50 *	I(1), possibly I(2)
	20 C	-3.12 **	-1.83	μ	2.24 *	
DLWAG	19 TC	-2.34	39.82	τ	0.11	
	18 C	-1.05	-3.79	μ	0.90 *	
LNER	7 TC	-3.96 **	-11.52	τ	0.40 *	I(1), possibly I(0)
	7 C	-3.08 **	-2.34	μ	2.20 *	
DLNER	6 TC	-3.54 **	-76.12 *	τ	0.09	
	6 C	-2.81 ***	-29.22 *	μ	0.55 **	
LNTWI	7 TC	-4.19 *	-10.09	τ	0.43 *	I(1), possibly I(0)
	7 C	-3.62 *	-2.53	μ	2.18 *	
DLNTWI	6 TC	-3.81 **	-116.19 *	τ	0.08	
	6 C	-2.82 ***	-30.62 *	μ	0.59 **	
LM2	12 TC	-0.82	-6.69	τ	0.49 *	I(1), possibly I(2)
	12 C	-1.06	-0.63	μ	2.32 *	
DLM2	11 TC	-1.73	-9.74	τ	0.11	
	11 C	-1.46	-5.09	μ	0.37 ***	
LM2X	12 TC	-0.35	-1.31	τ	0.53 *	I(1), possibly I(2)
	12 C	-1.55	-0.83	μ	2.32 *	
DLM2X	12 TC	-1.80	11.90	τ	0.10	
	11 C	-0.98	-3.01	μ	0.49 **	
LCRED	12 TC	0.73	1.95	τ	0.48 *	I(1), possibly I(2)
	12 C	-1.75	-0.82	μ	2.32 *	
DLCRED	11 TC	-2.40	-42.22 *	τ	0.10	
	11 C	-1.55	-10.28	μ	0.27	

The Johansen Procedure

This study uses the Johansen and Juselius (1990, 1992) procedure to test for cointegrating vectors in multivariate models.

The procedure is based on the following p -dimensional VAR with k lags:

$$X_t = A_1 X_{t-1} + \dots + A_k X_{t-k} + \mu + \psi D_t + \varepsilon_t, \quad t = 1, \dots, T \quad (\text{AII.1})$$

where X_t is the $p \times 1$ vector of variables of interest, D_t is an (optional) matrix of centered seasonal dummies and ε_t is a vector of Gaussian i.i.d. errors. This levels model may be rewritten in error-correction form:

$$\Delta X_t = \Gamma_1 \Delta X_{t-1} + \dots + \Gamma_{k-1} \Delta X_{t-k+1} + \Pi X_{t-k} + \mu + \psi D_t + \varepsilon_t, \quad t = 1, \dots, T \quad (\text{AII.2})$$

where the Γ and Π matrices are given by:

$$\Gamma_i = - \left[I - \sum_{i=1}^{k-1} \pi_i \right] \quad (\text{AII.3})$$

$$\text{and } \Pi = - \left[I - \sum_{i=1}^k \pi_i \right] \quad (\text{AII.4})$$

Under the hypothesis of cointegration, the $p \times p$ matrix Π contains information about the long-run relationships among the variables in X_t . This hypothesis will depend on the rank r of Π .

There are three possibilities to consider:

- (i) r may be full, i.e. the rank of Π is equal to p . In this case, all the variables of X_t are stationary, and a standard VAR should be estimated in levels. In general, this will not occur when one or more of the variables is $I(1)$.
- (ii) r is zero, i.e. Π is a null matrix. In this case, no long-run relationships exist among the variables, and the VAR must be estimated in differences.
- (iii) r is between 0 and p , and represents the number of cointegrating vectors among the variables in X_t . This implies that there exist $p \times r$ matrices α and β such that $\Pi = \alpha\beta'$, where β is a matrix of r cointegrating vectors, and α is a matrix of adjustment coefficients. Even though the elements of X_t may be non-stationary, the cointegrating vectors represent linear combinations of these elements which are stationary, i.e. $\beta'X_t$ is stationary.

Johansen and Juselius have devised two likelihood ratio tests to determine the rank of Π . The first test is the trace test, which tests the hypothesis that $r \leq p$ against the general alternative of stationarity. The trace statistic is given by:

$$\text{Trace} = -T \sum_{i=r+1}^p \ln(1 - \hat{\lambda}_i) \quad (\text{AII.5})$$

The second test is the maximal eigenvalue test, which tests the null hypothesis of at most r cointegrating vectors against the alternative of $r+1$ cointegrating vectors. The maximal eigenvalue test statistic is given by:

$$\lambda_{\max} = -T \ln(1 - \hat{\lambda}_{r+1}) \quad (\text{AII.6})$$

Critical values for these tests have been generated by Osterwald-Lenum (1992); updated critical values for the trace tests appear in Hansen and Juselius (1995).

If cointegration is found and the cointegrating vectors β are estimated, the significance of the coefficients of β may then be tested by additional likelihood ratio tests. Not all of the variables in the model need be important in the long-run relationships, and so each variable may be tested for *exclusion*. The test takes the form of the restriction $\beta_i = 0$ for the i th variable. The test statistic is defined as:

$$LR = T \sum_{i=1}^r \ln[(1 - \tilde{\lambda}_i)/(1 - \hat{\lambda}_i)] \quad (\text{AII.7})$$

where r is the number of cointegrating vectors, and $\tilde{\lambda}_i$ and $\hat{\lambda}_i$ are the eigenvalues from the restricted and unrestricted estimates of β respectively. The test statistic is distributed as χ^2 with the degrees of freedom equal to the number of restrictions.

The α matrix contains the "adjustment" vectors, which describe the speed with which the dependent variables adjust to long-run equilibrium. The variables of the model may then be tested for *exogeneity*, by testing the restriction $\alpha_j = 0$ for the j th variable, in a test procedure similar to the exclusion test. If this restriction cannot be rejected for a given variable, then that variable will be weakly exogenous to the long-run relationship, since it will not adjust to shocks to other variables.

Tests for cointegration were performed using unrestricted 5-variable VARs, using the various measures of exchange rates and monetary aggregates, with four lags and eleven centered seasonal dummies. The tests were performed with and without a trend in the cointegrating space. Tests were also performed including a structural break in February 1997.¹⁹ The maximum eigenvalue statistic and the trace statistic provide evidence for the existence of one cointegrating relationship across a range of specifications (Tables AII.1 and AII.2).

¹⁹ A motivation for the inclusion of a trend could be as a possible correction for omitted variable bias, for example because of relative price variability. Note also that the inclusion of dummy variables (other than seasonal dummies) can change the distribution of the Johansen test statistics; accordingly, the significance of the test results including the structural break should therefore be regarded as approximate only.

Each VAR was estimated with the constraint of one cointegrating relationship to give estimates of the long-run relationships (the coefficients of the “ β vector”), which were then tested for significance, or “exclusion” from the long-run relationship (Tables AII.3 and AII.4). In most cases, exclusion hypotheses were generally rejected most strongly for the CPI and ULC; also, weak exogeneity was usually rejected for the CPI. In general, exclusion could not be rejected for the exchange rate in the absence of a structural dummy in 1997, but was rejected when the dummy was included. Exclusion could not be systematically rejected for the monetary aggregates or activity.

To narrow the focus on the relationships between the CPI, ULC and exchange rate, three-variable VARs were estimated:

Model A	β	LR test	α	LR test	Model B	β	LR test	α	LR test
		$H^0: \beta_i=0$		$H^0: \alpha_j=0$			$H^0: \beta_i=0$		$H^0: \alpha_j=0$
LNTWI	-0.020	0.01	0.075	0.30	LNTWI	-0.147	3.88**	0.254	0.94
LULC	-1.097	5.44**	0.192	6.42**	LULC	-0.868	13.23*	0.252	2.42
LCPI	1.000	5.34**	-0.022	0.29	LCPI	1.000	13.99*	-0.263	9.42*

(*) and (**) indicate rejection of the null hypothesis at significance levels of 1 and 5 percent, respectively.

The results are sensitive to the inclusion of the dummy. Without the dummy (model A), exclusion cannot be rejected for the exchange rate, and exogeneity cannot be rejected for the CPI—in other words, the CPI helps explain unit labor costs but is not itself explained.

However, including the dummy (model B) yields intuitively plausible results. Rejection can be excluded for all three variables, which are correctly signed; exogeneity cannot be rejected for the exchange rate and unit labor costs, but is rejected for the CPI. Note that long-run exogeneity for unit labor costs does not imply that wages do not react to inflation in the short run; but it does imply that in the long run, wages are determined by real instead of nominal factors.

This model was reestimated holding the exchange rate and unit labor costs exogenous, to yield the following long-run vector:

$$LCPI = 0.156 LNTWI + 0.846 LULC$$

These parameters appear plausible, and Figure I.8 shows that the model does quite a reasonable job of explaining inflation ($R^2=0.672$). However, there is some evidence of non-normal residuals, as well as of first-order autocorrelation. Moreover, recursively estimated one-step ahead prediction tests and tests for constancy of the long-run parameters (Figure I.9) point to problems with the parameters of the model in early 1997, probably reflecting the price liberalization episode in early 1997.

Table AII.1. Tests for Cointegration, Unrestricted Model

Model 1a	No. of vectors	Λ -max	Trace	Model 1b (w/ trend)	No. of vectors	λ -max	Trace
LNTWI	1	27.87**	73.93**	LNTWI	1	30.14**	89.03**
LULC	2	19.54***	46.06***	LULC	2	21.60***	58.90
LIP	3	12.23	26.53	LIP	3	15.06	37.30
LCRED	4	11.33	14.30	LCRED	4	11.95	22.24
LCPI	5	2.97	2.97	LCPI	5	10.29	10.29

Model 2a	No. of vectors	Λ -max	Trace	Model 2b (w/ trend)	No. of vectors	λ -max	Trace
LNER	1	28.26**	75.16**	LNER	1	31.13**	89.98**
LULC	2	20.02***	46.90***	LULC	2	21.53***	58.85
LIP	3	12.75	26.87	LIP	3	14.98	37.32
LCRED	4	10.90	14.12	LCRED	4	12.51	22.34
LCPI	5	3.22	3.22	LCPI	5	9.83	9.83

Model 3a	No. of vectors	Λ -max	Trace	Model 3b (w/ trend)	No. of vectors	λ -max	Trace
LNTWI	1	23.35**	69.36**	LNTWI	1	29.30**	83.32***
LULC	2	21.16***	46.01***	LULC	2	21.18***	54.03
LIP	3	11.93	24.85	LIP	3	16.85	32.84
LM2	4	9.86	12.92	LM2	4	11.43	16.00
LCPI	5	3.06	3.06	LCPI	5	4.57	4.57

Model 4a	No. of vectors	Λ -max	Trace	Model 4b (w/ trend)	No. of vectors	λ -max	Trace
LNER	1	23.62**	69.63***	LNER	1	30.92**	82.84***
LULC	2	19.70***	45.01***	LULC	2	19.73	51.92
LIP	3	11.36	25.31	LIP	3	16.18	32.19
LM2	4	10.65	13.96	LM2	4	11.28	16.01
LCPI	5	3.31	3.31	LCPI	5	4.72	4.72

Model 5a	No. of vectors	Λ -max	Trace	Model 5b (w/ trend)	No. of vectors	λ -max	Trace
LNTWI	1	26.33**	69.36***	LNTWI	1	31.32**	87.54**
LULC	2	18.50***	43.03	LULC	2	19.32	56.22
LIP	3	12.17	24.53	LIP	3	17.74	36.90
LM2X	4	9.34	12.36	LM2X	4	9.93	19.15
LCPI	5	3.02	3.02	LCPI	5	9.23	9.23

Model 6a	No. of vectors	Λ -max	Trace	Model 6b (w/ trend)	No. of vectors	λ -max	Trace
LNER	1	26.43**	67.94***	LNER	1	32.25**	86.44***
LULC	2	17.32***	41.51	LULC	2	18.63	54.19
LIP	3	11.56	24.19	LIP	3	16.52	35.56
LM2X	4	9.40	12.63	LM2X	4	10.43	19.04
LCPI	5	3.23	3.23	LCPI	5	8.62	8.62

(*), (**), (***) indicate rejection of the null hypothesis at significance levels of 1, 5, and 10 percent, respectively.

Table AII.2: Tests for Cointegration, Unrestricted Model, Break in February 1997

Model 1c	No. of vectors	Λ -max	Trace	Model 1d (w/ trend)	No. of vectors	λ -max	Trace
LNTWI	1	30.30*	80.05*	LNTWI	1	52.32*	108.20*
LULC	2	25.83**	49.74**	LULC	2	25.97***	55.88
LIP	3	13.58***	23.91	LIP	3	15.25	29.91
LCRED	4	9.63	10.33	LCRED	4	11.76	14.66
LCPI	5	0.70	0.70	LCPI	5	2.90	2.90

Model 2c	No. of vectors	Λ -max	Trace	Model 2d (w/ trend)	No. of vectors	λ -max	Trace
LNER	1	34.67*	84.07*	LNER	1	52.72*	108.62*
LULC	2	25.43**	49.40**	LULC	2	25.47***	55.90
LIP	3	14.36***	23.97	LIP	3	15.86	30.42
LCRED	4	9.10	9.61	LCRED	4	12.15	14.57
LCPI	5	0.51	0.51	LCPI	5	2.42	2.42

Model 3c	No. of vectors	Λ -max	Trace	Model 3d (w/ trend)	No. of vectors	λ -max	Trace
LNTWI	1	33.33*	78.86*	LNTWI	1	59.37*	107.72*
LULC	2	21.37***	45.53***	LULC	2	21.40***	48.34
LIP	3	15.00***	26.70	LIP	3	15.36	26.94
LM2	4	7.43	9.16	LM2	4	7.90	11.58
LCPI	5	1.73	1.73	LCPI	5	3.67	3.67

Model 4c	No. of vectors	Λ -max	Trace	Model 4d (w/ trend)	No. of vectors	λ -max	Trace
LNER	1	37.66*	81.42*	LNER	1	58.08*	105.84*
LULC	2	21.10***	43.76	LULC	2	21.11***	47.75
LIP	3	14.55***	22.66	LIP	3	15.33	26.64
LM2	4	6.93	8.11	LM2	4	7.93	11.31
LCPI	5	1.18	1.18	LCPI	5	3.37	3.37

Model 5c	No. of vectors	Λ -max	Trace	Model 5d (w/ trend)	No. of vectors	λ -max	Trace
LNTWI	1	29.49**	72.67**	LNTWI	1	48.19*	102.37*
LULC	2	19.05***	43.18	LULC	2	21.01***	54.18
LIP	3	15.46***	24.14	LIP	3	18.81	33.17
LM2X	4	8.28	8.67	LM2X	4	10.24	14.36
LCPI	5	0.39	0.39	LCPI	5	4.12	4.12

Model 6c	No. of vectors	Λ -max	Trace	Model 6d (w/ trend)	No. of vectors	λ -max	Trace
LNER	1	31.90*	75.00**	LNER	1	48.46*	101.77*
LULC	2	18.67***	43.10	LULC	2	20.41***	53.30
LIP	3	16.39***	24.43	LIP	3	17.87***	32.90
LM2X	4	7.81	8.04	LM2X	4	11.44	15.03
LCPI	5	0.23	0.23	LCPI	5	3.59	3.59

(*), (**), (***) indicate rejection of the null hypothesis at significance levels of 1, 5, and 10 percent, respectively.

Table AII.3: Estimates and Tests of the Long-Run Relationships, Unrestricted Model

Model 1a	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$	Model 1b	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$
LNTWI	0.039	0.10	-0.142	0.63	LNTWI	-0.064	0.33	-0.210	1.02
LULC	-1.123	8.18*	0.197	3.12***	LULC	-1.061	8.53*	0.125	0.71
LIP	0.077	0.14	-0.129	4.38**	LIP	-0.347	1.24	-0.086	0.95
LCRED	0.025	0.07	-0.193	6.37**	LCRED	0.329	2.28	-0.283	8.16*
LCPI	1.000	6.43**	-0.017	0.10	LCPI	1.000	7.96*	-0.087	1.34
					TREND	-0.015	2.27		

Model 2a	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$	Model 2b	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$
LNER	-0.030	0.04	-0.081	0.22	LNER	-0.115	0.95	-0.145	0.50
LULC	-1.060	8.17*	0.189	3.00***	LULC	-1.010	9.58*	0.128	0.84
LIP	0.076	0.14	-0.145	5.58**	LIP	-0.359	1.57	-0.100	1.26
LCRED	0.032	0.10	-0.201	6.77*	LCRED	0.326	2.85***	-0.286	8.68*
LCPI	1.000	6.13**	-0.032	0.28	LCPI	1.000	8.69**	-0.110	1.97
					TREND	-0.014	2.87***		

Model 3a	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$	Model 3b	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$
LNTWI	0.025	0.03	-0.262	0.98	LNTWI	-0.086	0.64	-0.309	2.17
LULC	-0.841	1.79	0.075	0.09	LULC	-0.937	7.20*	0.050	0.11
LIP	0.467	2.17	-0.179	1.79	LIP	-0.246	0.71	-0.128	2.41
LM2	-0.226	2.07	0.034	0.33	LM2	0.313	2.16	-0.042	0.47
LCPI	1.000	2.03	-0.131	1.81	LCPI	1.000	7.76*	-0.190	6.76**
					TREND	-0.018	5.95**		

Model 4a	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$	Model 4b	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$
LNER	-0.059	0.17	-0.183	0.67	LNER	-0.136	1.55	-0.298	2.27
LULC	-0.797	3.50***	0.116	0.34	LULC	-0.900	9.91*	0.056	0.16
LIP	0.387	3.79***	-0.197	3.43***	LIP	-0.282	1.20	-0.130	2.57
LM2	-0.198	3.77***	0.040	0.46	LM2	0.310	2.83***	-0.038	0.42
LCPI	1.000	3.88**	-0.144	2.57	LCPI	1.000	10.76*	-0.207	8.55*
					TREND	-0.017	7.30*		

Model 5a	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$	Model 5b	β	LR test $H^0: \beta_f=0$	α	LR test $H^0: \alpha_f=0$
LNTWI	0.033	0.07	-0.152	0.90	LNTWI	-0.098	0.53	-0.256	3.34***
LULC	-0.602	2.10	-0.023	0.04	LULC	-0.891	5.44**	-0.073	0.57
LIP	0.655	7.52*	-0.111	2.47	LIP	-0.335	0.51	-0.029	0.19
LM2X	-0.433	7.50*	0.010	0.05	LM2X	0.511	1.43	-0.045	1.06
LCPI	1.000	4.67**	-0.126	7.18*	LCPI	1.000	6.75**	-0.147	11.38*
					TREND	-0.031	4.99**		

Table AII.3 (continued): Estimates and Tests of the Long-Run Relationships,
Unrestricted Model

Model 6a	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$	Model 6b	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$
LNER	-0.039	0.09	-0.152	0.86	LNER	-0.138	1.14	-0.278	3.58***
LULC	-0.572	2.73***	-0.013	0.01	LULC	-0.854	7.17*	-0.061	0.38
LIP	0.565	8.26*	-0.122	2.64	LIP	-0.343	0.75	-0.032	0.21
LM2X	-0.406	9.07*	0.014	0.08	LM2X	0.447	1.59	-0.045	0.97
LCPI	1.000	6.21**	-0.142	7.66*	LCPI	1.000	9.36*	-0.168	12.55*
					TREND	-0.028	5.82**		

Table AII.4: Estimates and Tests of the Long-Run Relationships, Unrestricted Model, Break in February 1997

Model 1c	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$	Model 1d	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$
LNTWI	-0.185	3.11***	0.361	1.28	LNTWI	-0.207	19.85*	0.285	0.97
LULC	-0.839	3.88**	0.148	0.31	LULC	-0.904	21.67*	-0.057	0.11
LIP	-0.140	1.35	-0.086	0.34	LIP	-0.613	21.67*	0.154	1.54
LCRED	0.014	0.09	-0.082	0.24	LCRED	0.379	20.33*	-0.199	2.30
LCPI	1.000	4.37**	-0.305	3.61***	LCPI	1.000	24.30*	-0.428	22.45*
					TREND	-0.016	22.02*		

Model 2c	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$	Model 2d	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$
LNER	-0.232	7.47*	0.398	2.06	LNER	-0.214	20.11*	0.284	1.01
LULC	-0.802	7.55*	0.118	0.34	LULC	-0.888	23.03*	0.004	0.00
LIP	-0.188	2.83***	-0.073	0.33	LIP	-0.566	20.08*	0.115	0.84
LCRED	0.024	0.28	-0.068	0.24	LCRED	0.328	17.16*	-0.184	1.96
LCPI	1.000	8.93*	-0.325	7.66*	LCPI	1.000	25.88*	-0.431	22.25*
					TREND	-0.013	18.05*		

Model 3c	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$	Model 3d	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$
LNTWI	-0.206	6.57**	0.296	1.37	LNTWI	-0.222	21.14*	0.130	0.28
LULC	-0.873	10.00*	0.093	0.31	LULC	-0.927	32.30*	0.046	0.10
LIP	-0.291	3.22***	-0.004	0.00	LIP	-0.628	24.70*	0.052	0.23
LM2	0.079	1.24	0.015	0.04	LM2	0.413	24.77*	-0.057	0.62
LCPI	1.000	10.44*	-0.303	11.69*	LCPI	1.000	32.46*	-0.414	28.41*
					TREND	-0.014	26.04*		

Model 4c	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$	Model 4d	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$
LNER	-0.242	11.01*	0.297	1.54	LNER	-0.222	20.14*	0.075	0.09
LULC	-0.841	13.83*	0.074	0.23	LULC	-0.907	32.72*	0.065	0.20
LIP	-0.311	5.14*	0.002	0.00	LIP	-0.564	22.42*	0.039	0.12
LM2	0.083	1.97	0.022	0.09	LM2	0.346	20.97*	-0.042	0.32
LCPI	1.000	14.57*	-0.335	15.98*	LCPI	1.000	33.08*	-0.433	29.22*
					TREND	-0.012	20.42*		

Model 5c	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$	Model 5d	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$
LNTWI	-0.117	1.50	0.086	0.12	LNTWI	-0.251	12.92*	-0.082	0.14
LULC	-0.712	5.51**	-0.017	0.01	LULC	-0.991	21.33*	-0.124	0.89
LIP	0.119	0.45	-0.072	0.39	LIP	-0.789	12.58*	0.134	1.77
LM2X	-0.166	2.99***	0.101	2.74	LM2X	0.658	12.71*	0.004	0.00
LCPI	1.000	8.41*	-0.275	10.01*	LCPI	1.000	21.40*	-0.352	25.69*
					TREND	-0.024	18.70*		

Table AII.4 (continued): Estimates and Tests of the Long-Run Relationships, Unrestricted Model, Break in February 1997

Model 6c	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$	Model 6d	β	LR test $H^0: \beta_i=0$	α	LR test $H^0: \alpha_j=0$
LNER	-0.179	3.97**	0.124	0.23	LNER	-0.244	13.12*	-0.104	0.21
LULC	-0.715	8.12*	-0.014	0.01	LULC	-0.944	22.92*	-0.087	0.41
LIP	0.001	0.00	-0.061	0.25	LIP	-0.669	11.74*	0.112	1.12
LM2X	-0.108	1.57	0.105	2.72***	LM2X	-0.520	10.86*	0.010	0.03
LCPI	1.000	11.88*	-0.321	12.69*	LCPI	1.000	24.17*	-0.375	26.91*
					TREND	-0.019	16.57*		

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II. PUBLIC FINANCE 1990–2000¹

1. **Despite important progress toward more efficient and sustainable public finances over the last decade, Romania's fiscal position remains precarious.** Following the collapse of the Communists in 1989, public finance was in a highly imbalanced

macroeconomic imbalances had emerged in late 1996, and urgent reform became inevitable. A new reform government faced the immediate task of averting a crisis. While fiscal

curtailing quasi-fiscal subsidies, and improving the tax policy environment, and, perhaps most importantly by cutting the overall size and deficit of government operations. Nevertheless, the fiscal position has remained precarious as indicated by persistent problems

2. **The excessively expansionary fiscal cum quasi-fiscal stance pursued up until 1996 precipitated a sharp recession in the subsequent years.** Between 1993 and 1996

economic sectors facing hardships, significant quasi-fiscal deficits were also incurred (see Box II.1). While the ensuing profligate fiscal cum quasi-fiscal stance helped to secure the

end of 1996. The subsequent task of fiscal consolidation was only made more difficult by the eventual fiscalization of earlier incurred quasi-fiscal debt—mostly in the form of recapitalizing insolvent banks and calling of loan guarantees. This resulted in new

3. **A substantial fiscal adjustment has been undertaken since 1997 through cuts in primary expenditures and increases in revenue.** The initial focus was on expenditures and

1999. At the end of 1999, revenue collections had rebounded to the same share in GDP as in 1993, while primary expenditure in relation to GDP was significantly lower than in 1990–96.

in interest expenditures limited the improvement in the overall deficit to only 1 percentage point during the same period.

Box II.1: Quasi-Fiscal Operations and Deficits

Quasi-fiscal operations quickly increased in the early 1990s and by 1996 had reached very large levels. The rapid expansion of such activities—beyond the level witnessed in other transition economies in Central and Eastern Europe—was a reaction to efforts to bring the fiscal deficit under control, most notably the 1993 reduction in transfer and subsidy spending by 6 percent of GDP. The quasi-fiscal operations took the form of (a) subsidies through the extension of directed low-interest credit by the NBR to agriculture and energy-intensive sectors; (b) sharp increases in lending by state-owned commercial banks to the same sectors; (c) NBR sales of foreign exchange at an appreciated exchange rate to the energy sector; (d) a pickup in the extension of government loan guarantees; and (e) a general increase in payments arrears by state owned companies. The following summary table provides a quantification of some of these factors (annual flows in percent of GDP):

	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
Net directed credits to agriculture	1.8	2.2	0.3	1.1
NBR interest subsidies to agriculture	0.5	0.3	0.2	1.6
Exchange rate subsidy to industry	1.0	1.0	1.0	1.0
 Total banking system support to agriculture and industry	 3.3	 3.5	 1.5	 3.7

While these activities ceased following the exchange and interest rate liberalization of 1997, much of their cost was subsequently brought on budget, either through recapitalizing state-owned banks in 1997 and 1999 (in a combined amount of some 8 percent of GDP), or through lowered NBR profit transfers to the budget.

The extent to which these quasi-fiscal operations gave rise to deficits, however, is less clear. While much of the bad bank loans eventually found their way into the budget in 1997 and 1999—thus supporting the notion that these were not backed by any offsetting quasi-fiscal revenue at the time—an assessment is somewhat more difficult as concerns the support extended by the central bank (in terms of directed lending, interest subsidies, and exchange rate subsidy). Clearly, the NBR was able to rely on its own seignorage income (only part of its profits were supposed to be passed on to the budget), and part of the exchange rate subsidy to energy intensive importers was financed by an implicit tax on exporters who had to sell their proceeds at the too appreciated rate. However, several factors point to the fact that indeed significant quasi-fiscal deficits were recorded: seignorage revenue averaged around 2.5 percent of GDP over the period, below the combined total of NBR support to industry and agriculture; exporters found ways to sell their proceeds on the parallel market, thus evading the implicit export tax; and the NBR witnessed a considerable deterioration in its net foreign asset position over the period, which it financed by foreign borrowing at market interest rates.

4. The focus of reform now has to shift toward a prioritization of government functions in line with available resources. On the one hand, substantial quasi-fiscal operations have been eliminated and the share of government expenditure in GDP is now in line with economies like the U.S., albeit considerably lower than in the EU countries or more advanced transition economies. This reflects difficulties encountered in tax administration and collections as well as a policy effort by government to limit its use of productive resources. On the other hand, the Romanian system of public finance attempts to emulate all the features of a European-type welfare state, which—in order to be sustainably financed—would require a significantly higher revenue collection than is currently the case. In addition, the public pension system has become increasingly unsustainable and the needed augmentation of outlays in key social sectors as well as projected new expenditure obligations—notably associated with Romania's efforts to accede to the European Union,

and to join NATO—will need to be financed. In order to achieve fiscal sustainability—an important ingredient to the so far elusive macroeconomic stability—a choice between a concerted effort at increasing revenue collections or cutting the reaches of government spending and welfare entitlements thus needs to be made.

5. **The task is far from easy and considerable downside risk is present.** Attempts to increase revenue have in the past been largely met by increased tax evasion and/or arrears accumulation while the only effective way to control (real) expenditures has been higher-than-targeted inflation. In the period ahead it is, therefore, important to maintain the efficiency gains made in tax policy; to greatly improve tax administration; to streamline spending; and to reform the pension system. Failure to progress along these fronts could again rapidly undermine the health of public finances.

6. In the remainder of the chapter, the most important developments in the areas of revenue and expenditure policy during the last ten years will be reviewed. The analysis will be geared toward identifying the remaining immediate and future challenges. Accordingly, considerable attention is devoted to the incentive effects of tax policy (especially on labor supply and demand) and on needed reforms in the areas of wage and employment policy, as well as of the unsustainable pension system. The chapter also seeks to identify trends in public debt and interest payments, and concludes with a brief review of the main medium-term challenges.

B. Revenue Policies

7. **The downward trend in revenue collections has now been reversed, and important efficiency gains have been recorded in tax policy.** The share of revenue collections in GDP in 1999 has rebounded to a level last recorded in 1993—an experience unique among transition economies, which, in general, have witnessed a continuous erosion and eventual bottoming out of revenues. Tax policy has become more efficient: the importance of income- and wage taxation has been lowered, thereby reducing distortions and incentives for rent-seeking activities as well as non-wage labor costs (however, continuous increases in social security contributions—necessitated by increasing imbalances in the pension system—largely offset this beneficial effect). At the same time, more reliance is being placed on broader-based indirect taxes which generally are easier to administer and subject to fewer distortions (see Table II.1).

Table II.1: Composition of Revenue, 1990–2000 1/											
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
	(In percent of GDP)										
Total revenue	39.8	41.9	37.4	33.4	31.2	31.4	29.2	28.6	30.1	33.3	14.2
Income and wage-based taxes	21.8	23.0	24.4	21.0	19.6	18.4	17.0	16.8	16.2	17.7	7.6
Company income tax	7.1	5.1	5.3	3.8	3.8	3.9	3.3	4.3	3.0	3.3	1.1
Personal income tax	6.8	7.6	7.6	6.6	6.5	6.4	6.1	5.5	4.1	3.4	1.5
Social security contributions	7.9	10.3	11.5	10.7	9.2	8.2	7.6	7.0	9.1	11.1	4.9
Indirect taxes	12.0	9.4	8.4	8.7	7.2	8.1	7.9	7.6	10.0	11.0	4.3
Value added tax 2/	11.9	8.3	6.9	3.6	4.6	5.2	4.9	4.6	6.1	6.2	2.7
Excise taxes	0.0	0.0	0.0	3.7	1.6	1.5	1.4	1.7	2.3	3.3	1.1
Taxes on international trade	0.1	1.1	1.4	1.4	1.1	1.4	1.5	1.3	1.6	1.5	0.5
Other taxes and nontax revenue	6.0	9.6	4.6	3.7	4.4	4.8	4.3	4.2	4.0	4.6	2.3
Memorandum items:											
Shares in total revenue (in percent)											
Income and wage-based taxes	54.7	54.8	65.2	62.9	62.6	58.7	58.2	58.7	53.7	53.2	53.4
Of which: Excluding social security contributions	34.9	30.1	34.5	31.0	33.0	32.7	32.3	34.3	23.6	20.1	18.5
Indirect taxes	30.2	22.4	22.4	26.0	23.2	25.9	27.0	26.6	33.0	32.9	30.5
Sources: Data provided by the Romanian authorities and staff estimates											
1/ Data for 2000 refer to developments through June 30, 2000, and are affected by seasonality.											
2/ Prior to 1993, turnover tax.											

8. The following paragraphs take a more detailed look at tax policy and developments in tax administration and also compare developments to the experience of other transition economies. Appendix II-1 summarizes the Romanian tax system as of September 2000, while Appendix II-2 provides a description of changes in income and value-added taxation since 1996.

Company income taxation

9. **Short-run attempts to balance the twin objectives of raising revenue and providing incentives for investment undermined the integrity of company income taxation throughout the 1990s.** The profit tax was introduced in 1990 to replace the communist-era confiscatory profits transfer tax.² However, already early on, further progress in making the tax more efficient was hampered by *ad hoc* and frequently reversed measures on tax holidays and other “tax incentives” (see Box II.2), which were typically based on short-term assessments of the relative importance of revenue collections *vis-à-vis* investment promotion. Far from benefiting investment and employment, these frequent changes and the

² Early reforms centered on a reduction in the number and the statutory level of tax rates. The number of rates, which had amounted to 68 (ranging from 0 to 77 percent in 1991 in an effort to introduce progressivity into company income taxation), was subsequently reduced to two in 1992 (30 and 45 percent), and further to a uniform 38 percent in 1996.

attendant instability of the regime—described as “tax mayhem” by private-sector legal experts—eroded the credibility of tax policy, and made holding out a more valuable option for potential investors.

Box II.2. Tax Holidays and Investment Incentives

In an effort to mitigate the effects of high statutory profit tax rates, especially in the absence of proper inflation accounting on new investment, the authorities found it desirable to introduce tax holidays and other selective incentives into the tax code at numerous stages during the 1990s. The following provides a brief timeline:

- In 1991, generous company tax holidays and investment tax allowances were introduced. Over the next two years, these measures—along with the ongoing economic contraction—contributed to a steady erosion in company income tax collections.
- In an effort to strengthen revenue collections from companies, the 1991 tax holiday provisions were partially rescinded in 1994. However, law 71 of the same year awarded new long-term tax holidays selectively to foreign investors.
- New tax holidays and tax cuts for companies (including on customs duties and VAT) were introduced in 1997 through Emergency Ordinance (EO) 92, and subsequently generalized to a larger class of beneficiaries through law 241 of 1998.
- In order to avoid the sharp loss of revenue implied by the coming on stream of the latter tax cuts, the 1999 budget law suspended for one year all tax holidays and incentives, including those already awarded.
- In an effort to secure a major privatization deal, government passed EO 67 of 1999, granting even more generous selective tax holidays and cuts.
- In mid-1999, a moratorium was put on the implementation of the EO 67 in order to stem the potential loss of revenue and efficiency of the tax code, limiting its application to one company.
- In July 1999 Law 139 was passed which extended the benefits of EO 67 to small- and medium-sized enterprises.
- Beginning in 2000, with the previous suspensions and moratoria set to expire, companies were set to benefit from complete or partial tax holidays which could have been granted through a number of laws or through the discretion of government agencies. Tax holidays would have also been available for actual or planned investments in excess of differing amounts (starting at US\$500,000), for companies of differing sizes (specified in terms of employment or turnover), for reinvested earnings (in some cases without any expiration date), and for investment in areas with high unemployment or other disadvantages.
- Instead, in early 2000, a comprehensive reform of company income taxation was undertaken, reducing the statutory rate, introducing an investment tax allowance, and abrogating and repealing EO67 and Law 139 of 1999, as well as all other provisions suspended in the 1999 budget law.

10. **By the beginning of the year 2000, the corporate tax regime was set to undergo further drastic changes.** The need to increase revenue collections had led to the imposition of various one-year moratoria on, and suspensions of, tax holidays in 1999. On the one hand, with the lapse of these moratoria in 2000, large-scale revenue losses, estimated at 2 percent of GDP, and stark distortions of business taxation would have resulted. On the other hand, the statutory taxation of companies in Romania was considerably more onerous than elsewhere in the region. The statutory tax rate of 38 percent was the second highest in Eastern Europe and—given the absence of proper inflation adjustment—implied the highest *effective tax rate on investments* (ETR) in the entire region, more than twice as high as in the country with the second highest taxation (see Table II.2).³ The available tax holidays would have put company taxation to the lowest comparable level, at less than half the next lowest ETR (see Bergsman, Chen, and Mintz (1999)). Since not all companies would have benefited from these holidays, stark tax distortions would have arisen, which would have been compounded by the effect of inflation on taxable income. With high levels of inflation, no proper adjustment of tax liabilities, but unlimited deductibility of interest expenditures for taxable profits, the tax system was extremely tilted in favor of companies able to raise debt finance.⁴

³ ETR is an analytical construct which aims to relate an investment project's actual tax liability to its before-tax income in economic terms (i.e., including the effects of depreciation, operating expenses, inflation, etc.). The ETR can be either lower or higher than the statutory rate. It would be lower, if, for example, tax holidays reduce tax liabilities. It could be higher, if company profits were affected by inflation, but the value of the investment and depreciation allowances were not benefiting from revaluation.

⁴ In environments of high inflation and liberalized interest rates, actual interest payments include a large component of monetary correction, *de facto* amortization payments. Full deductibility of interest expenditure from taxable profits may, thus, result in extremely low—potentially negative—taxation of investments and thereby provide an incentive for excessive accumulation of corporate debt (see Mintz, 1990).

Table II.2: Comparison of Company Income Taxation		
	Statutory Rate	Effective Rate 1/
Romania		
End-1999	38	45.4
2000 in absence of reform 2/	38	4.3
2000	25	21.0
Neighboring countries 3/		
Czech Republic	35	10.9
Hungary	18	13.1
Poland	34	22.1
Slovakia	40	16.9
Slovenia	25	12.4
Sources: Bergsman, Chen and Mintz (1999); and staff estimates.		
1/ Estimates for the manufacturing sector.		
2/ Indicates the situation where suspensions and moratoria expired.		
3/ Assumes that investments benefit from all available incentives, including tax holidays.		

11. **The 2000 reform has greatly improved the investment climate, and brought Romania's company taxation more in line with regional standards.** Most importantly, all previous tax-holiday and investment-incentive legislation was abrogated and the statutory tax rate lowered from 38 to 25 percent, while an investment tax allowance of 10 percent was introduced, which established an indirect inflation adjustment into the tax code.⁵ After the reform, the effective taxation of investments is close to the levels in Poland and Slovakia.⁶ Moreover, the expected deceleration in inflation should also mitigate the detrimental incentives posed by unlimited deductibility of interest expenditures.

12. **However, some challenges remain.** The lower taxation of company income arising from exports—subject to an estimated ETR of only 1 percent—has introduced new distortions and administrative difficulties, and, in due course, will lead to calls for similar beneficial taxation from other sectors.⁷ Subject to overall fiscal resource availability, a preferable approach would have been a further lowering of the standard rate, eschewing the

⁵ A new distortion was, however, introduced with a preferential 5 percent rate for profits arising from export activities.

⁶ It is worthy to note that the lower ETRs in the Czech Republic and Slovakia reflect their respective tax holiday provisions. Without tax holidays, investments in these two countries would face a significantly higher ETR than in Romania.

⁷ The tax is assessed by applying the share of export proceeds in total company turnover to taxable company profits. This assessment poses obvious incentives for overreporting export earnings.

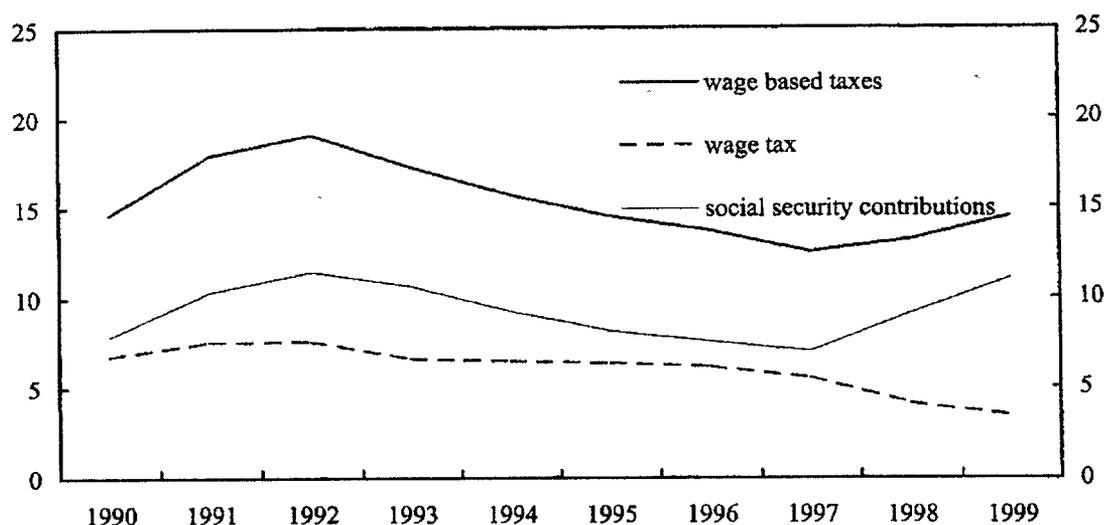
introduction of sector-specific rates. Another challenge will be to strengthen centralized authority in the area of tax policy so as to end the practice of special agencies (for example, the Romanian Development Agency or the Agency for Regional Development) initiating tax holidays. Such noncentralized power to grant sector-specific tax incentives has done much to undermine the credibility and stability of the tax system, and every effort should be made to avoid a relapse into past practices.

Wage-based taxes

13. Considerable progress has been recorded in modernizing personal income taxation and reducing adverse incentives for employment throughout the decade. However, the perilous state of the pension system, as well as attempts to introduce a broad wage-taxed financed social welfare system, have prevented a lowering of non-wage labor costs, imparted through wage-based taxes.

14. Overall wage-based taxation has been driven by diverging developments in personal income taxation and social security contributions (see Figure II.1). In the early

**Figure II.1: Trends in Wage-Based Taxes, 1990–99
(In percent of GDP)**



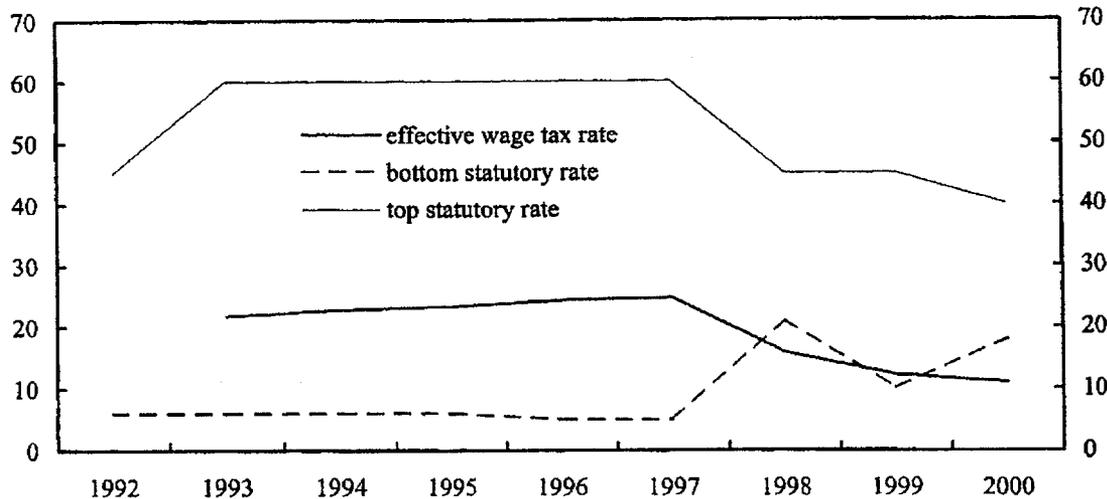
transition period, the share of both components in GDP increased sharply, reflecting mainly the regressive bias imparted by bracket creep in a high-inflation environment and the increasing share of labor in GDP. However, successive tax cuts, adjustments in brackets, as well as weaknesses in tax administration had by 1997 resulted in lower collections of wage-based taxes than in the pre-transition period. For wage taxes, this trend continued unabated, as new tax cuts resulted in a further reduction in personal income taxes. However, collections

of contributions picked up again in 1998 when the by then precarious state of pension fund finances resulted in the first drastic increase in social security contributions.

Personal income tax

15. **The burden of personal income taxation has been drastically reduced.** In 1992, Romania had a personal income tax schedule with 13 brackets and marginal rates from 6 to 45 percent. There was no general allowance level—i.e., income became taxable with the first leu earned—except for special cases (e.g., participants in the 1989 revolution).⁸ The top marginal rate was further increased to 60 percent in 1993, but the number and classes of exempted tax payers continued to grow. Recognizing the pernicious effects of such high marginal tax rates, as well as the strong pressure for exemption of additional groups, the authorities rolled back the increase of the top rate in 1997 and 98, reduced the number of brackets, and decreased the spread between the top and bottom rates. However, the addition of new exemptions, as well as the attendant administrative difficulties, led to sharply reduced effective tax rates—as measured by the difference between average gross and net wages—so that in 1998 the effective tax rate was 16 percent, well below the statutory minimum of 21 percent (see Figure II.2).

**Figure II.2: Trends in Statutory and Effective Wage Tax, 1992-2000H1
(In percent)**



16. **The income tax reform of 2000 aimed at broadening the base while further reducing marginal rates, and lowering the tax burden on low-wage earners.** In January

⁸ Tax credits were, however, available, according to the number of children in a household.

2000, the previous schedular system was replaced by a global income tax law, which covers all sources of personal income. However, difficulties in administration will ensure that the tax will continue to be predominantly based on withheld wage taxes.⁹ Against the background of the adverse incentive effects of high top marginal rates, the reform also included a further reduction in the top rate to 40 percent with a simultaneous increase of the bottom rate to 18 percent (thereby lowering the spread from 35 percentage points to 22 percentage points). So as to mitigate the impact on low-income earners, the general tax free allowance was more than doubled to about 40 percent of average wages.

Social security contributions

17. **Following significant increases in statutory social security contribution rates, there are signs that collections in relation to GDP have now reached an upper limit.**¹⁰ After initial increases in 1990 and 1991, statutory social security contribution rates were kept unchanged at 35 percent of gross wages through 1997.¹¹ The statutory rate was increased to 43 percent in 1998 and 60 percent in 1999, reflecting both the establishment of the National Health Insurance House modeled on the German system, as well as the dramatic deterioration in the finances of the pension fund (see below). Apart from the large implied increases in nonwage labor costs—*ceteris paribus* equivalent to a 25 percent increase in real wages over two years—and the attendant adverse effects on employment and inflation, these increases also resulted in sharply lower compliance (see Table II.3). Moreover, the level of contributions is now by far the highest compared to the region and western Europe.¹²

⁹ Incremental withholding taxes on other income are, however, being introduced, for example, on pension income exceeding two million lei as of July 2000.

¹⁰ Social security contributions currently are collected by the pension and unemployment funds, health insurance, the risk, accident, and handicapped special funds, as well as a special fund used to top up wage payments in the education sector.

¹¹ The contribution rates quoted in the text are based on the standard pension contribution rate (currently 35 percent). Special higher contribution rates of 40 or 45 percent apply in industries eligible for special early retirement benefits (e.g., mining and railways).

¹² The statutory rate of 60 percent in Romania compares to 50 and 47.5 percent in the Slovak and Czech Republics, to 41 percent in Hungary, 43 percent in Poland, an EU average of 36.5 percent, and 25 percent in the OECD (see Christou (2000)).

	1997	1998	1999	2000H1
Statutory social contribution rate (in percent)	35.0	43.0	60.0	60.0
Outstanding arrears to pension fund (in percent of GDP)	0.6	1.0	2.5	2.6
Number of civil contracts (in thousands)	...	...	3,100	...
Number of labor contracts (in thousands)	5,415	5,187	4,785	...
Estimated degree of compliance 2/	53.5	52.6	46.8	44.0

Sources: Data provided by the Romanian authorities.
 1/ Data for 2000 refer to the first six months.
 2/ Estimated on the basis of actual contributions collected by potential contributors.

18. **Declining compliance was facilitated on the one hand by attempts at needed labor market liberalization, and, on the other hand, by increasing tolerance to nonpayment of obligations by large public enterprises.**

- In an effort to stimulate part-time employment, so called “civil contracts of employment” were introduced in 1995. These were intended to be constrained to small-time and contractual employment, which was at the time thought to not require pension coverage. Accordingly, such contracts were only made liable to wage tax and health insurance contributions. Subsequently, employment under such contracts witnessed sharp increases—in contrast to the ongoing and unchecked decline in employment governed by standard labor contracts subject also to pension and unemployment contributions. Reflecting the urgent need for labor market liberalization, the growth was not confined to part time jobs, as regular employment relations became increasingly governed by such civil contracts.
- At the same time, contribution arrears by large state owned companies—many of them in sectors subject to higher-than-standard pension contributions—were allowed to balloon.¹³ The resulting increases in arrears are even understated given the low penalty rate over much of the last four years, that permitted an erosion of the real value of these arrears. While the pension fund was given legal means to enforce better payment performance—notably through seizing bank balances and shipments or deliveries, as well as the option to convert such debt into shares for sale to investors—concerns about the adverse employment effects of such actions have in the past prevented a more forceful enforcement of payments due.

19. **There is an urgent need to reverse the unsustainable level and composition of social security contributions.** In an effort to increase the number of contributors, in May

¹³ The biggest debtors to the pension fund are concentrated in steel production, refineries, and the railways, all subject to an overall 70 percent social contribution rate.

2000, the authorities took steps to increase the tax base by subjecting civil contracts to all social security contributions.¹⁴ However, it is doubtful, as early revenue collections indicate, that the resulting 41 percentage points rise in non-wage labor cost for such contracts will generate additional revenue as opposed to further tax evasion (for example, by shifting work into uncontracted arrangements, which would in addition result in a loss of wage tax revenue so far collected under civil contracts). At the same time, the buildup of arrears to the pension fund has continued unabated. While in the recent past, the reductions in the personal income tax have mitigated the adverse effects of higher social contributions on the cost of employment, such mitigation is unlikely to be available in the future given the now rather low level of personal income taxation. Instead, it is now imperative to enforce strict payment discipline, and to dramatically turn around the financial position of the pension system (see below), to be able to improve incentives for employment.

Indirect taxes

20. Over the last decade, substantial progress was made in introducing a modern system of indirect taxes. However, collection efficiency has considerably fallen short of potential, reflecting both genuine administrative difficulties, but also inconsistent attempts at steering the tax burden into politically desired directions. With a reform in early 2000 undoing much of such unproductive regulation, it is now important to concentrate on urgent administrative improvements.

Value-added tax

21. **VAT collections have only recently begun to reverse the downward trend since the inception of the tax.** The VAT was introduced in mid-1993 to replace the turnover tax. With a statutory rate of 18 percent, international experience would have suggested that revenue collections of 9 percent of GDP were well within reach. However, actual collections declined from 5.3 percent of GDP in 1993 to 4.6 percent in 1997, with the effectiveness of the tax—i.e. the share of actual to theoretical collections—on a downward trend (see Table II.4).

¹⁴ The number of contributors, at 5.3 million, is only 55 percent of the active population.

Table II.4: VAT indicators, 1993–2000 1/								
	1993	1994	1995	1996	1997	1998	1999	2000
Statutory rate (in percent)								
Standard rate	18.0	18.0	18.0	18.0	18.0	22.0	22.0	19.0
Reduced rate	18.0	9.0	9.0	9.0	9.0	11.0	11.0	n.a.
Number of exempted groups of goods	0	...	...	11	18	19	19	3
Effective rate (in percent)	8.2	6.9	7.5	6.7	5.8	7.6	8.0	7.0
Collections (in percent of GDP)	5.3	4.6	5.2	4.9	4.6	6.1	6.3	6.0

Sources: Data provided by the Romanian authorities; and staff estimates.
1/ Data for 2000 pertain to the first 6 months.

22. This poor performance reflects the fact that, from its inception, tax administration became heavily burdened by a large number of exemptions and multiple rates, and by difficulties of tax administrators in adjusting to the fundamental difference in the nature of the VAT from the previous turnover tax:

- **Multiple rates were quickly introduced.** While the VAT was introduced with a uniform rate of 18 percent, a reduced rate of 9 percent was added shortly thereafter in 1994. The lower rate was designed to cover basic and educational goods, but, in rapid additions, also began to apply to public transport and newspapers. Moreover, in sharp contrast to international practice which, in line with the “destination principle,” levies a zero rate only on exported goods,¹⁵ Romania also subjected domestic consumption goods like electricity and gas to a zero VAT rate.
- **Large scale exemptions were provided.** Initially reflecting an attempt to further cushion the adverse impact of a consumption tax on poorer households, entire classes of goods were exempted. However, further exemptions were provided for services provided by self-employed, many of which did not command a high proportion in poor households’ consumption baskets (such as lawyers’ services, cultural performances, and spa holidays).
- **The tax authorities took time to adjust to the administrative requirements of a VAT.** The self-enforcing element of the VAT was greatly weakened by the delay in adjusting tax administration to the difference between a final consumption tax and a turnover tax. In particular, a successful VAT depends on the prompt payment of credits to taxpayers for VAT paid on inputs, particularly for exporters. However, a conservative approach toward processing requests for reimbursements led to long delays, during which, in addition to the carrying costs for the tax payer, high inflation

¹⁵ The zero rate would also apply to international transportation and diplomatic purchases.

substantially reduced the real value of the eventual credit, and in practice reintroduced some of the distortions of the earlier cascading turnover tax. Moreover, the delayed processing of reimbursements and refunds undermined the self-enforcing character of a VAT, i.e., for producers to register and pay VAT, so as to be able to claim such credits; and incentives for evasion remained large.

- **The VAT was used as a tool for providing business incentives.** Recognizing the adverse impact of delayed reimbursements for company profitability, the authorities found themselves compelled early on to award selective VAT exemptions to specific companies (see Box II.2). However, the award of such exemptions for one company only triggered demands for similar treatment from additional companies, notably competitors and suppliers, thereby undermining the base of a successful VAT, which for its proper functioning, needs to rely on an unbroken chain of tax payments and invoices through all stages of production up to final consumption.

23. **A comprehensive VAT reform to redress these problems was launched in 2000.** An initial attempt to improve the revenue yield in 1999 relied on an increase in statutory rates, but had limited success, as further requests for exemptions or coverage at the lower rate proved impossible to ignore. In contrast, the reform launched in January 2000 included the following elements designed to move the VAT closer to an ideal type, embodying a single positive rate, zero-rating for exports, and as wide a tax base as possible:

- **The statutory rate was lowered and unified.** While the standard rate was reduced from 22 percent to 19 percent, it is still higher than the 18 percent rate in place through 1996. In addition, the reduced rate was abolished, thus effecting a VAT increase of 7 percentage points on goods previously taxed at the lower rate of 11 percent. Moreover, Romania is now one of the few countries in Europe with a uniform rate—albeit a comparatively low one.¹⁶ Finally, the zero rate is now limited to exports. Actual collections through mid-2000 suggest that this reform has been almost revenue neutral.
- **Exemptions were reduced from 19 groups to three.**
- **The processing of credits and refunds was speeded up.** In a first step, export-oriented large-scale companies were beneficiaries, but the new procedures are expected to quickly benefit all other tax payers.
- **Selective company-specific VAT exemptions were generally revoked.** Against the background of speedier processing of VAT reimbursements, the demands for company-specific VAT exemptions were expected to drop, and most such

¹⁶ Other transition countries typically have standard rates in excess of 20 percent, but also (sometimes multiple) lower rates. Among countries with a uniform rate, Romania's 19 percent is lower than the 25 percent in Denmark, but higher than the 17.5 percent in the United Kingdom (see Christou (2000)).

arrangements have now been cancelled. However, to the extent that they do remain (primarily in politically important enterprises), they still constitute an anomaly that severely impedes the proper functioning of a VAT and would best be phased out at the earliest possible opportunity.

24. **The stage is now set for a major improvement in VAT performance.** International experience would suggest that with the reform in place, a significant increase in VAT collections, up to at least a level of 9 percent of GDP over the next several years, should be possible. This would imply a 30 percent increase in real VAT collections, and should serve as a yardstick in designing tax administration improvements.

Other indirect taxes

25. **The administration of excise taxes has been subject to frequent and contradictory shifts, and continues to be plagued by poor collection performance as the tax authorities continue to play catch-up with tax avoiders.** Excises were introduced in 1993, as part of the tax reform program abolishing the turnover tax. They are levied on petroleum, alcohol and tobacco products, as well as passenger cars and selected luxury goods. From the beginning, their administration proved difficult, and the authorities undertook numerous reforms to tackle the underlying problems. Initially levied at specific rates, their yield was quickly undermined by rapid inflation. However, the change to *ad valorem* rates did not significantly improve matters as the tax authorities found it difficult to detect cases of declared undervaluation of the excisable product. To address the latter problem, excises were returned to a specific valuation, but in euro terms, thereby obviating the need for frequent inflation adjustments. However, tax evasion quickly shifted to redenominating excisable products into non-excisable ones, resulting in a 15 percent fall in real excise collections in the first 8 months of 2000. Recently modified legislation now seeks to put less ambiguous definitions of excisable products in place.

26. **Revenue from trade taxes increased quickly in the early stages of transition, but has recently been declining.** With the opening of trade and the tariffication of quantitative restrictions, customs receipts increased from close to zero to 1.5 percent of GDP in 1993. This level has on average been maintained through 1999, notwithstanding further trade liberalization and the proliferation of exemptions. However, in view of the build up of significant current account pressures, the authorities felt compelled to introduce a general import surcharge of 6 percent in 1998. The surcharge has since been reduced to 4 percent in 1999, and 2 percent in 2000, and is scheduled to be eliminated in 2001. Reflecting continued difficulties in customs administration, trade tax collections are currently projected to fall some 25 percent in real terms to 1.1 percent of GDP in 2000, and can be expected to fall lower still, given the need to lower tariff rates in preparation for EU accession.

C. Expenditure Policy Issues

27. After large increases in fiscal cum quasi fiscal expenditures in the first half of the decade, a corrective tightening has been achieved, setting the foundation for improved fiscal sustainability. By 1996, unsustainably large spending had resulted in a debt level which had become burdensome to finance. The stabilization effort begun in 1997 effected a drastic

reduction in primary spending, accommodating the higher interest costs and making an important contribution to an improved fiscal position in the future. However, the pension system has clearly become unsustainable. The following paragraphs will discuss some of the relevant issue in more detail.

Personnel expenditures

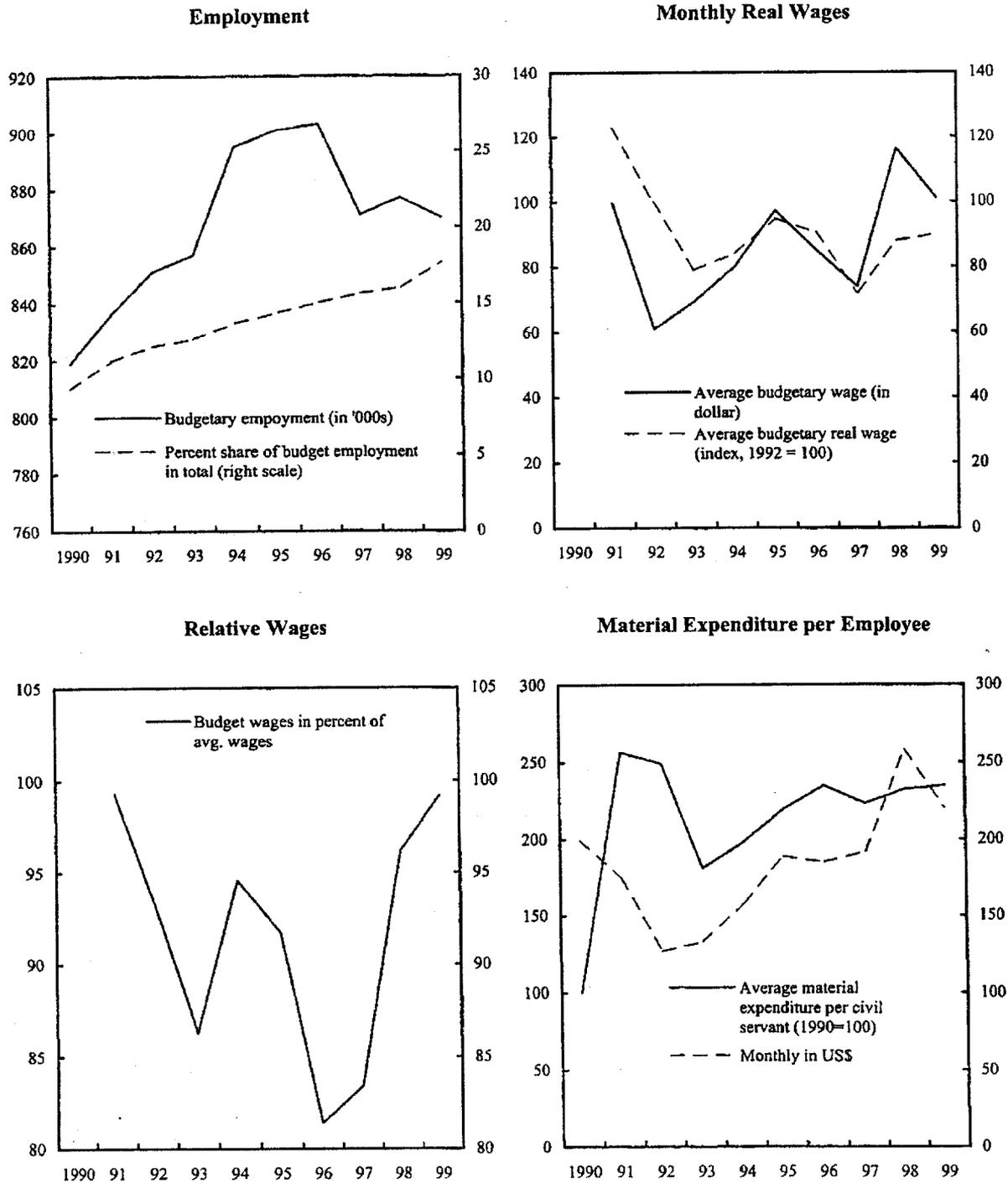
28. **Throughout the decade, attempts at expenditure consolidation were complicated by difficulties in trimming personnel outlays.** While the share of government wage expenditures in GDP up to 1996 was about in line with other transition countries, the share of wage expenditures in total government expenditures, at some 20 percent was relatively high.¹⁷ A drastic cut in wage expenditure effected in 1997—resulting from sizeable reductions in employment and wages—proved not to be sustainable, and wage expenditure has subsequently inched up again. The following points discuss the reasons behind these developments in some more detail (see also Figure II.3).

- **Despite the move from plan to market, government employment has increased over the last decade** (Figure II.3, Panel 1). In the first six years of the 1990s, the budget had increasingly assumed the role of employer of last resort, and government employment had grown some 10 percent to more than 903,000 by end-1996. Notwithstanding repeated attempts, it has proved politically difficult to reverse these increases, and employment has been reduced only by some 4 percent to 870,000 at end 1999.¹⁸ In fact, reflecting the ongoing restructuring in the rest of the economy, and the resulting decline of formal employment, the share of government employment in total employment has continued to increase, from 9.4 percent in 1990 to 17.7 percent in 1999.
- **Early attempts at reducing remuneration proved unsustainable** (Figure II.3, Panel 2). While real wages and dollar wages declined by one third between 1990 and 1993, difficulties in maintaining morale and attracting qualified applicants, and the electoral cycle all put pressures on salaries in the following years. Against this background, average monthly government wages have risen to a historic high of US\$110 by mid-2000, driven by initial wage increases in the education and defense and security sectors, which proved themselves politically hard to withhold from other government employees.

¹⁷ This observation pertains to reported personnel expenditure. To the extent that countries include some personnel spending (e.g., for sub-national government levels) in transfer spending, this statement would need to be qualified.

¹⁸ These numbers exclude employment in the defense and security sectors, which amounted to some additional 130,000.

Figure II.3. Romania: Indicators of Government Personnel Expenditure, 1990-99



Source: Data provided by the Romanian authorities.

- **Government wages have caught up again with wages in the rest of the economy** (Figure II.3, Panel 3). Arguably reflecting higher job security, wages in the government sector, which started out at close to the average wage level in the entire economy, initially fell behind wages in the rest of the economy, so that by 1996 the average civil service wage had fallen to some 80 percent of the economy-wide average. Since then, partly owing to lower wage growth in public enterprises, the differential has been largely eliminated, and with the hefty wage increases accorded recently, is projected to reach a historic low in 2000.
- **Efforts were also undertaken to secure critical operating outlays** (see Figure II.3, Panel 4). While initial efforts at controlling budget spending early in the 1990s were centered on cutting operating expenditures—also resulting in the accumulation of some arrears—the ensuing decline in the quality of public services necessitated increases in material allocations. Moreover, the establishment of a self-financing medical insurance scheme in 1998 helped to secure funding for medical services, which had suffered in prior years.

29. **Making up for lost time, and reducing the size of government will be a key challenge in improving fiscal sustainability.** The twin objectives of limiting the drain of government on the private economy, as well as improving the quality of government services will require a significant cut in overstaffing. On the assumption that a self-supporting growth process has taken hold in the economy, and that productivity is set to rise, there will be pressure on wages in the private sector, especially for critical skills. Moreover, further efficiency improvements through use of technology will likely result in higher material expenditure per employee. Government will only be able to compete for the needed skills as well as improve its operations if employment is cut. The government has announced plans in this direction which were, however, delayed in the run up to the elections.

Pensions

30. **Romania entered the 1990's with an already unsustainable pension system.** While nominally a pay-as-you-go (PAYG) defined-benefit (DB) system, the financial health of the pension system was compromised by the extension of pension benefits to non-contributing employees—notably farmers and employees in agricultural enterprises—while contributions were kept at a level too low to cover the implied replacement rate. In addition, the benefits were based on only a fraction of a worker's work history.¹⁹ On the other hand, with a relatively young population, demographic trends did not imply a worsening of the pension system's finances.

31. **Subsequent pension policy compounded the initial problems.** Chief among the adverse policies pursued was the large expansion of the number of pensioners through legislative fiat, by introducing generous early retirement regulation, which has massively

¹⁹ The benefit formula calculated a worker's pension at 75 percent of the average wage earned in the in the five best consecutive years in the previous 10-year period.

undermined the previously benign demographic trends (see Figure II.4).²⁰ Furthermore, the DB link between a worker's wage- and employment history and pension benefits was further weakened, most notably in 1996 when, in response to the political fallout of declining real pensions, the government passed a decision linking all pensions to the economy-wide average wage.

32. **In the absence of comprehensive reform, past "fixes" have compounded the underlying imbalance.**

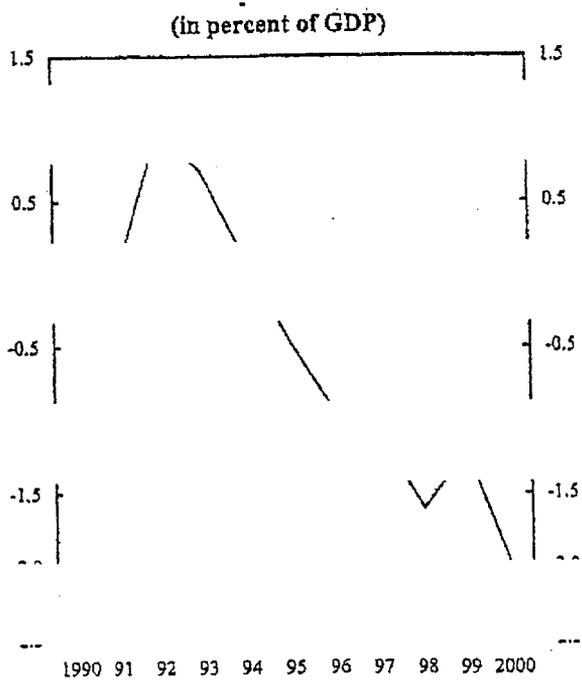
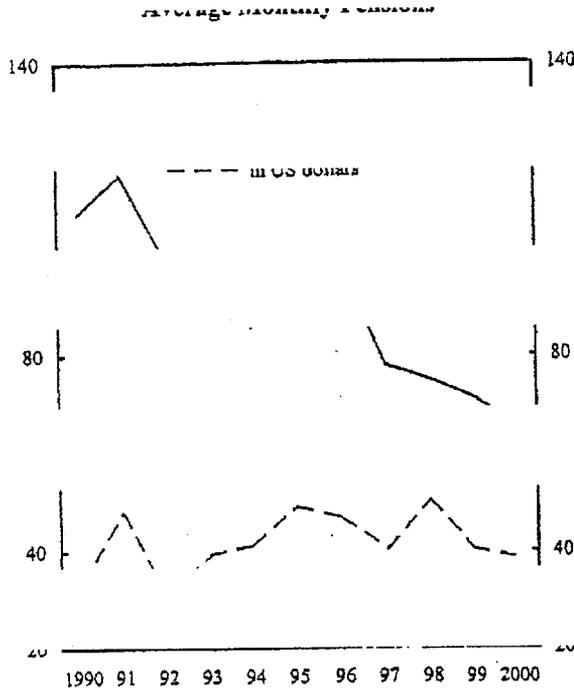
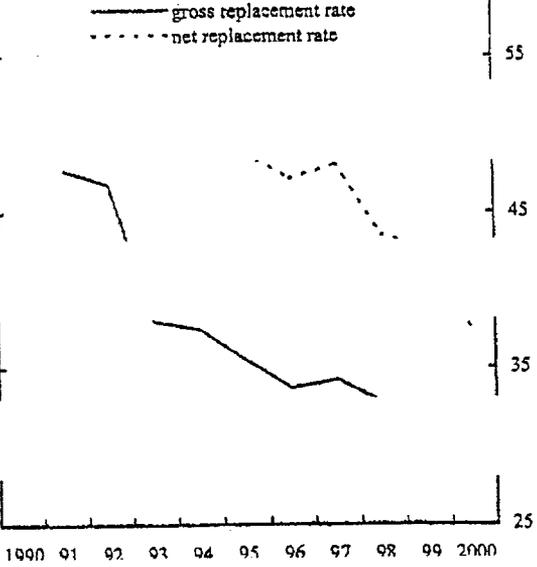
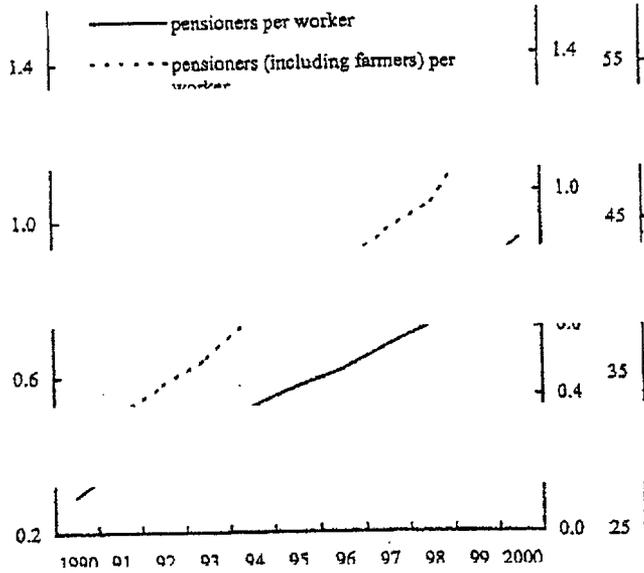
- In the first place, **social security contributions** were increased in steps (see above). The large increases also raised non-wage labor costs of employment, thus contributing to higher unemployment as well as enhancing incentives for tax evasion. These adverse dynamics have materialized in a fall in the number of contributors to the social security system—at a time when the working age population actually increased by some 0.3–0.5 percent per year. Moreover, with lacking enforcement of financial discipline, large-scale and loss-making state-owned enterprises started to default on the employer contributions outright, which has led to a decline in the effective contribution rate collected. Finally, in conjunction with the very high contribution rates, the generous early retirement provisions have implied a very high implicit tax on additional work, further undermining the sustainability of the system (see Sin (2000)).²¹
- With efforts to increase pension fund revenue thus being met by only partial success, the **curtailment of benefits** assumed key importance. Efforts in this direction have progressed along two lines: first, the distribution of pensions was compressed by

²⁰ In 1991, a comprehensive early retirement scheme was introduced which increased the number of pensioners by almost 40 percent (see De Menil and Sheshinsky (2000)). Subsequent modifications relaxed early retirement provisions further for workers in selected employment categories, while at the same time greatly expanding the definition of these eligible categories. At the beginning of the decade, some 300,000 workers qualified for these categories, as compared to 2.3 million at present.

²¹ In conjunction with the absence of a penalty for early retirement—and the *de facto* option to work in the informal sector after retirement—the high contribution rates imply a very high tax on one additional year of work. The implicit tax amounts to the wage tax, plus the loss of one year equivalent of the lifetime present value of the pension. This becomes even more true to the extent that workers have been able to use ambiguous definitions so as to claim a disability pension when they have not yet achieved the necessary number of working years for a full pension. The number of disability pensions has tripled between 1990 and 2000, and now stands at 600,000.

Dependency Rate

Replacement Rate



capping increases in high pensions while ensuring a higher rate of increase in low pensions—further eroding the DB mechanism.²² Secondly, pensions have been increased by less than the rate of inflation. However, both “solutions” had adverse implications. On the one hand, in the last three years, a cycle has emerged, in which a round of pension compression was followed by a round of “decompression”, while, on the other hand, caps on real pension benefits were being secured throughout by incomplete inflation adjustment. However, as much as inflation has permitted a control of real pension benefits, it has by the same token introduced ever larger demands for pension increases, heightening concerns about the sustainability of the pension system.

- There have also been attempts at **structural reform**, so as to rid the system of non-core, non-insurance activities. In this vein, the farmers’ pension fund was abolished in August 2000, and folded into the public pension system. While the financial base of that fund had been narrow and underperforming, the measure nevertheless further worsened the financial situation of the existing system as no new revenue source was specified. Moreover, the authorities tried to widen the net of contributors in mid-2000 by subjecting workers under “civil contracts” (mostly part-time contracts) to full social security contributions (see above). However, the outcome has been mixed, reflecting both the high incentive for tax evasion given the implied effective doubling of the marginal wage tax rate, as well as the very poor administrative capacity for handling the new contributors.

33. **The pension system is now unsustainable in a number of dimensions.**²³ The system is headed toward a dependency ratio (the number of pensioners per contributor) of 1 and higher, while statutory contribution rates have become unproductively large (they are on the wrong side of the Laffer curve), and pensions have reached an historic low. Meanwhile, the deficit of the pension system continues to increase.

- **An ever growing number of pensioners is met by continuing declines in the number of contributors.** Under the present system—with statutory early retirement,

²² There were some 50 indexation adjustments of pensions during the 1990s which, however, did not reverse the erosion of real pensions (De Menil, Hamayon and Seitan, 1999). Indexation increases were agreed between the Ministry of Labor and trade unions as well as employers’ and pensioner’s organizations. While initial increases were substantial and drastically increased the real value of pensions compared to preceding months, rampant inflation and delays in the following indexation resulted in steadily declining real pensions.

²³ The same—however in even more drastic form—holds true for the farmers’ pension system. With a very small number of contributors (around 80,000), the farmer’s system supports 1.7 million pensions (up from a level of less than 1 million in 1989). Notwithstanding past and ultimately unsuccessful attempts to broaden its financial base by earmarking a food products tax, the system delivers only extremely small pensions.

selective early retirement for large segments of the workforce, and a ballooning number of disability pensions—workers retire on average at age 54 (men) and 50 (women), with just under 30 and 25 years of service, respectively. They are legally entitled to a lifetime pension of some 50 percent of their best 5 years of earnings—typically, given Romania's inflation levels, the last 5 active years—while the life expectancy at pension age is 15 years for men and 22 for women (Sin (2000)). These factors have resulted in almost a doubling in the number of pensioners between 1989 and 2000. At the same time, the number of contributors has fallen by almost 40 percent.

- **Contribution rates have reached excessive levels.** They are not only extremely high by international standards, but imply further incentives for early retirement and tax evasion, as evidenced by the decline in compliance estimated above.
- **The replacement rate has continued to fall and put pensioners at a high risk of poverty.** Both net and gross replacement rates are now less than 75 percent of levels recorded in 1993, with much of the decline having occurred in the last four years. An average monthly pension now amounts to some US\$40. Given these developments, pensioners, who in the early to mid-1990s tended to be relatively better off than other population segments, have recently been identified as one of the major groups threatened by poverty.
- **Deficits of the pension system have continued to mount.** After recording surpluses through 1994, the pension system had to subsequently rely on transfers from the central government budget to balance its books. By 1998, the deficit had amounted to 1.5 percent of GDP, and recent World Bank estimates project a deficit of some 2 percent of GDP for 2000.
- **In addition, the current system also fails the test for fairness, from both an inter- and intra-generational perspective.** Regarding the first, it burdens future generations with ever higher contribution rates and/or lower replacement rates. Regarding the second, the lack of a proper DB mechanism implies net transfers to workers with less-than-complete work history.

34. **Demographic trends have now also turned sharply adverse.** According to World Bank projections, Romania's population is projected to fall from 22.6 million to 19 million by 2050 (see Table II.5). During this period, the population will age rapidly, and the old-age dependency ratio will double. With these trends, a World Bank study has estimated that an unchanged pension system would require further increases in contribution rates (from 37.5 percent today to 60 percent in 2050) or lower replacement rates, from more than 30 percent at present to less than 20 percent in 2050 or a combination between these two (see Sin (2000)).

	1999	2000	2025	2050
Population (in millions)	22.4	22.3	20.6	19.1
Old age dependency rate	31.2	31.2	40.2	62.4
Life expectancy at birth (male/female)	66.0/73.7	66.2/73.8	69.4/76.2	72.4/78.5
Life expectancy at age 20 (male/female)	48.6/55.8	48.7/55.8	51.5/58.0	54.3/60.1
Life expectancy at retirement (male/female)	14.5/21.6	14.6/21.7	16.7/23.6	18.8/25.5

Source: Sin (2000)

35. **Reform has been initiated.** As a stop-gap measure, the authorities have identified urgent steps, which are slated to become effective next year. The self-employed are to be made subject to social security contributions; a “points system” linking wage history and benefits modeled after the German system, and designed to limit the replacement rate to 45 percent, is to be introduced;²⁴ all pensions are to be indexed to the CPI; and the retirement age is to be increased by two years initially, and subsequently by another three years over a 13-year period.²⁵

36. **But more will need to be done.** Even with these reforms, the financial decline of the public pension system is only projected to be arrested, but not reversed, with a deficit of 2 percent of GDP in 2001, falling only to 0.7 percent by 2005, and—after dramatically increasing in the interim—again reaching 1 percent of GDP in 2050. Moreover, the effect of these reforms will still need to be seen once they are implemented, and may in general not provide much of a short-term relief: given the very high contribution rates, the general extension of the obligation to contribute is likely to result in increased tax evasion;²⁶ the

²⁴ The points system is designed to take into account a worker’s entire wage and employment history by assigning scores to every year of contributions. The score (points) will be a function of the worker’s monthly gross wage during any given year in comparison to the economy-wide monthly gross average wage in that same year. At retirement, a worker will have a number of points given by the sum of all the yearly scores. The system is to be calibrated by valuing the points such that a hypothetical newly retired individual who has worked each year of its work history at the economy-wide average wage will achieve a replacement rate of 45 percent.

²⁵ The initial increase in the statutory retirement age to 62 for men and 57 for women only restores the legal statutory retirement age, which was previously subject to a generalized 2-year early retirement.

²⁶ International evidence suggests that coverage of the self-employed is unlikely to raise significant revenue, as the administration of self-employed contributions is usually too

(continued)

maximum replacement rate guaranteed under the new law is still significantly larger than the current effective replacement rate of some 35 percent (a 14 percent increase) and—should this prove unaffordable—could no longer be adjusted in real terms by inflation, given the explicit full indexation mechanism; and the envisaged initial increase in the statutory minimum retirement age has reportedly triggered a substantial increase in early retirement in 2000, thereby already eroding the potential savings, and in any event will need to be protected by tightening eligibility requirements for disability pensions. The fact that the current legal minimum retirement age of 60 and 55 years for men and women, respectively, has been consistent with actual average retirement ages of 54 and 50 years highlights the need to tighten administrative procedures.

37. **A more comprehensive reform will need to tackle the underlying problems in the public system, and tough choices will need to be made.** As long as contribution rates persist at current levels, tax evasion will persist, or—if enforcement were considerably toughened—significant additional unemployment would arise from the implied increase in the effective cost of employment. A reduction in statutory contribution rates is, therefore essential. More ambitious increases in the retirement age may also need to be considered.²⁷ Also, bringing the female retirement age in line with the male retirement age might be a useful measure. In any event, the outright elimination of, or drastic cuts in privileged pension categories will be essential, while tightened eligibility requirements for disability pensions and maternity leave need to be introduced, preferably accompanied by shifting their financing to the general government from the pension system. Moreover, it needs to be recognized that social protection schemes—such as the past “compressions”—have no place in DB entitlements, but should, instead, be met by budgetary social policy.

38. **There is no “silver bullet” which can obviate the need for difficult reform.** In particular, while being an essential addition to a sustainable pension system in the longer term, the introduction of a private fully funded pension system in the current circumstances may be premature.²⁸ It will cut contribution revenue—by siphoning off previous contributions from the PAYG system to the funded system—while leaving the PAYG pension liabilities unchanged. In the short term this will increase the deficit, resulting in a transitory gap of some 1.5 percent of GDP over the next years, according to recent World

complicated. Thus, many countries do not even try to mandate the self employed into contributions.

²⁷ Given the projected demographic trends, this may also be required by economic efficiency considerations as it may well prove economically too costly to retire experienced workers early..

²⁸ World Bank projections indicated that a joint PAYG/funded system could achieve a cash surplus of 0.5 percent of GDP in the year 2050, as compared to a deficit of one percent of GDP under an exclusive PAYG system.

Bank estimates.²⁹ Such transitory gaps are a normal feature of introducing a funded system, and countries have typically relied on one or a mixture of the following mechanisms to cover the gap: cutting benefits; raising contributions, earmarking privatization revenue, or issuing debt. The difficulty is that none of these options is very attractive—or even feasible—in the current Romanian circumstances: the pension benefits and contributions have already reached unsustainably low and high levels, respectively; privatization revenue is projected to dry up, while issuing new debt and the attendant interest costs in fact will amount to a straightforward transfer of budgetary funds to the holders of such debt, which may not at this point be the best (or fairest) use of scarce public pension fund resources. Moreover, given the poor record of financial market development and supervision (see Chapter IV), some considerable caution is in order before private fund managers are licensed.

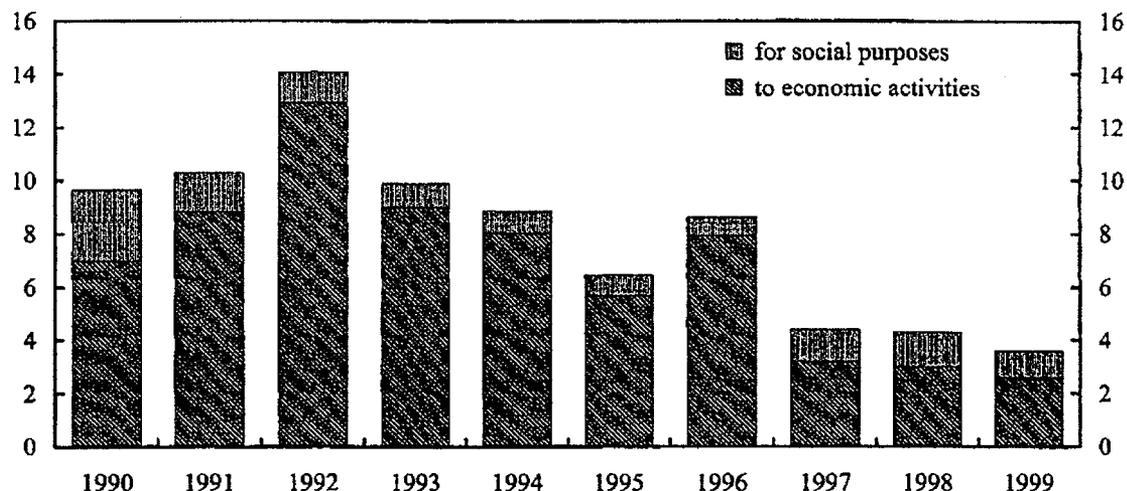
Other transfers and subsidies

39. **Sharp increases in transfer and subsidy expenditures marked the beginning of the transition process.** By 1992, subsidies and transfers amounted to some 23 percent of GDP, more than twice their level in the late 1980s. While much of the increase reflected poor classification of expenditure and the highly distorted public expenditure environment under the Ceaucescu regime, it is not out of line with developments encountered in other transition economies at the launch of the transition process. However, in Romania, the rise contributed to fiscal sustainability problems as it proved politically difficult to scale back these payments—and to avoid demands for the extension of new ones—while the overall budgetary revenue envelope tightened.

40. **Reflecting increasing difficulties in financing these expenditures within a given budgetary envelope, a large share was moved off-budget in 1993.** In particular, subsidies to energy-intensive industry and to agriculture were now starting to be extended in the form of directed credit (see Box II.1). In support of these operations, the National Bank started to incur large external debt—from a level of zero in 1992 to 4.8 percent of GDP by 1996—and major state owned banks accumulated significant non-performing loans. On the other hand, the removal of price difference subsidies resulted in the accumulation of large payments arrears.

²⁹ In other words, the introduction of the funded pension pillar would imply a pension system deficit of 3–3.5 percent of GDP, higher than the targeted deficit of the consolidated general government under the Romanian Medium-Term Economic Strategy (MTES). Therefore, for the introduction of the private pillar to be consistent with the MTES, the remainder of the consolidated government would need to run a surplus of some 0.5 percent of GDP.

Figure II.5: Expenditure on Transfers and Subsidies, 1990–99
(Excluding pensions, in percent of GDP)



41. After 1997, subsidy and transfer expenditures were reduced, the targeting was improved, but difficulties remained (see Figure II.5). In conjunction with full price liberalization, price difference subsidies were drastically reduced. On the other hand, it was possible to increase allocations for social transfers, in particular for child allowances—albeit to a level still short of levels prior to 1992—and temporary transfer payments resulting from severance payments in the mining sector were brought on budget. Nevertheless, overall social conditions are estimated to have deteriorated—not an unexpected outcome, given the overall economic situation.³⁰ Also, while considerable progress was made in cutting subsidies and transfers to economic activities—in particular by ceasing quasi-fiscal support through the banking system—some sectors, such as public transportation and housing showed themselves resilient to cuts, in part, however, the result of explicit budgeting.³¹

³⁰ Some progress was made in reducing standard poverty measures in 1995 and 1996. (see OECD (1998)) However, these proved to be as unsustainable as the output growth recorded in these years, and by 1998 poverty standards had again increased. Moreover, poverty became concentrated in households headed by low-wage earners and pensioners (see Pop and Tesliuč (2000)). The latter trend suggests that the maintenance of low-value-added employment and the burdening of the pension system with social assistance tasks have failed to yield the expected poverty reducing outcomes.

³¹ For example, following a restructuring of the railways, an explicit budgetary subsidy (equivalent to 0.7 percent of GDP) was introduced in 1999. Previous subsidization of the
(continued)

Other primary expenditure

6.2 percent in 1996. While this is at the lower end compared to other central European countries, given data comparability difficulties, it would appear to be an adequate level for

material and operating expenditure. Part of the recent recovery in material and operating spending reflected efforts of line ministries to secure expenditure through earmarking

necessary room for budgetary maneuver to flexibly address shifting expenditure priorities, they have managed to increase the allocation to the health and roads sectors. The task is now to ensure that the allocations to such priority sectors result in efficient spending, well focused

spending in prestige projects, while key basic health funding has started to deteriorate again.

44 Capital expenditure and net lending declined throughout the 1990s. Much of the

program after 1997 opened the possibility of private sector investment in infrastructure. However, there is evidence that recent cuts have begun to threaten the viability of the public

INTEREST EXPENDITURE

45. Notwithstanding Romania's modest public indebtedness, interest expenditure

large fiscal and quasi-fiscal deficits (see above). In 1999, interest payments amounted to 5.3 percent of GDP, representing 14 percent of all government spending, the highest level among Central Eastern European countries, with the exception of Albania, largely reflecting

expenditure is explained by the extension of significant loan guarantees, which were increasingly called up; haphazard and ultimately only partially successful stabilization

that this practice has not yet been entirely discontinued.

³² Absolute spending is at a roughly equivalent level to the Czech Republic, but higher than

attempts; and the poor state of the domestic banking system. The following paragraphs discuss these points in more detail.

46. The early years of transition witnessed a rapid buildup of public debt. The nature of much of the debt financed expenditure is unclear, as budgetary accounts for the early years fail to show significant deficits.³³ Moreover, selected industrial enterprises and the agricultural sector benefited from government loan guarantees which by 1996 had reached 6.8 percent of GDP. As the fiscal accounts became more transparent, the underlying deterioration in the primary balance became also more evident.

Table II.6. Public Debt and Interest Expenditure, 1990–2000 1/											
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
	(In percent of GDP)										
Net government debt outstanding 2/	0.8	0.0	11.1	11.6	9.2	11.2	13.1	15.4	15.6	20.2	18.3
External	0.8	0.0	7.5	8.5	5.7	7.3	9.1	9.4	8.6	10.1	9.4
Domestic	0.0	0.0	3.7	3.1	3.5	3.9	4.0	6.0	7.0	10.1	8.9
Of which: For bank restructuring	0.0	0.0	0.0	0.0	0.0	0.0	0.2	3.2	2.3	5.9	3.4
Government guaranteed debt	0.0	0.0	1.4	4.8	4.4	5.5	6.8	6.5	6.4	7.9	6.1
Interest payments	0.0	0.0	0.2	0.9	1.4	1.4	1.7	3.8	4.7	5.5	2.8
External debt	0.0	0.0	0.0	0.0	0.2	0.3	0.4	0.4	0.5	0.6	0.3
Domestic debt	0.0	0.0	0.2	0.9	1.2	1.2	1.4	2.7	3.5	4.4	2.0
Guaranteed debt 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.7	0.8	0.6	0.5
Memorandum items:											
Implied average ex post real interest rate (in percent)											
Treasury bills	...	...	...	-48.0	-16.6	15.0	-12.4	2.8	28.8	27.4	-0.8
External debt	0.0	0.0	0.0	0.0	5.7	5.1	6.4	4.3	4.2	3.5	3.9
Implied default rate of guaranteed debt (in percent)	...	...	0.0	0.0	0.0	1.7	2.3	7.3	6.5	7.2	9.6
Primary balance (in percent of GDP)	1.0	3.3	-4.4	0.6	-0.9	-2.0	-3.1	-1.4	-0.7	1.7	1.1
Sources: Data provided by the Romanian authorities and Fund staff estimates.											
1/ Data for 2000 refer to June 30, 2000.											
2/ Excluding debt of the National Bank of Romania.											
3/ Includes principal repayments as well as interest on called guarantees.											

³³ In addition, the NBR also quickly accumulated substantial external debt, including, but not limited, to the Fund. From zero foreign indebtedness, the NBR had accumulated US\$2 billion (7.3 percent of GDP) of external debt by 1996.

47. Contingent liabilities increasingly turned into actual ones. Two main mechanisms were at work here:

- **The state owned banking system**, which until 1996 had served as a major conduit for quasi-fiscal subsidies to the heavy industry and agriculture, had accumulated a large nonperforming loan portfolio, and become arguably insolvent. Distress borrowing by ailing banks would have severely undermined the stabilization objective, and the government sought to recapitalize state-owned banks and to assume their accumulated bad debt. In this way, in 1997, government took over some three percent of GDP in additional debt for the purpose of partially recapitalizing Bancorex and Banca Agricola (see Chapter IV). However, continued poor management practices at these banks, as well as difficulties in financing past losses necessitated a renewed bail out in 1999, adding a further five percent of GDP in debt.
- **Loan guarantees** which had been generously extended through 1996 became called up more frequently. Many of these guarantees were extended so as to finance current operating and subsidy expenditures for state enterprises and agriculture. With little or no productive investment backing up these liabilities, default occurred with increasing frequency, further burdening the budget.

48. Eventual stabilization attempts and price liberalization introduced positive real interest rates. Over much of the period through 1996, the government was able to raise domestic finance at negative real interest rates. However, with repressed inflation rapidly building up, the comprehensive price liberalization in 1997 necessitated sharply higher interest rates so as to keep inflation from accelerating further. Reflecting tighter monetary conditions, real interest rates turned positive. While a significant reduction in the primary deficit as well as some pickup in privatization proceeds and considerable foreign financing accompanied the 1997 stabilization program, the situation was aggravated by a lack of progress in fiscal consolidation in 1998. This contributed to a pernicious macro policy mix with too loose a fiscal policy and too tight a monetary stance. Correcting this policy mix necessitated a renewed stabilization effort—this time supported by a larger fiscal adjustment in 1999 and 2000—with real interest rates having recently been drastically lower.

49. The overall debt dynamics for the period ahead are not unfavorable. Provided prudent macroeconomic policies are pursued, it should be possible to reduce the share of the interest bill in GDP over the next years. Given the comparatively low level of public debt, interest expenditure will be highly sensitive to the choice of the primary surplus target. In an illustrative scenario, and assuming positive single-digit real interest rates, the maintenance of an average primary surplus (including grants) of some 2.3 percent of GDP would bring down government interest expenditure to some 2 percent of GDP by 2004.

D. Concluding Observations and Issues for the Medium Term

50. While important progress has been made in fiscal reform—especially over the last two years—critical issues remain for the immediate period ahead. In the first instance, there is a question of philosophy: the authorities need to decide which model of a government Romania is to emulate: a full fledged welfare state, or a smaller government more attuned to recently observed revenue performance. If it is to aim to the same structure as Western European welfare states, it will be important to raise revenue to comparable levels. If such a route is chosen, this will require tax administration to make massive inroads so as to break the past experience of revenue erosion. However, even if the choice is to aim for a less broad government, important actions need to be taken so as to preserve the recent advances in tax policy and improve tax administration and the composition of public expenditure.

51. By and large, tax policy has made great strides, and the advances need to be preserved. In particular, it will require vigilance to preserve the integrity of company taxation against attempts to reintroduce selective incentives. Not doing so would risk repeating the pattern of the 1990 that has done so much harm in tarnishing Romania's reputation as a safe destination for investment. Building on the legal structure already implemented, an appropriately ambitious program of globalizing personal income taxation should be introduced. It will also be essential to improve tax administration, in particular to start bringing the VAT to its potential.

52. As concerns expenditure, a more sustainable way of keeping real expenditure allocations in check needs to be found. In the past, higher-than-targeted—and budgeted for—inflation has permitted the containment of real expenditure. However, this system has greatly burdened rational budget policy and is not sustainable as inflation expectations will ultimately run out of control; at any rate, it is inconsistent with the targeted disinflation over the medium term. Keeping expenditure in check will thus require real reform, particularly as concerns the reduction in overstaffing and a reform of the pension system. Moreover, recent problems regarding local authority finance and earmarked revenue will also be needed to be addressed.

53. Additional expenditure commitments are already on the horizon. First and foremost, the EU and NATO accession will put new demands on the budget (see Box II.3). In addition, efforts will have to be made to ameliorate social conditions and deep-seated pockets of poverty.

Box II.3: The Fiscal Implications of Accession to the European Union and NATO

Romania has entered in accession agreements with the North Atlantic Treaty Organization (NATO) and the European Union (EU) (on the latter, see Chapter VI). Both these plans will have important fiscal implications.

EU accession will require significant additional expenditure, particularly on agriculture, transport infrastructure and the environment. The EBRD estimates the annual accession costs for Romania to amount to 3.5 percent of GDP. While large grants from the EU have been earmarked to benefit these additional expenditures—SAPARD instruments for agriculture and ISPA instruments for infrastructure and environment, and PHARE instruments for institution building—averaging €650 million over the next 5 years, it is important to note that on a net basis, Romania will be confronted with an additional financing gap from EU accession, some 1 percent of GDP according to staff estimates. Many of the grants will require a domestic cofinancing component. Moreover, these grant-financed expenditures will in a short time give rise to recurrent operating and maintenance expenditure which have to be met from Romania's own budgetary resources. It is, therefore, important that great selectivity and budgetary prudence be exercised in allocating the available grant finance on high-priority and sustainable projects.

Romania's armed forces will have to undergo extensive restructuring in order to meet NATO requirements. At present, the Romanian armed forces structure is still characterized by a top-heavy mix with a large number of officers and conscripts, and a pronounced shortage of professional soldiers and non-commissioned officers (NCOs). In addition, the forces are not geared toward mobility and rapid deployment, while electronic communication, command, control, and intelligence (C3I) infrastructure falls far short of NATO standards. As a step in redressing these shortcomings, the armed forces, which amounted to some 204,000, were cut by some 26,000 staff since 1997, while conscription was cut by 11,000 in 2000 through greater selectivity. The target is to reduce force strength to 153,000 while reducing the numbers of officers and conscripts and boosting the ranks of NCOs and professional troops, which is, however, expected to be financed from the savings generated by the overall cuts. The cuts should also help to bolster the defense spending per soldier—which presently ranks among the lowest in Europe. On the other hand, additional capital outlays for upgrading readiness, mobility and C3I infrastructure can be expected to arise in pursuit of the targeted NATO membership in 2005.

Romania: Tax Summary (as of September 30, 2000) 1/

Tax	Nature of Tax	Deductions and Exemptions	Rates	Remarks
A. Taxes on Income, Profits, and Capital Gains				
1	Individual income tax (salary tax and personal income tax)	Natural Romanian and foreign persons shall pay taxes for certain income in cash or in kind arising from: salaries, pensions, independent activities, transfer of the right to use, dividends, interest, income derived from the transfer of the ownership right on securities and shares, income derived from gambling, prizes and other incomes.	A personal deduction of 800,000 lei (around US\$40) and supplementary deductions, depending on the number of dependants. Certain incomes such as agricultural income, inherited amounts, donations, etc. are not subject to taxation. Exemptions are granted to members of diplomatic missions, pupils and students for prizes, etc.	Starting January 1, 2000, the Government Ordinance no. 73/1999 regarding the Individual Income Tax is in force. Salary taxes are calculated and withheld by employers at the same time that salaries are paid. Starting July 1, 2000 pensions above a monthly level of lei 2,000,000 are taxed (EO 87/2000). Income tax is paid to the State Budget.
a	Tax on income from intellectual property rights	Incomes from intellectual property rights are defined as those arising from know-how, inventions, copyrights, etc.	25 percent of gross income is generally deductible; copyright for monumental masterpiece; 40 percent of gross income is deductible.	The income on intellectual property rights is included in the annual global income.
b	Dividend tax	Dividends paid by a Romanian company are subject to a dividend withholding tax regardless of whether the dividends are paid to Romanian or foreign shareholders - legal or natural persons.	10 percent for legal persons, 5 percent for natural persons.	Where double taxation treaties provide for a different withholding tax rates than the domestic legislation, the most favorable rates shall apply.
c	Tax on interest	Interests paid by Romanian companies are generally subject to a withholding tax.	1 percent for Romanian natural persons; 10 percent for nonresidents	Where double taxation treaties provide for a different withholding tax rates than the domestic legislation, the most favorable rates shall apply. Applicable for the non-residents who cannot prove their residence status.
d	Gambling tax	Incomes from gambling, premia in cash or in kind are subject to a withholding tax.	10 percent on gross income	

Romania: Tax Summary (as of September 30, 2000) 1/

Tax	Nature of Tax	Deductions and Exemptions	Rates	Remarks
e	Tax on capital gains	Capital gains are defined as incomes derived from the transfer of property rights over stocks and securities if the selling price is higher than the acquisition price net of commissions and fees. It is a withholding tax.	1 percent	The tax on capital gains provided in Emergency Ordinance 73/1999 was recently modified through the Government Emergency Ordinance 87/2000 and will be applied starting January 1, 2001. During the 2000 fiscal year, a 1% tax rate applies to the transaction value.
f	Tax on other incomes	Other incomes than those specifically indicated in the Government Ordinance 73/1999 as subsequently modified and completed are subject to a withholding tax.	10 percent	Other incomes are usually incidental earnings.
2	Profit Tax	Legal entities undertaking business in Romania are liable for payment of corporate income tax ("profit tax").	Standard tax rate: 25 percent; Additional rate of 50% for night clubs, bars, casinos; National Bank of Romania: 80 percent. Legal entities exporting directly goods and services benefit from 5 percent profit tax rate for the revenues earned from exports.	The fiscal year is the calendar year. Profits must be determined on a monthly basis, cumulated from the beginning of the fiscal year. However, payments of profit tax must be made on quarterly basis (except NBR and banks - on a monthly basis). Reserves, set up from the net profit, used to increase the share capital are taxed at a rate of 10 percent.
B. Social Security Contributions				
3	Employees: a) supplementary pension to Social Security Budget b) unemployment fund; c) health fund	Romanian employees are required to contribute to the system of supplementary pension, health and unemployment security. Employees under civil contracts are required to contribute to social and health security.	Supplementary pension: 5 percent; Unemployment: 1 percent; Health: 7 percent	Employees' contributions are to be calculated, withheld and paid to the State Budget/Social Security Budget by employers at the same time that salaries are paid.

Romania: Tax Summary (as of September 30, 2000) 1/

Tax	Nature of Tax	Deductions and Exemptions	Rates	Remarks
<p>4</p> <p>Employers:</p> <ul style="list-style-type: none"> a) social security fund; b) unemployment fund; c) health fund; d) social solidarity fund; e) state education fund 	<p>Romanian employers are required to contribute to the system of social, health and unemployment security, etc.</p>	<p>Under certain conditions the employers might benefit from discounts on social security contributions such as:</p> <ul style="list-style-type: none"> - for payment in time: 7 percent; - new jobs creation: between 4 to 6 percent depending on the number of new jobs created. 	<p>Social security:</p> <ul style="list-style-type: none"> - group I - 40 percent; - group II - 35 percent; - group III - 30 percent; <p>Unemployment: 5 percent;</p> <p>Health: 7 percent;</p> <p>Social solidarity fund: 3 percent;</p> <p>State education fund: 2 percent.</p>	<p>Social security contribution paid by employers is aimed at covering the following main expenses: pensions; social benefits (according to the pension legislation), maternity leave, etc. The social security contribution rates are differentiated on working groups (group I, group II, and group III) depending on the working conditions.</p>
<p>C. Domestic Taxes on Goods and Services</p>				
<p>5</p> <p>Value added tax</p>	<p>VAT generally applies to imports, domestic supply of goods and services, and transfer of real estate. Unless specifically exempted, all commercial transactions are subject to VAT.</p>	<ul style="list-style-type: none"> a) imported raw materials and components of finished goods which are to be subsequently exported within 45 days from the import date, under a certificate issued by the Ministry of Finance; b) services rendered by foreign suppliers which are exempted domestically; c) imports of goods financed by international loans with Romanian State guarantee, made by public institutions. 	<p>The standard VAT rate is 19 percent. Exported goods and services, as well as transportation and services directly connected to the export of goods whose consideration is paid in hard currency are zero rated.</p>	<p>Imports are generally subject to VAT at the Custom Office. The "import" of services is also subject to VAT under the reverse charge mechanism. Romanian companies should register as VAT payers if their annual turnover exceeds ROL 50 million. Registration as a VAT payer where turnover is under this threshold is optional/otherwise, the registration is optional.</p>
<p>6</p> <p>Excise tax</p>	<p>Excise duties are imposed on certain imported and domestically produced goods. Excise duties are mainly charged on cigarettes, alcohol, tobacco, coffee, fuels, gambling and other luxury products.</p>	<p>Certain categories such as products exported directly, goods sold in duty-free shops, goods delivered to the state reserves, etc. are exempted.</p>	<p>Excise tax is generally denominated in euro, and varies among different groups of products:</p> <ul style="list-style-type: none"> - alcohol: 140 - 180 euro per hectoliter of alcohol; - bear and wines: 0.55 - 2.75 euro per hectoliter on alcoholic degrees; - tobacco: 2 - 14 euro per 1,000 cigarettes or kg; - fuels: 40 - 270 euro per ton; - coffee: 775 - 1,035 euro per ton; - automobiles: 1 - 18 percent; - other luxury products: 15 - 50 percent; - oil: 4 euro/ton; - natural gas: 7.4 euro/1000 cubic metres 	

Romania: Tax Summary (as of September 30, 2000) 1/

Tax	Nature of Tax	Deductions and Exemptions	Rates	Remarks
7	Social stamp duties	Social stamp takes two forms: a) social stamp on gambling levied on the price of each participation at TV interactive games and at all the other categories of games; b) social stamp levied on the value of newly imported cars having minimum engine capacity of 2,000 cubic m., acquired by natural or legal persons.	a) social stamp duty over gambling: 5 percent for each participation in TV games and 10 percent for participating in other games; b) social stamp tax on imported cars: 1 percent	The social stamp duties were introduced in June 30, 1999, as a financing source for the National Solidarity Fund to contribute to reducing poverty for families under extremely difficult situations.
8	Royalties	The tax is withheld and paid by Romanian companies on behalf of the non-resident companies which are the beneficial owners of the royalties.	15 percent withholding tax	Where double tax treaties provide for a different withholding tax rates than the domestic legislation, the most favorable rates shall apply.
9	Road tax	The tax is included in the prices of fuels and both legal entities and natural persons are subject to taxation.		The road tax represents a financing source of the Road Fund (a component of the consolidated budget)
D. Taxes on International Trade and Transactions				
10	Import duties a) Custom duties b) Import surcharge	Customs duties vary depending upon the product being imported. Customs duties must be paid at the time the goods are imported into Romania, or when they are removed from "bonded" premises. The import surcharge is applied to all imported goods with some exceptions.	Import surcharge: 2 percent	Preferential duty rates apply to a wide range of products and the trend is to reduce customs duties in respect of imported goods originating from EU and EFTA member countries. Starting with October 10, 1998, an import surcharge of 6 percent has been introduced. In 1999 the rate declined to 4 percent, and beginning with January 1, 2000 the surcharge decreased to 2 percent. On January 1, 2001, the import surcharge is to be removed.
E. Local Taxes				
11	Tax on buildings	The buildings used by public institutions, museums, historical, archeological, architectural monuments, churches and some special constructions are exempted.	Natural persons: 0.1-0.2 percent of the building value set in the annex 1 to the law legal entities: between 0.5 percent and 1 percent of the accounting value; the rate is decided by the local councils.	The value of the building depends on the kind, destination and quality of the building.

Romania: Tax Summary (as of September 30, 2000) 1/

Tax	Nature of Tax	Deductions and Exemptions	Rates	Remarks
12	Tax on land	The tax on land is payable annually by both natural persons and legal entities. The tax is calculated on the basis of square meter of land.	Between lei 50- lei 2,500 per square meter	The tax rate varies depending on the location of the land (cities, villages, etc.)
13	Tax on means of transportation	The tax on transportation means is based on the vehicle's engine capacity. Both legal entities and natural persons are subject to taxation.	Between 24,000 lei - 152,000 lei per each 500 cubic centimeters of the engine's capacity.	Water transportation means are taxed separately and the tax value is set up in lei by the law.
14	Advertising tax	Beneficiaries of the advertising services, regardless of the manner in which they are provided, are bound to conclude advertising contracts in this respect and to pay to the local budgets advertising tax applied to the contractual value, net of V.A.T.	1 percent to 3 percent of the contract value The tax varies between 50,000 lei and 650,000 lei per year and square meter used for display.	
15	Other local taxes	Other local taxes provided by the legislation are mainly taxes for resorts, licence for constructions, tax on temporary use of public areas, etc.		

1/ The table does not include local taxes set individually by local authorities.

VALUE ADDED AND INCOME AND WAGE TAXATION, 1996-2000

1996	
STANDARD RATE	REDUCED RATE
<p>18%</p> <p>All deliveries of goods, real-estate transfers</p>	<p>9%</p> <p>a) meat of animals and poultry, including organs and trimmings;</p> <p>b) fish and fish products, including semipreserved and preserved fish;</p> <p>c) milk, powdered milk and dairy products;</p> <p>d) edible fats and oils;</p> <p>e) pharmaceutical substances, medicinal plants, medical equipment and other goods to be used exclusively for medical, surgical, dental or veterinary purposes;</p> <p>f) live fowl of domestic species;</p> <p>g) agricultural and land-improvement works;</p> <p>h) fresh vegetables and fruits;</p> <p>i) advertising and publicity activities conducted through the mass media;</p>
<p>at the reduced rate</p>	
1997	
<p>and services rendered, from within the country and from abroad, except those taxed at the standard rate</p>	<p>a) meat of animals and poultry, including organs and trimmings, sold fresh, as products and preserved foods;</p> <p>b) fish and fish products, including semipreserved and preserved fish;</p> <p>c) milk, powdered milk and dairy products;</p> <p>d) edible fats and oils;</p> <p>e) medications for human and veterinary use;</p> <p>f) live fowl of domestic species;</p> <p>g) agricultural and land-improvement works;</p> <p>h) fresh vegetables and fruits;</p> <p>i) advertising and publicity activities conducted through the mass media;</p> <p>j) surgical, dental or veterinary purposes;</p>

1997 (continued)	
	<ul style="list-style-type: none"> f) live animals of the following species: bovines, swine, sheep and goats; g) live fowl of domestic species; h) agricultural and land-improvement works; i) chemical and mineral fertilizers, insecticides, fungicides and herbicides; j) fresh vegetables and fruits – <u>until April 29, 1997</u>; k) advertising and publicity activities conducted through newspapers and magazines, except publications which are primarily for advertising; l) frozen, dried, dehydrated, preserved or processed edible vegetables and fruits – <u>until April 29, 1997</u>; m) eggs of domestic species of fowl; n) flour, semolina, cornmeal, flour pastes, biscuits, sugar, rice; o) uniforms for preschool and elementary-school pupils; p) articles of clothing and footwear for babies; q) urban public transport for travellers, including that which also traverses a distance beyond the urban route. r) prostheses and orthopedic products – <u>beginning August 28, 1997</u>
1998-1999	
<p>22% – <u>beginning February 1, 1998</u></p> <p>All deliveries of goods, real-estate transfers, and services rendered, from within the country and from abroad, except those taxed at the reduced rate</p>	<p>11% – <u>beginning February 1, 1998</u></p> <ul style="list-style-type: none"> a) edible meat of animals and poultry, including organs and tripe, sold fresh, in prepared form and preserved; b) fish and edible fish products, including semipreserved and preserved foods, excluding caviar; c) milk, powdered milk and edible dairy products; d) edible fats and oils; e) eggs of domestic species of fowl; f) flour. <p>The reduced rate of 11% applies to economic agents who are producers, importers and those who market the products mentioned above, with the exception of economic agents in the public nutrition network and those who apply the commercial markup in the area of public nutrition.</p>

1998-1999 (continued)	
	<p>g) medications for human and veterinary use, pharmaceutical substances, medicinal plants, medical equipment, other goods to be used exclusively for medical, surgical, dental or veterinary purposes;</p> <p>h) prostheses, orthopedic products;</p> <p>i) live animals of the following species: bovines, swine, sheep and goats;</p> <p>j) live fowl of domestic species;</p> <p>k) uniforms for preschool and elementary-school pupils;</p> <p>l) articles of clothing and footwear for children less than one year old;</p> <p>m) urban public transport for travellers, including that which also traverses a distance beyond the urban route;</p> <p>n) agricultural works;</p> <p>o) chemical and mineral fertilizers, insecticides, fungicides and herbicides;</p> <p>p) certified and phytosanitarily treated seed of sunflower, hybrid maize and sugar beet;</p> <p>r) bread, wheat for consumption and for seed.</p> <p>s) publishing, printing and selling of newspapers and magazines, with the exception of activities whose nature is that of advertising and publicity – beginning October 1, 1998.</p>
2000	
<p>19%</p> <p>All deliveries of goods, real-estate transfers, and services rendered, from within the country and from abroad</p>	<p>- has been eliminated -</p>

B. Income and Wage Taxes

1996	
Income from liberal professions, commercial income, income from works of literature, art and science, including that resulting from inheritance of the rights to such works	Progressive rates according to income brackets, ranging from 17% to 43% (the tax cannot exceed 38% of taxable yearly income)
Income from rental of real estate	Progressive rates according to brackets of taxable income, ranging from 6% to 45%
Wages	Progressive rates according to income brackets, ranging from 5% to 60%
Dividends to partners or shareholders (legal entities or individuals)	10%
Profit	38%
Exceptions:	
- The National Bank of Romania	80%
- Gaming, bars, nightclubs	60%
- Taxpayers who obtain at least 80% of their income from agriculture	25%
- Permanent headquarters	44.2%
- Consumer cooperative organizations	25%
Interest earned by nonresidents on commercial loans	15%
Commissions earned by nonresidents in commercial transactions	15%
Income from activities conducted within the territory of Romania by nonresidents in the area of technical assistance, education of personnel, quantity and quality control of goods, scientific or technical consulting, medical consultations, evaluations, and other services rendered.	15%
Income from air and sea transport provided by nonresidents	15%
Income earned from Romania by nonresidents, from the transfer or utilization of invention patents, licenses, manufacturing trademarks and other similar rights	20%
Income from activities of art or entertainment, other than those performed for wages or as collaborations, earned from Romania by nonresidents	25%
1997	
Income from liberal professions, commercial income, income from works of literature, art and science, including that resulting from inheritance of the rights to such works	Progressive rates according to income brackets, ranging from 17% to 43% (the tax cannot exceed 38% of taxable yearly income)
Income from rental of real estate	Progressive rates according to brackets of taxable income, ranging from 6% to 45%
Wages	Progressive rates according to income brackets, ranging from 5% to 60%
Dividends to partners or shareholders (legal entities or individuals)	10%
Profit	38%
Exceptions:	
- National Bank of Romania	80%
- Gaming, bars, nightclubs	60%
- Taxpayers who obtain at least 80% of their income from agriculture	25%
- Permanent headquarters	44.2%
- Consumer cooperative organizations	25%

1997 (continued)	
Interest earned by nonresidents on commercial loans	15%
Commissions earned by nonresidents in commercial transactions	15%
Income from activities conducted within the territory of Romania by nonresidents in the area of technical assistance, education of personnel, quantity and quality control of goods, scientific or technical consulting, medical consultations, evaluations, and other services rendered.	15%
Income from air and sea transport provided by nonresidents	15%
Income earned from Romania by nonresidents, from the transfer or utilization of invention patents, licenses, manufacturing trademarks and other similar rights	20%
Income from activities of art or entertainment, other than those performed for wages or as collaborations, earned from Romania by nonresidents	25%
1998	
Tax on income from activities conducted on a free-enterprise basis; tax on income from the utilization, in any form, of a copyright, or of rights connected with a copyright, including such utilization by any persons who have acquired these rights by inheritance	Progressive rates according to brackets of taxable income, ranging from 15% to 35%
Tax on income from rentals, from subleases, or from establishment of the right of usufruct, use or inhabitation, as well as for contracts of power of attorney and transfer	A rate of 15% on taxable yearly income
Tax on gross amounts owed to individuals for services rendered and work performed by them, as well as for any activity conducted outside of the unit at which the individual income beneficiary is a paid employee.	Progressive rates according to taxable-income brackets, ranging from 10% to 40%
Income earned by individuals who deliver merchandise or sell goods by consignment.	15%
Monetary rights due for inventions and innovations	20%
Income from prizes and any earnings of the same nature	10%
Interest paid by bank companies on individuals' deposits	1%
Wages	Progressive rates according to income brackets, ranging from 21% to 45%
Dividends to partners or shareholders (legal entities or individuals)	10%
Profit	38%
Exceptions:	
- The National Bank of Romania	80%
- Bars, nightclubs	60%
- Taxpayers who obtain at least 80% of their income from agriculture	25%
- Consumer cooperative organizations	25%
Interest paid to nonresidents	10%
Interest paid to nonresidents by banks registered in Romania for sight deposits and time deposits, for certificates of deposit as well as for those connected with any savings instruments.	Exempt as of September 1, 1998 and thereafter

1998 (continued)	
Interest paid to nonresidents on foreign loans contracted and/or guaranteed by the Government of Romania, by the National Bank of Romania, by territorial administrative units or by a financial institution in which the State has controlling interest, as well as those connected with government bond issues in the domestic and the foreign capital market.	Exempt
Commissions paid to nonresidents	15%
Income earned by nonresidents and originating from the rendering of services of any nature, including medical consultations and surgical operations.	15%
Income paid to nonresidents for international transport by air and by ship, road and railway	15%
Income from royalties paid to nonresidents	15%
Income paid to nonresidents for activities of art, entertainment or sports conducted in an independent manner, including income earned from the organizing of contests	20%
Income paid to nonresidents active in letters, art and science, as a result of activities of this type carried out in an independent manner in Romanian territory	20%
Prizes won by nonresidents, awarded to them in contests organized in any field, other than those in the category of wages	10%
Income earned from gambling by nonresident individuals, for amounts which exceed the ceiling of 3,000,000 lei	10%
1999	
Tax on income from activities conducted on a free-enterprise basis; tax on income from the utilization, in any form, of a copyright, or of rights connected with a copyright, including such utilization by any persons who have acquired these rights by inheritance	Progressive rates according to brackets of taxable income, ranging from 15% to 35%
Tax on income from rentals, from subleases, or from establishment of the right of usufruct, use or inhabitation, as well as for contracts of power of attorney and transfer	A rate of 15% on taxable yearly income
Tax on gross amounts owed to individuals for services rendered and work performed by them, as well as for any activity conducted outside of the unit at which the individual income beneficiary is a paid employee.	Progressive rates according to taxable-income brackets, ranging from 10% to 40%
Income earned by individuals who deliver merchandise or sell goods by consignment.	15%
Monetary rights due for inventions and innovations	20%
Income from prizes and any earnings of the same nature	10%
Wages	Progressive rates according to income brackets, ranging from 21% to 45%
Dividends to partners or shareholders (legal entities or individuals)	10%

1999 (continued)	
Profit	38%
Exceptions:	
- The National Bank of Romania	80%
- Bars, nightclubs	60%
- Taxpayers who obtain at least 80% of their income from agriculture	25%
- Consumer cooperative organizations	25%
Interest paid to nonresidents	10%
Interest paid to nonresidents by banks registered in Romania for sight deposits and time deposits, for certificates of deposit as well as for those connected with any savings instruments.	Exempt
Interest paid to nonresidents on foreign loans contracted and/or guaranteed by the Government of Romania, by the National Bank of Romania, by territorial administrative units or by a financial institution in which the State has controlling interest, as well as those connected with government bond issues in the domestic and the foreign capital market.	Exempt
Commissions paid to nonresidents	15%
Income earned by nonresidents and originating from the rendering of services of any nature, including medical consultations and surgical operations.	15%
Income paid to nonresidents for international transport by air and by ship, road and railway	15%
Income from royalties paid to nonresidents	15%
Income paid to nonresidents for activities of art, entertainment or sports conducted in an independent manner, including income earned from the organizing of contests	20%
Income paid to nonresidents active in letters, art and science, as a result of activities of this type carried out in an independent manner in Romanian territory	20%
Prizes won by nonresidents, awarded to them in contests organized in any field, other than those in the category of wages	10%
Income earned from gambling by nonresident individuals, for amounts which exceed the ceiling of 3,000,000 lei	10%
2000	
Income tax (independent activities, transfer of the use of assets, wages)	Yearly taxation standard comprising progressive rates according to brackets of taxable yearly income, ranging from 18% to 40%
Dividends to partners or shareholders (individuals)	5%
Interest earned by individuals	1%
Other income earned by individuals (income from gambling, income from prizes and bonuses, income from transfer of ownership of stock shares and commodities)	10%
Dividends to partners or shareholders (legal entities)	10%

2000 (continued)	
Profit	25%
Exceptions:	
- The National Bank of Romania	80%
- Bars, nightclubs, casinos	50%
- For the exporting of goods and rendering of services for which payment is collected in foreign currency	5%
Interest paid to nonresidents	10%
Interest paid to nonresidents by banks registered in Romania for sight deposits and time deposits, for certificates of deposit as well as for those connected with any savings instruments.	Exempt
Interest paid to nonresidents on foreign loans contracted and/or guaranteed by the Government of Romania, by the National Bank of Romania, by territorial administrative units or by a financial institution in which the State has controlling interest, as well as those connected with government bond issues in the domestic and the foreign capital market.	Exempt
Commissions paid to nonresidents	15%
Income earned by nonresidents and originating from the rendering of services of any nature, including medical consultations and surgical operations.	15%
Income paid to nonresidents for international transport by air and by ship, road and railway	15%
Income from royalties paid to nonresidents	15%
Income paid to nonresidents for activities of art, entertainment or sports conducted in an independent manner, including income earned from the organizing of contests	20%
Income paid to nonresidents active in letters, art and science, as a result of activities of this type carried out in an independent manner in Romanian territory	20%
Prizes won by nonresidents, awarded to them in contests organized in any field, other than those in the category of wages	10%
Income earned from gambling by nonresident individuals, for amounts which exceed the ceiling of 3,000,000 lei	10%

Note: For residents of countries, with which Romania has signed agreements for the avoidance of double taxation, in the period 1996–2000, income earned in the form of interest, dividends, royalties and commissions is taxed at the source, under the conditions and at the rates specified in these conventions, beginning from the date of application of the respective agreements (the date on which each agreement goes into effect, as well as the tax rate levels, is shown in the annex).

SUMMARY
of the agreements signed by Romania with other countries for avoidance of double taxation
(As of July 11, 2000)

No.	COUNTRY	No. and date of the Decree (Law) ratifying the Convention	Date from which it is effective	Solutions adopted with regard to taxation in the source country for income in:			
				Interest	Dividends	Royalties	Commissions
1	South Africa	59/13.07.1994	1.01.1996	15	15	15	***
2	Albania	86/18.10.1994	1.01.1996	10	10 15**	15	15
3	Algeria	25.12.04.1995	1.01.1997	15	15	15	***
4	England	26.03.02.1976	1.04.1976	10	10* 15**	15* 10**	12.5
5	Armenia	121/9.07.1997	1.01.1998	10	5* 10**	10	15
6	Austria	254/10.07.1978	1.01.1978	10	15	10	***
7	Bangladesh	221/04.09.1987	1.01.1989	10	10*	10* 15**	***
8	Belarus	102/26.05.1998	1.01.1999	10	10	15	***
9	Belgium	82/15.04.1977	1.01.1978- 31.12.1998	15	10	10	5
	Belgium (new)	126/16.10.1996	1.01.1999	10	5* 15**	5	5
10	Bulgaria	5/10.01.1995	1.01.1996	15	10* 15**	15	***
11	Canada	418/5.12.1979	1.01.1978	15	15	15* 10**	***
12	Czech Republic	37/23.06.1994	1.01.1995	7	10	10	***
13	China	5/24.01.1992	1.01.1993	10	10	7	5
14	Cyprus	261/9.07.1982	1.01.1983	10	10	5*	5
15	South Korea	18/8.04.1994	1.01.1995	10	7* 10**	7* 10**	10
16	Croatia	127/16.10.1996	1.01.1997	10	5	10	***
17	Denmark	389/27.10.1977	1.01.1974	10	10* 15**	10	4
18	U.A.E.	74/31.1.1993	1.01.1997	3	3 (exemptions)	3	3
19	Ecuador	111/9.11.1992	1.01.1997	10	15	10	10
20	Egypt	316/14/10/1980	1.01.1982	15	10	15	15

No.	COUNTRY	No. and date of the Decree (Law) ratifying the Convention	Date from which it is effective	Solutions adopted with regard to taxation in the source country for income in:			
21	Switzerland	60/13.07.1994	1.01.1994	10	10	(does not apply – see Protocol)	***
22	Russian Federation	38/16.06.1994	1.01.1996	15	15	10	***
23	Philippines	23/04.04.1995	1.01.1998	10 ⁰⁰⁰ 15 ^{0*}	10* 15**	10*** 15** 25	***
24	Finland	61/2.03.1978	1.01.1979 31.12.2000	10	10	10	3
	Finland (new)	201/24.12.1999	1.01.2001	5	5	2,5* 5	***
25	France	240/23.12.1974	1.01.1975	10	10	10	***
26	Georgia	45/26.03.1999	1.01.2000	10	8	5	5
27	Greece	25/12.03.1992	1.01.1996	10	45 20	7* 5**	5
28	India	221/04/09/1987	1.01.1988	15	15* 20**	22,5	5
29	Indonesia	50/2.03.1998	1.01.2000	12,5	12,5* 15**	12,5* 15**	10
30	Jordan	215/26.06.1984	1.01.1985	12,5	15	15	15
31	Israel	39/14.02.1998	1.01.1999	10 5	15	10	***
32	Italy	82/15.04.1977	1.01.1979	10	10	10	5
33	Japan	213/05.07.1976	1.01.1978	10	10	15* 10**	***
34	Kuwait	5/8.03.1993	1.01.1992	1	1 (exemptions)	20	***
35	Lebanon	10/21.03.1996	1.01.1998	5	5	5	***
36	Luxembourg	85/18.10.1994	1.01.1996	10	5* 15**	10	5
37	Malaysia	482/26.12.1983	1.01.1985	15	10	12	According to internal legislation
38	Malta	61/3.07.1996	1.01.1997	5	5*** 30***	5	10
39	Morocco	404/01.11.1982	1.01.1987	10	15	10	10 (see royalties)
40	Moldova	60/17.06.1995	1.01.1997	10	10	10* 15***	***

No.	COUNTRY	No. and date of the Decree (Law) ratifying the Convention	Date from which it is effective	Solutions adopted with regard to taxation in the source country for income in:			
41	Namibia	61/15.04.1999	1.01.2000	15	15	15	***
42	Nigeria	10/08.03.1993	1.01.1994	12,5	12,5	12,5	According to internal legislation
43	Norway	67/25.03.1981	1.01.1982	10	10	10	4
44	Netherlands	316/14.10.1980	1.01.1980 31.12.1999	10	10* 15**	10	5
	Netherlands (new)	85/15.12.1998	1.01.2000	3 (does not apply – see Protocol, point IX)	0* 10 15**	3 (does not apply – see Protocol, point X)	***
45	Pakistan	418/05.12.1979	1.01.1980	10	15**	12,5	10
46	Poland	6/10.01.1995	1.01.1996	10	5* 15**	10	10 (does not apply – see Protocol)
47	Portugal	63/15.04.1999	1.01.2000	10	10* 15**	10	***
48	R.F. Germany	625.21.11.1973	1.01.1972	10	10* 15* 25,75*	10	5
49	*) S.F.R. Yugoslavia	331/14.10.1986	1.01.1989	7,5	5 (exemptions)	10	10 (exemption)
50	R.F. Yugoslavia	122/9.07.1997	1.01.1998	10	10	10	10
51	U.S.A.	238/23.12.1974	1.01.1974	10	10	15* 10**	***
52	Syria	40/11.02.1988	1.01.1992	7,5	According to internal legislation	15* 10***	15
53	Slovak Republic	96/10.11.1994	1.01.1996	10	10	10* 15**	5
54	Spain	418/05.12.1979	1.01.1980	10	10* 15**	10	5
55	Sri Lanka	149/22.05.1985	1.01.1986	10	12,5	10	10
56	Sweden	432/31.10.1978	1.01.1978	10	10	10	10 ⁰⁰
57	Thailand	3/3.02.1997	1.01.1998	10 20 25	15* 20**	15	10
58	Tunisia	326/23.12.1987	1.01.1990	10	12	12	4

No.	COUNTRY	No. and date of the Decree (Law) ratifying the Convention	Date from which it is effective	Solutions adopted with regard to taxation in the source country for income in:			
59	Turkey	331/14.10.1986	1/01.1989	10	15	10	6
60	Ukraine	128/16.10.1996 15.01.1998	1.01.1998	10	10 15**	10 15**	***
61	Hungary	91/26.10.1994	1.01.1996	15	5* 15**	10	5
62	Uzbekistan	26/12.03.1997	1.01.1998	10	10	10	-
63	Vietnam	6/13.03.1996	1.01.1997	10	15	15	***
64	Zambia	215/26.06.1984	1.01.1993	10	10	15	***

*) The provisions of the agreement with the S.F.R. of Yugoslavia are applied in the case of Macedonia and Slovenia and for Bosnia-Herzegovina.

Dividends

** When participation in the company's capital represents at least 25% of the capital of the dividend-paying company.

Exception: Bangladesh, with 10%, and likewise in the case of the Netherlands (new agreement) for the second rate; Pakistan, with 20%; Hungary, with 40%; Greece, 45% – distributing company residing [in] Greece; 20% – company distributing to residents of Romania.

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III. MONETARY POLICY ISSUES¹

A. Overview

1. **The main objective of the National Bank of Romania (NBR)—to ensure the stability of the national currency, for the overall purpose of price stability—has proved to be elusive.** Except for a superficial and unsustainable improvement in inflation performance in the mid-1990s, inflation has remained above 40 percent since the beginning of the transition in 1990—with the peaks in 1991–92 and 1997 associated with measures to liberalize the price and exchange systems. This is in part because monetary policy often pursued inconsistent objectives and was carried out inconsistently during much of the last decade. Moreover, monetary policy has had to operate in a difficult economic environment. For instance, widespread financial indiscipline, in conjunction with the very fragile position of the corporate and banking sectors, has raised the economic costs of monetary tightening, while a vulnerable external position has prevented the effective use of the exchange rate as a nominal anchor. In addition, monetary policy has had to deal over time with the entrenchment of inflation expectations and the informal indexation of the economy.

2. **Romania's experience suggests that a successful disinflation effort must rely not only on the consistent implementation of an appropriately tight monetary policy, but also on the hardening of budget constraints in the state sector.** The latter requires measures to contain wage growth and reducing arrears in the state sector, pending the restructuring of banks and enterprises, notably through privatization, to address the root cause of financial indiscipline. The authorities' past efforts to contain wage growth in the state sector, reduce domestic arrears, and impose financial discipline through restructuring of state enterprises have frequently given way to political resistance and hence has achieved little in terms of disinflation.

3. **The monetary policy and exchange rate framework underwent a radical reform in early 1997, when monetary policy was relieved of its quasi-fiscal functions; the price, exchange, and trade systems were liberalized; and market-based policy instruments were introduced.** Since then, the NBR has adopted an exchange rate regime of managed floating, with the exchange rate, net foreign assets (NFA), reserve money, and net domestic assets (NDA) all serving at various times as intermediate targets. The NBR has mainly relied on sterilized intervention in the foreign exchange market in conducting its monetary policy. In 1997, the NBR simultaneously targeted the exchange rate and reserve money through large sterilized purchases of foreign exchange to address concerns on inflation and competitiveness in the face of large foreign exchange inflows that followed a sharp depreciation. In 1998, the NBR sought to contain the rate of leu depreciation to reduce inflation; and as foreign exchange inflows subsided and then reversed in the course of 1998, the NBR initially defended the exchange rate through a drawdown of reserves but was unable to sustain such a policy. In late 1998 and early 1999, the NBR tried to restore external competitiveness and limited downward pressures on reserves by accepting a large

¹ This chapter was prepared by Tao Wang.

acceleration of the leu depreciation. Since April 1999, when an acceptable level of external competitiveness was reached, the NBR has followed a policy of allowing the leu to depreciate broadly in line with the targeted rate of inflation, while seeking to adhere to the NDA and NFA targets that have been set under the Fund's Stand-by Arrangement.

4. **The sources of growth in monetary aggregates have varied in recent years, reflecting changes in the monetary policy stance as well as the external environment.** Broad money growth mainly came from that of the NFA in 1997 and 1999, and exclusively from NDA growth in 1998. In 1997, money supply grew much less than inflation, since it did not fully accommodate the price and exchange rate liberalization, and the large foreign exchange inflows were sterilized. Consequently, bank credit showed a sharp real contraction in 1997 from the already very low level. In 1998, the rapid expansion of domestic credit, against the background of the overvalued exchange rate and loss of central bank reserves, drove the growth of broad money. Since mid-1999, monetary policy has been tight as the NBR sterilized most of the foreign exchange inflows.

5. Although Romania still has a very low level of monetization, domestic credit started to recover in the last 1½ years, following the clean-up of the balance sheets of troubled banks. Problems of the insolvent state banks also led to high and volatile interest rates and to the expansion of the spread between lending and deposit rates, in particular in 1997 and 1999. Thus the closure of Bancorex and the clean-up of the banking sector in 1999 have contributed to the gradual decline of interest rates, as has the fiscal consolidation, which lowered the government's financing need.

6. Section B below outlines recent developments in Romania's monetary policy framework and policy stance; section C analyzes the monetary policy conduct and sources of reserve money growth; section D depicts the impact of banking sector fragility on monetary policy; and section E describes the developments in broad money and credit.

B. Monetary Policy Framework and Policy Stance

The period 1990–96

7. **Before 1997, Romania's monetary and exchange rate policies were predominantly quasi-fiscal in nature.** Inflation and balance of payments (external reserves) targets consistently gave way to demands for directed credit for the agricultural sector and state-owned enterprises, and for an overvalued currency to keep energy prices low – to subsidize the energy-intensive state sector (see Chapter II, Box II.1). As a result, monetary policy was highly accommodating, reserves were depleted while defending an overvalued currency and replenished with borrowing from the international capital market. By late 1996, the disequilibrium in the external sector created by the over-valued exchange rate and excess domestic demand became unsustainable.

The period 1997–98

8. In early 1997, the newly elected reformist coalition government, faced with rising inflation, mounting downward pressure on exchange rate, growing fiscal and

current account deficits, and a real possibility of a financial crisis, embarked on a different policy path. The quasi-fiscal functions of monetary and exchange rate policy were shifted to the state budget, the exchange rate regime was liberalized following a sharp downward correction, and directed (subsidized) credit by the central bank was terminated. This was accompanied by other reforms, including price and trade liberalization, and the initiation of structural reform in the enterprise sector.

9. **Confronted with large foreign exchange inflows during most of 1997, the NBR simultaneously targeted the nominal exchange rate and the reserve money to prevent a nominal appreciation and control inflation.** The downward correction and liberalization of the exchange rate in early 1997 not only served to foster exports (at least initially), but also encouraged large amounts of capital inflows as well as private transfers. In order to prevent the erosion of the competitiveness gains through a nominal appreciation, the NBR engaged in large purchases of foreign exchange. It also aimed, but with limited success, to contain the growth in reserve money and inflationary pressures through sterilization operations.

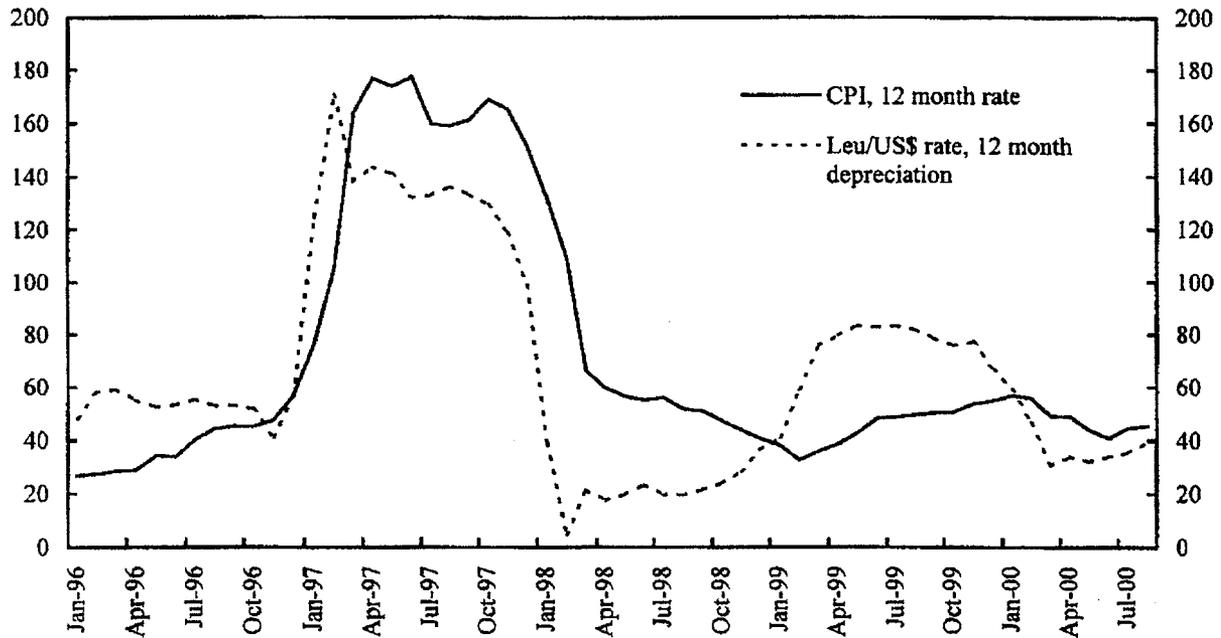
10. **However, starting in late 1997, external sector developments started to turn unfavorable, owing to rapid wage growth in conjunction with a low rate of leu depreciation.** Rapid wage growth eroded the competitiveness correction by late 1997. The NBR's decision to loosen monetary policy (along with fiscal policy) while continuing to target a nominal exchange rate served to reinforce the unfavorable trend. Although no single intermediate target for monetary policy unambiguously held sway, the exchange rate provided the main guide for reserve money management. The leu generally depreciated by 1-2 percent, well below the rate of inflation (Figures III.1-III.2), resulting in real appreciation of the leu, and foreign exchange inflows ran dry. The loss of external competitiveness contributed to the worsening of the current account deficit, and finally rendered the external imbalance unsustainable. The stance and conduct of monetary policy in 1998 were complicated by the need to inject liquidity to two large ailing state banks and by the low credibility of the NBR. In 1998 as a whole, monetary policy was loose—the NBR relaxed the monetary policy stance by using its foreign reserves to defend the currency. Finally, the Russian crisis in the fall of 1998 triggered a decline of confidence in Romania, and the NBR no longer could defend the currency after losing large amounts of reserves. The currency realignment in late 1998 and early 1999 reflected the need to return the leu to its equilibrium real level after inappropriate macroeconomic policies had misaligned it, and the fact that Romania economy had become increasingly vulnerable to changes in market sentiment.

The period 1999 to the present

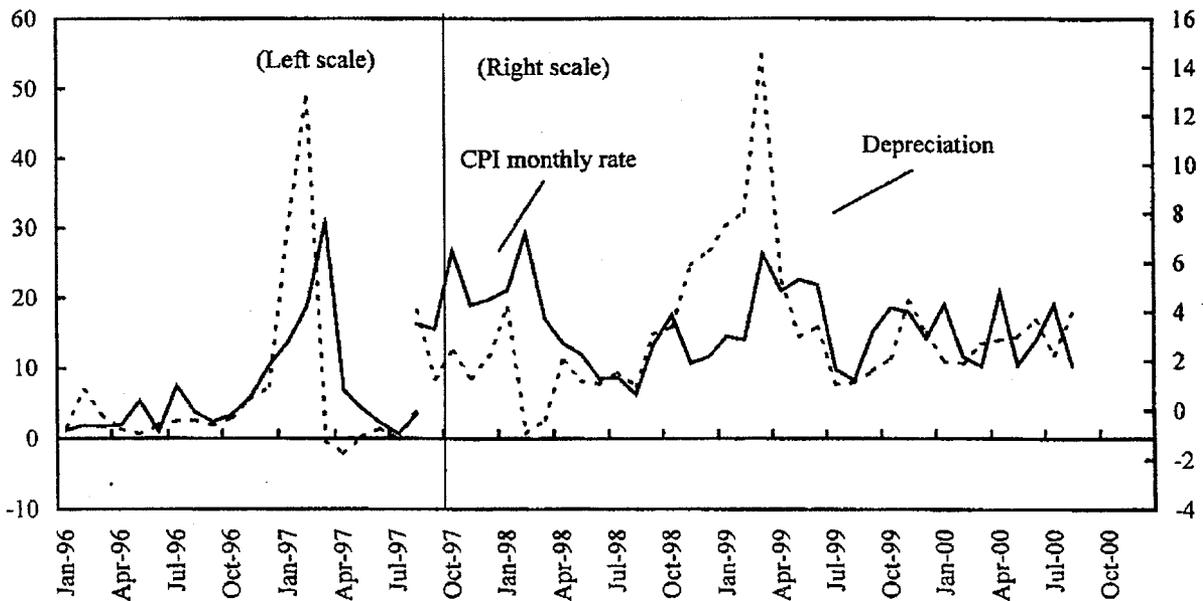
11. **The current monetary policy framework seeks to strike a balance between two potentially conflicting objectives of (a) reducing inflation through a degree of exchange rate stability, and (b) safeguarding the external position.** This monetary policy framework was instituted in early 1999 in the context of the SBA program, under the circumstances of a weak and highly uncertain external position and a history of volatile inflation and exchange rate movements. Specifically, the NBR's managed float exchange rate regime operates in

Figure III.1. Romania: Exchange Rate and Inflation Developments, 1996-2000

Developments of 12-month inflation and depreciation

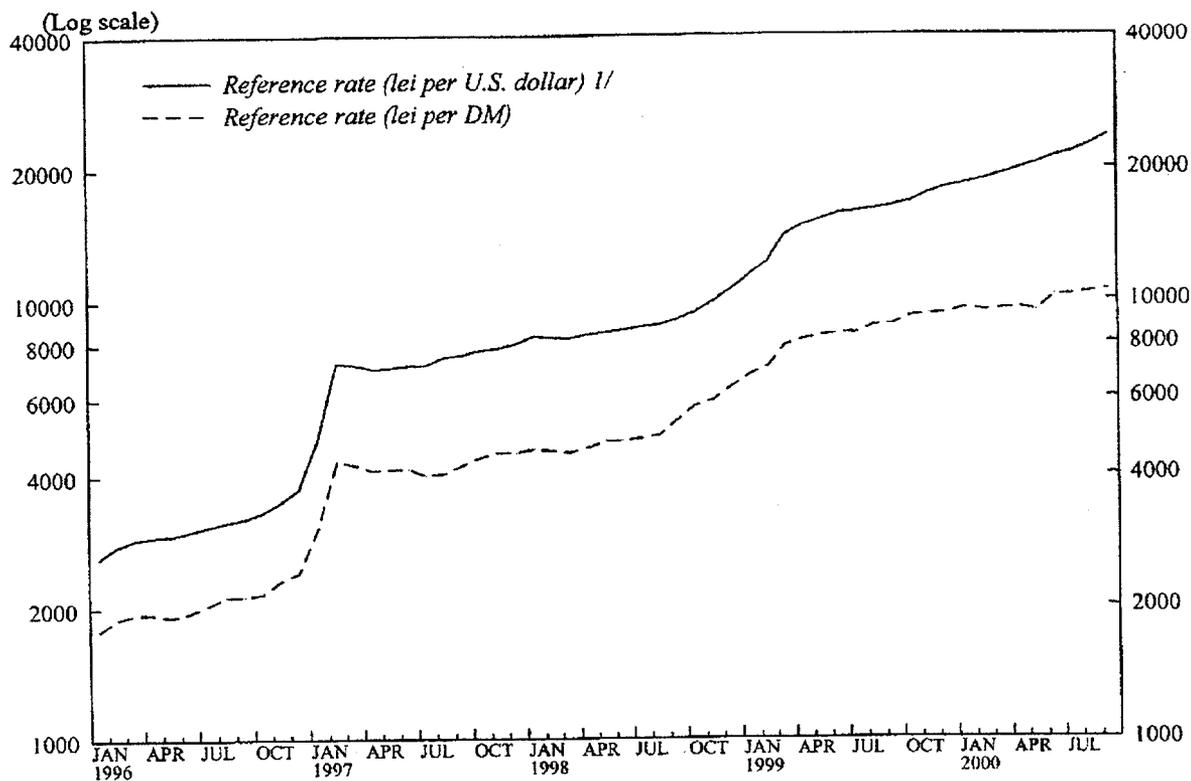


Developments of Monthly Inflation and Depreciation

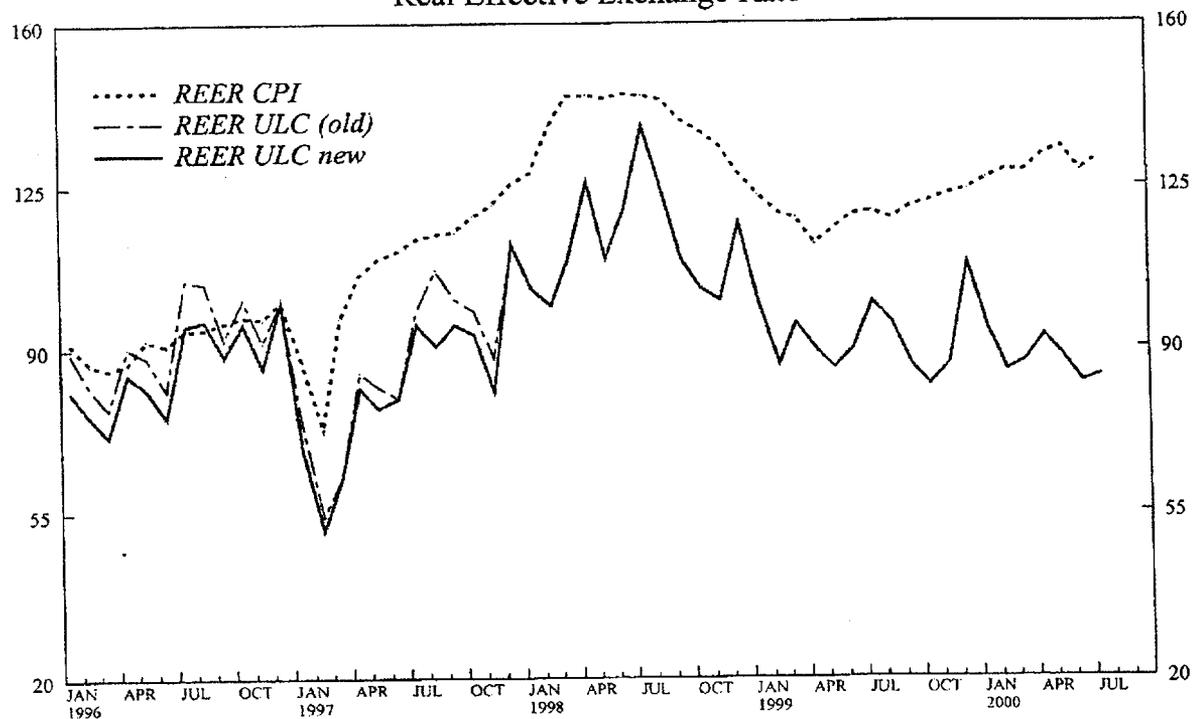


Sources: Romanian authorities; and Fund staff estimates.

Figure III.2. Romania: Nominal and Real Exchange Rate Developments, 1996-2000



Real Effective Exchange Rate



Source: National Bank of Romania.

1/ The official reference rate is published by the National Bank of Romania, computed as a weighted average based on the daily reports of foreign exchange operators.

practice as an unannounced crawling peg that crawls at a rate broadly in line with targeted inflation. There is thus no explicit NBR commitment to a specific exchange rate or inflation path; the exchange rate target is subject to revision in the event of external shocks and unexpected developments, with a view to safeguarding the external position. In light of large and often uncertain foreign exchange flows (including official financing) and significant dollarization (which raises the level of capital mobility), as well as the low policy credibility, a nominal exchange rate anchor may not provide sufficient flexibility to reconcile domestic and external objectives. On the other hand, avoiding excessive exchange rate volatility would serve to ensure smooth external trade transactions, and help to stabilize inflation expectations, given that the exchange rate is the key element of the transmission mechanism in Romania.

12. **Turning to the operational aspects of the monetary framework, in principle the NBR has one policy instrument—the NDA—but two intermediate targets: the NFA and the exchange rate.** In practice, the NBR is guided in its day-to-day operations by the exchange rate target, as long as the NFA remains above its targeted path. Broadly in line with this policy, the NBR has been able to achieve the exchange rate target over the past one year, in the context of a NFA over-performance, thereby helping to stabilize exchange rate and price expectations.

- Were the NFA target to be put at risk, however, the priority would effectively be the achievement of a minimum level of NFA. Thus, in the case of a negative shock and downward pressures on foreign reserves, the exchange rate target might be sacrificed after a point.
- By contrast, in the case of a positive shock, the NBR would face—and indeed has repeatedly faced over the past year—a choice between adding to reserves or letting the exchange rate appreciate. In light of the weak external position, the authorities would normally opt for a buildup in reserves in this case and, moreover, to sterilize the foreign exchange inflows associated with the larger-than-programmed NFA. However, the NBR would reassess whether the underlying money demand had picked up if the external over-performance persists.

13. **The current monetary policy framework has proven to be instrumental in the buildup of reserves and the maintaining of external competitiveness and exchange rate stability, but it has had limited success in bringing down inflation.** Amid large foreign exchange inflows, monetary policy remained tight in 1999 and early 2000, although it was loosened temporarily in mid-2000 as the NBR only partially sterilized the unexpected high inflows and its liquidity injection that bailed out depositors of a failed bank.² In the

² The loosening of monetary policy was influenced in part by an assessment that the higher-than-programmed increase in reserve money should be accommodated, as it reflected increased demand for currency, and in part by political pressure to lower the domestic financing costs of the budget deficit. The authorities started to tighten monetary policy in September 2000.

meantime, the NBR's net foreign assets, including gold, rose from US\$1.3 billion at the end of 1998 to US\$1.8 billion at the end of 1999 and US\$2.1 billion in June 2000. After the downward correction in early 1999, the exchange rate has depreciated in line with inflation and largely maintained its competitiveness. However, inflation rose to 55 percent at the end of 1999 compared with 40 percent in 1998, and has since decelerated only modestly.

14. **While the main objective of monetary policy shifted, the circumstances surrounding the operation of monetary policy changed markedly as well.** The favorable external conditions in 1996 and 1997, reflected in large capital inflows and relatively easy access to international capital markets, gave way to adverse sentiment following first the Asian crisis, and then the Russian crisis in August 1998, resulting in the denial of Romania's access to international capital markets in 1999. The strong policy effort in the areas of budget and external competitiveness in 1999 helped to avert a financial crisis and restore some confidence in the economy by mid-2000. In addition, the privatization and liquidation of large state-owned banks have drastically reduced the need for the NBR to constantly provide liquidity support to the ailing state banks which compromised its monetary policy conduct.

C. The Conduct of Monetary Policy and Sources of Reserve Money Growth

15. **Reserve money management in the last three and a half years mainly consists of large sterilized intervention in the foreign exchange market by the National Bank of Romania—sterilizing the accumulation of reserves from the inflows in 1997 and since mid-1999, and sterilizing the massive reserve loss and foreign exchange outflows in 1998.** leu reserve money³ soared by 87 percent in 1997 (although end-December inflation was much higher, at 150 percent), following the exchange rate and price liberalization, before decelerating in 1998 and 1999, to about 30 percent⁴ (Table III.1). In 1997, reserve money developments were driven exclusively by the large inflow of foreign exchange following the sharp depreciation and the liberalization of the exchange rate regime. The NBR sterilized most of the US\$1.5 billion increase in its net foreign assets, which in turn tightened credit conditions. As a result, NFA growth contributed more than 100 percent to the growth of reserve money, while NDA declined slightly in 1997. In sharp contrast to 1997, reserve money developments in 1998 were led by a decline in NFA. In the course of defending the stability of the nominal exchange rate, NFA dropped by US\$800 million in 1998 (Figure III.3), or some 46 percent from the level at the end of 1997 (excluding valuation effects). As the NBR sterilized the foreign exchange outflows, credit conditions were loosened, and domestic credit growth turned from large and negative to large and positive. Under the SBA program of 1999, building NFA became the paramount objective, and thus the forces underlying reserve money developments again reversed their courses. Following the large depreciation in early 1999, the exchange rate stabilized, while the real depreciation

³ In Romania, the analysis typically focuses on the leu component of reserve money, for reasons explained in Section E.

⁴ The rate of change is calculated at an unchanged required reserve ratio, using the beginning of the period required reserves ratio as a reference point, and assuming full compliance with reserve requirements.

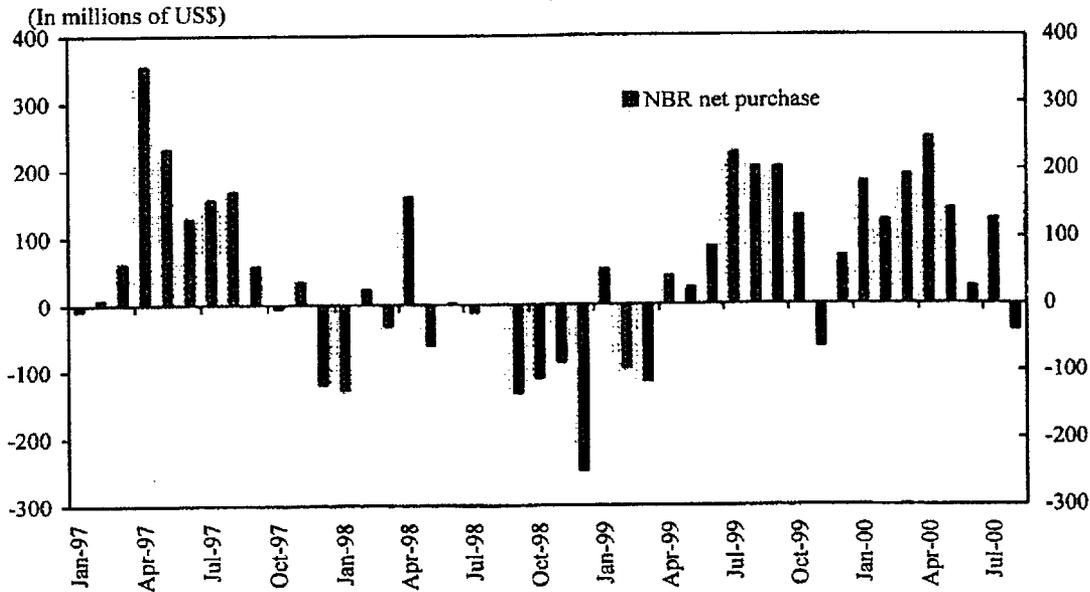
significantly improved the current account and increased the inflows of foreign exchange. The accumulation of foreign reserves contributed to about 70 percent of reserve money growth, while domestic credit growth decelerated. This trend has continued so far in 2000.

Table III.1. Contribution to Reserve Money Growth, 1997-99 (Percent change in relation to reserve money at the beginning of the year)					
	1997	1998	1999		2000 H1
			Actual	Program	
Reserve money excluding changes in reserve requirements & assuming full compliance	87.5	29.4	32.4	30.7	14.3
NFA					
Excluding valuation effects	89.7	(45.5)	22.6	17.4	14.2
NDA	(2.1)	74.9	9.8	13.3	...
Domestic Credit	(99.3)	82.7	30.7	8.6	3.0
Banks	(147.3)	37.9	(18.6)	24.0	(0.3)
Government	48.0	44.8	49.3	(15.4)	3.3
Changes in required reserves	(12.4)	(19.6)	(51.4)	-	-
Other items, net	92.2	12.1	25.7	5.7	9.9
<i>Of which: Valuation change</i>	62.8	8.5	30.8	14.8	14.2
Shortfall of required reserves		(0.3)	4.7	(1.0)	(12.9)
Sources: National Bank of Romania and staff estimates.					

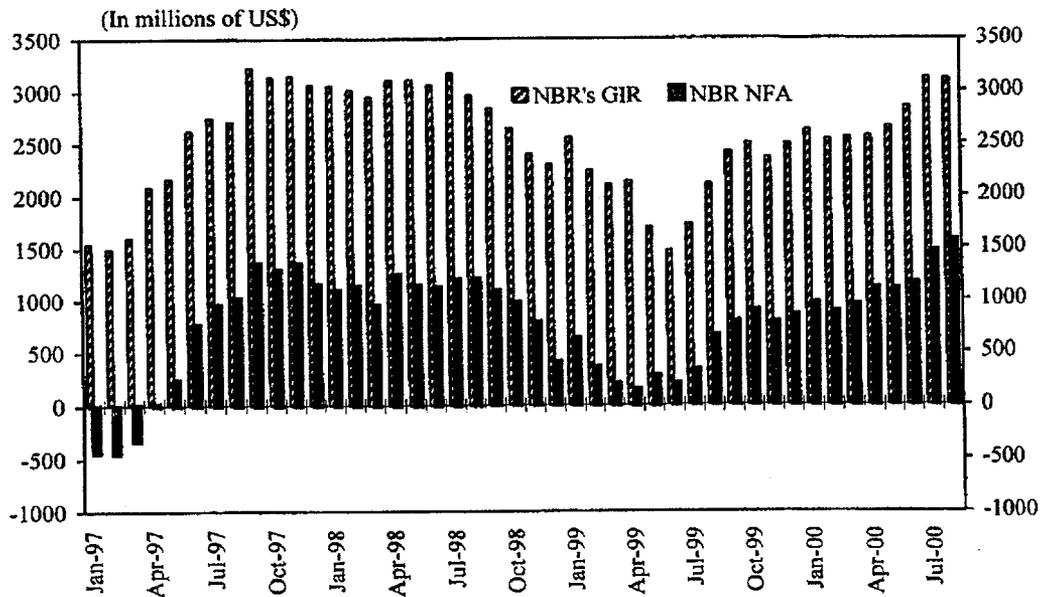
16. **The key instruments of monetary policy conduct have evolved in the last three years (Box III.1).** The elimination of directed credit by NBR, the subsequent need to inject liquidity into the ailing banks, and the large foreign exchange inflows transformed the NBR from a net creditor in the liquidity market to a net debtor vis-à-vis the commercial banks. Sterilization operations, the driving force behind the evolution of NDA, were conducted mainly through NBR's deposit-taking operations, and the increases in minimum reserve requirements on banks' deposits. Deposit-taking operations by the NBR were introduced in June 1997, initially to absorb the large amount of liquidity resulting from the NBR's foreign exchange purchases, and then to sterilize the liquidity support to two ailing state-owned banks. The financial market conditions—the existence of large distress borrowing, the

Figure III.3. Romania: Foreign Reserve, 1997-2000

NBR Net Purchase of Foreign Exchange in the Inter-bank Market



NBR's Gross and Net International Reserves, 1997-2000



Sources: Romanian authorities; and Fund staff estimates.

Box III.1. Monetary Policy Instruments and Their Evolution

Open market-type Operations:

Deposit-taking operations: Deposit-taking operations began in June 1997 to absorb large amounts of excess liquidity, mostly resulting from the NBR's purchases of foreign exchange. Later in 1997, liquidity support to the two ailing state-owned banks (BX and BA) required subsequent sterilization from the system, which led to the sharp rise of deposit-taking operations. In December 1997, the stock of deposit-taking operations peaked at 5.8 trillion lei, or 50 percent of reserve money. Apart from the heavy-handed adjustment of reserve requirements, deposit-taking operations have since been the most heavily utilized instrument to drain liquidity from the market. These operations are held frequently and maturities are usually for one week or two weeks, but they vary between one day and one month depending on liquidity conditions. Each day a set of bilateral transactions (and now, increasingly, auctions) are conducted, and terms and conditions can be different for different operations. The interest rates of the deposits with the NBR were often affected by the distress borrowing of troubled banks and competition from large financing needs of the government (T-bills) in the past – the high cost often drove the NBR to resort to changes in reserve requirements. The NBR has published a set of regulations governing money market operations, and started to rely more on the auction format in deposit-taking operations beginning in the third quarter of 2000.

Government securities operations: The two other instruments available to NBR to carry out open-market-like operations are outright purchases and sales of Treasury bills (T-bills), and repurchase and reverse repurchase agreements. To date there have been a few outright sales of T-bills (average daily amount of 120 billion lei in the last 12 months). The purchase of T-bills from two ailing banks were related to the need to inject liquidity into these banks and cannot be counted as true open market operations. The NBR conducted experimental repos and reverse repos with a few banks in 1998-99 and then formalized the regulations on such operations in March 2000. As the terms and maturities of T-bills have increased, and interest rates are more market related, the NBR began to use reverse repos as an important means of monetary policy conduct starting in August 2000. Nonetheless, the high inflation and highly uncertain interest rate environment remain an obstacle to further development in this area.

Reserve Requirement:

The system of reserve requirements underwent major reforms in 1998 and early 1999. Since March 1999, reserve requirements have been calculated for the average of the previous half month, and the coverage is in line with the international norm. In August 1998, reserve requirements on domestic currency deposit and foreign currency deposits were unified at 15 percent. The requirements diverged in November 1999, when the reserve ratio on lei deposits was raised to 25 percent and then in December to 30 percent, while the reserve ratio on foreign currency deposits remained at 20 percent. On lei reserve requirements, the first 15 percent is remunerated at the sight deposit rate, and the second 15 percent is remunerated at a rate determined by various market indicators, including the interbank market rate. The NBR's decision to raise reserve ratios to the current high level stemmed partly from the large sterilization need in light of large foreign exchange inflows in 1999, and liquidity injections to ailing state banks. The financial distortion created by the ailing banks, including nonobservance of their reserve requirements, also contributed to the need to tighten reserve requirements across the board.

NBR Credit Facilities:

Auction credit: The NBR introduced auction credit in 1993 as a semi-market-based means of monetary policy to replace soft credit dictated by government decisions. However, as the rules of the auction were not sound and very low bids were submitted in an environment of excess liquidity, auction credit was initially used exclusively by a few major state-owned banks to borrow at below-market interest rates. The auctions were reformed in 1995, whereby credit is granted for a maximum of 15 calendar days with collateral acceptable to the NBR, and interest rates are set competitively by the auctions. Credit auction loans reached a high of 1.5 trillion lei in December 1996 and dropped to zero after April 1997. From June 1997, the NBR has become a net borrower instead of lender vis-à-vis the banking system and has not used credit auctions.

The discount window (or structured credit facility) was once the main facility through which the NBR provided directed credit at heavily subsidized rates (about 70–90 percent of NBR's total refinancing credits were issued as directed credit during 1993–96). Structural credit was granted on the basis of laws passed by the parliament or government decisions to support activities in certain sectors (such as the agriculture sector). In 1997, structured credit was terminated, and discount credit volume declined subsequently, as maturing credit was not renewed. It has not been used since 1997, especially as the liquidity conditions have changed (with the NBR being a net borrower).

The Lombard facility is an overnight lending facility for banks to bridge temporary liquidity needs. This facility has not been used since December 1997. The NBR law of 1998 prohibits the NBR from providing overdraft credit, although the Lombard facility existed. The rate is set to be money market rate plus penalty, or the highest short-term money market rate. The regulation issued in 2000 provides a *marginal lending facility*, which will take the place of the Lombard facility, to allow overnight collateralized lending at the highest market interest rate to facilitate settlement.

The special credit facility is used for banks in serious distress and credit is granted for a maximum of 30 days, requires a submission of a financial recovery plan, and is collateralized with T-bills. In practice, there have been exceptions to the collateral requirement as well as the financial recovery plan. The facility was used to extend liquidity support to BX (1999) and BA (1999–2000).

dominance of certain banks, and not the least, the large sterilization requirement—rendered deposit-taking operations too costly and insufficient to mop up all the liquidity desired, and the NBR repeatedly turned to a more effective but heavy-handed instrument—the increase of minimum reserve requirements. Minimum reserve requirements for leu deposits were raised steadily from 7.5 percent in early 1997 to 30 percent in late 1999 (Table III.2).

Period in Effect	Leu Deposits	Foreign Currency Deposits
January 1997 to July 1997	7.5	20-30*
July 1997 to February 1998	10	20-30*
February 1998 to August 1998	12.5	20-30*
August 1998 to July 1999	15	15
July 1999 to October 1999	20	20
November 1999	25	20
December 1999 to present	30	20

Source: National Bank of Romania

*Depending on the foreign currency liquidity level.

17. **Among open market-like operations, apart from deposit-taking, the NBR could—but rarely did—resort to the sale and purchase of government securities to conduct its monetary policy.** While the NBR has sold some of its holdings of T-bills, its purchase of non-marketable T-bills from state-owned banks derived mainly from the need to pump in liquidity to support the ailing banks, and cannot be categorized as open market operations. Progress has been made in the development of open market operations through the development of more marketable government securities, a set of regulations clarifying the money market operations, the shift toward the auction format in conducting deposit-taking operations by the NBR, and the introduction of repurchase (repo) and reverse repurchase agreements of government securities. As of August 2000, most of the deposit-taking operations were conducted in auction format, and the NBR also started to rely more on reverse repo transactions to mop up liquidity.

D. Banking Sector Fragility and Monetary Policy

18. **The conduct of monetary policy in Romania has been complicated in recent years by the fragile condition of the banking system.** This section is devoted to the impact of banking sector problems, especially the two large insolvent state-owned banks—Bancorex and Banca Agricola - on the conduct of monetary policy.

19. **The insolvent state banks were the main agents for quasi-fiscal support to the state enterprises and the agricultural sector before 1997.** Bancorex (BX), the former bank of foreign trade and the largest bank in Romania, had mainly dealt with foreign currency lending and deposit taking, trade finance, foreign exchange, and international settlements.

BX financed a significant portion of Romania's energy import requirements, as well as imports of capital goods under the previously highly subsidized exchange rate. In addition, BX was used as a major vehicle for providing quasi-fiscal support to the energy sector and energy-intensive industry. When the exchange rate regime was liberalized and subsidized credit was terminated by the NBR in 1997, BX's already high level of nonperforming loans ballooned and the bank ran into serious liquidity and solvency problems. Banca Agricola (BA), the agricultural bank, had traditionally relied on extending subsidized credit to the agricultural sector. In early 1997, when such credits were eliminated, BA also encountered serious liquidity and solvency problems.

20. Large distress borrowing by the two insolvent state banks and the subsequent bailout by the government and the NBR compromised the monetary policy stance. As shown in the attached charts (Figure III.4), BX and BA pushed up interest rates via large distress borrowing at various times in the last few years. Their behavior forced the central bank to raise interest rates by a greater margin to absorb the liquidity in the system.⁵ The subsequent bailout of BX and BA by the government and the liquidity injection by the NBR required huge consequent sterilization.⁶ As a result, the conduct of monetary policy was significantly undermined.

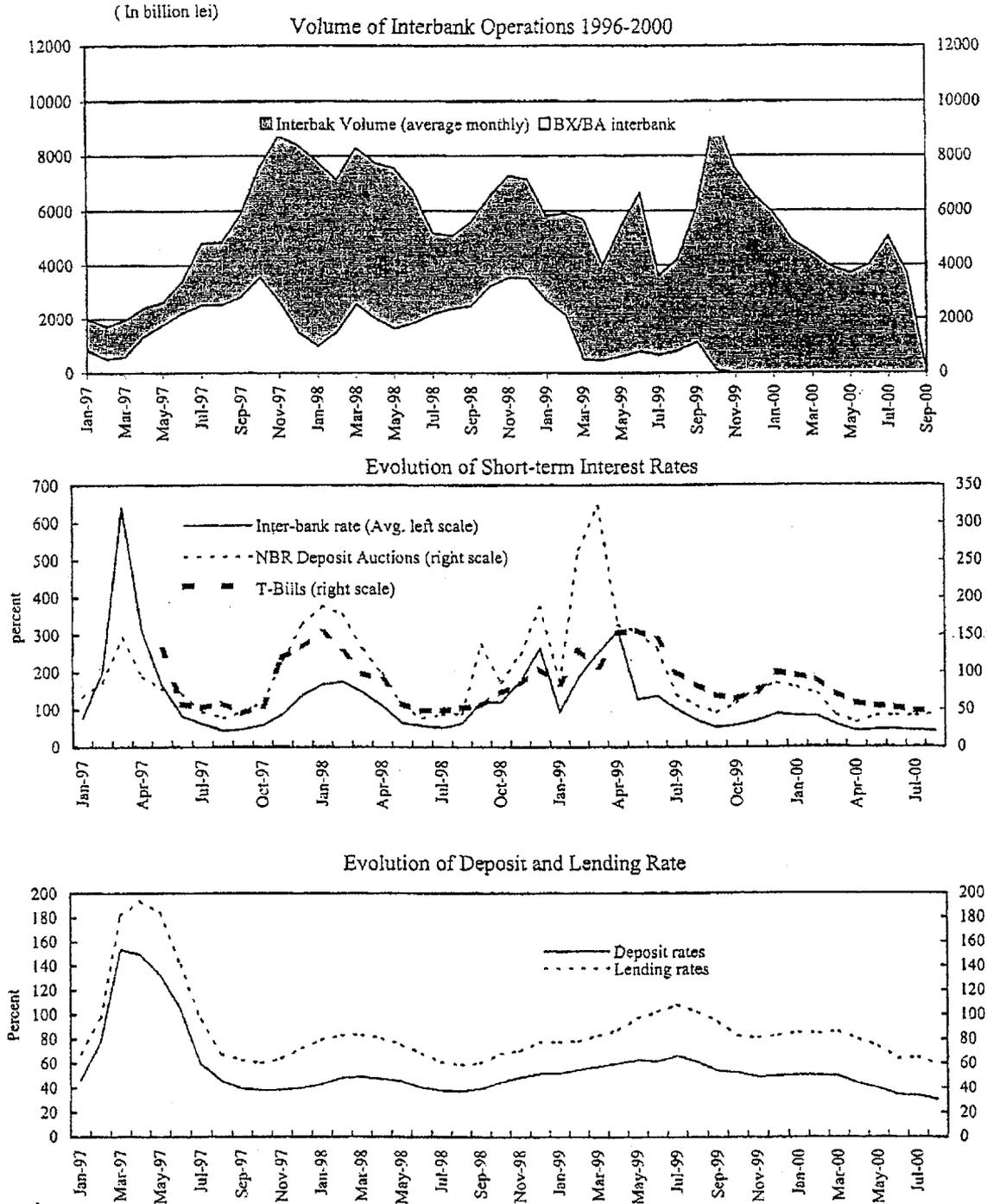
21. The liquidity support to the two banks made NBR's sterilization operations very expensive and caused distortion in the financial market. First, the large sterilization requirements stemming from NBR's massive liquidity support made its deposit-taking operations very expensive. As interest rates skyrocketed, the NBR resorted to increasing minimum reserve requirements on all bank deposits. Second, the two ailing banks' nonobservance of the minimum reserve requirements, along with other prudential regulations, clouded the true picture of the monetary situation and caused distortion in the banking system by shifting the burden to other banks.

22. The aforementioned distortion caused by the two banks altered the transmission of monetary policy. The level of interest rates associated with a given quantity of reserve money was often skewed upward by the presence of BX and BA—through, for example, large distress borrowing—while the overall volatility and uncertainty of interest rates increased. This in turn hindered financial market development—for example, the development of the secondary market for government securities—and discouraged the

⁵ When the two banks offered excessively high interest rates to attract deposits and avoid bank runs in 1997, they added to the upward pressure on interest rates arising from tight liquidity conditions owing to the NBR's sterilization of foreign exchange inflows.

⁶ In late 1997, the government bailed out the two banks with US\$1 billion in government bonds. The NBR immediately purchased a significant amount of those securities from the two banks and injected cash liquidity into the banking system. In 1999, as BX collapsed, the NBR stepped in again to extend about 10 trillion lei—or about 50 percent of reserve money—in special credit to the bank.

Figure III.4. Romania: The Impact of Bancorex and Banca Agricola, 1997-2000



Sources: Romanian authorities; and Fund staff estimates.

financing of real activities, as such activities are less sensitive to interest rate (see the next section on the low level of financial intermediation).

E. Recent Developments in Broad Money and Credit

Broad money developments

23. **Romania's monetary programming is based on leu broad money (henceforth M2),⁷ but both leu broad money and broad money including foreign currency deposits (henceforth M2X) are monitored.** Table III.3 shows developments in broad money and sources of growth in the last three years. Even though M2 grew by 91 percent in 1997, this was still far below that of end-year inflation of 151 percent, resulting in a sharp real contraction that year. In 1998, M2 grew by 40 percent in 1998, in line with end-year inflation, though the credit policy stance in 1998 was loose, as money demand declined in the latter part of the year. Reflecting a tightening of monetary stance since early 1999, M2 grew by 34 percent in 1999. The developments in M2X in the meantime mainly reflected developments in M2 and exchange rate movements, as the dollar amount of foreign currency deposits has changed little.

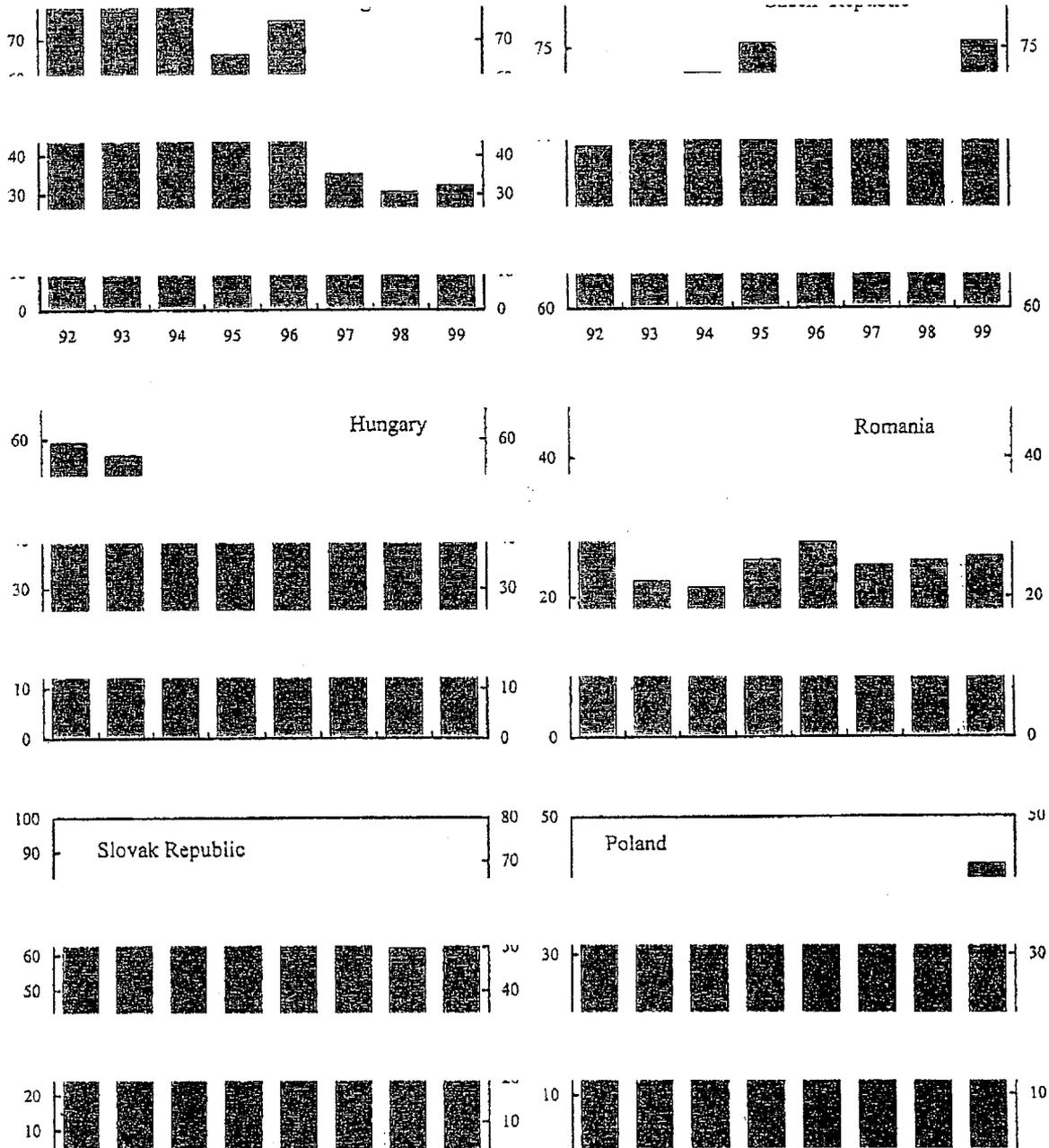
The low level of monetization

24. **The level of financial intermediation is extremely low in Romania, and has been so for many years.** Measured by the share of broad money (including FCDs) in GDP, Romania ranks the lowest among countries in the region, falling behind Bulgaria, the Slovak Republic, Poland, the Czech Republic, and Hungary (Figure III.5). The monetization levels of these countries, with the exception of Bulgaria, were between 40 percent and 70 percent of GDP at the end of 1999. In contrast, Romania's M2X to GDP was a mere 26 percent, lower than the ratio of post-crisis Bulgaria, which saw its broad money-to-GDP ratio halved from some 70 percent of GDP following the banking crisis in 1996.

25. **Moreover, unlike most transition countries in Eastern Europe, the broad money-to-GDP ratio in Romania shrank by half at the beginning of the transition process between 1991 and 1993.** The main reason behind Romania's rapid demonetization is that rampant inflation in the first three years of the 1990s resulted in highly negative real interest rates and hence heavy taxation on holdings of domestic currency; meanwhile, controls on

⁷ Even though the share of FCDs in M2X is significant, hovering around 30 percent in recent years, there is no strong evidence of foreign currency as a means of payment or unit of account in a significant way. FCDs are mostly a form of assets that the population uses in a high inflation and volatile exchange rate environment to substitute for domestic deposits.

Figure III.5. Romania. International Comparison of Monetization, 1992-1999
(Broad money as a percent of GDP)



Source: EBRD Transition Report 2000.

foreign exchange were not liberalized, which led to the collapse of demand for money.⁸ (Table III.4). Since then, progress in re-monetization and financial intermediation in Romania has been slow, owing to the persistence of high inflation and, for the most part, negative interest rates on leu deposits, and concerns about the health of the banking system.

26. As shown in Figures III.6 and III.7, commercial banks' average deposit rate have fluctuated widely and have often been highly negative in real terms. Real deposit rate was consistently positive in only two periods, 1995–96, and much of 1999, and both periods witnessed a recovery of broad money-to-GDP ratio.

27. **Most recently, the development of capital markets in Romania may have offered people some alternatives to bank savings—the securities market, investment funds, and treasury bonds.** However, the market capitalization of these alternatives remains low, and hence it has not been among the main reasons so far for the low level of monetization in Romania. Stock market capitalization reached about 2 percent of GDP in the last two years, while bonds sold to households accounted for another 1½ percent of GDP. Investment funds are estimated to account for less than 1 percent of GDP (most of which was the failed FNI), as do deposits at credit cooperatives—although data from these latter two sources are imprecise and should be viewed with caution.

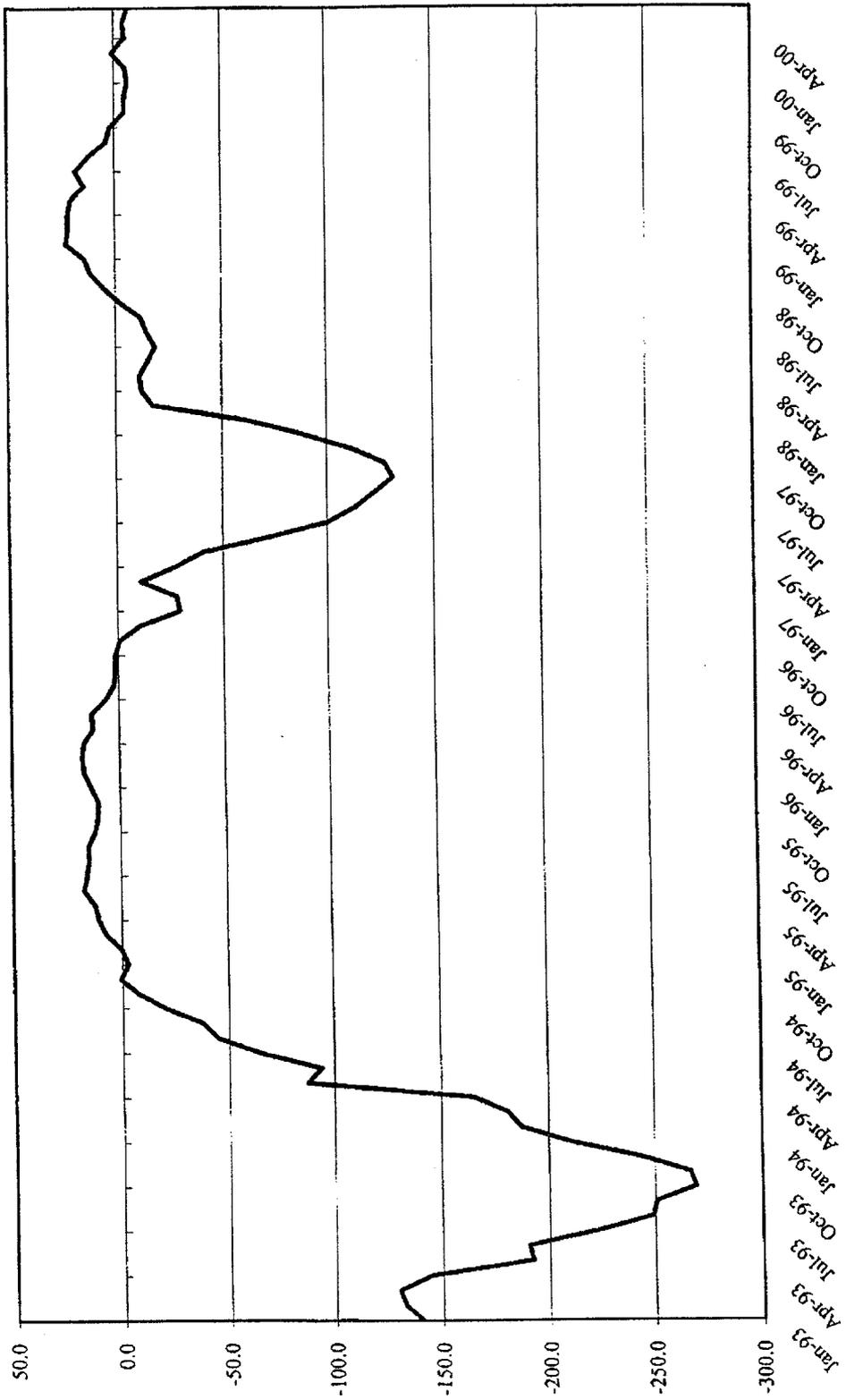
Developments in bank credit

28. **Associated with the low monetization level, bank credit to the nongovernment sector, especially the private sector, is very low (Figure III.8).** Compared with other countries in the region, Romania again ranked at the bottom, along with Bulgaria. Unlike Bulgaria, whose credit level declined sharply after the financial crisis in 1996, Romania's credit to the private sector has always been low. More recently, credit to the nongovernment sector declined sharply in 1997, along with a sharp contraction of domestic credit owing to the tightening of the monetary stance, and the erosion of credit by inflation. Credit to the private sector has since recovered, although still at a very low level, from some 8.5 percent of GDP in 1997 to some 12–13 percent in 1999.⁹ Credit to the state-owned enterprises (SOEs) has shrunk over time, from some 12 percent of GDP at end-1996 to about 3–4 percent of GDP at end-1999. The shift of banking credit from SOEs to the private sector partly reflected the accelerated enterprise privatization and reform, and partly reflected the termination of subsidized directed credit to the SOEs and enhanced banking supervision.

⁸ This did not happen in some other high inflation economies such as Poland, because its population was able to hold dollar deposits freely.

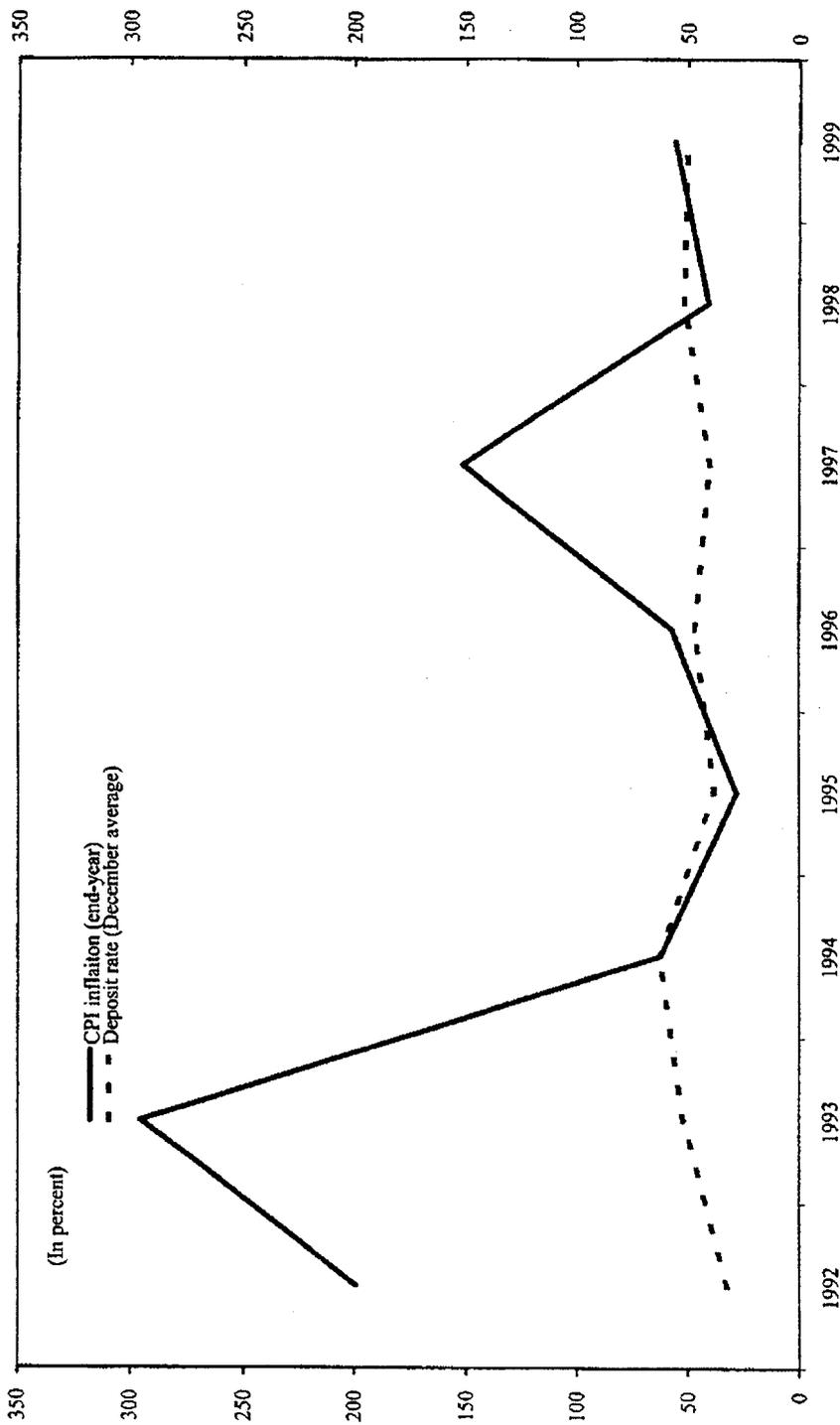
⁹ In mid-1999, before BX was merged with BCR, its bad assets were transferred to the newly founded asset recovery agency (AVAB), removing the bad loans from the banking sector. While the transfer of these assets did not affect underlying credit to the economy, it did change the statistics on banking system credit. As a result of the transfer, credit in the amount of 4½ percent of GDP was removed from the banking system—of which about 3 percent of GDP represented nonperforming foreign currency loans.

Figure III.6. Romania: Real Monthly Deposit Rate, 1993-2000



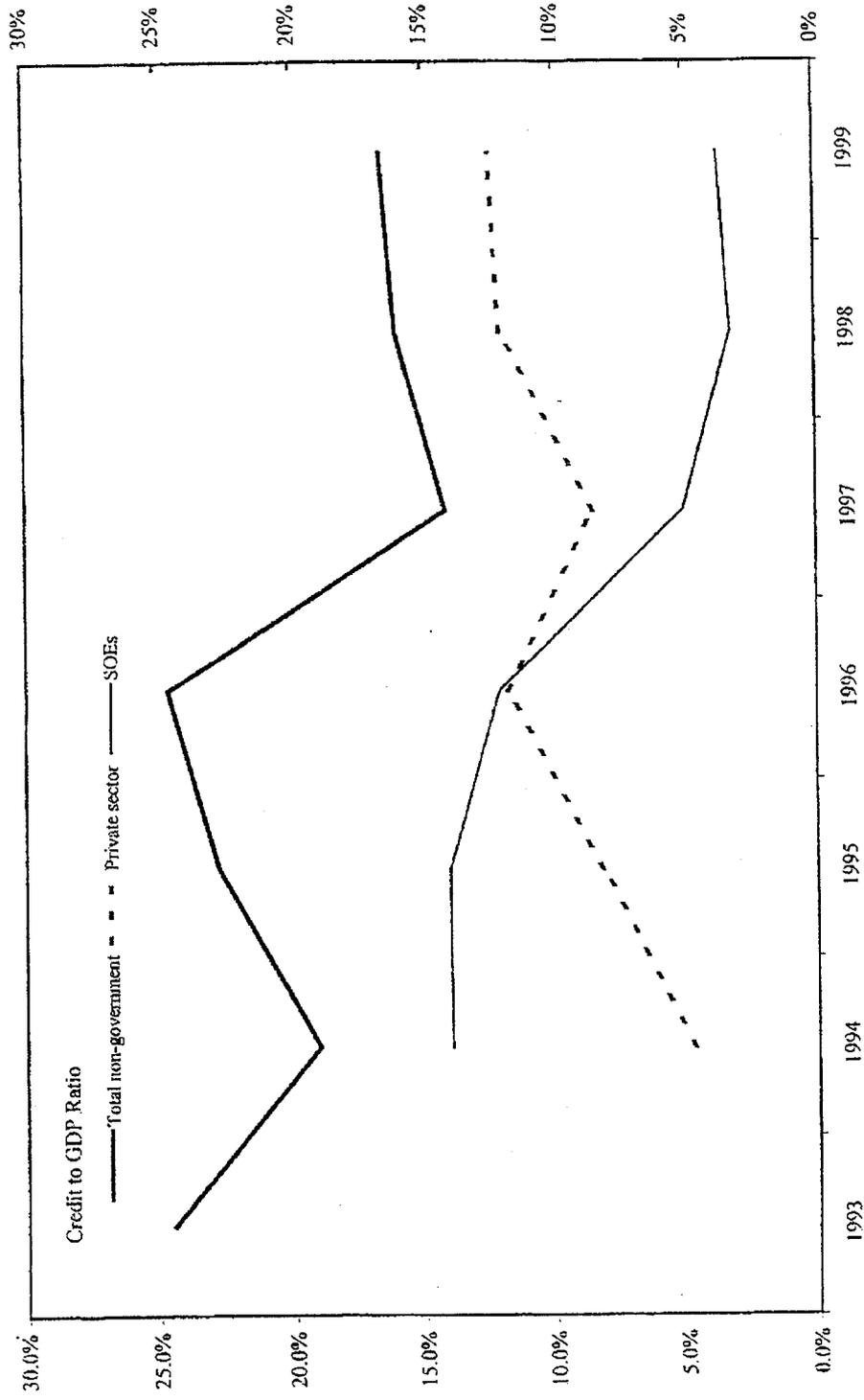
Source: Romanian authorities.

Figure III.7. Romania: End-Year Commercial Bank Deposit Rate and Inflation, 1992-1999



Source: Romania authorities.

Figure III.8. Romania: Credit to the Private Sector, 1993-1999



Source: Romanian authorities.

29. **Apart from the generally low level of financial intermediation, the exceptionally low credit level in Romania is also attributable to the following demand and supply factors:** on the demand side, the lending rates are very high, even in real terms, owing to both the high cost of financial intermediation and the lack of competition in the banking sector; wide-spread financial indiscipline renders much of the nongovernment sector able to use arrears as an alternative to bank financing; on the supply side, banks' capacity to enforce contracts and collect debt is limited, which makes them unwilling to extend credit; banks are saddled with nonperforming loans and hence are unable to expand credit significantly; banks could be better off investing in T-bills, which offer good rates of return as a result of high domestic financing needs.

30. **As a result, on average, less than half of bank assets in Romania are loans.** Healthier banks have even smaller shares of assets in loans, and often more than one-third in Treasury bills. T-bill rates have often been much higher than the average lending rates charged by the banks in the last few years (Figure III.9). Given that T-bills are low risk compared to lending, banks are therefore provided with an extra incentive to hold Treasury bills rather than lend to real economic activities.

31. **The maturity of the loan structure has evolved in recent years as well.** While in 1991 three-fourths of all credit to the nongovernment sector involved long-term credit, only one-tenth of such credit was long term at end-1999. This is closely related to the fact that foreign currency loans now account for some 60 percent of total loans (even after transferring BX's bad foreign currency loans to AVAB) to the nongovernment sector, up from one-fourth a few years ago. More than 85 percent of foreign currency loans are short- or medium-term lending. In addition, domestic currency loans are now almost exclusively short and medium term, as banks are not willing to lend on a long-term basis in an environment characterized by highly variable interest rates and general uncertainty.

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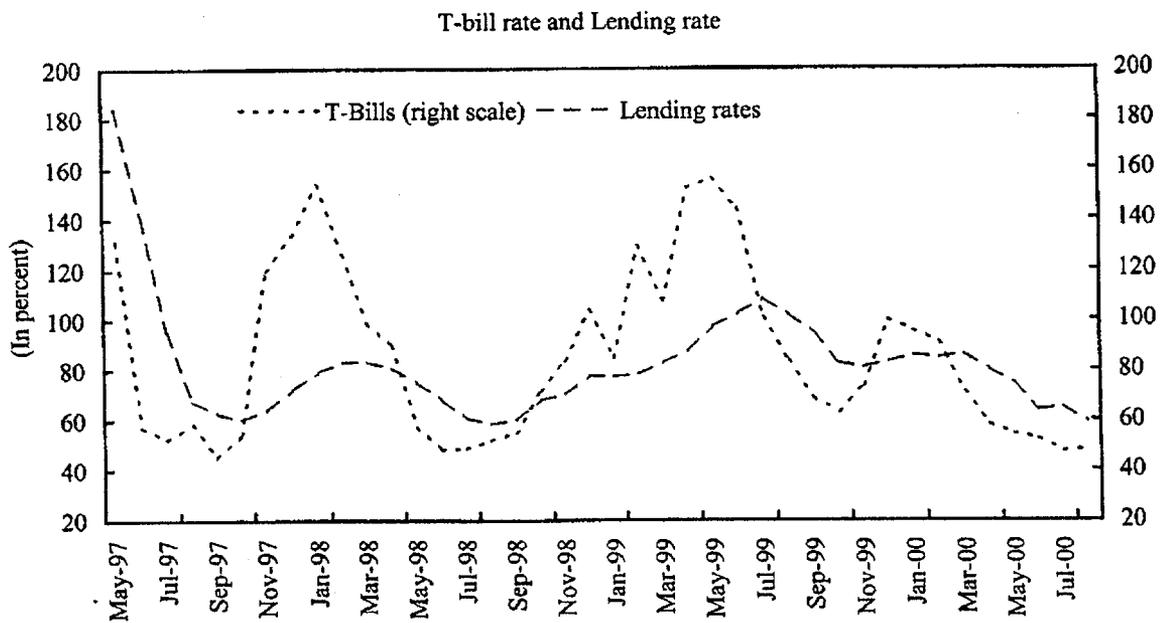
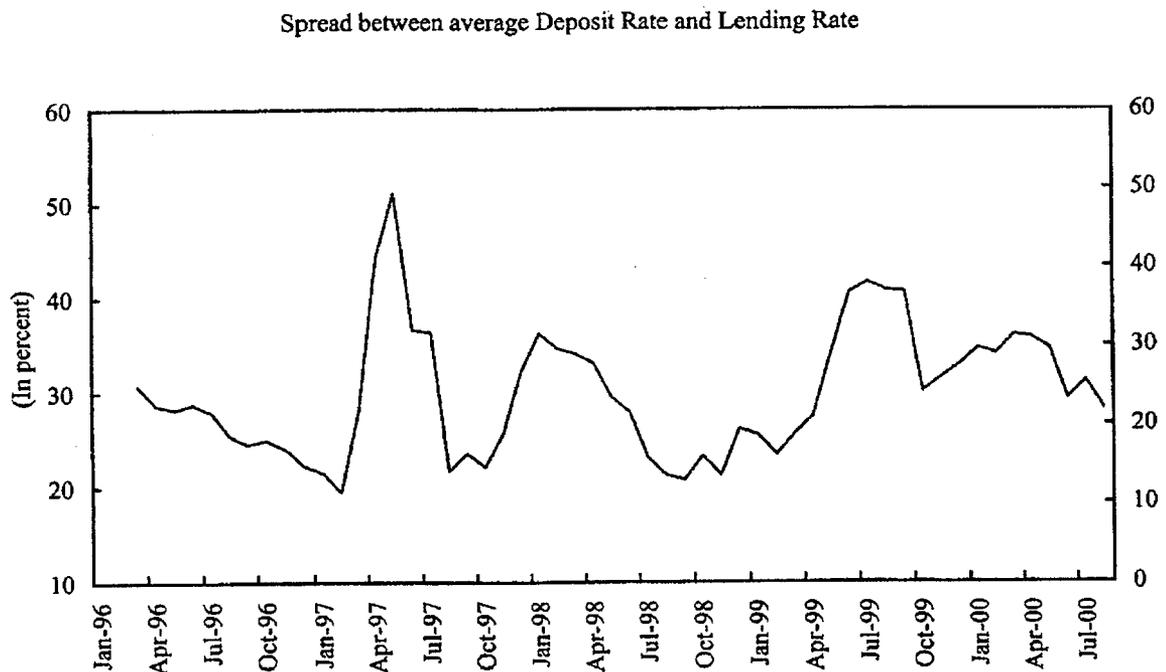
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Figure III.9. Romania: Developments of Interest Rates, 1996-2000



Source: Romanian authorities.

IV. FINANCIAL SECTOR ISSUES¹

1. **Significant progress has been made in restructuring Romania's financial sector in the past few years.** Largely as a result of the privatization and closure of some large state-owned banks in 1999, private banks now own more than half of the total banking sector assets in Romania. The enhanced supervision and stricter rules and regulations, along with the cleaning up of the bad loans of two large state-owned banks, have helped to substantially improve the quality of banks' loan portfolios. Substantial capital injections into the banking system have also improved the strength of the banks' financial position. In addition, the government is currently implementing asset classification and provisioning rules that are close to international standards, and is introducing International Accounting Standards in the banking system.

2. In spite of the meaningful progress achieved so far, a large part of the financial system remains weak and much needs to be done to enable Romania's banking system as a whole to carry out its intermediation function more effectively. The weakness in much of the financial system is reflected in the poor quality of assets even after significant cleaning up, and in the vulnerability of the system. The limited effectiveness of the banking system is revealed by the extremely low level of banking sector credit in the economy, as banks are unable or unwilling to lend. While the financial sector problem fundamentally reflects that of the rest of the economy, it is also attributable to the delay in restructuring the state-owned problem banks, the inadequate regulation and supervision of the banking sector, the unsatisfactory exit mechanism (procedures and legislations) for bankrupt banks, and the lax supervision over the nonbank financial sector.

3. The first three sections below describe recent developments in, and the current status of, the structure, the soundness, and the regulatory and supervisory environment of the banking sector, and the last section deals with the nonbank financial sector.

A. The Structure of Romania's Banking System

4. **Following the establishment of a two-tier system in 1991, Romania's banking system expanded rapidly but remained dominated by state-owned banks at the end-1998.** Romania effectively operated a monobank system until November 1990, when the two-tier banking structure was introduced. Specialized state-owned commercial banks were established in 1990² and developed rapidly, while private banks, including some with foreign

¹ This chapter was prepared by Olivier Frecaut and Tao Wang.

² Four specialized state banks—Banca Agricola (BA), BANCOREX (BX), Romania Commercial Bank (BCR), and Romania Bank of Development (BRD)—were established at the end of 1990, although Bancorex had existed since 1972, involved exclusively in foreign trade related transactions. Banc Post and the EXIM bank were established in 1991 and 1992, respectively. While the savings bank (CEC) was existed since 1949, it remained a state institution rather than a bank until the late 1990s.

ownership, emerged and expanded at an even faster pace. Nonetheless, at the end of 1998, the banking system remained dominated by heavily segmented state-owned banks, none of which had been privatized.

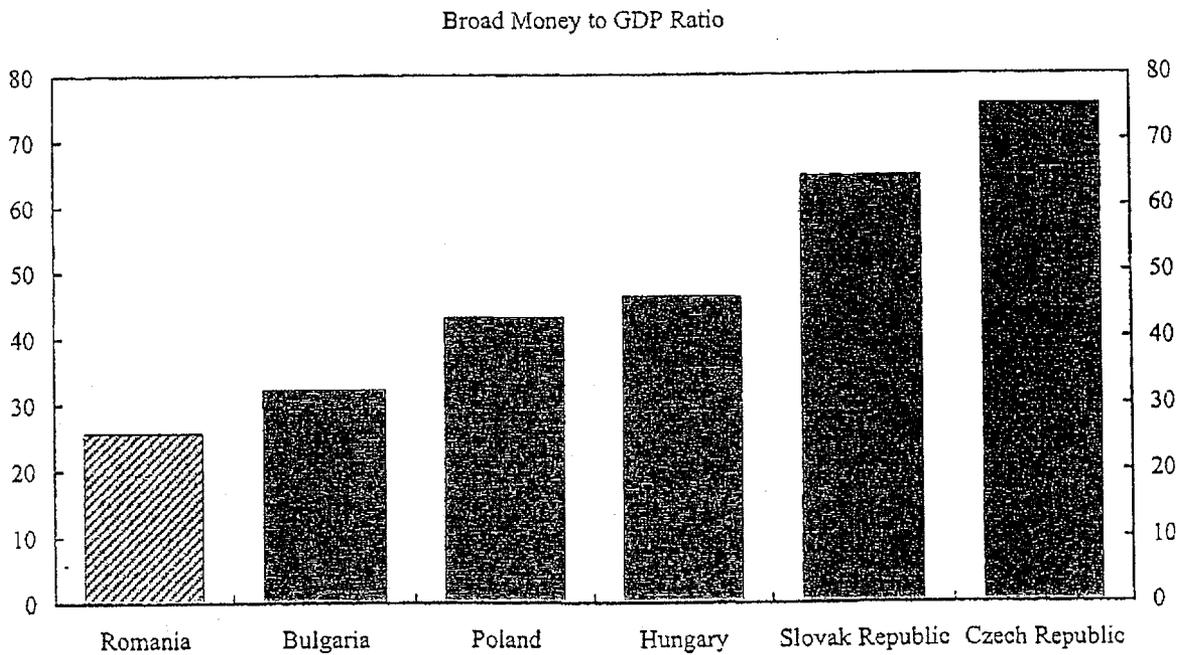
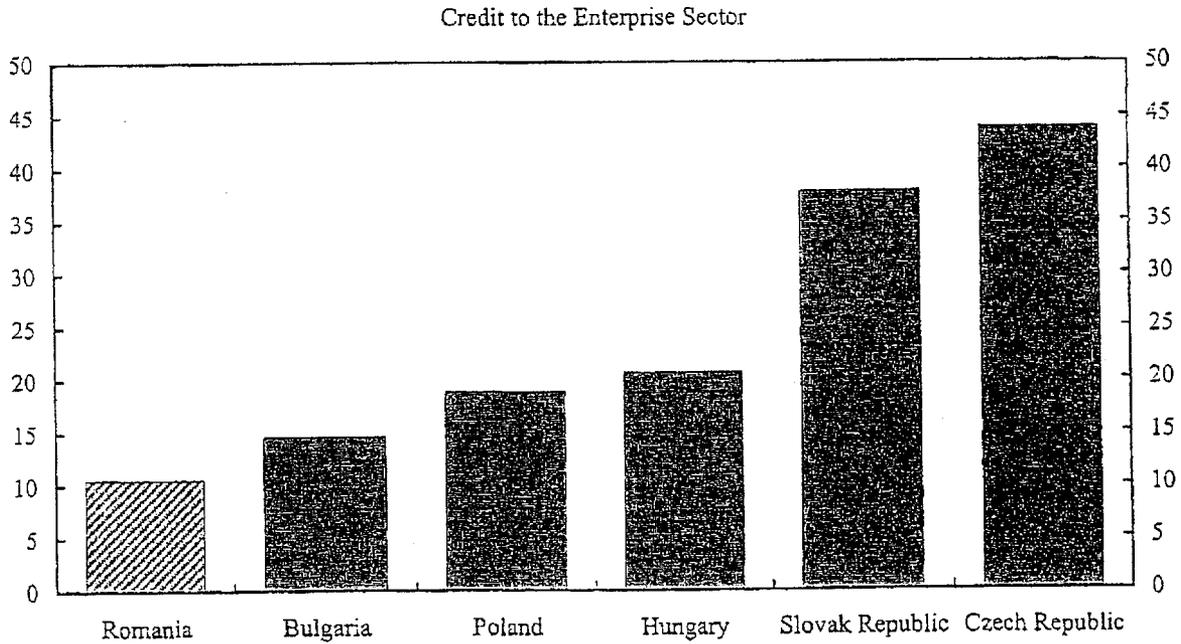
5. **The ownership structure of Romania's banking system has been altered drastically in the last two years with the privatization of two state-owned banks (BRD and Banc Post) and the closure of another, Bancorex (see Table IV.1).** At the middle of 2000, Romania's banking system consisted of 42 banks, of which 7 were branches of foreign banks. Four state-owned or majority state-owned banks remain in the system, and together they account for less than half of the total assets of the banking system. The private sector (majority private-owned) accounts for 56 percent, of which banks with majority foreign participation (majority foreign ownership, and foreign branches and subsidiaries) account for 44 percent of the banking system assets.

6. **The state-owned banks continue to take a majority share of domestic currency deposits, while the private banks concentrate on foreign currency deposits.** The four existing state-owned banks—BCR, BA, EXIMBank, and the Savings Bank (CEC)—accounted for about three-fourths of total lei deposits in the banking system as of June 2000, but only a quarter of total foreign currency deposits by residents. BCR became the largest bank in the system after receiving transfers of assets and liabilities from BX in mid-1999 and the final absorption of BX's balance sheet in September, and its share in the banking system in terms of total assets rose from 20 percent at the end of 1998 to about 30 percent at the end of 1999. Private banks, especially foreign banks and foreign branches, have concentrated on foreign currency transactions, taking about three quarters of residents' foreign currency deposits as of end-June 2000. The asset share of foreign banks (some with substantial Romanian participation) almost tripled in 1999 alone, bringing not only technical expertise and competition, but also capital in the form of direct foreign investment.

7. **Despite rapid development over the past decade and especially in the last two years, Romania's banking system as a whole plays a limited role in its intermediation function.** Ten years into transition, the overall level of monetization of the economy remains low, and the credit to GDP ratio in Romania ranks the lowest among the EU accession economies in the region.³ (Figure IV.1). The low level of financial intermediation in Romania reflected the lagged progress in restructuring and stabilization in the economy, as well as the weak financial system. Persistently high rates of inflation, variable interest rates (often negative in real terms), and problems at the large state banks all dampened confidence in and demand for the domestic currency and deposits (see previous chapter). Meanwhile, the large amount of nonperforming loans, the less-than-satisfactory enforcement on loan contracts, and the generally weak domestic activity discouraged lending.

³ The credit to GDP ratio was understated in 1999 when bad assets from BX and BA were transferred to the Asset Recovery Agency (AVAB), effectively removing credit amounting to 5 percent of GDP from the system.

Figure IV.1. Romania: Money and Credit, an International Comparison, 1999
(In percent of GDP)



Source: EBRD Transition report 2000.

Table IV.1. The Ownership Structure of the Banking Sector, 1996–2000					
	1996	1997	1998	1999	June 2000
(Number of banks)					
All commercial banks	35	37	45	41	42
<i>Of which:</i>					
Romanian incorporated banks	29	31	36	34	35
State-owned	7	7	7	4	4
<i>Of which:</i> Savings bank	1	1	1	1	1
Private	22	24	29	30	31
<i>Of which:</i> Joint venture with foreign investors	8	11	15	19	22
Branches of foreign banks	6	6	9	7	7
Banks under special treatment (including: under suspension, in court, etc)	1	1	3	3	3
(Share of total banking sector assets)					
All commercial banks	100	100	100	100	100
<i>Of which:</i>					
Romanian incorporated banks	96.1	93.4	94.3	92.9	92.5
State-owned	77.8	74.7	71.0	46.8	44.3
Private	18.4	18.7	23.3	46.2	48.2
<i>Of which:</i> Joint venture with foreign investors	4.3	6.4	10.4	40.5	44.1
Branches of foreign banks	3.9	6.6	5.7	7.1	7.5
Banks under special treatment (including: under suspension, in court, etc)	3.7	1.7	2.5	1.8	2.0
Source: Data provided by the NBR.					

B. The Soundness of the Banking Sector

8. **The soundness of Romania's banking system has improved significantly in the last two years, owing to the restructuring of state-owned banks, and the stricter loan loss provisioning and bank supervision.** The most visible improvement of Romania's banking system occurred in 1999, helped by the closure of BX (Box IV.1), and the restructuring of BA (Box IV.2). The AVAB—an Asset Recovery Agency—was established in early 1999 to help recover bad loans from the banking system, especially those of BX. A total of about US\$2.3 billion bad assets from BX and BA was transferred to the AVAB during the course of 1999, accounting for about 6 percent of GDP. The closure of BX and the removal of bad loans greatly reduced the presence of problem banks in the whole system (Table IV.2), and the total share of the nonperforming loans in the banking system declined to 35 percent at the end of 1999, compared with 59 percent in 1998 (Table IV.3). In particular, standard loans increased from 12 percent at end-1998 to more than 20 percent at the end of 1999.

Box IV.1. The Closing of Bancorex

Bancorex (BX), the former foreign trade bank, was the largest, most troubled state-owned bank in Romania prior to its closure in 1999. Accounting for about one-fourth of total banking sector assets, BX financed a significant portion of Romania's energy import requirements, as well as imports of capital goods, and was used as a major vehicle to subsidize the energy sector and energy-intensive industrial sector. The legacies of subsidized loans, years of mismanagement, and webbed political connections rendered BX the most troubled bank in the wake of exchange rate and price liberalization in early 1997. As BX was greatly exposed to debtors who traditionally relied on directed credit and the highly subsidized exchange rate, the termination of NBR's directed credit and exchange rate liberalization in 1997 made it unequivocally evident that the bank was insolvent.

The 1997 rescue effort for BX failed to solve its deep-rooted problems and turn the bank around, and BX collapsed in early 1999. At the end of 1997, BX received an equivalent of US\$600 million in government bonds (2 percent of GDP) in order to restructure its nonperforming loans in the portfolio. However, the restructuring of BX, which was to accompany the recapitalization, never took shape. Although a new management team was appointed in April 1998 and a few other steps were taken, a comprehensive restructuring plan was never implemented and the bank's situation deteriorated further. When BX was again in crisis in late 1998, the authorities considered restructuring measures with a view to privatizing the bank, although international experience would have favored liquidation of the bank. The authorities were concerned about the systemic risk and the cost of liquidation, and contemplated an up-front recapitalization, followed by restructuring and privatization. As the depth of the bank's problems was investigated, it became clear in early 1999 that BX was in much worse shape than expected, and that privatization with recapitalization would be prohibitively costly. Finally in April 1999, BX collapsed as depositors lined up to withdraw their money.

Realizing the magnitude of BX's problem, the authorities finalized, in April 2000, a liquidation plan aimed at the orderly removal of BX from the banking system. An estimate at the end of February 1999 put the nonperforming loans of BX at about 85-90 percent of its loan portfolio, or US\$1.7 billion (5 percent of GDP; this number increased as more became known about BX during the process of closing the bank), with most of the portfolio being in foreign currency. At that time, Bancorex accounted for one-fourth of total banking system assets and 47 percent of all foreign currency loans. A recapitalization would have required up to US\$2 billion from the budget, or almost 6 percent of GDP. It became clear that the only solution was to liquidate the bank in a rapid and orderly fashion. To avoid further runs on the bank and a systemic crisis amid fragile external and economic situations, the liquidation plan included the following key elements: appointment of a special administrator to replace BX's management (February 1999); transfer of all bad loans classified as such to the newly established Asset Recovery Agency (AVAB) for loan workout and debt recovery; winding down of BX operations, including transferring all liabilities to other banks and reducing staff and subsidiaries; and withdrawal of the banking license of BX before the end of July 1999.

In the event, the final resolution of BX was completed in the following manner:

- All bad assets classified as such at the end of 1998 were transferred to AVAB before July 31, 1999.
- Some of the deposit liabilities and most foreign debt liabilities were transferred to BCR, while a large part of the deposits was withdrawn from BX before July 31, 1999, owing to delays in transfers. The NBR provided special credit to staunch the financial hemorrhage of the bank. Both BCR and the NBR were compensated by government securities in corresponding currencies.
- The remainder of BX was merged with BCR, which absorbed the balance sheet of BX, as the authorities considered the actual liquidation politically unacceptable and too lengthy to complete. BCR received government securities to compensate for the gap in BX's balance sheet, and had the rights of first refusal to any BX assets transferred (on and off the balance sheet).
- The government approved the withdrawal of the banking license of BX on July 31 1999 (effective August 2).
- The final absorption of BX by BCR was completed only in September 1999, while BCR's refusal of the BX assets, which were transferred to AVAB in exchange of government securities, continued well into 2000. The Ministry of Finance also agreed to guarantee BX's off-balance sheet items (more than US\$400 million) transferred to BCR.

The closure of BX removed a large destabilizing factor in the financial system, albeit at a heavy cost to the tax-payers. The closure of BX removed some US\$2 billion in nonperforming assets from the banking system, which helped to improve the general soundness of the banking system. The removal of a large source of distress borrowing from the system also greatly diminished the level and volatility of market interest rates. In this process, the government took on public debt amounting to US\$1.5 billion (net of provisions and other assets), or 4.5 percent of GDP in 1999. This should be added to the 1997 recapitalization of US\$600 million, and the future assumption by the government of off-balance-sheet items and litigious liabilities currently with BCR (the exact number is unknown; estimated need for government securities is about US\$300 million).

It needs to be noted that the heavy fiscal costs incurred on BX in the last few years are mostly the realization of the losses incurred before 1997, caused both by the use of BX as a quasi-fiscal vehicle and by the mismanagement of the bank. Based on data provided by the authorities, the staff estimate that nonperforming loans before the recapitalization of 1997 amounted to about US\$1.5 billion, and much of the off-balance-sheet liabilities and litigious liabilities had been incurred before then as well. The delays in any meaningful restructuring or liquidation of BX in the subsequent two years cost the tax-payers an additional amount of money.

Box IV 2 The Restructuring of Banca Agricola

Banca Agricola (BA) was established in 1990 to specialize in financing the agricultural and rural sector on behalf of the state, and became the second largest insolvent bank in 1997. It expanded rapidly its portfolio, branch network, and

enterprises, with funding sources primarily from the central bank as part of the government's directed credit programs, in addition to aggressive mobilization of consumer deposits. As a consequence of lending to nonviable firms and ongoing structural changes in the agricultural sector, BA accumulated large amounts of bad loans over the years. The problems worsened considerably when the directed credit to the agricultural sector was terminated in early 1997. By the middle of

The government initiated a restructuring plan in 1997 which succeeded in reducing the number of retail branches

consisted of the following elements: A total of 6 trillion lei in nonperforming debts was identified, of which 2.6 trillion lei was removed to an account of "assets in the course of realization," and the rest was written off against the 3.375 trillion lei

the bank's situation. The total number of employees was reduced from 10,686 at the end of 1997 to 8,316 at the end of 1998 and 6,000 in August 1999, and one-fourth of the branches were closed down in the meantime. Nonetheless, the bank

invested in non-market-determined and nontransparent investments such as the recently collapsed investment fund, FNI.

1997-2000 while containing the cost to the budget. BA continued to accumulate non-performing loans until 1999, while losses mounted in part because its performing assets were yielding below market returns. Once again, more than two-thirds of the loans, or about 2.7 trillion lei, were nonperforming as of mid-1999, in addition to about 1 trillion lei in assets in the

from the bank in mid-1999, which were temporarily met by NBR's exemption of BA's minimum reserve requirements, and by heavy borrowing in the interbank market. The government decided to accelerate the restructuring process, which

effectively place BA under the control of the NBR; (c) establishment of a strict time table for restructuring and privatization of the bank; and (d) resolution of the bank if privatization turned out to be unrealistic or too costly to the budget.

- A consortium of privatization advisors headed by a foreign investment bank was contracted using tendering procedures

- All bad assets and assets from the Danube Fund were transferred to AVAB by December 1999;

more drastic measures in downsizing the bank while cutting operational costs;

- A firm interest letter from a potential investor was received in May 2000 but the investor withdrew its intention later

- An offer by the second investor was reportedly made in September 2000. Negotiations are reportedly ongoing between

¹Stipulated by Emergency Ordinance No. 43/1997.

Percentage of Total	End-1998	End-1999	Mid-2000
Liabilities - Problem banks	38.9%	12.2%	8.2%
Problem banks – state-owned	30.4%	6.1%	5.1%
Bancorex	22.7%	0.0%	0.0%
Banca Agricola	7.6%	6.1%	5.1%
Problem banks – private	8.6%	6.1%	3.0%

9. **Meanwhile, stricter requirements on loan loss provisions, capital adequacy levels, and enhanced supervision improved the banks' capital and provisioning levels and their compliance in the last two years (Tables IV.3 and IV.4). Thanks to the increased minimum capital adequacy requirement from 8 percent to 12 percent in 1999, the resolution of a large amount of non-performing loans, and significant capital injection, the ratio of banks' capital to assets increased markedly in 1999 and 2000. In part owing to stricter supervisory enforcement, the actual provisions for loans improved from about 73 percent in 1997 and 1998 to about 100 percent in 1999.⁴**

	1996	1997	1998	1999	June 2000
<i>(Share of nonperforming loans)</i>					
Romanian incorporated commercial banks	47.2	52.6	58.5	35.4	35.4
State-owned	43.0	51.1	52.9	32.3	36.2
Private	63.3	60.1	73.9	37.5	34.8
<i>Of which: Joint venture with foreign investors</i>	24.1	56.2	45.1	26.0	34.2
<i>(Share of actual provision/required provision)</i>					
Romanian incorporated commercial banks	64.5	73.1	73.8	102.7	94.4
State-owned	59.2	74.5	72.3	114.5	91.2
Private	79.0	57.0	77.4	94.6	96.9
<i>Of which: Joint venture with foreign investors</i>	40.3	56.0	57.6	90.7	97.3

⁴ The write-off of bad loans and transfer of bad assets to AVAB obviously contributed to the decline of required loan loss provisioning.

	1996	1997	1998	1999	2000
Romanian incorporated commercial banks	14.0	13.6	10.3	17.5	21.4
State-owned	13.2	12.0	10.3	17.5	20.4
Private	18.4	22.0	10.0	17.5	22.1
<i>Of which: Joint venture with foreign investors</i>	22.2	34.7	36.6	27.0	22.2

10. **Notwithstanding the meaningful progress in improving the underlying health of banks' balance sheets, a large part of Romania's banking system is still plagued by poor loan quality and underprovisioning.** Nonperforming loans in the banking system still accounted for about 35 percent of the total loan portfolio at end-December 1999 and June 2000, reflecting past legacies of subsidized loans and poor accounting standards, as well as poor banking supervision.⁵ Economic recession and another large depreciation in 1999 further worsened banks' balance sheets. In addition, while the restructuring helped to improve indicators of bank soundness, stricter loan classification and provisioning rules contributed to the worsening of the indicators even though the underlying soundness of the banks may have improved.

11. Nonetheless, the official figures presented above show a grim picture of Romania's banking system. In addition, the official figures understate the true scope of the banking system problems, albeit less so over time, for the following two reasons:

12. **First, the current loan loss provisions are insufficient, owing to unsatisfactory asset classification regulations and substandard loan loss provisioning requirements.** The current loan classification rules in Romania are based on the financial standing of the borrower as well as the record of debt service, and lax requirements on debt service and the judgment element of the rule sometimes wrongly classify what should be nonperforming loans as standard loans. In addition, because the provisions are made on the basis of the loan classification conducted six months earlier, there is substantial underprovisioning compared with required provisions based on the current loan classification. Moreover, required provisions are based on loan values net of collateral based on its book value, and the book value of collateral is often much higher than the market value. Also, no specific provisions are made against interbank claims.

⁵ The state-owned banks were used as a means of quasi-fiscal operations to sustain the inefficient loss-making state enterprises and the agricultural sector prior to 1997, accumulating nonperforming loans on their balance sheets. The problems were aggravated by the elimination of NBR's directed credit and by the sharp depreciation and high interest rates that followed the exchange rate and price liberalization in early 1997.

13. **Second, the reported capital adequacy ratio overstates the solvency situation of the banks.** Banks' assets are improperly valued (through, for example, the aforementioned insufficient loan loss provisioning), and insufficient consideration is given to market risks (exchange rate and interest rate risks, for example). Partly because of the problematic measuring of capital and assets in the Romanian system, the NBR increased banks' minimum capital requirements from 8 percent to 12 percent in 1999 to partially compensate for the problem.

14. **The authorities' new regulations concerning asset classification and provisioning represent a major step forward in addressing these problems and putting Romania's banking sector on a sounder footing.** The new regulations on asset classification and provisioning, introduced in October 2000, bring Romania closer to the international standards. Based on the new regulations, loans are classified solely on the debtors' debt-service record, for which a more stringent rule on debt-service delays is in place. Moreover, banks are required to classify and provision for their assets every month, and the write-offs of bad assets and related interests are 100 percent tax deductible.⁶ The authorities are also introducing the International Accounting Standard (IAS) to replace the Romania Accounting Standard (RAS) for all commercial banks, which will improve further the adequacy of asset valuation in the banking system.⁷

15. **Another weakness of Romania's banking system is its vulnerability in a number of aspects.** First, a significant portion of the profits in the profitable banks comes from high returns on the T-bills, which is highly volatile and can not be sustained over the long-run. Second, as the share of nonperforming loans in banks portfolio is high, the banks are particularly vulnerable to economic recession and restructuring at the enterprise level—especially since the major enterprise restructuring still lies ahead. Third, since the banking sector as a whole has significant foreign currency liabilities and foreign currency lending, it is vulnerable to a serious decline of market confidence in the domestic currency, and/or to a sharp un-anticipated exchange rate depreciation.

C. Regulatory and Supervisory Issues in the Banking Sector

The regulatory framework

16. **Over the last three years, the regulatory framework for banking has been continuously strengthened.** In spite of some remaining weaknesses, it is being progressively

⁶ One key improvement that is not in the regulation was a rule implemented in 1999—banks are now required to provision 100 percent for interest overdue by more than 90 days (which was previously counted as income), irrespective of the value of collateral.

⁷ One main difference between the two standards is that under the RAS, fixed assets (and collateral) are valued at book value rather than market value, but are not inflation adjusted, while the IAS values the fixed assets (and collateral) at market value, but inflation adjusted.

brought in line with European and international standards and practices, with technical assistance from various sources, including the Fund, the EU, and USAID.

17. New laws governing the banking sector, including a Central Bank Law, a Commercial Banking Law, and a Bank Insolvency Law were adopted during the first half of 1998. The first two are by and large satisfactory, and have brought Romania close to accepted international practices. On this basis, a number of new and revised prudential regulations have been and continue to be issued to progressively tighten prudential standards, plug loopholes and address remaining shortcomings. By contrast, the legislation on problem banks still suffers from severe shortcomings. In particular, the determination of a bank's insolvency is made by a Court instead of the central bank in its capacity as banking supervisor, and the procedure to initiate bankruptcy proceedings remains cumbersome and ineffective.

18. The minimum capital requirement was raised to Lei 100 billion in May 2000, and is planned to be raised again to Lei 150 billion in May 2001. Consideration is being given to steeper raises. However, contrary to international practices, there is currently no requirement for banks to permanently feature a surplus of assets over liabilities equal to or larger than the minimum capital. It is the central bank's intention to address this regulatory shortcoming in the near future.

19. The capital adequacy requirements are consistent with the Basel Committee standards. During 1999, the minimum level was raised from 8–12 percent. This triggered a substantial improvement in the banking sector's reported equity position. However, capital adequacy is relevant only as far as bank assets are properly appraised. Since Romania's current loan loss provisioning rules are not strict enough, the banking system's real solvency position is weaker than the reported one.

20. Thus, the next step in tightening the regulatory framework was to prepare stricter loan classification and provisioning rules. Such rules have been issued, and, at the expiration of a transitory period, came into force in October 2000, forcing the banks to set aside significant amounts of additional provisions. Another major improvement in this field is the tax deductibility of loan loss provisions. In the past, some of the failed banks had paid taxes on accrued interest that they did not receive, exacerbating their insolvency. Banks are striving to comply with the new loan classification and provisioning rules, and significant progress is being achieved, under close monitoring of the central bank.

21. Progress is still underway as regards foreign exchange risk. A new regulation has been prepared, but is not enforced yet. It takes into account the overall position, but fails to set limits on individual currencies, and on intra-day positions. There are still some unsettled issues on the elements to be included in the foreign currency position, in particular the capital when denominated in foreign currency, and on the tax treatment of positive revaluation differences of foreign exchange denominated assets and liabilities. Reporting requirements on foreign exchange positions are also still somewhat below best international standards and practices.

22. The regulation of banks' liquidity is also a work in progress. Options are currently being considered, and, with outside technical assistance, a draft prudential regulation is being prepared.

Banking supervision

23. **Banking supervision has also been significantly strengthened in a number of aspects, although more needs to be done on resolution methods for problem banks, and the Deposit Guarantee Fund is in financial disarray.**

24. The improvement in banking supervision is reflected in a more effective organization, the implementation of an early warning system, and the development of on-site inspections. These improvements are summarized in Box IV.3.

25. As concerns the resolution methods of problem banks, several bank closures over the recent past have tested both the central bank's ability and the applicable laws and regulations' suitability in dealing with distressed banks. A few insolvent banks have been able to remain open and active for several years, defying the central bank's efforts to get them closed. As a result, there are still several unresolved problem banks requiring daily attention and waiting for a resolution of some sort.

26. This experience confirms that further improvements in the Bank Insolvency Law are needed. In particular, the central bank needs more discretionary power to take special administrative measures against problem banks and to file for bankruptcy, while appeal possibilities by third parties should not hold up the bankruptcy procedure as easily as they do now. Ways to improve the effectiveness of the Court system also need to be considered. Detailed proposals are being prepared within the central bank and are to be discussed in the near future with the government with a view to introducing amendments to the current Law.

27. As regards the Deposit Insurance Fund, it has been an operational success but a grave financial failure. The Deposit Guarantee Fund was established in 1996, i.e. before the banking system had been cleaned up and stabilized. By the time it had to repay the depositors of a failed bank for the first time in 1999, its reserves were still modest, and two thirds of its resources were soaked up, in spite of that bank's limited size (0.4 percent of the banking sector). When a second, more sizeable bank (2.4 percent of the banking sector) closed in early 2000, the cost for the Fund represented 6.5 years of ordinary assessments, and the Fund had to be financially supported by the central bank. With the closure of a third bank (1.7 percent of the banking sector) in mid 2000, additional central bank support was unavoidable. For years to come, the Fund will struggle to repay the central bank, even without any new bank closure, and remain unable to accumulate any reserves, defeating the very purpose of its establishment.

Box IV.3. Recent Improvements in Banking Supervision

Organization

The NBR's supervisory function was reorganized in September 1999. On-site and off-site supervision were combined in a new Supervision Department. It consists of four Divisions. Three are in charge of a portfolio of individual banks. There is no separate division for problem banks: they are spread among the Divisions to level off the workload. The fourth Division of the Supervision Department is the Synthesis Division. This division is in charge of the Bank Rating and Early Warning system described below.

As part of the reorganization, a second department was formed: the Financial and Banking Policies Department. This department is responsible for licensing banks and exchange offices, issuing prudential regulations, and managing the Credit Information Bureau.

This new organizational structure appears by and large satisfactory. However, the coordination between the supervisory and policy departments could be improved; there is not yet adequate legal expertise in the Supervision Department and in the Financial and Banking Policies Department, and an efficient division of labor with the central bank's Legal Department remains to be defined.

Off-site monitoring

Bank Rating and Early Warning system: Since September 1999, the Synthesis Division of the Supervision Department, has been focusing on the development and the implementation of a Bank Rating and Early Warning system based on accepted international standards. This system covers capital adequacy, asset quality, profitability, and liquidity. It is based on 30 internally developed ratios per component, which result in a rating (scale 1 to 5) for each component as well as in a composite rating, which characterizes the overall quality of a bank. The quality of management is not directly included in the system, but taken into account when computing the composite ratio.

Apart from the composite rating per bank, an extensive number of ratios has been defined, which, in combination with the rating system, are used for the monthly analysis of the banking system. The analysis is in principle on an aggregate level, but where necessary details of individual banks are added as an explanation. The analysis, together with the result of the rating system is presented monthly to the Board of Directors. There is a delay of two months in the presentation of the data. The implementation of the rating system as well as the monthly analysis are significant achievements bringing Romania closer to EU and international best practices.

Decision Matrix for Progressive Enforcement Actions; Also since September 1999, a Decision Matrix for Progressive Enforcement Actions has been put in force. It identifies remedial actions appropriate in various situations, based on the Banking Law. After a break-in period of a few months, the matrix has been revised and the measures to be taken have been strengthened. A manual, which contains the procedures for the actions to be taken on the basis of the situation identified in the matrix is currently being drafted.

On-site inspections

Considerable achievements have also been made regarding on-site inspections. Much effort has been made to improve the on-site methodology and to train the staff of the three divisions, also with technical assistance from USAID. Gradually, the coverage of on-site inspections is widened, and the focus moved away from the formal checking of data towards a more risk-oriented approach of understanding the facts behind the figures.

Each bank is now inspected at least once per year. Moreover, the Savings Bank (CEC) has been included in the inspections since September 1999; previously this was not the case, because of the special status of the CEC, of which the deposits are guaranteed by the state.

D. Nonbank Financial Sector Issues

28. **The nonbank financial sector is still in the midst of serious unresolved issues and acute problems. While progress has been initiated on bringing credit cooperatives and popular banks under an appropriate supervisory umbrella, the mutual funds sector has been devastated by a high-profile incident and will need to be rebuilt from the ground up, and other nonbank financial institutions' situation still needs to be comprehensively assessed.**

Credit cooperatives

29. A 1996 Law has authorized the introduction of credit cooperatives and popular banks. These are grass-root, unregulated (no licensing, no prudential norms, no required reserves, no reporting requirements) financial intermediaries which compete directly and on uneven terms with regular banks. About 2000 entities of this kind are active in Romania. Most of them are very small, and some organized themselves in networks. Although specific data is missing, their aggregated assets are estimated at ROL 3,000 billion, some 2 percent of the total for the banking system or 0.5 percent of GDP

30. The dangers of this situation were clearly demonstrated when the largest institution of this type, Banca Populara Romana, with assets of Lei 800 billion, appeared unable to repay its depositors in June 2000. This unfortunate incident triggered adverse sentiment about the financial sector as a whole. On the other hand, it provided the impetus to accelerate the completion of a new legislation, already being prepared within the central bank, to regulate these institutions.

31. Under an Emergency Ordinance issued in July 2000, the credit cooperatives and popular banks were given one month to identify themselves with the central bank or wind down their operations. The identified institutions have been given two options. They can become full fledged banks, provided that they meet all prudential requirements imposed on banks. It is not expected that any of the concerned institutions will be able to take this option. The second option is to join a cluster of at least 100 similar institutions and organize a network. Two such networks, and possibly a third one, are in the process of emerging. They will be subjected to specific prudential regulations and requirements, somewhat lighter, but by and large comparable, to those imposed on banks. They will not be allowed to use the word "bank" in their names. The rules are based on the principles of the cooperative banks as applied in a number of European Union countries. Each network will have a central institution, coordinating the activities of the cooperatives and serving as administrative center. The supervision of the individual cooperatives in the group will be delegated to the central institution. The central institution will be supervised by the central bank.

Investment funds

32. The investment fund sector is in deep disarray in Romania at the current juncture, following the May 2000 collapse of the largest mutual fund, Fondul National de Investitii (FNI), which represented 90 percent of the market and had high visibility, with high profile

nationwide advertisement campaigns on television and magazines. After the collapse, it became clear that FNI had been little more than a pyramid scheme for years, and that none of the safety measures against fraud had been effective in stopping it. The head of FNI's management company fled abroad, thereby impeding the investigations. The National Securities Commission (CNVM), in charge of supervising the investment funds, did not play its role, in spite of blatant anomalies, and its former Head has been jailed. Moreover, CEC, the state owned savings bank, developed a complex and unhealthy relationship with the FNI, as a shareholder in the management company; an investor for substantial amounts, generating large profits until the collapse; a provider of a disputed guarantee for the investors; and a close business partner, allowing, through a subsidiary, use of its name and reputation as a state owned bank as a promotion tool in advertisement.

33. Meanwhile the investigations into the affair have taken longer than initially expected. The results of the investigations on FNI as regards the beneficiaries of the fraud and the complexity which made it possible to last for several years have reportedly been concluded but not been announced yet. The incident has now taken a political turn, with the Parliament getting involved, amidst growing controversy. Most recently, the cabinet has initiated legislation that would grant limited compensation to all FNI investors before the fund's assets are recovered.

34. In the meantime, two courts have decided that CEC be held responsible for the guarantee extended compensate for the losses of the FNI investors. The financial impact is potentially very large, more than CEC's net equity. An new appeal by the CEC is pending. The authorities, with World Bank assistance, have begun work on the governance issues involved in the FNI incident, and more generally on the regulation and supervision of the non bank financial sector.

V. ASSESSING EXTERNAL VULNERABILITY¹

1. THE MOST SIGNIFICANT DEVELOPMENT IN ROMANIA'S EXTERNAL SECTOR DURING 1997-98 WAS the period of intensified exchange market pressure and the correspondingly large external adjustment that began in the latter part of 1998 and continued through the first half of 1999. This chapter assesses Romania's external vulnerability leading up to and following this period by examining a range of vulnerability indicators.

VULNERABILITY INDICES BASED ON BRASSIERE AND HENRIOT (1997), SHOW THAT ROMANIA WAS POTENTIALLY vulnerable to crisis by mid-1998. This vulnerability was due to a misalignment of fundamentals, in particular an overvalued exchange rate, as well as to an escalating liquidity

3. Towards the end of 1998, exchange market pressure intensified considerably, and was sufficiently high to be classified as a balance of payments crisis by some of the measures common in the research literature. The authorities understood the seriousness of the situation

more serious crisis. However, at the time the authorities responded, the scope for a more gradual approach was very limited. Such an approach may have been feasible earlier.

VULNERABILITY HAS LESSENED CONSIDERABLY. THIS HAS BEEN ACCOMPANIED BY CLEAR SIGNS OF A strengthened external position, both in terms of fundamentals and liquidity, most notably a sharp acceleration in export volumes and a successful return to international bond markets in

the continued accumulation of foreign reserves.

5. The rest of the chapter is organized as follows. The next section compares the period

Section C looks at Romania's external vulnerability after the crisis, and discusses areas where further steps could be taken to reduce vulnerability in the future. The final section

B. INDICATORS OF EXTERNAL VULNERABILITY

6. In the literature, there have been two main approaches taken towards the use of

¹ Prepared by Ward Brown.

Reinhart (1998), attempts to identify variables that are leading indicators of balance of payments crises (so called "early warning systems"). An alternative approach, taken, for example, by Sachs, Tornell, and Velasco (1996), tries to identify characteristics of an economy which make it relatively vulnerable to a balance of payments crisis should one occur elsewhere.

7. The approach taken in this section is closer to that of Sachs, Tornell, and Velasco (1996). A set of indicators is compared informally across a cross-section of countries just before and after the Russia crisis of August 1998.³ Several indicators do show that Romania was comparatively vulnerable to a balance of payments crisis in 1998: (i) the appreciation of the real exchange rate; (ii) the size of the current account deficit; and (iii) the decrease in liquidity, evidenced in particular by the increase in short-term debt to reserves in the first half of 1998. In an effort to formalize this approach, a fitted vulnerability index is calculated using the estimates from a cross-sectional regression run by Brüssière and Mulder (1999). Those results also show Romania to have been relatively vulnerable in 1998. Romania's index value ranks 9th out of 23 emerging market countries in the Brüssière and Mulder (1999) sample.

Balance of payments crisis?

8. We begin by asking whether the episode of intensified exchange market pressure was significant enough to expect indicators to be (informally) signaling Romania's potential vulnerability. In other words, by the standards in the literature, could this episode be classified as a balance of payments crisis?

9. An early and simple approach was taken by Frankel and Rose (1996), who defined a balance of payments crisis as a year with a nominal depreciation of least 25 percent that was also at least 10 percent higher than the previous year. The episode in Romania easily falls into this definition. In 1999 Romania's currency depreciated by 70 percent, against a 32 percent depreciation in 1998. Moreover, if we measure the period of depreciation from June to June, the contrast is even starker: 84 percent in 98/99 versus 20 percent in 1997/98.⁴

² For a brief overview of the literature, see Berg, et. al. (1999).

³ The following cross-section of central and eastern European countries was chosen: Bulgaria, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Romania, Russia, Slovak Republic, Turkey, and Ukraine. An advantage of focusing on these countries is their similarity, in terms of economic structure and institutions, to Romania's economy. Moreover, they are all emerging markets, the majority of which have accessed international capital markets in the last five years.

⁴ For countries with high inflation, this definition is not sufficiently strict in that it leads to too many episodes being classified as crises. However, even in real terms the Romanian currency fell by over 20 percent over this period.

10. However, this somewhat narrow definition of a crisis does not capture periods where pressure on the exchange rate is intensified, but where policy makers take the necessary steps to avoid a sharp nominal depreciation. Therefore, alternative quantifications of balance of payments crises have looked at indices of several variables. For example, Kaminsky, Lizondo and Reinhart (1998) use an index based on a weighted average of the exchange rate and reserves. Similarly, Eichengreen, Rose and Wyplosz (1995) use a weighted average of the exchange rate, reserves and domestic interest rates.

11. Figure V.1 shows both of these indices calculated on a monthly basis for Romania.⁵ Positive values indicate periods of increased exchange market pressure—that is periods when reserves are falling, nominal exchange rate depreciation is high, and interest rates are high. These indices show exchange market pressure was highest between September 1998 and June 1999, with peaks in March 1999 for the Kaminsky, Lizondo and Reinhart index, and May 1999 for the Eichengreen, Rose and Wyplosz index. Kaminsky, Lizondo and Reinhart (1998) quantitatively defined a crisis as a month in which their index variable was at least three standard deviations from its mean, while Eichengreen, Rose and Wyplosz (1996) used two standard deviations. Formally, therefore, the Romanian episode can be classified as a crisis only under Eichengreen, Rose and Wyplosz 's methodology.⁶ Nonetheless, regardless of the formal classification, exchange market pressure was sufficiently intense to expect some indicators to have signaled Romania's vulnerability.

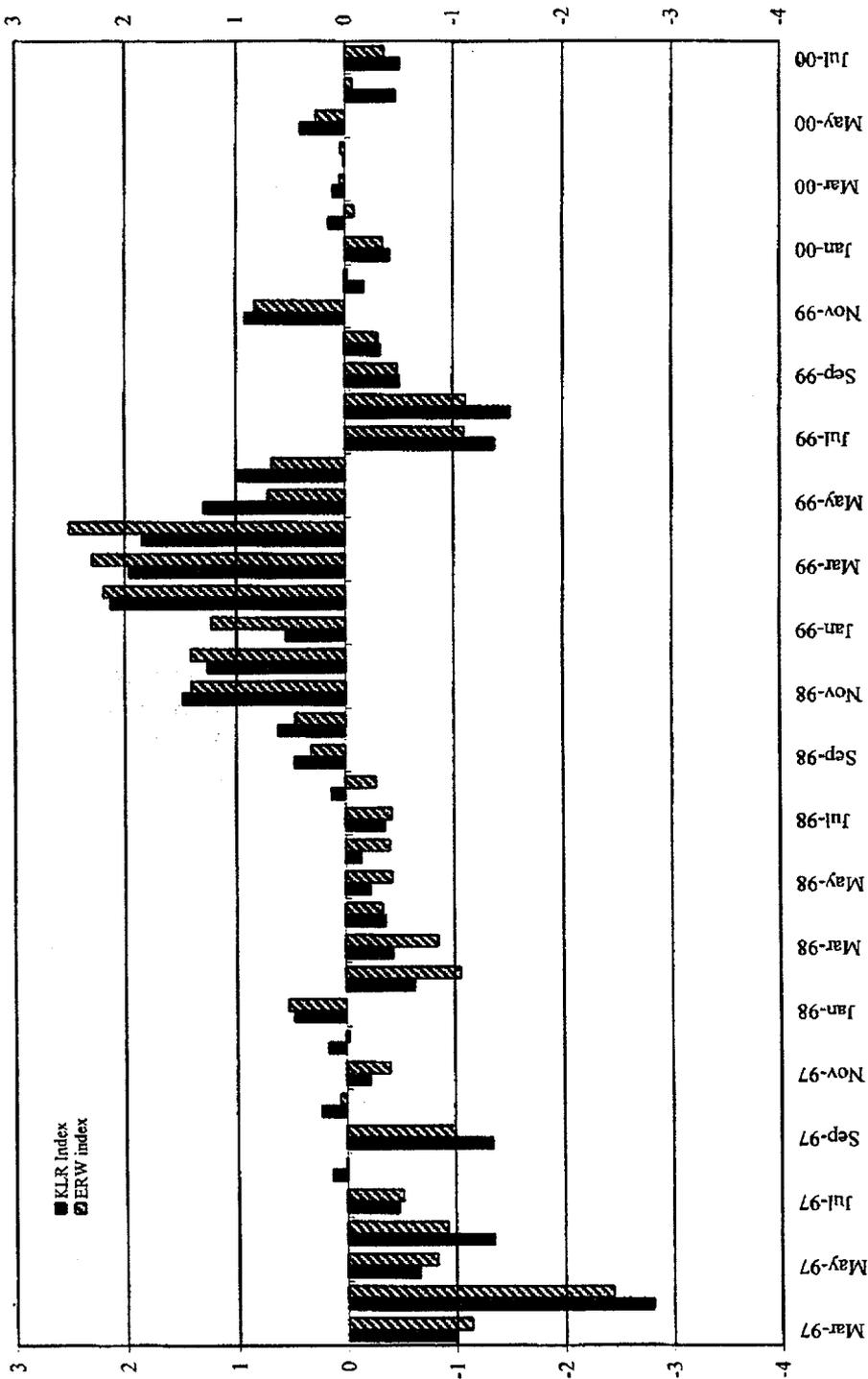
12. Rather than using a threshold cutoff, Sachs, Tornell and Velasco (1996) interpret the different values of their index as different intensities of a crisis. To apply this approach to this episode, a crisis index used in Brusière and Mulder (1999) was calculated for Romania and is presented alongside the results for the cross-section of countries used in that study (Table V.1).⁷ For the countries in that table, the value of the index was calculated for the period July–October 1998. As shown above this is before exchange market pressure was at its most intense in Romania. Nevertheless, the value of the index for Romania is 11.3, making Romania the sixth most vulnerable country in the sample. The only European country in this sample with a higher ranking was Russia itself.

⁵ The weights were calculated to equate the conditional variances of the variables in the index. The indices have been normalized to have zero mean and standard deviation one (plotted on the vertical axis). The sample period used was from 1997M3 to 2000M7 thus avoiding the large nominal depreciation of the official exchange rate due to the liberalization of the foreign exchange market in early 1997.

⁶ However, the exchange market was relatively volatile over the whole sample period, which would bias upwards the standard deviation of the indices. Using a longer sample has the drawback that this would encompass several regime shifts.

⁷ Brusière and Mulder (1999) use the index proposed by Sachs, Tornell and Velsaco (1996), which is very similar to the Kaminsky, Lizondo and Reinhart (1998) index.

Figure V.1. Romania: Indices of Exchange Market Pressure, 1997-2000



Sources: Romanian authorities and Fund staff estimates.

Solvency indicators

13. Turning to an examination of indicators, the analysis focuses on a narrow set of variables which can be divided into two classes: (i) solvency indicators, and (ii) liquidity indicators. Very simply, a country is solvent if the net present value of its future stream of current account surpluses is at least equal the its outstanding stock of net external debt. In order to assess a country's solvency then, a natural starting point is to look at measures of its outstanding external debt.⁸

Debt indicators

14. Cross-country comparisons of debt levels are problematic, as debt data typically vary in coverage or accuracy across countries. To mitigate this problem somewhat, a cross-country database, the *World Development Indicators*, is used rather than a country specific database such as the WEO.⁹ Tables V.3–V.5 show the total external debt for the sample of countries scaled by three different variables: GDP, GDP using PPP exchange rates, and exports of goods and services.

15. None of these measures show Romania to have a level of external debt which would be difficult to service under relatively moderate assumptions regarding future GDP growth. Romania's debt-to-GDP ratio is slightly under the median for the sample in 1997. This ratio falls in 1998, improving Romania's ranking even further, though the decline is to some extent due to the appreciation of the lei. Using PPP exchange rates to value GDP does not change the picture significantly. Romania's ratio remains below the sample median and declines in 1998. Scaling by exports shows Romania's debt burden to be comparatively heavier, but still not in a range that would be a clear signal of vulnerability. Its ratio is slightly above the median in both years, while its ranking in the sample remains unchanged.

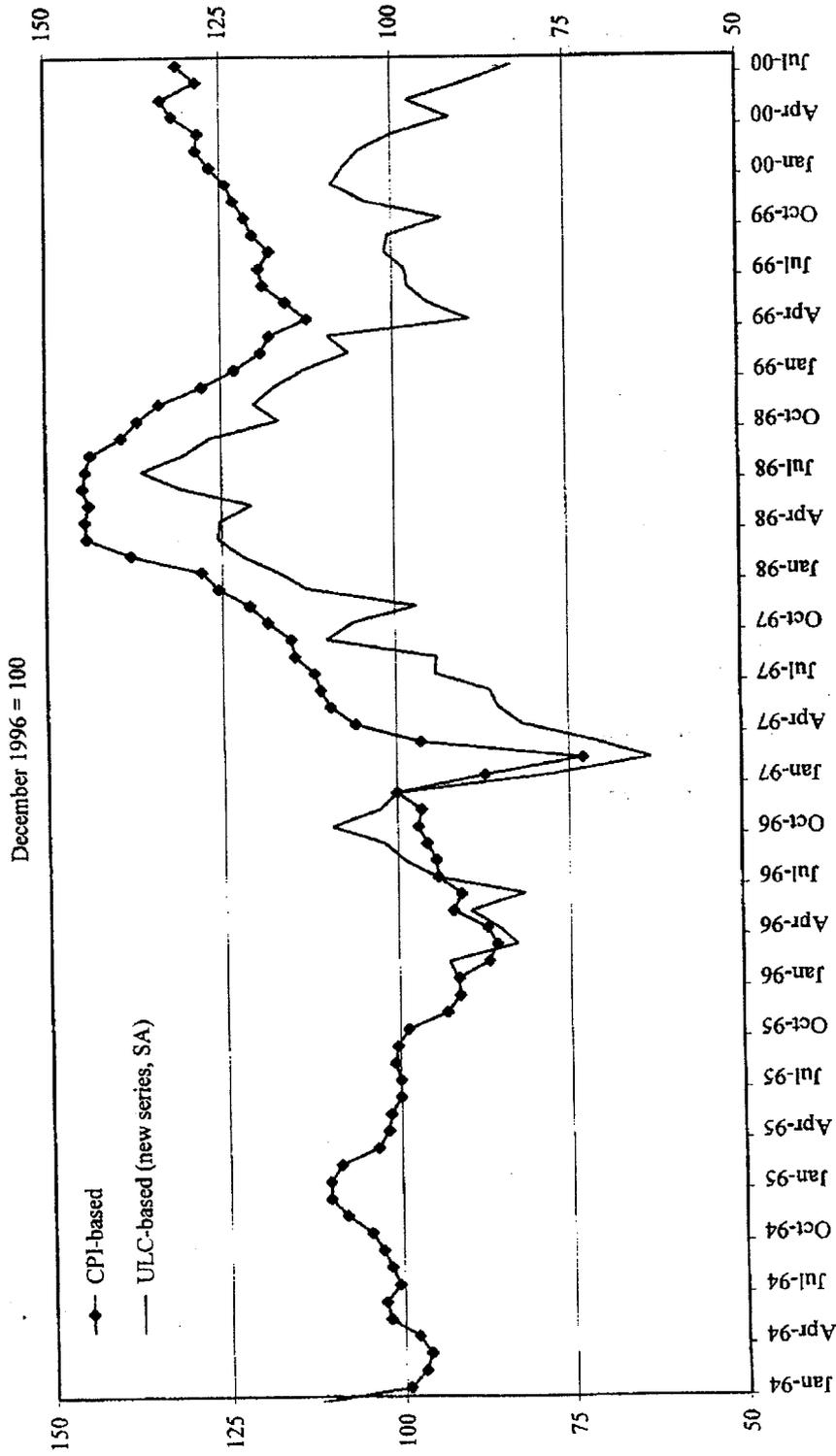
16. However, though the stock of debt was at manageable levels, it was growing quickly (Table V.2). In 1996 and again in 1997, the stock of debt increased by 25.3 and 10.1 percent in U.S. dollar terms respectively. In 1998, the growth rate slowed to 4.6 percent.

17. This section looks at three widely used competitiveness indicators: changes in the real exchange rate, the growth rate of exports, and the current account deficit. From March 1997 the real exchange rate began a rapid appreciation (Figure V.2), which was sustained until the onset of the balance of payments crisis in the third quarter of 1998. It is likely that some of

⁸ Strictly speaking, one should look at external debt net of external assets. However, limitations in the reporting of international investment positions make this difficult to do for a cross-section of countries. A commonly used approach is simply to look at gross external debt levels.

⁹ Another cross-country database was also used, the *Joint BIS-IMF-OECD-World Bank* database. Those results (not reported here) lead to the same qualitative conclusions.

Figure V.2. Romania: The Real Exchange Rate, 1994-2000



Sources: Romanian authorities and Fund staff estimates.

the initial appreciation corrected for an overshooting of the nominal exchange rate, which depreciated sharply in early 1997 as a result of the liberalization of the foreign exchange market. However, even compared to its level at end-1996 (prior to the liberalization), the appreciation of the real exchange rate in 1997 stands out in the cross-sectional analysis (Table V.6).^{10 11} Romania's real effective exchange rate appreciated by 16.5 percent, compared to the median appreciation of 5.4 percent. The contrast is even more striking in 1998 where the Romanian appreciation of 30 percent is more than double that of the second ranked Bulgaria, and more than ten times the median of 2.5 percent.

18. Much of the appreciation, particularly in 1997, was due to the one-off inflationary impact of the liberalization of prices and the foreign exchange market. While real wages most likely overcorrected immediately following the liberalization, the subsequent inflationary episode fueled wage demands, and by the end of 1997 wages, measured in U.S. dollar terms, had returned to their end-1996 level. They continued to rise in dollar terms through the first three quarters of 1998. However, at end-96 wage levels, Romanian costs were probably uncompetitive. Wages in dollar terms had increased since 1994, and the end-96 level was a further 16 percent higher than the average 1996 level.

19. It is unlikely that this wage growth was driven by productivity growth, causing the equilibrium real exchange rate to appreciate due to the Balassa-Samuelson effect. Real GDP growth was negative in both 1997 and 1998, led by declines in the output of large tradable sectors such as industry and agriculture. Moreover, much of the impetus for productivity growth in a transition economy such as Romania stems from economic restructuring of key sectors. Yet Romania's structural reform program had again become stalled by the end of 1997. Measuring the real exchange rate using unit labor costs shows the same trend appreciation (Figure V.2).

20. In addition, trends in imports and exports also lend support to the argument of Romania's weakening competitiveness. Despite the declines in real GDP, imports of goods and services remained constant in dollar terms in 1997, and actually grew by 4.9 percent in 1998, indicative of a dominant price effect. At the same time, export growth stalled. Though export volume growth rebounded somewhat in 1997 (due in part to the temporary improvement in competitiveness mentioned above), export growth was significantly lower in

¹⁰ Moreover, at end-96 the official exchange rate was most likely overvalued, as evidenced by a significant premium in the grey market rate, which averaged 12 percent over 1996. Following the liberalization, this fell to an average 1.5 percent in 1997 and 0.5 percent in 1998. Prior to the liberalization the Romanian authorities used the official exchange rate as a means to provide implicit subsidies to selected industries.

¹¹ Real effective exchange rates (REERs) are not calculated for Estonia, Latvia, Lithuania, and Turkey, and hence they are excluded from this cross-section. However, using the real exchange rates of these countries against either the US dollar or the Deutsche Mark would not change Romania's ranking. In 1997 and 1998, the highest appreciation was that of Estonia's currency against the U.S. dollar in 1997—6.7 percent.

both value and volume terms after 1995 (Figure V.3). Looking at the cross-sectional comparison shows Romania to be well in the lower half of the sample in both 1997 and 1998 (Table V.7).

21. Finally, the current account deficit remained large throughout this period, and widened considerably in 1998. Even compared to a cross-section which includes many transition countries, Romania's deficits were large (Table V.8). For Romania, it is more difficult to explain these large deficits with the argument of high investment during transition. Romania's real GDP was contracting over this period, while the average real GDP growth of the economies with larger deficits than Romania was 8.1 percent in 1997 and 4.6 percent in 1998. Moreover, with the exception of the Slovak republic, their debt-to-GDP ratios were also lower.

22. Based on the solvency indicators, several conclusions can be drawn. First, though Romania's indebtedness was relatively low, by 1998 its real exchange rate had become overvalued, and its current account deficit likely was unsustainable. Second, Romania's persistently large current account deficit left it particularly vulnerable to a sudden change in capital flows. In 1996 and 1997 Romania's current account had increasingly been financed by private sector creditors, raising Romania's exposure to changes in market sentiment.

Liquidity indicators

23. Liquidity indicators have received greater attention since the Asian crisis, when it became apparent that, with the increase in the volume of private international capital flows, even countries with strong macroeconomic fundamentals can be vulnerable to balance of payments crises resulting from sudden acute liquidity shortages. Moreover, some research on balance of payments crises suggests that high liquidity may, to a certain extent, be able to "offset" the increased vulnerability of a country due to weak fundamentals.¹² This section looks at a set of liquidity indicators for Romania to see if they may have sent offsetting or reinforcing signals to those of the solvency indicators.

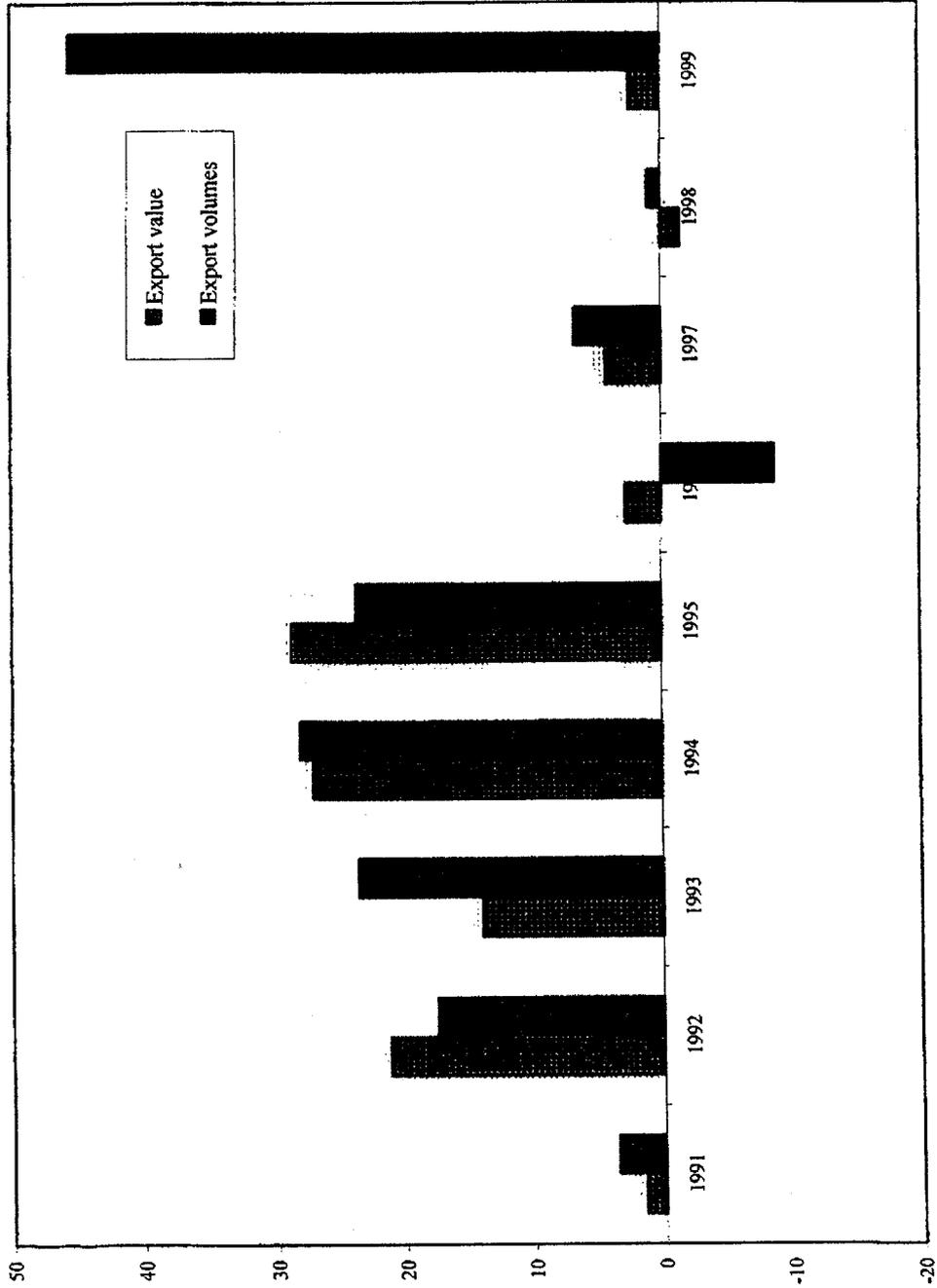
24. Reserves are the primary indicator of liquidity, and Tables V.9-V.11 present four different scale measures of reserves which are commonly found in the literature.¹³

- *Reserves-to-GDP (Table V.9):* With this scale variable Romania's reserve levels are in the lower half of the sample, in both 1997 and 1998. Using the PPP exchange rate to value GDP lowers Romania's ranking (Table V.10). By this measure, the only two countries in the sample with lower rankings are Russia and Ukraine.

¹² See, for example, Brüssière and Mulder (1999).

¹³ Reserve data is taken from the *International Financial Statistics*, line 11.d, which includes reserves of commercial banks as well as official reserves, and line 1 (gold reserves). For Romania, data on gold reserves is taken from the NBR's monetary survey.

Figure V.3. Romania: Export Growth Rates, 1991-99



Sources: Romanian authorities and Fund staff estimates.

- *Reserves-to-M2 (Table V.11)*: Though this is arguably a more relevant indicator for countries with fixed exchange rates, Romania's ranking is far higher than with GDP as the scale variable. Romania is ranked fourth in 1997 and seventh in 1998.
- *Reserves-to-Imports (Table V.12)*: Using the traditional scale variable of imports puts Romania's liquidity in the best light. In both years Romania is above the median, ranking third in 1997.

25. An alternative ratio, which several studies have found to perform well as an indicator of vulnerability, is reserves to short-term debt by remaining maturity.¹⁴ *Joint BIS-IMF-OECD-World Bank* (BIS) data is used for short-term debt. While this has the advantage of being a cross-country dataset, it understates short-term debt because it excludes debt to official creditors, which accounts for a significant proportion of the external obligations of these countries. As this ratio is sensitive to low values of short-term debt, a second measure is presented—the difference between reserves and short-term debt scaled by GDP.

- *Reserves-to-Short-term Debt (Table V.13)*: Again, by this measure of liquidity Romania is above the sample median in both years. However, Romania's ratio drops by more than 50 percent, from 370 to 173 percent, between end-1997 and end-1998.
- *Reserves less Short-term Debt-to-GDP (Table V.14)*: This measure gives a similar picture, though Romania ratio drops below the sample median in 1998. Again, the drop in the ratio, from 9.7 to 3.9 percent, is large.¹⁵

26. Looking at the cross-section comparison of liquidity indicators, though Romania's liquidity was not particularly high, neither does it stand out as particularly vulnerable. This is in large part due to the substantial increase in gross reserves in 1997, which partially offset the increase in vulnerability due to weakening competitiveness. However, the levels of reserves with respect to short-term debt are overstated by the BIS data, which excludes official creditor debt. Reserves to *total* short-term debt were significantly lower for Romania—for example, at end-1997 it was 183 percent (compared to 370 percent using BIS data). Official reserves were lower still at 118 percent of short-term debt at end-1997.

27. However, it is the decline in liquidity, rather than its level, which best signaled Romania's vulnerability. This decline is reflected in all of the indicators. For example, the drop in the ratio of reserves less short-term debt-to-GDP from end-1997 to end-1998 was the largest in the sample. This was due to declining reserve levels in 1998, and for the relevant indicators, a rise in short-term debt. For the latter indicators, this trend was clearly evident by

¹⁴ See for example, Brüssière and Mulder (1999).

¹⁵ An alternative formulation is to subtract both short-term debt and the current account deficit from reserves. This was performed for the sample using the realized current account deficit in the year of measurement. This gave very similar results to those excluding the current account deficit.

the second quarter of 1998. Looking just at official reserves, by end-1997 the reserves to short term debt ratio began to fall (Table V.15). By the second quarter of 1998, the ratio of official reserves to short-term debt fell below 100 percent.¹⁶ Moreover, the large increase in short-term debt in the second quarter of 1998 was due to bullet repayments on bonds contracted by the government in 1996, and thus was an identified source of pressure on liquidity well before it was captured by the vulnerability indicators.

28. Difficulties in the banking sector began in 1997, with two large state-owned banks insolvent (see Chapter IV). Though this occurred close to the time of the balance of payments crisis, there is no strong evidence that a crisis of confidence in the banking system triggered a crisis of confidence in the currency, a linkage emphasized in the literature.¹⁷ Although there were several years of strong real credit growth to the non-government sector which certainly deteriorated the banks' balance sheets, that credit growth was not driven by capital inflows nor did it immediately precede the balance of payments crisis.¹⁸ In 1997, there were signs of a crisis in the banking system: real credit to the non-government sector fell by 47 percent, real lei deposits declined by 21 percent while foreign currency deposits grew by 25 percent in U.S. dollar terms. However, at the same time exchange market pressure was not relatively intense, capital inflows were high, and gross foreign reserves were building. Conversely, both credit to the non-government sector and M2 increased as a percent of GDP in 1998 and 1999, at the same time exchange market pressure was intensifying.

29. Nevertheless, the problems in the banking sector certainly put additional pressure on the exchange market. Having to rescue the failed banks complicated the implementation of monetary policy. Moreover, many of the liabilities in one of the failed banks, Bancorex, were foreign currency denominated. As most of its foreign currency assets were nonperforming, servicing these liabilities implied net pressure on the currency. In addition, foreign currency liabilities—for which Bancorex did not have matching liquid foreign currency assets—were withdrawn in the first six months of 1999.

¹⁶ At that point, official reserves were not sufficient to cover all amortization payments falling due over the next year. Alan Greenspan (1999) and Pablo Guidiotti have put forward a reserve coverage of one hundred percent short-term debt as a rule of thumb.

¹⁷ Several papers in the literature focus on the links between balance of payments crises and banking crises. Sustained capital inflows can fuel a boom in bank-intermediated credit driven by capital inflows which, after an extended period, can lead to a weakening of banks' balance sheets (particularly in the financial sector is newly liberalized). This can result in a simultaneous loss of confidence in both the banking sector and the currency. See for example, Goldfajn and Valdes (1997), Kaminsky and Reinhart (1996) and Sachs, Tornell and Velasco (1995).

¹⁸ Strong private sector credit growth—often interpreted as a signal of weakening bank balance sheets, and thus, of greater vulnerability—occurred in 1994 and 1995. With significantly lower growth rates in 1997 and 1998 (Table V.2), this indicator did not signal strongly. Nevertheless, the fragility of the banking sector was well-known.

30. To conclude this section, a “fitted” vulnerability index is calculated using parameters from a crisis index equation estimated by Brusière and Mulder (1999). Column 2 of Table V.1 reproduces their rankings of vulnerability during the Russian crisis in 1998.¹⁹ Romania’s fitted index value is 20.6, which would rank it 9th out of 23 in the sample. This measure reinforces the view that by mid-1998, Romania’s indicators showed it to be comparatively vulnerable to a crisis, even in a broader cross-section of emerging market economies.²⁰ Moreover, given that it uses variables measured up to June 1998—six months before the crisis in Romania—it also lends some support to the view that measures of real exchange rate appreciation and short-term debt to reserves may be able to serve to some extent as leading indicators.

C. Romania’s Future Vulnerability

31. The indicators at end-1999 show that Romania’s vulnerability to a balance of payments crisis has lessened. The current account deficit shrunk dramatically in 1999, to a more sustainable level than in either 1997 or 1998. Moreover, though export prices (in U.S. dollars) sagged, export volume growth rebounded in 1999 with an annual growth rate of 46 percent, the majority of which occurred in the second half of the year (Figure V.3). This improvement in fundamentals is reflected in Romania’s solvency indicators in 1999 (Tables .3–V.8). Romania’s ranking for all three competitiveness indicators improved markedly over 1997 and 1998.²¹

32. By contrast, the liquidity indicators (Tables V.9–V.14) in 1999 show little change from their levels in both 1997 and 1998. However, this reflects a considerable rebuilding of reserves in the latter half of 1999 following their equally considerable depletion in the first half of the year (see, for example, the quarterly path of official reserves in Table V.15). Moreover, Romania has continued to rebuild reserves thus far in 2000. As of end-September 2000, they stood at US\$4.5 billion dollars, an increase of over 22 percent since end-December.

33. Despite these improvements, further steps to lessen Romania’s vulnerability to balance of payments crises in the medium term would be beneficial. As Romania’s economy continues to develop and restructure, its increased attractiveness to foreign investors will raise the possibility of a resurgence of capital inflows. For now, Romania’s partially liberalized capital account may provide some protection. However, as Romania further

¹⁹ Brusière and Mulder (1999) used a parsimonious specification based on three independent variables—real exchange rate appreciation, the current account deficit, and the ratio of reserves to short-term debt. The fitted index for Romania was calculated using the parameter estimates reported in column 6 of Table V.6 in their paper.

²⁰ The short-term debt data used excludes Romania’s large bond repayments due in 1999, suggesting that Romania’s ranking may be underestimated.

²¹ WDI debt data is not yet available for 1999.

integrates with global capital markets over the medium-term, strong macroeconomic fundamentals and higher reserve levels will be important means of mitigating the impact of a potential surge in capital inflows.

34. In the near term, this will require addressing some key structural weaknesses that are potential risks to external stability:

- *Excessive wage growth:* Real wage growth in excess of productivity growth poses the risk of a potential erosion of Romania's competitiveness, and a corresponding return to wider, less sustainable, current account deficits. In Romania's current environment disinflation will depend on controlling wage growth. Until wage growth subsides, disinflation objectives will have to be carefully weighed against the objective of preserving external competitiveness.
- *Banking system soundness:* Although significant gains were made over this period in strengthening Romania's banking system, the system remains fragile. Effective supervision will be essential to ensure that banks' balance sheets do not deteriorate as credit growth picks up. Another potential source of risk is open foreign positions of commercial banks. Although there are prudential regulations governing these positions, they are not based on international definitions, and have not been tightly enforced in the past, in part due to uncertainty surrounding the definitions used. The scope for running large net (unhedged) open positions and the fragility of the banking system imply that there is the potential for crises in the foreign exchange market and in the banking system to coincide and be mutually reinforcing.
- *Fiscal stability:* Containing the fiscal deficit will be important to maintaining the current account deficit at sustainable levels, and greater flexibility to adjust the fiscal stance quickly may be necessary to facilitate an appropriate policy response to a potential resurgence in capital inflows. This will require, *inter alia*, addressing some of the remaining risks to fiscal stability (see Chapter II).
- *Data weaknesses:* Data availability is a critical component of crisis prevention. At present, there are some important gaps in coverage in external sector data, as evidenced by persistently large net errors and omissions. The authorities are planning to take steps to reduce these gaps. An objective should be the adoption of the Fund's General Data Dissemination Standard (GDSD).

D. Conclusions

35. Romania underwent a period of exchange market pressure from September 1998 through to June 1999 sufficiently intense to be classified as a balance of payments crisis. The crisis was due both to misaligned fundamentals, in particular an overvalued exchange rate, as well as to a shortage of liquidity. External vulnerability indicators were clearly signaling Romania's heightened vulnerability to such a crisis by June 1998, though some signs were beginning to show as early as the end of 1997. The most important of these indicators were the appreciation of the real exchange rate, the current account deficit, and by the middle of 1998, the increase in the ratio of short-term debt to reserves.

36. In view of the worsening external situation the authorities took necessary corrective action which likely averted a worse crisis. However, at the time the authorities responded, the scope for a more gradual approach was very limited. Such an approach may have been feasible earlier.

37. Indicators at the end of 1999 point to considerably lessened external vulnerability. Moreover, Romania's reserves have continued to increase thus far in 2000. Despite this improvement, further steps to lessen Romania's vulnerability would be beneficial. In the near term, this would include steps to control excessive wage growth, strengthen the banking system, reduce risks to the fiscal balance, and improve external data coverage.

Table V.1: Ranking of Most Vulnerable Countries to 1998 Russia Crisis 1/

Actual Crisis Index for 1998 CrisindGLD			Fitted Crisis Index with EWS Actual Rank (2)		
1	87.2	Russia	1	68.9	Zimbabwe
2	82.2	Zimbabwe	2	53.7	Russia
3	32.4	Brazil	3	35.4	Pakistan
4	13.8	Colombia	4	29.7	Argentina
5	13.2	Mexico	5	26.4	Brazil
6	11.3	Romania	6	23.1	Colombia
7	8.6	Turkey	7	23.1	Peru
8	4.3	Peru	8	23.0	Venezuela
9	2.4	Philippines	9	20.6	Romania
10	1.5	Sri Lanka	10	19.8	Philippines
11	0.2	Jordan	11	19.6	Turkey
12	0.1	Pakistan	12	19.1	Chile
13	-0.3	Hungary	13	16.4	South Africa
14	-0.7	Chile	14	11.6	Mexico
15	-0.9	Poland	15	11.6	Thailand
16	-0.9	Venezuela	16	7.4	Indonesia
17	-0.9	Argentina	17	7.1	Poland
18	-2.1	India	18	5.2	Hungary
19	-3.4	Korea	19	3.1	Korea
20	-6.7	South Africa	20	1.5	Malaysia
21	-7.1	Thailand	21	-0.6	Sri Lanka
22	-9.8	Malaysia	22	-4.7	Jordan
23	-16.7	Indonesia	23	-6.5	India

1/ All results, except for Romania, are from Brusière and Mulder (1999), Table 7.

Table V.2. Romania: Indicators of External Vulnerability 1996-2000 1/
(In percent of GDP unless otherwise specified)

	1996	1997	1998	1999	2000 Proj.
Financial indicators					
Public sector debt	23.5	25.5	25.6	30.5	28.2
Broad money (percent change, 12-month basis)	66.1	104.8	48.9	44.9	28.6
Private sector credit (percent change, 12-month basis) 2/	63.3	33.7	64.7	46.5	21.8
Real private sector credit (percent change, 12-month basis) 2/	4.2	-46.9	17.0	-5.4	...
Monthly weighted average t-bill rate	...	133.5	57.9	99.9	52.5 4/
Monthly weighted average real t-bill rate 3/	...	32.1	4.0	44.4	7.1 4/
External Indicators					
Exports (percent change, 12-month basis in US\$)	2.3	4.6	-1.6	2.4	16.7
Imports (percent change, 12-month basis in US\$)	11.3	-1.4	4.8	-12.1	18.4
Terms of Trade (percent change, 12-month basis)	-2.4	-0.3	0.0	0.2	-6.1
Current account balance	-7.4	-6.1	-7.5	-3.8	-4.3
Current account balance after FDI	-6.7	-2.7	-2.6	-0.8	-1.5
Errors and omissions	2.2	3.1	1.7	1.8	2.4
Gross official reserves (in US\$ millions)	1,593	3,075	2,299	2,472	3,112
(in months of imports GS of the following year)	1.5	2.9	2.4	2.2	2.5
Central Bank short-term foreign liabilities (in US\$ millions)	0	100	0	170	100
Gross reserves of the banking system (in US\$ millions)	3,145	4,763	3,789	3,633	4,491
(in months of imports GS of the following year)	3.0	4.4	4.0	3.2	3.7
Short term foreign liabilities of the commercial banks (in US\$)	602	267	188	240	221
Foreign currency liabilities of the commercial banks (in US\$)	362	383	401	881	818
Official reserves/Broad money (M2)	19.7	39.5	27.2	23.7	40.8
Official reserves/Narrow money (M0)	49.9	237.7	107.1	102.5	143.4
Total short term external debt by original maturity	2.9	2.5	1.4	1.0	...
In percent of reserves	64.5	28.7	24.4	14.1	23.7
In percent of total debt	11.9	9.3	5.7	4.0	7.9
Total short term external debt by remaining maturity 5/	7.4	7.4	7.0	5.6	8.3
In percent of reserves	163.8	84.6	126.8	77.3	96.3
In percent of total debt	28.5	27.4	29.6	23.7	32.1
Total external debt (in US\$ millions)	8,597	9,467	9,903	8,784	9,347
Of which: Public and Publicly guaranteed debt	6,507	6,855	7,001	6,169	6,936
Total external debt (in percent of exports of G&S)	88.7	93.4	101.3	87.7	79.5
Total external debt/ GDP	24.5	26.9	23.9	25.7	26.0
External interest payments (in percent of exports of G&S)	3.7	5.0	6.0	5.1	5.1
External amortization payments (in percent of exports of G&S)	9.9	15.9	18.0	23.6	13.5
Exchange rate (per US\$, period average)	3,084	7,195	8,881	15,274	...
REER appreciation (+) (12-month basis)	-9.6	16.5	30.0	-14.9	...
Financial Market Indicators					
Foreign currency debt ratings					
Moody's	Ba3	Ba3	B3	B3	B3 6/
Standard and Poor's	BB-	BB-	B-	B-	B- 6/
Spread of benchmark bonds (basis points, end of period)	364	350	1,300	780	562 7/

Sources: Romanian authorities; and Fund staff estimates.

1/ All stocks are measured end-of-period.

2/ Adjusted for bad loans transferred to AVAB.

3/ Real rate is based on ex-post CPI inflation.

4/ As of June 2000.

5/ Defined as short-term debt by original maturity basis plus amortization falling due on medium-term loans and bonds.

6/ As of October 20, 2000.

7/ As of October 17, 2000.

Table V.3: External Debt (In percent of GDP), 1997-98

	1997		1998	
		Rank		Rank
BULGARIA	97.2	12	80.8	12
CZECH REPUBLIC	43.8	8	45.4	7
ESTONIA	13.9	2	15.0	2
HUNGARY	53.6	11	60.8	10
LATVIA	8.9	1	12.4	1
LITHUANIA	16.0	3	18.1	3
POLAND	28.2	6	30.3	5
ROMANIA	27.0	5	22.9	4
RUSSIA	28.9	7	66.1	11
SLOVAK REPUBLIC	46.0	9	48.6	8
TURKEY	47.8	10	50.8	9
UKRAINE	25.5	4	30.4	6

Source: International Financial Statistics and World Development indicators.

Table V.4: External Debt (In percent of GDP; (PPP valuation), 1997-98

	1997		1998	
		Rank		Rank
BULGARIA	25.0	12	24.0	10
CZECH REPUBLIC	16.9	8	18.7	8
ESTONIA	5.9	2	6.8	2
HUNGARY	24.2	11	26.6	12
LATVIA	3.7	1	5.3	1
LITHUANIA	6.6	3	7.9	5
POLAND	13.2	7	14.7	6
ROMANIA	6.7	5	7.2	3
RUSSIA	12.7	6	19.1	9
SLOVAK REPUBLIC	17.5	9	18.3	7
TURKEY	22.9	10	24.6	11
UKRAINE	6.6	4	7.6	4

Source: International Financial Statistics and World Development indicators.

Table V.5: External Debt , 1997-98
(In percent of exports of goods and services)

	1997		1998	
		Rank		Rank
BULGARIA	151.7	11	167.7	10
CZECH REPUBLIC	77.3	6	74.8	5
ESTONIA	18.7	2	19.9	1
HUNGARY	99.9	8	100.8	8
LATVIA	16.8	1	24.0	2
LITHUANIA	29.3	3	38.5	3
POLAND	130.5	10	141.1	9
ROMANIA	95.3	7	100.1	7
RUSSIA	122.2	9	210.4	12
SLOVAK REPUBLIC	75.8	5	76.0	6
TURKEY	183.9	12	196.2	11
UKRAINE	54.5	4	72.2	4

Source: International Financial Statistics and World Development indicators.

Table V.6. Annual REER Depreciation, 1997-99

	1997		1998		1999	
		Rank		Rank		Rank
BULGARIA	19.2	8	13.3	7	1.5	7
CZECH REPUBLIC	0.7	1	8.2	6	-1.3	6
HUNGARY	5.1	4	-0.6	4	1.9	8
POLAND	2.4	2	5.6	5	-4.6	3
ROMANIA	16.5	7	30.0	8	-14.9	2
RUSSIA	5.6	5	-11.5	1	-29.1	1
SLOVAK REPUBLIC	5.0	3	-2.2	3	-2.3	5
UKRAINE	13.3	6	-2.4	2	-2.9	4

Source: International Financial Statistics.

Table V.7. Growth of Exports of Goods and Services, 1997-98

	1997		1998		1999	
		Rank		Rank		Rank
BULGARIA	1.4	9	-9.1	10	-13.0	10
CZECH REPUBLIC	0.2	11	13.0	3	-0.2	5
ESTONIA	18.3	3	14.0	2	16.7	1
HUNGARY	27.8	1	15.6	1	14.9	2
LATVIA	6.6	7	4.7	7	9.7	3
LITHUANIA	24.1	2	-2.9	8	-16.4	12
POLAND	11.2	5	9.2	5	-12.3	9
ROMANIA	3.3	8	-4.4	9	3.8	4
RUSSIA	0.4	10	-15.4	12	-3.3	6
SLOVAK REPUBLIC	8.3	6	10.2	4	-6.3	7
TURKEY	13.9	4	5.0	6	-14.4	11
UKRAINE	0.0	12	-13.4	11	-7.9	8

Sources: International Financial Statistics and World Development indicators.

Table V.8. Current Account Balance, 1997-99

	1997		1998		1999	
BULGARIA	4.4	1	-0.5	3	-5.4	7
CYPRUS	12.1	14	7.2	7	5.1	7
HUNGARY	-2.1	4	-4.9	7	-4.3	6
LATVIA	5.1	7	10.1	10	0.7	11
POLAND	-3.0	5	-4.4	6	-7.5	10
ROMANIA	-6.1	9	-7.2	8	-3.8	5
TURKEY	-1.4	3	1.0	1	-0.7	3
UKRAINE	-3.1	6	-3.1	5	-0.1	2

Source: International Financial Statistics.

Table V.9. Reserves, 1997-99

	1997		1998		1999	
BULGARIA	25.0	1	25.5	1	26.3	1
HUNGARY	18.4	3	19.9	3	22.7	3
LATVIA	13.8	7	13.2	8	14.6	7
POLAND	17.7	8	17.7	7	18.5	8
ROMANIA	13.3	8	9.1	10	10.7	10
UKRAINE	5.4	11	1.9	12	3.6	12

Source: International Financial Statistics.

Table V.10. Reserves, 1997-99
(In percent of GDP; PPP valuation)

	1997		1998		1999	
		Rank		Rank		Rank
BULGARIA	6.4	6	7.6	4	7.9	3
CZECH REPUBLIC	7.1	2	9.3	1	9.3	2
ESTONIA	6.9	3	7.0	5	7.3	5
HUNGARY	8.4	1	8.7	2	9.7	1
LATVIA	5.8	7	5.7	7	6.2	6
LITHUANIA	4.6	9	5.9	6	4.9	9
POLAND	6.7	4	8.4	3	7.4	4
ROMANIA	3.3	10	2.9	10	2.8	10
RUSSIA	1.8	11	1.3	11	1.2	11
SLOVAK REPUBLIC	6.5	5	5.4	8	6.2	7
TURKEY	5.0	8	5.0	9	5.7	8
UKRAINE	1.4	12	0.5	12	0.7	12

Source: International Financial Statistics.

Table V.11. Reserves, 1997-99
(In percent of M2)

	1997		1998		1999	
		Rank		Rank		Rank
BULGARIA	77.1	1	89.1	1	88.9	1
CZECH REPUBLIC	26.4	10	33.4	8	35.6	8
ESTONIA	54.1	3	55.0	3	48.4	5
HUNGARY	44.7	6	43.7	5	49.1	4
LATVIA	50.3	5	49.5	4	51.4	3
LITHUANIA	58.5	2	70.1	2	55.4	2
POLAND	38.4	7	43.1	6	38.4	7
ROMANIA	53.9	4	36.4	7	41.8	6
RUSSIA	22.5	12	18.9	11	31.1	9
SLOVAK REPUBLIC	24.9	11	22.1	10	27.2	10
TURKEY	28.2	9	26.3	9	25.1	11
UKRAINE	35.0	8	12.7	12	20.9	12

Source: International Financial Statistics.

Table V.12. Reserves, 1997-99
(In percent of imports of goods and services)

	1997		1998		1999	
		Rank		Rank		Rank
BULGARIA	40.4	2	50.3	2	55.7	2
CZECH REPUBLIC	29.9	6	36.3	4	37.1	4
ESTONIA	19.1	10	18.2	10	17.2	11
HUNGARY	33.7	5	31.4	5	32.3	5
LATVIA	23.0	8	21.1	8	22.3	10
LITHUANIA	17.0	11	23.0	7	23.3	9
POLAND	49.3	1	57.0	1	55.8	1
ROMANIA	37.8	3	30.0	6	32.2	6
RUSSIA	19.7	9	16.5	11	23.8	8
SLOVAK REPUBLIC	23.9	7	19.1	9	26.1	7
TURKEY	35.4	4	37.3	3	50.0	3
UKRAINE	10.8	12	4.2	12	6.8	12

Source: International Financial Statistics.

Table V.13. Reserves, 1997-99
(In percent of short-term debt)

	1997		1998		1999	
		Rank		Rank		Rank
BULGARIA	339.4	5	668.2	1	924.9	1
CZECH REPUBLIC	178.5	6	161.6	6	244.1	5
ESTONIA	174.3	7	156.6	7	67.0	12
HUNGARY	148.9	9	121.3	8	162.1	8
LATVIA	1341.5	1	428.3	3	378.7	2
LITHUANIA	685.6	2	368.7	4	196.5	6
POLAND	573.2	3	434.9	2	368.0	3
ROMANIA	370.7	4	172.8	5	294.4	4
RUSSIA	54.8	12	68.0	12	105.9	10
SLOVAK REPUBLIC	148.4	10	114.3	9	175.5	7
TURKEY	102.2	11	91.6	11	104.8	11
UKRAINE	159.9	8	113.9	10	120.2	9

Source: International Financial Statistics and BIS debt data.

Table V.14: Reserves, 1997-99
(Less short-term debt in percent of GDP)

	1997		1998		1999	
		Rank		Rank		Rank
BULGARIA	17.7	1	21.7	1	23.5	1
CZECH REPUBLIC	8.2	6	8.6	5	14.3	2
ESTONIA	7.0	7	5.6	6	-8.2	12
HUNGARY	6.1	8	3.5	8	8.7	5
LATVIA	12.8	2	10.1	3	10.7	4
LITHUANIA	9.5	5	9.9	4	5.7	8
POLAND	11.9	3	13.4	2	12.0	3
ROMANIA	9.7	4	3.9	7	7.1	7
RUSSIA	-3.4	12	-2.1	12	0.4	11
SLOVAK REPUBLIC	5.5	9	1.8	9	7.8	6
TURKEY	0.2	11	-0.9	11	0.6	9
UKRAINE	2.0	10	0.2	10	0.6	10

Sources: International Financial Statistics and BIS.

Table V.15. Gross Official Reserves, 1997-99

	1997				1998				1999			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross Reserves of the NBR (in US\$ million)	2,898	2,620	2,448	2,601	2,628	3,295	3,189	2,916	2,212	1,580	1,630	1,911
In percent of short-term debt	55.4	100.0	131.7	118.2	112.8	92.1	88.5	78.8	95.2	97.1	143.3	130.4

Sources: Romanian authorities; and Fund staff estimates

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VI. PAVING THE WAY TO EU ACCESSION: THE ECONOMIC AND FINANCIAL DIMENSION IN ROMANIA ¹

A. Introduction

1. The historic decision adopted by EU member countries at their Helsinki meeting in December 1999 to include Romania in the group of countries that are EU accession candidates signifies that Romania has moved to a new stage of its European integration process.² The accession process provides an important impetus for the acceleration of much-needed reforms in Romania. Admittedly, with or without EU membership, most of the EU membership requirements (market liberalization and increased competitiveness) are necessary for long-term growth—but the EU accession process brings further opportunities as well as greater challenges to Romania and the other candidate countries. Eventual EU membership should improve long-term development prospects by providing access to a large single market and allowing free movement of goods, services, capital and people within the market. In the context of Romania's candidacy for EU membership, this chapter (a) briefly reviews the economic and financial implications, and (b) assesses Romania's compliance with EU economic criteria.³

2. The economics of EU accession is predicated on the assumption that incomes and living standards should converge toward EU standards. Economic integration is to be facilitated by bringing new opportunities for trade, and, as the economic environment becomes more attractive, by increasing foreign direct investment inflows. To this end, the "Europe Agreement" with the European Union provides Romania with easier access to EU

¹ This chapter was prepared by Stephane Cosse.

² In Eastern and Central Europe, Slovenia, the Czech Republic, Hungary, Poland and Estonia were chosen as the first group of candidate countries, the so-called "front runners," in 1998. Latvia, Lithuania, Slovakia, Bulgaria, and Romania were invited to start EU accession negotiations in Helsinki.

³ There are four accession criteria. Three of them were set in the Copenhagen European Council (1993):

- political criteria: "*achieve stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities*";
- economic criteria: "*the existence of a functional market economy as well as the capacity to cope with competitive pressure and market forces within the Union*";
- the ability to assume the obligations of membership (adoption of the *acquis*).

More recently, EU member countries have extended their requirements to the existence of an administrative and judicial capacity to apply the *acquis*.

markets, while the use of nonreimbursable resources provided by the EU (through the pre-accession instruments) would support investment-based growth. Harmonization of policies and regulations toward the *acquis communautaire* will in parallel gradually facilitate the circulation of goods, services, capital, and labor, and the entry into the single market.⁴

3. In aiming at converging to the EU's living standards, Romania faces a daunting task. Closing the income gap with the EU will require that Romania raise its real GDP growth to rates that it has never attained so far. On a per capita basis, Romania has the second lowest income level after Bulgaria among the candidate countries. Moreover, the level of the population below the standard poverty lines is by far the highest in Romania (Table VI.1). Tang (2000) notes that, assuming an average real growth rate of 5 percent per annum and an EU average growth rate of 2 percent per annum, it would take 45 years to close the gap. Romania would need to grow annually by 7 percent to catch up with the EU in 2025.⁵

4. The European Commission has specified the following prerequisites before Romania can pave a solid way to EU accession. First, macroeconomic stability, without which there cannot be sustainable growth, is essential.⁶ The transition experiences in neighboring Central European countries clearly show that a recovery in growth was achieved only after the economy had been stabilized and inflation had been brought down substantially.⁷ With an

⁴ The negotiations for Romania's accession to the EU were formally launched in February 2000. Negotiations with Romania have effectively started by opening 5 of the 31 chapters: small and medium-sized enterprises, education, training and youth, science and research, external relations, and common foreign and security policy. The *acquis* included in these chapters has been accepted provisionally in its entirety in May, with no derogation being requested. One should note the low complexity of the *acquis* in these chapters, and the high degree of conformity between the Romanian situation and the demands of the *acquis*. In October 2000, two new chapters were opened: audio-visual and statistics (the latter was provisionally closed, given Romania's compliance with EU norms). Two other chapters—competition and telecommunications—are expected to be opened by the end of the year.

⁵ In 1998, only two candidate countries had per capita incomes (on a purchasing power parity basis) that exceeded 50 percent of the EU average. These are Slovenia and the Czech Republic, which had per capita incomes of around two-thirds and around 60 percent of the EU average, respectively. Hungary's per capita income in 1998 was about half that of the EU average, while the rest of candidate countries recorded lower averages. The difference in the structure of household consumption is also revealing: Romanian households spend more than 58 percent of their budget on food, compared with only 17 percent in EU countries.

⁶ The key importance of macroeconomic stability is in particular stated in the second regular report of the Commission on progress toward EU accession (October 13, 1999). The Commission has proposed to make the opening of negotiations with Romania "*conditional upon a further assessment of the economic situation, in the expectation that appropriate measures will have been taken to address the macro-economic situation.*"

⁷ See Fischer (1998).

economic growth rate since 1990 among the lowest in the group of candidate countries, and an inflation rate among the highest, Romania is lagging behind, thereby undermining its chances of acceding to the Union at the same time as more advanced candidates.⁸ Second, the reform effort in structural areas must be pursued, as a means of enhancing economic efficiency and supporting the stabilization effort.⁹ Third, there is a need for a broad national consensus on economic policies in support of EU accession (see Box VI.1).

5. As elaborated in the remainder of this chapter, the EU's invitation to accession negotiations entails (a) access to sizable external resources through pre-accession instruments; and (b) requirements on economic policies, with a view to ensuring nominal and real convergence.

B. The Impact of EU Transfers on the Romanian Economy

A privileged share of EU pre-accession aid

6. In order to help candidate countries meet the accession criteria, the EU has set up three types of pre-accession aid instruments (see Box VI.2). In addition to the existing PHARE programs, two other grant instruments have been established: SAPARD (Structural Adhesion Program for Agriculture and Rural Development) and ISPA (Pre-Adhesion Structural Instrument). Within the framework of the Agenda 2000 (the budgetary envelope allocated by the European Union to the Commission over the period 2000-2006), total disbursements on these instruments are foreseen to amount to €10.5 billion. In a full year, provided that all projected tranches funded through the pre-accession instruments are disbursed, the amount of transfers from the EU to Romania would reach €630 million, or about 2 percent of GDP. It would represent, in 2000, 6 percent of government primary spending under the budget, and 25 percent of investment expenditure. By comparison, total EU assistance to the country during 1990-99, amounted to €1.2 billion (Figure VI.1). Of the 10 candidate countries from central and eastern Europe eligible for support under these three financing instruments, Romania ranks second after Poland in terms of volume of annual budgeted allocation, second after Bulgaria on a GDP comparison and fifth, after the Baltic States and Bulgaria, on a per capita comparison (Table VI.2).

⁸ Notwithstanding the European Council's decision, the Conclusions of the Presidency of the European Council in December 1999 stated that: "*it emerges that some candidates will not be in a position to meet all the Copenhagen criteria in the medium term.*"

⁹ Havrylyshyn (1999) shows—in part on the basis of the fallout from the financial crisis in Russia of August 1998—that lasting stabilization and recovery is never assured so long as the process of structural and governance reforms is not finished.

**BOX 1.1. NATIONAL CONSENSUS VIS-A-VIS A MARKET ECONOMY
and European Integration**

HELSINKI, Romanian political parties initiated a dialogue from which emerged a broad consensus about the essentials of economic policy over the medium term. More generally, representatives of the civil society expressed their willingness to undertake the necessary policies to meet the economic criteria set

in March 2000, the main political parties, in consultation with the trade unions, employers' associations and other representatives of the civil society (including churches), elaborated Romania's Medium-Term Economic Strategy (MTES), which called for the creation of a "smooth-functioning market economy

to fill existing legal gap and inconsistencies; (3) the improvement in financial discipline; and (4) the reduction of the informal sector. The document was fleshed out in May 2000 by an Action Plan adopted by the Government in order to ensure implementation of the MTES. The Action Plan lists economic and

not only improve the living standards of the Romanian population but also to improve its chances of meeting the Copenhagen criteria for accession to the EU." In addition, the National Programme for Accession to the European Union updated every year, is to ensure the continuation of the process of

valued as it addresses the pressing issues of economic reform in a constructive and realistic manner and is coherent with other international commitments in the area of economic policies, in particular the International Monetary Fund's stand-by arrangement and the World Bank's Structural Adjustment

To prove its determination, the Romanian Government, with the support of all political parties, also

- a. The pace of negotiation. The Government of Romania would like to maintain the negotiation process at a sustained pace so as to keep the efforts and the attention of the decision makers, the administration and public opinion both in Romania and in the European Union

start as of 2007, will take into account the accession of countries presently engaged in negotiations and their participation in the reformed structural funds, such as the Common Agricultural Policy.

FROM THE ROMANIAN POINT OF VIEW, AN ACQUIS IS NECESSARY.

Box VI.2. The Pre-Accession Instruments

PHARE

Within the 2000 PHARE budget, Romania will benefit from assistance amounting to €251 million distributed between a national program, community programs, and cross-border co-operation (Hungary and Bulgaria).

The biggest amount (€215 million) is allocated for the PHARE national program, which focuses on the following priority areas: (a) "institution building," including twinning projects; (b) converging with the *acquis* on areas such as strengthening the judicial system and civil society development, liberalizing the electrical power and gas sectors, strengthening the institutional capacity of the Ministry of Agriculture, improving border management, and the fight against drugs; and (c) regional development.

Financed out of a PHARE national budget, twinning projects with a EU member country consist of a bilateral partnership between a member country and an applicant for strengthening the institutional development, aiming at creating a public administration able to apply the European *acquis* at the same standards than the EU member states.

ISPA

This pre-accession instrument, taking as reference model the Cohesion Fund, foresees an allocation for Romania up to €240 million. The budget will be allocated for projects in the areas of transport and the environment.

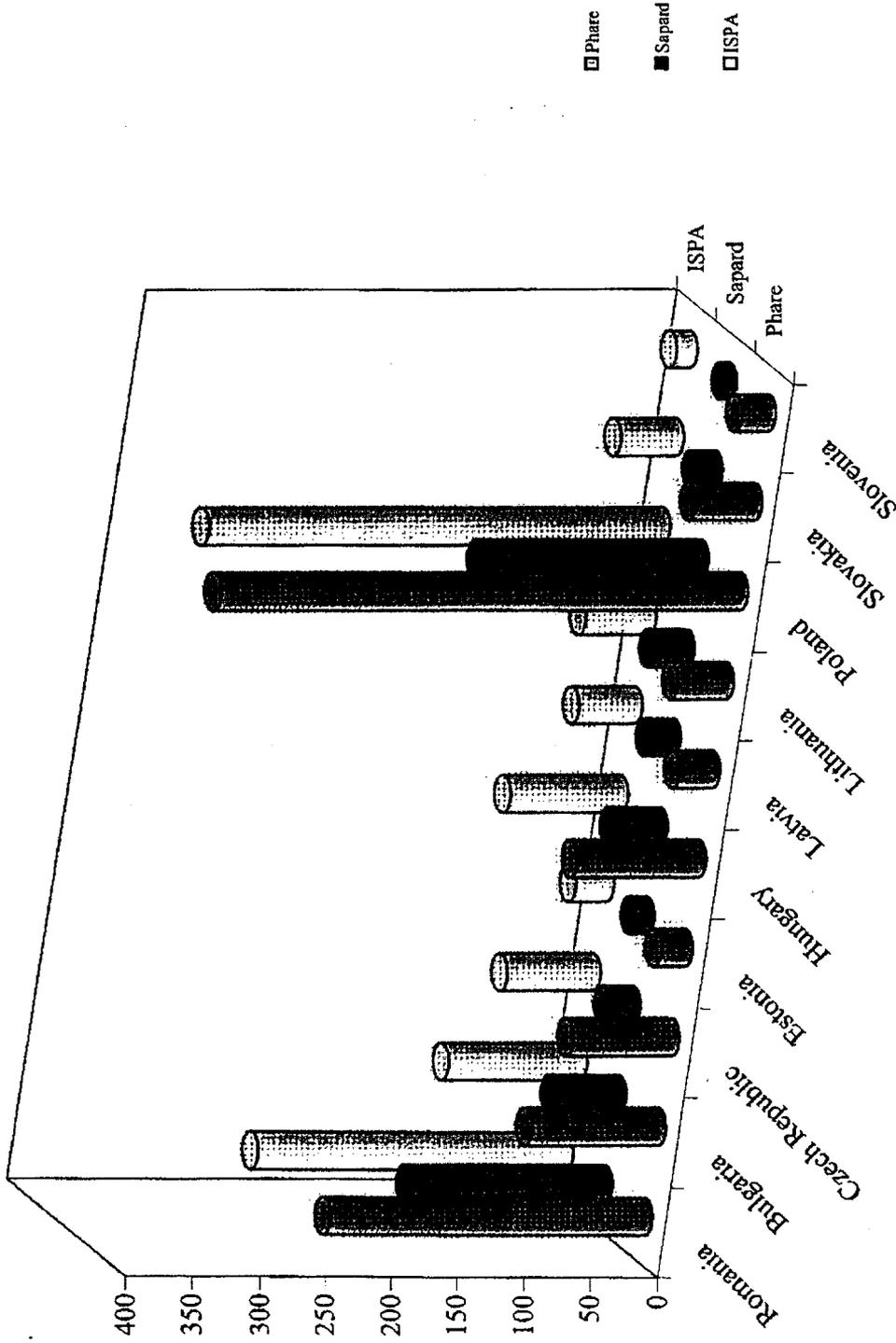
In order to access the ISPA funds starting as of 2000, the Ministry of Transport elaborated the "ISPA National Strategy 2000-2006 in the Transport Sector" in the framework of the National Development Program for Accession to the European Union. Priorities in the field of transport are concentrated on improving the infrastructure on the trans-European corridors.

As regards the environment, the main objective of the investment projects is to support the Romanian government in ensuring compliance with the "heavy" *acquis communautaire* in fields such as drinking and waste water standards as well as air pollution.

SAPARD

Within the SAPARD pre-accession instrument, Romania can benefit as of 2000 from an annual allocation up to €150 million. SAPARD will function along the same model as the European Agricultural Fund—the agricultural subsidy system in the EU. It will support projects in the areas of rural development modernize infrastructure, tourism and the agro-food industry (notably quality). It will target private entities, especially small farmers.

Figure VI.1. EU Pre-Accession Annual Resources in Central and Eastern European Countries (in million of euros)



Priority given to development expenditures

7. In allocating a large volume of its pre-accession resources to Romania, the European Union has taken into consideration the size of the population, the relatively low level of development of the country, and the need for high and sustained economic growth. If Romania is to converge to Western European living standards, the upgrade of the institutional and physical infrastructures needs to be accelerated. EU annual budgeted allocations to Romania during the pre-accession period (2000-2006) are expected to be roughly distributed as follows: PHARE (€240 million); ISPA (€208-270 million); and SAPARD (€150 million). Thus, the share of grants to Romania has been oriented in priority toward development projects—ISPA (transport, water supply and environmental infrastructure), SAPARD (agriculture and rural development), as well as the regional development component of PHARE. The total amount of resources allocated (through PHARE programs) to institution building and the adoption of the *acquis* is somewhat less significant, though it is likely to increase at a later stage.¹⁰

8. The priorities set by the EU can be illustrated through the GDP composition between Romania and the EU. In 1999, the share of agriculture in GDP was 13.9 percent in Romania, compared with 2.3 percent in the EU. In terms of employment, farmers represent by far the largest share of the active population (40 percent, or ten times the level in the EU). Preparing for integration requires large agricultural support programs to increase efficiency and gradually apply relevant EU standards. Moreover, the weight of the industrial sector represents some 28 percent, and the services and construction sector account for 58 percent of the gross value added (compared with, respectively, 31 percent and 67 percent in the EU). It is for this reason that 29 percent of the budget allocated by the EU to SAPARD for candidate countries is earmarked for Romania (compared with 22-23 percent for PHARE and ISPA). With the exception of Poland, which receives 32 percent, this is three times more funding than any other country receives, and the highest allocation per capita (Baltic states excluded).

9. In addition, to the pre-accession instruments, the EU provides resources to support the implementation of the structural adjustment programs agreed with the World Bank and the macroeconomic stabilization program supported by the International Monetary Fund. From 1990 to 1999, the EU provided Romania with €680 million of macro-financial assistance. In 2000, a tranche of €100 million was granted in June upon approval of the first review of the stand-by arrangement and a second tranche of an equivalent amount is to be

¹⁰ Contrary to previous years, only one third of the PHARE programs will be used for “institution building,” including twinning projects that are implemented by member countries’ institutions. Two-thirds will be allocated to financing investments, with roughly one-half of the funds earmarked for investment necessary to reach compliance with the *acquis* and the other half to regional development (assistance to small and medium-sized companies, human resources development, infrastructure, etc.).

disbursed upon approval of the second review of the stand-by arrangement. €100 million was also provided through RICOP,¹¹ a program financing social safety nets in the context of the restructuring (liquidation/privatization) of the public companies. This reflects a large degree of overlap between the accession agenda and measures to strengthen economic management, as well as complementarity between reforms designed to facilitate accession and inevitable structural reforms.

Strengthening absorption capacities

10. To absorb the additional volume of EU grants, the Romanian Government needs to take a number of necessary fiscal and institutional measures.

11. On the fiscal front, both ISPA and SAPARD require co-financing, as the support of the European Community cannot exceed 75 percent of the value of the project. In the case of SAPARD, the co-financing element must come from the national, regional (judet) or local budget, while for ISPA the co-financing element may also be provided by international financing institutions and interested commercial banks. The PHARE projects financing investments will also require co-financing from national public funds and the EU contribution will be limited to 75 percent of the public expenditures. The additional direct cost for the budget will amount at a minimum to €100–150 million, equivalent to 0.5–0.7 percent of GDP. In addition, one should take into account the indirect maintenance cost to ensure the functioning of the projects following their implementation.

12. As regards institutional measures, solid and transparent policymaking and administrative capacities needed to be established. The new aid instruments represent a major change since there are three programs with more than twice as much funding, as well as different rules for each instrument. ISPA requires the preparation of strategies for both transportation and the environment, as well as a financing memorandum for each project, rather than a financing memorandum covering an entire program (as is the case under PHARE). SAPARD requires a paying agency to be set up (which on accession will be responsible for the management of the EU's agricultural fund). Different regional agencies may be needed, as SAPARD support goes to individual farmers. Project management capabilities, financial management structures, and public procurement systems have to be built.

13. Modifications to Romanian national financial control have been adopted in line with the requirement of the pre-accession funds. But the move to ex post financial control will be made by the Commission only when it deems the system fully operational. The Romanian government experiences difficulties in setting up the relevant administration eligible to

¹¹ RICOP is a PHARE program closely linked to the implementation of the Private Sector Adjustment Loan (PSAL) agreed with the World Bank. The non-reimbursable assistance is provided for: redundancy intervention (outplacement and severance pay); job creation in the field of public works; employment promotion initiatives; small business finance; social response measures; and technical assistance.

manage the funds and there will be delays in starting the SAPARD projects. Moreover, many of the possible SAPARD projects that are to be selected rely on the financing through regional (judet) and local budgets, where co-financing possibilities are very limited, in part because of weak financial management. It is therefore likely that disbursements for ISPA and SAPARD will not start before 2001 (at the earliest for the latter).

The Stability Pact projects: An additional volume of resources

14. Romania and Bulgaria are the only two countries that belong both to the group of countries invited to negotiations to EU accession and beneficiary parties of the Stability Pact for South-Eastern Europe. The two countries have been affected by two main political developments in the region. First, the sanctions decided by the UN as of 1994 against the Federal Republic of Yugoslavia through a gradual embargo on goods (and then services) have reduced trade relations with a neighboring country and shrunk economic activity in the border areas. Second, following the start of the war in Kosovo, the destruction of bridges has hindered navigation on the Danube River, thereby freezing the emerging activity of the shipping companies that had been recently privatized. Romania and Bulgaria, therefore, became beneficiary countries of the Stability Pact, which aims at promoting a comprehensive regional development approach to the Balkans. This also meant further resources, mainly in the form of grants, in the context of new funding of programs and projects. The source of these funds comes in the first place from the EU, either through bilateral aid, the budget of the Commission, or its financial arm, the European Investment Bank.¹²

15. In March 2000, donors participating in the Regional Funding Conference for South-Eastern Europe considered a first round of projects and programs for the development of the Balkans. Individual countries and multilateral institutions pledged €2.4 billion of financial support to the Quick Start projects, of which half of the funds were estimated to be in the form of grants. Quick Start projects are expected to begin within a year and are mostly geared to upgrade infrastructure, promote trade, and encourage investment. Romania's Quick Start program consists of two road infrastructure projects, for an amount of €332 million, or some 30 percent of the total funding of projects.¹³ Its other "near-term projects," which will be considered subsequently for funding, amount to €770 million or 28 percent of the projected total cost. To date, Romania is the leading beneficiary country of the Stability Pact in terms of volume of aid pledged.¹⁴

¹² Based on the April 2000 Report to the Working Level Steering Group on the financial results of the regional funding conference for South-Eastern Europe.

¹³ The list of projects also includes the protracted construction of a second bridge between Romania and Bulgaria, which will open an important road corridor for the latter.

¹⁴ The Federal Republic of Yugoslavia joined the Stability Pact on October 26, 2000.

C. On the Way to Accession

Establishing a “functioning market economy”

16. The degree of state ownership in the economy is often a good indicator of whether a market economy is free of distortions and functions properly. The state maintains an important role in the Romanian economy, in particular through its ownership of large companies. The share of the private sector in production has remained constant at about 61 percent of GDP since 1997. In mid-2000, about 60 percent of large companies (in terms of State Ownership Fund (SOF) capital) remained to be privatized. In addition, all utilities remain in state hands, with the exception of ROMTELECOM. The lack of financial discipline of public companies and their high level of arrears has turned into a major distortion for the Romanian market, while hampering the privatization process. Moreover, despite the high degree of estimated private land ownership (about 85 percent), the government also remains a key actor in the land market, mainly as a result of the lack of progress on the issue of restitution of agricultural land and forests and the deficiencies of the land cadastre. The law on the restitution of state arable land and forests was promulgated in January 2000, but implementation remains slow.

17. The existence of fair access to market financing is a second indicator. Progress in this area would require privatization of the banks and strengthening of supervision activities. The privatization process has started in the last two years, with two state-owned banks and the closure of another one. Two commercial banks owned by the government, representing at end-1999, respectively, 29.1 percent and 4.2 percent of the total assets of the banking sector, as well as the savings bank of the country (10.6 percent of the total assets), are still owned by the government. Provided the government remains committed to the process of bank privatization, it should be possible to complete the privatization of the two commercial banks by 2001. The National Bank of Romania has also embarked on a reform to consolidate the supervision of the banking system.

18. Transparency in the market—namely whether the government is able to regulate the market in order to ensure fair competition—is another indicator of whether the economy functions properly. Admittedly, some share of the Romanian economy is unregulated, with the emergence of a parallel economy that has developed rapidly in recent years. According to various studies that have been carried out to assess its size, the parallel economy could represent between 20 percent and 40 percent of Romanian GDP, reflecting some of the weaknesses of the transition process.¹⁵ As regards competition rules, the European Commission stated in its progress report in 1998 that “*Romania's Competition Law is largely in line with EU legislation,*” but called for “*efforts toward full and effective application of the legislation.*” The same remarks apply to state aid and public procurement, as the new law that entered into force in 2000 transposes most of the *acquis communautaire*. A related issue is the ability to protect intellectual property rights. Under the Europe Agreement, Romania made the commitment to provide by 2000 a level of protection of intellectual property rights

¹⁵ See Mungiu (2000).

similar to that in the EU. The government acknowledges that effective enforcement remains a challenge and intends to allocate additional resources allocated to this purpose.

19. A fourth indicator is the degree of price liberalization, where progress has been positive so far. The prices of most goods are freely set, with the notable exception of gas prices and utilities, which account for about 11 percent of the total consumer price index basket. Controlled prices have been periodically adjusted, though not always with the same frequency in the last 12 months.

20. Finally, a legal environment conducive to business activities is a key aspect. In the context of the acceleration of structural reforms, the authorities introduced a number of important legislative changes, including modifications to the company law and the bankruptcy law, and to the legal regime for leasing operations, as well as new laws on secured transactions. In general, though, the weaknesses of the legal and judicial framework continue to hinder the development of economic activity and encourage the emergence of a parallel economy.

21. Against this background, notwithstanding considerable progress in stabilization and structural reform over the past two years, the Commission noted in October 1999 that "*Romania cannot be considered to be a functioning market economy,*" and conditioned a revision of this assessment on many legal and institutional changes and achievement of macroeconomic stability.

Consolidating trade and foreign investment, and liberalizing capital flows

22. Trade is among the areas where Romania is most integrated with the EU. Much progress has been made toward the liberalization of the sector and the reduction of tariff barriers. The composition of external trade and its geographical structure have gradually shifted, thereby providing the conditions for a smooth transition to the EU single market. As regards the latter, Romania is driven by the implementation of the Europe Agreement, a free-trade agreement that requires the elimination of remaining tariffs on nonagricultural imports from the EU by 2002 (see Box VI.3) and gradual reciprocal tariff reductions for agricultural products. Meeting this commitment will not be unduly difficult, as tariffs on industrial products are relatively low, with an average most favored nation rate at 16 percent (well below the upper limits defined jointly with the WTO of some 35 percent) and a preferential rate of 7 percent on average for imports from the European Union (see Table VI.3).¹⁶ The phasing out by 2002 is likely nevertheless to lead to more intense competition on the domestic market, as the tariff elimination was back-loaded for sensitive products such as footwear, and textile and clothing products. On agricultural products, the liberalization of tariffs has been substantial in recent years, since Romania applied up to 1997 the limits applicable for the most favored nation (MFN) tariff rates agreed with WTO—an average

¹⁶ See the Trade Policy Review of the WTO for a detailed description of the tariff regime in Romania.

Box VI.3. Romania and Free-Trade Agreements

Romania has concluded free-trade agreements with the European Union, EFTA, CEFTA, Moldova, and Turkey.

Entering into force in 1995, the Europe Agreement with the European Union, aims at accelerating the economic integration of Romania. The basic principles of the agreement are:

- (i) the introduction of a free trade area, to be achieved gradually, on an asymmetric basis; to this end, the European Union eliminated, from the entry into force of the agreement, the customs duties on most industrial products, while Romania is gradually reducing customs duties, with a view to eliminating them by the start of 2002;
- (ii) the mutual elimination of quantitative restrictions on imports, enforced from the entry into force of the Agreement;
- (iii) the elimination of quantitative restrictions on exports (eliminated by the European Union from the entry into force of the agreement and from 1998 by Romania);
- (iv) the initiation of trade liberalization for agricultural goods on the basis of concessions granted to one another.

The Europe Agreement allows the Romanian economy to prepare for the moment of accession. The asymmetry of the concessions provides the basis for an increase of industrial product exports to the EU, thus positively influencing the process of productivity increase through the use of new technologies. At the same time, the need to observe internationally accepted rules improves the commercial behavior of the Romanian exporters.

The Free Trade Agreement with the EFTA States is largely patterned on the trade provision of the Europe Agreement.

The process of regional integration is consolidated by the accession of Romania to the Central European Free Trade Agreement (CEFTA), on 1 July 1997. The CEFTA countries, all "front-runners" to EU accession, agreed before the entry of Romania, to complete trade liberalization among themselves by 2001. Without changing that objective, the CEFTA countries aim at gradually eliminating customs duties reciprocally with Romania by 2002.

Romania is also a member country of the Black Sea Economic Cooperation, which promotes trade in the Black Sea area.

bound rate of 134.1 percent—and brought it down to 33.9 percent. However, there is no significant preferential tariff applied so far to the European Union and the cost of tariff elimination on agricultural goods might be more significant for Romania. The two parties are committed through the Europe Agreement to move gradually toward (asymmetric) concessions and tariff reduction.¹⁷ Romania is also committed to eliminate most tariff barriers with EFTA and CEFTA countries. As regards the latter group, tariffs on industrial products are virtually down to zero and on agricultural products, at some 23 percent. Finally, the issue of application of the EU third-countries tariff to non-EU countries with which Romania is committed in trade arrangements (Moldova, Black Sea countries) will need to be settled. As regards temporary measures, Romania ended the practice, which had intensified in 1995-96, of tariff reductions subject to quotas. All remaining quantitative restrictions on exports have been eliminated and replaced with automatic licensing for statistical purposes. In addition, no anti-dumping, countervailing, or safeguard measures have been taken under the WTO Agreements. The import surcharge, which was introduced in 1998 at 6 percent, is gradually being phased out and is expected to be eliminated by January 1, 2001. The new Customs Code of 1997 unified the regime for importers and exporters in a single framework. It converges with the EU's Customs Code, as the principles of customs valuation are largely the same. Comparison values were used until 1998 for products subject to excise taxes, but were replaced in 1999 with a data base of prices.

23. In line with EU requirements, excise taxes are levied on alcoholic beverages, tobacco products, and petroleum products (as well as a general category of other products). Although excise duties were increased in December 1999, their level remains low in relation to EU levels. The government is wary that relatively high levels of duties and taxes could contribute to smuggling and customs fraud. Also, the strengthening of border controls is perceived as complicating customs procedures, often described as complex, cumbersome or time-consuming. As regards VAT, Romania has applied a uniform VAT rate of 19 percent since January 2000 (see Chapter II).

24. An indicator of Romania's preparedness for EU accession is the level of its commercial integration with the EU, reflecting, as the Commission states it, the "*capacity to cope with competitive pressure and market forces within the Union.*" Romania's commercial relations with the EU became predominant beginning in 1995 (see Table VI.4). The share of exports to EU countries in the total Romanian exports increased from 33.9 percent in 1990 to 65.5 percent in 1999. The same trend was registered for Romanian imports from EU countries, whose share in total Romanian imports was 55.1 percent in 1999, compared with 21.8 percent in 1990. Among the candidate countries in 1999 (including Turkey, Cyprus, and Malta), Romania was both the sixth largest destination for exports and the sixth largest

¹⁷ As of August 2000, the EU and Romania elaborated a separate list of meat and food products that can be exported with zero customs duties, most often on the basis of quotas.

source of imports. On a per capita basis, however, EU trade with Romania is the lowest among candidate countries and the trade balance has, since 1993, been positive for the EU.¹⁸

25. The analysis of Romania's trade with the EU from 1990 to 1999 illustrates the important structural changes in the country's economy. Export activities have shifted from capital- and energy-intensive industries to labor-intensive manufactured goods with a low value added. There has been, therefore, a substantial decline in exports of mineral and chemical products, a surge of exports of textiles, footwear, and wood products, and an increasing reliance on imports of raw materials for these industries from the EU (fabrics, hides, skins, etc.). In central and eastern Europe, Romania is the largest exporter of clothing products to the EU.

26. As regards foreign direct investment, the investment regime is broadly liberal. All investors, domestic and foreign, benefit from a general guarantee against nationalization and expropriation. In principle, there is equality between foreign and domestic investors in establishing a Romanian company and foreign direct investments are free (except for the oil exploitation and insurance sectors), as are investments in real estate for business purposes.¹⁹ Notwithstanding these provisions, foreign direct investment played only a minor role in Romania's transition between 1989 and 1996 (a total of US\$1.7 billion), with levels becoming more significant only in 1997 (US\$1.3 billion) and 1998 (US\$2 billion) and below US\$1 billion in 1999. The relatively low level of foreign direct investment to date has been an obstacle to the modernization of the capital base and creation of jobs in the private sector. The status of Romania as an EU candidate should enhance its attractiveness to foreign investors.

27. Turning to foreign exchange regulations, Romania enjoys full convertibility of current account transactions (Romania accepted the Article VIII obligations in March 1998). However, there are still in practice some constraints on capital account transactions: Romania applies an authorization procedure for most outward capital transactions as well as short-term capital inflows.²⁰ In choosing to limit short-term capital inflows, the government wants to prevent instability in the foreign exchange market. In July 1999, to prepare for

¹⁸ In 1999, Italy was Romania's largest trading partner, with 34 percent of total bilateral trade between Romania and the EU, followed by Germany (28 percent) and France (10 percent).

¹⁹ One of the major flaws up to 2000 has been the large number of laws providing local and foreign enterprises with exemptions from the payment of customs duties and taxes collected at the border. Given the complexity of the incentives system, the investment regime lacked transparency and turned into an unstable and unfair system. In the course of the first half of 2000, most investment incentives were removed (see Chapter II).

²⁰ However, the repatriation of capital and capital gains is free of taxes in Romania; dividends paid by a Romanian company are subject to a 10 percent withholding tax; and interest earned by nonresidents is subject to a 10 percent withholding tax with the exception of payments made by banks registered in Romania.

integration to the European capital market, the National Bank of Romania approved a three-stage liberalization program, to be completed by the date of accession. The first stage envisaged would encompass the liberalization of capital inflows, excluding short-term operations (such as transactions with money market instruments, securities issued or guaranteed by public entities, and the placement of deposits in lei by nonresidents), and the second stage would include the liberalization of capital outflows. The timetable for the two stages is not yet finalized; it is understood that when Romania joins the EU, it will need to have completed the third stage by opening its capital account fully.

Joining EMU: Implications for Romania

28. The European Commission now considers the participation in EMU an integral part of the *acquis* while the EU member countries have decided that no more opt-out clauses from-EMU will be granted to candidate countries. As 2007 is the date set by the Romanian Government to join the EU, the question of the implications of the accession to the EMU is therefore not premature. But a clear distinction should be made between compulsory participation in the EMU and the adoption of the euro as a single currency. In its 1999 Composite paper on progress toward enlargement, the Commission stated that "*new-Member States are not expected to adopt the single currency immediately upon accession, even though they will be taking part in EMU*". Upon accession, the newcomers will have the status of Member States with a derogation under the rights and obligation, specified under article 122 of the Amsterdam Treaty, of a country which takes part in EMU but which still uses its national currency. With an insufficient degree of real economic convergence and financial integration, newcomers may be confronted with asymmetric shocks with respect to the euro area. Priority should therefore be given to consolidate the well functioning of markets as well as to macroeconomic stability in order to reach a high degree of sustainable convergence. As noted by the Commission, "*there is a risk that candidate countries will rigidly orient their policies towards compliance with the Maastricht convergence criteria in an effort to adopt the euro at the earliest possible opportunity.*"

Institutional and legal requirements

29. To comply with the *acquis* and fully access the EMU (Stage III), the Romanian government will need to take four main institutional and legal requirements into consideration, unless the EU countries grant a transitory period.²¹ The liberalization of capital flows and an efficient financial sector will be instrumental in building the capacity to join the EMU and subsequently the euro area.

30. The first key pre-condition in joining EMU relates to exchange rate policy. Prior to accession, Romania is free to choose whatever exchange rate system suits it, although admittedly the system should be appropriate in facilitating economic and financial convergence to the EU. Upon membership, a new member is obliged to avoid exchange rate fluctuations and competitive devaluations. This is why in principle, though on a voluntary

²¹ See Temprano-Arroyo and Feldman (1998).

basis, a newcomer is likely to enter the exchange rate mechanism (ERM II), a system established to maintain the exchange rate of the currency of the applicant member country against the euro within a band (± 15 percent) around the central rate. This would imply for instance that Romania's macroeconomic parameters enable the country to modify its floating exchange rate system to join ERM II.

31. Second, the central bank must be able to formulate monetary policy without government interference so as to meet its primary objective, the maintenance of price stability. The central bank should also comply with rules on the appointment, dismissal, and term of office of the governor. In Romania, the independence of the central bank is functional but remains conditional.²² The law on the National Bank of Romania (NBR) remains, among the ten candidate countries, the only one that has no explicit reference to independence (reportedly out of concern that it might have been interpreted as "unaccountability"). The NBR nevertheless freely chooses the instruments and techniques of monetary control and exchange rate policy, which ultimately lead to price stability.²³ As regards political independence, the Governor, as well as the members of the Board, are appointed for six years and are accountable to the Parliament.²⁴

32. Third, countries joining EMU must renounce all forms of direct central bank financing of government deficits. Romania has relatively restrictive rules. Overdrafts are permitted but for a limited amount (7 percent of state budget revenues, or about 1.2 percent of GDP in 1999), and a short maturity.²⁵ The purchase of national government securities by

²² For an analysis of the institutional framework of central banks in ten Central and East European countries, see Hochreiter and Kowolski (1996).

²³ "The main objective of the National Bank of Romania (NBR) is to ensure the stability of the national currency, for the overall purpose of price stability," Article 2 of the National Bank Act.

²⁴ According to Article 34 of the National Bank Act: "A member of the Board of Directors may be recalled from office by the Parliament whenever he/she is no longer eligible, according to the provisions of Article 36 (incompatibilities and conflict of interests; a prison sentence was pronounced and the court ruling is final; during his/her mandate he/she engaged in inadequate operations, substantially damaging to the NBR's interests)."

²⁵ Article 29 of the National Bank Act: "The total amount of loans granted during one financial year shall not exceed 7 percent of the state budget revenues of the previous years, and the outstanding balance of loans granted and unpaid shall not exceed at any time, twice the amount of the NBR's own capital and reserves." The loan has to be repaid within 180 days at a market interest rate.

the central bank in the primary market, as well as the privileged access of public authorities to financial institutions, are implicitly not allowed but not explicitly prohibited by the law.²⁶

33. Finally, the smooth functioning of the financial sector and the ability to cope with free but volatile movements of capital are critical and part of the EMU *acquis*. The prospect of EU membership will increase pressure to make progress toward developing a healthy, efficient and market-oriented financial sector.²⁷

Maastricht criteria

34. The Commission noted in 1999 that "*attempts at too early adoption of the euro (i.e. before these economies have reached a high degree of sustainable convergence) could be highly damaging for the candidate and ought to be discouraged.*" In this regard, it would seem too early to assess Romania's macroeconomic convergence through the Maastricht criteria. Sustainable nominal convergence is more likely to be judged when Romania will have demonstrated its capacity to successfully operate within the single market and liberalized capital movements, as was the case with existing member countries.

35. Looking ahead, Romania's performance gap in terms of the Maastricht criteria as compared to most other candidate countries may, however, raise difficulties for the EU (Table VI.5). Romania's inflation rate is not only much above the EU average, but at the highest average level among the applicant countries since the transition process has started. The inflation rate reached an annual average of 123 percent in the period 1991-99, and has never declined below 30 percent, a threshold that will remain unchanged in 2000. Romania's fiscal policy may appear rather tight and in line with the target set by the Maastricht criteria, with the average general consolidated budget balance reaching a deficit of slightly above 3 percent of GDP since the start of the transition period, but this measure does not reflect large quasi-fiscal costs related to public companies' debts. In the years ahead, fiscal balances will be burdened by the cost of the bank restructuring and the much delayed restructuring of the public sector, with considerable hidden debts in the form of arrears. Interest rates, which have been among the highest of the group of candidate countries in recent years, are likely to remain high until Romania's inflation converges to EU levels. It should be noted that a long-term interest rate indicator is lacking; ten-year bonds still do not exist and the longest maturity in Romania is currently the two-year treasury note, reflecting the overall lack of confidence in government paper, of the short term structure of bank deposits in an inflationary context, and the shallowness of the capital market. Romania meets consistently only the convergence criteria related to the level of the government debt to GDP, a ratio close to zero in 1990, which rose to some 30 percent of GDP in 1999, less than half the EU average, and is largely contracted on short- and medium-term maturities.

²⁶ Moreover, some recent bailing out operations, when the NBR bought large amount of T-bills issued to recapitalize two state-owned banks following their restructuring and the closing of a third one, would probably not be in conformity with EMU rules.

²⁷ See Koehler and Wes (1999).

36. In meeting one convergence criterion out of four and experiencing a recurrent instability of its nominal and real exchange rates, the question of Romania's convergence to the macroeconomic parameters of the EU member countries is rhetorical in the short and medium run, though it remains a benchmark in a longer horizon. The main conclusion of this chapter is that stabilization is a prerequisite and macroeconomic stability needs to be achieved to build up a macro-performance record that will convince EU member countries about the sustainability of the convergence track. This will require tight fiscal and monetary policies that will need to be reconciled with development and public investment needs. To this end, Romania will benefit from a substantial share of the resources made available by the EU during the pre-accession period. It will be important to promptly use, and efficiently absorb, the EU pre-accession transfers to upgrade the country's infrastructure and to set the conditions to boost the economic growth indispensable to real convergence.

Table VI.1. Differences in GDP Per Capita and Poverty Lines in Central and Eastern European Countries

	Bulgaria	Czech Republic	Estonia	Hungary	Latvia	Lithuania	Poland	Romania	Slovakia	Slovenia	EU
GDP per capita ¹	4,809	12,362	7,682	10,232	5,728	6,436	7,619	5,648	9,699	14,293	21,227
As percent of EU average	23	59	37	49	27	31	36	27	46	68	...
Poverty line at US\$4.30 a day ²	18.2	0.8	19.3	15.4	34.8	22.5	18.4	44.5	8.6	0.7	...

Source: World Bank Development Indicators 2000

1/ 1998 GDP per capita at PPP

2/ In percent

Table VI.2. Annual Distribution of EU Pre-Accession Aid Between Central and Eastern European Countries

	Phare			Sapard			ISPA ²			Total		
	Allocation (in million of Euros)	As percent of total	Per capita (in Euros)	Allocation (in million of Euros)	As percent of total	Per capita (in Euros)	Allocation (in million of Euros)	As percent of total	Per capita (in Euros)	Allocation (in million of Euros)	As percent of total	Per capita (in Euros)
Romania	242	28.7	0.71	151	40.8	0.44	239	23.0	0.70	632	31.4	1.86
Bulgaria	100	11.9	0.91	52	14.1	0.47	104	10.0	0.94	256	12.7	2.33
Czech Republic	79	9.4	0.16	22	6.0	0.04	70	6.8	0.14	171	8.5	0.34
Estonia	24	2.8	0.52	12	3.3	0.26	29	2.8	0.62	65	3.2	1.41
Hungary	96	11.4	0.23	38	10.3	0.09	88	8.5	0.21	222	11.0	0.52
Latvia	30	3.6	0.53	22	5.9	0.38	47	4.5	0.82	99	4.9	1.73
Lithuania	42	5.0	0.44	30	8.1	0.31	52	5.0	0.55	124	6.2	1.30
Poland	398	47.2	0.28	169	45.7	0.12	348	33.5	0.25	915	45.5	0.65
Slovakia	49	5.8	0.27	18	5.0	0.10	47	4.5	0.26	114	5.7	0.63
Slovenia	25	3.0	0.14	6	1.7	0.04	16	1.5	0.09	47	2.3	0.27
Total	843.0	100.0		369.4	100.0		800.0	77.0		2,012.4	100.0	

Source: EU Commission, Eurostat.

Note: This table indicates the program allocations budgeted by the EU Commission in 2000, not the disbursements. For SAPARD and ISPA, a roughly equivalent budget allocation is planned during the period 2000-2006 and for PHARE during the period 2000-2002.

1/ GDP in 1998 at current prices

2/ Central scenario. The EU Commission has projected three scenarios by countries: Romania is to receive an annual allocation between €208 and €270 million.

Table VI.3. Romania: Average Tariffs in 1999
(In percent)

Origin	Agricultural Products	Other Products	All Products
Most Favored Nation			
Statutory ¹	134.1	16.2	16.2
Applied	33.9	16.2	19.8
Preferential			
European Union	31.6	7.0	12.0
Turkey	32.5	7.1	12.2
EFTA	32.2	6.1	11.4
CEFTA			
Bulgaria	22.7	0.9	5.3
Czech Republic	22.8	0.0	4.6
Poland	22.6	0.6	5.0
Slovak Republic	22.8	0.0	4.6
Slovenia	24.6	0.5	5.3
Hungary	22.8	0.9	5.3

Source: World Trade Organization (WTO).

1/ Upper limit set with WTO.

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Exports to EU (FOB)	(In percent of total)									
2 Mineral and chemical products	36.2	27.5	16.7	14.4	11.3	8.0	8.0	5.2	4.0	2.5
3 Textiles	12.5	12.7	18.2	31.0	33.1	31.2	33.4	36.0	36.4	36.1
4 Footwear and related products	1.7	2.7	2.9	6.4	9.5	9.3	10.3	11.0	11.1	11.8
5 Common metals	11.2	12.2	13.4	10.4	11.5	17.0	14.8	16.5	15.8	12.1
Memorandum items:										
Value of trade (in million of US\$)	5,775	4,266	4,363	4,892	6,151	7,910	8,084	8,431	8,302	8,503
Share of CEFTA in total exports (in percent)	9.1	5.4	3.8	3.4	4.5	3.5	3.6	4.1	5.4	7.0
Total	100	100	100	100	100	100	100	100	100	100
1 Agricultural products	22.4	27.0	17.4	15.2	13.1	8.7	7.5	7.6	6.6	7.2
Common metals	11.2	12.2	13.4	10.4	11.5	17.0	14.8	16.5	15.8	12.1
6 Electric equipment	23.5	24.6	21.9	27.2	32.0	28.8	29.3	27.6	27.0	26.4
7 Other	17.7	11.8	21.6	20.7	15.9	21.8	21.3	20.9	23.4	19.6
Share of EU in total imports (in percent)	41.8	28.7	41.3	45.3	48.2	50.5	52.3	52.5	51.7	55.1

Source: National Commission for Statistics.

Table VI.5. Maastricht Criteria: Convergence Indicators

	Consumer Price Index				Government Budget Balance As Percentage of GDP				Government Debt to GDP ratio				Long Term Interest Rates ³							
	1997		1998		1999		1997		1998		1999		1997		1998		1999			
	Average 1992-96	1997	1998	1999	Average 1992-96	1997	1998	1999	Average 1992-96	1997	1998	1999	Average 1992-96	1997	1998	1999	Average 1992-96	1997	1998	1999
EU	...	1.7	1.3	1.1	-4.9	-2.6	-2.0	-1.2	69.7	74.0	73.4	72.2	8.0	2/	4.7	4.7	8.0	2/	4.7	4.7
Romania	134.8	134.8	59.1	45.8	-2.7	-4.6	-5.0	-3.5	21.7	27.8	28.0	34.5	38.9	1/	63.7	55.2	38.9	1/	63.7	55.2
Bulgaria	88.8	1,061.6	18.7	2.6	-6.3	-2.1	0.9	-0.9	106.4	97.0	80.8	...	74.0	1/	13.3	12.8	74.0	1/	13.3	12.8
Czech Republic	12.0	8.4	10.7	2.1	-1.4	-1.7	-2.0	-3.3	12.7	10.0	10.8	12.4	13.1	1/	12.8	8.7	13.1	1/	12.8	8.7
Estonia	253.1	10.6	8.2	3.3	-0.6	2.2	-0.3	-4.7	8.1	8.9	12.4	...	22.1	1/	16.7	8.7	22.1	1/	16.7	8.7
Hungary	23.2	18.3	14.4	10.3	-6.8	-6.6	-5.6	-5.6	82.8	63.9	60.6	...	29.2	1/	19.3	16.3	29.2	1/	19.3	16.3
Latvia	86.1	8.4	4.6	2.4	-3.4	0.3	-0.8	-4.2	9.1	8.9	12.4	...	50.6	1/	14.3	14.2	50.6	1/	14.3	14.2
Poland	32.5	15.9	11.7	7.3	-3.2	-3.1	-3.2	-3.3	56.6	46.9	42.8	...	33.3	1/	24.5	17.0	33.3	1/	24.5	17.0
Slovak Republic	12.4	6.1	6.7	10.6	-4.1	-5.2	-5.0	-3.6	32.1	46.0	48.6	...	14.9	1/	21.2	21.1	14.9	1/	21.2	21.1
Slovenia	46.1	9.1	8.6	6.6	0.0	-1.7	-1.4	-0.9	...	...	...	...	65.7	1/	16.1	12.4	65.7	1/	16.1	12.4

Sources: EBRD; IMF; and World Bank.

1/ Average for 1993-96.

2/ Average for 1994-96.

3/ Lending interest rates, year average; except for the EU (government bond yield).

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Table 1. Romania: GDP by Origin, 1993-99

	1993	1994	1995	1996	1997	1998	1999
(In billions of lei; at current prices)							
Total	20,036	49,773	72,136	108,920	252,926	368,261	521,736
Agriculture and forestry	4,206	9,898	14,269	20,949	45,533	53,682	72,595
Industry	6,781	18,018	23,711	36,182	78,094	101,166	144,955
Construction	1,040	3,251	4,755	7,067	13,230	19,612	25,189
Trade 1/	2,058	4,076	7,570	12,722	28,768	50,610	70,316
Other	5,951	14,530	21,830	32,000	87,301	143,191	208,680
(Sectoral GDP shares; in percent)							
Agriculture and forestry	21.0	19.9	19.8	19.2	18.0	14.6	13.9
Industry	33.8	36.2	32.9	33.2	30.9	27.5	27.8
Construction	5.2	6.5	6.6	6.5	5.2	5.3	4.8
Trade 1/	10.3	8.2	10.5	11.7	11.4	13.7	13.5
Other	29.7	29.2	30.3	29.4	34.5	38.9	40.0

Source: National Statistics Commission.

1/ From 1993, "Trade" includes hotels and restaurants.

Table 2. Romania: GDP by Expenditure, 1993-99

(In percent)

	1993	1994	1995	1996	1997	1998	1999
	(Real annual change)						
GDP	1.5	3.9	7.1	3.9	-6.1	-5.4	-3.2
Total consumption	1.2	3.8	10.8	7.0	-4.3	-4.0	-4.5
Households	0.9	2.6	13.0	8.0	-3.7	-4.6	-4.9
Public & private	2.8	9.5	1.1	1.9	-7.5	-0.8	-2.4
Gross fixed capital formation	8.3	20.7	6.9	5.7	1.7	-5.1	-10.8
Exports	11.1	19.0	17.0	2.0	11.4	5.9	8.8
Imports	4.4	2.8	16.3	8.7	7.5	14.3	-5.1
	(Shares of GDP)						
GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total consumption	76.0	77.2	81.3	82.6	86.4	86.7	84.3
Households	63.2	63.2	67.3	69.1	73.6	72.2	69.6
Public & private	12.8	14.0	14.0	13.5	12.8	14.5	14.7
Gross fixed capital formation	17.9	20.3	21.4	23.0	21.2	19.4	18.5
Changes in stocks	11.1	4.5	2.9	2.9	-0.6	2.0	1.4
Net exports	-5.0	-2.0	-5.6	-8.5	-7.0	-8.1	-4.2
Exports	23.0	24.9	27.6	28.1	29.2	23.7	30.1
Imports	28.0	26.9	33.2	36.6	36.2	31.8	34.3
	(Contributions to GDP growth)						
GDP	1.5	3.9	7.1	3.9	-6.1	-5.4	-3.2
Total consumption	1.0	2.9	8.3	5.7	-3.5	-3.5	-3.9
Households	0.5	1.7	8.2	5.4	-2.5	-3.4	-3.5
Public & private	0.4	1.2	0.1	0.3	-1.0	-0.1	-0.3
Gross fixed capital formation	1.6	3.7	1.4	1.2	0.4	-1.1	-2.1
Changes in stocks	-2.5	-6.3	-2.4	-0.6	-3.4	2.6	-0.9
Net exports	1.5	3.6	-0.2	-2.3	0.5	-3.5	3.7
Exports	3.1	4.4	4.2	0.6	3.2	1.7	2.1
Imports	1.6	0.8	4.4	2.9	2.7	5.2	-1.6

Source: National Statistics Commission.

Table 3. Romania: Investment by Sector, 1993-99

(In billions of lei at current prices)

	1993	1994	1995	1996	1997	1998	1999
Industry	1,410.8	2,951.8	5,402.4	9,186.8	19,771.6	27,568.2	28,935.4
Construction and geological explorations	78.2	431.0	678.8	1,309.8	3,675.8	4,226.9	4,669.3
Agriculture and forestry	196.4	1,528.6	1,420.3	2,427.4	2,889.8	4,088.4	8,571.4
Transport	316.8	750.3	710.5	1,286.5	2,332.6	3,472.7	6,389.4
Telecommunications	134.2	300.1	368.4	761.1	3,015.7	4,588.9	4,111.3
Trade 1/	272.5	678.6	1,144.2	2,071.0	3,868.3	7,220.3	2,959.2
Housing	165.2	442.6	557.9	975.1	...	...	...
Education	16.9	67.2	109.0	295.1	709.8	768.3	604.7
Health and social assistance	20.6	43.4	104.8	166.1	355.5	581.0	512.2
Public administration and defense	56.3	291.8	577.8	808.9	2,703.4	2,287.0	3,854.5
Financial sector	80.6	311.3	471.9	830.9	2,070.8	3,002.0	2,650.9
Other	238.5	650.5	2,007.4	1,802.0	2,741.4	2,711.7	7,313.5
Investment in the national economy	2,821.8	8,004.6	12,995.5	20,945.3	44,134.7	60,515.2	70,571.8
Of which:							
State sector	1,958.5	4,692.7	6,898.5	10,704.9	20,083.6	21,670.0	24,553.7
investment housing	165.2	442.6	557.9	975.1	2,303.0	3,204.2	4,754.3

Source: Data supplied by the Romanian authorities.

1/ For 1996 and 1997, "Trade" includes hotels and restaurants.

Table 4. Romania: Saving-Investment Balance, 1993-99

(Current prices)

	1993	1994	1995	1996	1997	1998	1999
(Billions of lei)							
Gross domestic saving	4,803.9	11,222.8	13,713.9	19,187.9	34,691.6	49,124.7	80,681.3
Net factor receipts and transfers from abroad	56.3	271.4	274.5	953.0	1,942.6	3,401.2	3,202.9
Gross national saving	4,860.1	11,494.3	13,988.4	20,140.9	36,634.2	52,525.9	83,884.2
General government	3,985.9	9,590.3	11,560.9	18,370.8	34,933.7	55,382.1	86,639.0
Non government	874.2	1,904.0	2,427.5	1,770.1	1,700.5	-2,856.2	-2,754.8
Gross investment	5,795.9	12,348.3	17,510.0	28,160.0	52,171.4	78,954.3	103,877.9
General government	5,394.6	11,345.6	15,907.4	26,056.7	47,693.2	73,270.5	97,722.0
Non government	401.3	1,002.7	1,602.6	2,103.3	4,478.2	5,683.8	6,155.9
Non-financial sector balances	-935.8	-854.0	-3,521.6	-8,019.1	-15,537.2	-26,428.4	-19,993.7
General government	-1,408.7	-1,755.3	-4,346.5	-7,685.9	-12,759.4	-17,888.4	-11,083.0
Non government	472.9	901.3	824.9	-333.2	-2,777.7	-8,540.0	-8,910.7
External current account	935.8	854.0	3,521.6	8,019.1	15,537.2	26,428.4	19,993.7
Memo: Nominal GDP	20,035.7	49,773.2	72,135.5	108,919.6	252,925.7	368,260.7	521,735.5
(Percent of GDP)							
Gross domestic saving	24.0	22.5	19.0	17.6	13.7	13.3	15.5
Net factor receipts and transfers from abroad	0.3	0.5	0.4	0.9	0.8	0.9	0.6
Gross national saving	24.3	23.1	19.4	18.5	14.5	14.3	16.1
General government	19.9	19.3	16.0	16.9	13.8	15.0	16.6
Non government	4.4	3.8	3.4	1.6	0.7	-0.8	-0.5
Gross investment	28.9	24.8	24.3	25.9	20.6	21.4	19.9
General government	26.9	22.8	22.1	23.9	18.9	19.9	18.7
Non government	2.0	2.0	2.2	1.9	1.8	1.5	1.2
Nonfinancial sector balances	-4.7	-1.7	-4.9	-7.4	-6.1	-7.2	-3.8
General government	-7.0	-3.5	-6.0	-7.1	-5.0	-4.9	-2.1
Non government	2.4	1.8	1.1	-0.3	-1.1	-2.3	-1.7
External current account	4.7	1.7	4.9	7.4	6.1	7.2	3.8

Sources: National Statistics Commission; and Fund staff estimates.

Table 5. Romania: Employment in Agriculture (Including Self-Employed), 1993-98

(In thousands of persons, end of year)

	1993	1994	1995	1996	1997	1998
Total employment in agriculture	3,537	3,561	3,187	3,249	3,322	3,296
Private farms	3,139	3,242	2,926	3,000	3,156	3,143
State farms (public and mixed)	398	318	261	249	166	153
Agroprocessing (average)	255	244	231	219	213	214
Memorandum items:						
Total employment in economy	10,062	10,011	9,493	9,379	9,023	8,813
Employment in agriculture (percent of total)	35.2	35.6	33.6	34.6	36.8	37.4

Sources: Ministry of Agriculture and Food; and National Statistics Commission.

Table 6. Romania: Distribution of Land Ownership, 1993-99

(In thousands of hectares)

	1993	1994	1995	1996	1997	1998	1999
Total land area	14,793	14,798	14,797	14,789	14,794	14,746	14,781
<i>Of which:</i>							
Private	10,336	10,371	10,694	10,694	10,431	12,342	12,561
(for which titles distributed) 1/	1,353	3,724	5,738	6,771	7,268	7,688	8,018
Memorandum items:							
Number of titles distributed	566	1,558	2,401	2,833	3,041	3,217	3,356
Number to be distributed	4,990	4,990	4,990	4,242	4,284	4,312	4,334
(percent of total distributed) 1/	11.3	31.2	48.1	66.8	71.0	74.6	77.4

Source: Ministry of Agriculture and Food.

1/ Out of 9,200 hectares of land covered by the Land Law.

Table 7. Romania: Output of Main Agricultural Products, 1993-99

(In thousands of tonnes, unless otherwise indicated)

	1993	1994	1995	1996	1997	1998	1999
Grains, total	15,493	18,184	19,883	14,200	22,100	15,453	17,037
<i>Of which:</i>							
Wheat and rye	5,355	6,187	7,709	3,164	7,186	5,208	4,683
Maize	7,987	9,343	9,923	9,608	12,680	8,623	10,935
Sunflower seeds	696	764	933	1,096	858	1,073	1,301
Sugar beet	1,776	2,764	2,655	2,848	2,726	2,361	1,415
Potatoes	3,709	2,947	3,020	3,591	3,206	3,319	3,957
Field vegetables	2,766	2,476	2,783	2,647	2,354	2,754	2,996
Fruit	2,183	980	917	1,632	1,416	1,036	936
Grapes	1,339	1,033	1,314	1,431	1,179	874	1,117
Livestock production							
Meat (live weight)	1,935	1,852	1,846	1,868	1,705	1,672	1,521
Milk (in millions of hectoliters)	47.3	53.6	56.8	57.2	56.2	54.3	52.6
Eggs (in millions)	5,633	5,407	5,567	5,783	5,271	5,331	5,668
Wool (in tons)	26,011	25,141	24,323	23,165	22,120	19,967	18,983
Honey (in tons)	9,936	9,820	10,435	11,157	10,543	10,198	11,153
Memorandum items:							
Agricultural area							
Total (in thousands of hectares)	14,793	14,798	14,797	14,789	14,794	14,802	14,731
<i>Of which:</i>							
Irrigated	3,102	3,104	3,110	3,096	3,089	3,085	3,084
Per capita output							
Wheat and rye (in kg.)	235	272	340	140	319	231	209
Potatoes (in kg.)	163	130	133	159	142	148	176
Meat (in kg.)	85	82	81	83	76	74	68
Milk (in liters)	208	236	250	253	249	242	234

Source: Data provided by the Romanian authorities.

Table 8. Romania: Industrial Production Index, 1993-99 1/

(Average 1991 = 100) 1/

	1993 2/		1994 3/		1995 3/		1996 3/		1997 3/		1998 4/		1999 4/	
	Index	Monthly Change												
January	66.9	-1	71.2	1	74.0	-2	80.2	1	90.7	-3	67.6	-7	59.4	-8
February	75.0	12	68.5	-4	76.1	3	81.4	1	94.3	4	68.5	1	62.4	5
March	84.2	12	77.3	13	89.5	18	91.6	13	100.0	6	75.3	10	69.2	11
April	81.7	-3	76.7	-1	81.5	-9	91.9	0	88.2	-12	68.3	-9	63.1	-9
May	81.7	0	77.0	0	86.8	7	96.0	4	86.5	-2	69.4	2	62.5	-1
June	85.7	5	82.4	7	87.0	0	92.2	-4	88.7	3	69.5	0	63.2	1
July	77.8	-9	76.3	-7	83.2	-4	96.8	5	86.4	-3	67.2	-3	61.1	-3
August	77.1	-1	80.8	6	87.4	5	92.4	-5	74.5	-14	66.6	-1	62.2	2
September	80.3	4	79.7	-1	87.8	0	97.0	5	81.9	10	73.8	11	66.6	7
October	80.5	0	80.7	1	92.6	5	104.8	8	92.6	13	75.3	2	67.4	1
November	82.5	3	84.9	5	93.7	1	101.6	-3	89.7	-3	70.0	-7	69.6	3
December	73.9	-10	75.4	-11	79.3	-15	93.5	-8	80.1	-11	64.4	-8	62.7	-10
Year Average	79.1	1	77.6	3	84.9	9	93.3	10	87.8	-6	69.9	-17	64.1	-8

Source: National Statistics Commission.

1/ Unadjusted series.

2/ 1991-1993 are in structure 1989.

3/ 1994-1997 are in structure 1991.

4/ 1998-1999 are in structure 1995

Table 9. Romania: Number of Employees by Sector and Type of Ownership, 1995-98 1/

	1995			1996			1997			1998		
	Private Sector			Private Sector			Private Sector			Private Sector		
	Total employees (1000s)	Total employment in sector (%)	Total 2/	Total employees (1000s)	Total employment in sector (%)	Total 2/	Total employees (1000s)	Total employment in sector (%)	Total 2/	Total employees (1000s)	Total employment in sector (%)	Total 2/
Total economy	6,047.7	1,364.2	100.0	5,893.9	1,332.4	100.0	5,399.1	1,531.2	100.0	5,181.6	1,759.5	100.0
Of which:												
Industry	2,600.3	439.6	32.2	2,633.0	490.4	36.8	2,341.4	600.2	39.2	2,221.3	747.6	42.5
Agriculture and forestry	422.9	91.9	6.8	369.1	57.7	4.3	283.9	62.8	4.1	257.4	66.1	3.7
Transport and telecommunications	510.1	52.8	3.9	493.4	48.5	3.6	457.5	51.6	3.4	415.7	65.5	3.7
Construction	425.8	228.2	16.7	425.4	232.8	17.5	382.0	235.6	15.4	340.7	222.8	12.7
Trade	667.3	430.1	31.5	581.2	387.0	29.1	619.8	450.0	29.4	644.8	506.5	28.8
Other	1,421.3	121.6	8.9	1,391.8	116.0	8.7	1,314.5	131.0	8.5	1,301.7	150.9	8.6

Source: Data provided by the Romanian authorities.

1/ Excludes the self-employed.

2/ Distribution by sector of private employees.

Table 10. Romania: Enterprise Payment Arrears, 1995-99
(in percent of GDP)

	1995 1/ Dec.	1996 Dec.	1997 Dec.	1998 Dec.	1999 Dec.
National economy 2/	25.15	36.07	33.74	36.15	42.22
To suppliers	13.35	16.05	11.92	15.22	18.02
To other creditors 3/	3.57	6.90	6.21	6.78	9.46
To banks	3.12	6.22	5.81	6.06	6.44
Of which : Principal	2.33	3.87	...	3.67	4.54
Of which : Overdue interest	0.79	2.36	...	2.39	1.90
To budget	5.11	6.89	6.62	8.08	8.29
Private sector 2/	8.14	14.28	13.24	15.60	19.52
To suppliers	4.51	7.60	7.62	8.50	9.65
To other creditors 3/	2.28	2.40	2.16	2.53	3.67
To banks	0.83	2.12	2.29	3.00	4.21
To budgets	0.52	1.32	1.18	1.57	1.99
State sector (50-100% ownership)	16.00	20.29	17.94	17.65	18.24
To suppliers	8.15	7.57	5.99	5.03	5.75
To other creditors 3/	1.20	4.32	3.95	3.88	4.89
To banks	2.25	3.08	3.35	2.71	1.79
Of which : Principal	...	...	...	...	...
Of which : Overdue Interest	...	...	...	...	...
To budget	4.47	5.32	5.05	6.03	5.81
Wholly state-owned	14.71	14.30	10.28	9.83	8.57
To suppliers	7.61	2.57	3.53	2.68	3.40
To other creditors 3/	0.97	3.22	1.92	2.18	2.55
To banks	1.99	1.94	1.59	1.22	0.52
To budget	4.13	3.87	3.24	3.75	2.11
Mixed ownership	2.18	7.36	10.13	10.62	14.04
To suppliers	1.17	3.14	3.92	4.02	4.96
To other creditors 3/	0.30	1.24	2.11	2.04	3.21
To banks	0.30	1.31	1.92	1.84	1.71
To budget	0.42	1.67	2.18	2.73	4.17
State share > 50% (but less than 100%)	1.29	5.99	7.66	7.82	9.66
To suppliers	0.54	2.31	2.47	2.34	2.35
To other creditors 3/	0.22	1.10	2.02	1.70	2.34
To banks	0.26	1.14	1.76	1.50	1.27
To budget	0.34	1.45	1.81	2.28	3.70
State share < 50%	0.81	1.37	2.47	2.80	4.38
To suppliers	0.63	0.83	1.46	1.67	2.61
To other creditors 3/	0.07	0.15	0.49	0.34	0.87
To banks	0.03	0.18	0.16	0.34	0.44
To budget	0.07	0.22	0.37	0.45	0.46

Sources: Romanian Ministry of Finance; and Fund staff estimates.

1/ 1995 stocks and flows are understated owing to the writeoff of some arrears as part of the FESAL debt conciliations in Fall 1995.

2/ Lei 7,875 billion have been added to the December 1997 figures to adjust for the write off associated with Bancorex and Banca Agricola.

3/ Other arrears, including e.g. wage arrears, dividend arrears, and arrears to the social security, pension and unemployment funds.

Table 11. Romania: State Sector, Losses and Arrears, 1998-99

(Billions of lei)

	1998	1999	
1. Losses			
SOF Portfolio	9,756	24,593	1/
<i>Of which</i> : Sidex	48	7,516	2/
Regies Autonomes and National Companies			
<i>Of which</i> : Renel / Conel	...	4,245	
<i>Of which</i> : Romgaz	...	...
<i>Of which</i> : Petrom	...	...
	1998	1999	
	Dec	Dec	
2. Arrears to Consolidated General Government			
SOF Portfolio			
<i>Of which</i> : Sidex	2,440	11,031	3/
Regies Autonomes and National Companies			
<i>Of which</i> : Renel / Conel	2,009	1,605	
<i>Of which</i> : Romgaz	556	1,208	
<i>Of which</i> : Petrom	3,338	6,244	
3a. Arrears to the utilities - RENEL / CONEL	4,020	6,557	
SOF Portfolio			
<i>Of which</i> : Sidex	553	1,983	
Regies Autonomes and National Companies			
<i>Of which</i> : Romgaz			
<i>Of which</i> : Petrom			
3b. Arrears to the utilities - ROMGAZ	1,971	3,351	
SOF Portfolio			
<i>Of which</i> : Sidex	17	60	
Regies Autonomes and National Companies			
<i>Of which</i> : Renel / Conel	315	1,088	
<i>Of which</i> : Petrom			
3c. Arrears to the utilities - PETROM	4,576	5,800	
SOF Portfolio			
<i>Of which</i> : Sidex			
Regies Autonomes and National Companies			
<i>Of which</i> : Renel / Conel	76	1,234	
<i>Of which</i> : Romgaz	823	863	

Source: Ministry of Industry and Trade, State Ownership Fund

1/ Including the companies in SOF portfolio under liquidation and companies where SOF owns residual shares.

2/ Including penalties.

3/ Sidex did not and has no arrears to PETROM.

Table 12. Romania: Average Monthly Nominal and Real Wages, 1993-2000
(October 1990 = 100)

	Nominal Wage 1/	Real Wage 2/	Real Wage in Industry 3/
1993 December	2,968	56	59
1994 December	5,824	69	67
1995 December	8,314	77	79
1996 December	12,738	75	80
1997 January	11,655	60	64
February	13,404	58	64
March	14,891	50	55
April	17,378	54	60
May	16,666	50	55
June	17,049	50	55
July	18,242	53	59
August	19,100	53	59
September	20,857	56	62
October	23,401	60	65
November	24,103	59	63
December	27,623	64	67
1998 January	26,601	59	62
February	26,414	55	58
March	28,686	57	61
April	31,440	61	65
May	30,056	57	60
June	31,289	59	62
July	33,041	61	66
August	33,768	62	66
September	34,274	62	65
October	35,200	61	64
November	35,833	61	63
December	40,922	68	69
1999 January	37,321	60	61
February	38,925	61	62
March	42,429	63	66
April	44,465	62	64
May	43,887	59	60
June	45,467	58	61
July	48,195	60	64
August	48,822	60	64
September	49,017	59	62
October	49,850	57	60
November	52,692	58	63
December	59,858	64	68
2000 January	51,897	53	56
February	52,571	53	56
March	57,355	57	59
April	64,238	61	62
May	61,026	57	58
June			

Sources: Data provided by the Romanian authorities; and Fund staff calculations.

1/ Index net of taxes and social security contributions. Excludes the private sector.

2/ Nominal wage deflated by the consumer price index.

3/ Nominal wage in the industry branch, deflated by the consumer price index.

Table 13. Romania: Economy-Wide Wages and Productivity, 1994-2000 Q2

		Nominal wages (net, in lei)	Exchange rate (lei / \$)	Wages		CPI	PPI	GDP deflator	Output	Employees (thousands)	Real wage		Real wage growth (in percent)	Labor productivity growth (in percent)	Real unit labor cost growth (in percent)
				In US\$	(index)						CPI	PPI			
1994	Q1	106,925	1,494	72	82	79	94	97	94	97	-4.4	-8.5			
	Q2	127,931	1,665	77	97	99	94	92	94	92	0.9	-4.7			
	Q3	150,009	1,700	88	105	107	103	101	103	101	9.0	8.9			
	Q4	175,586	1,761	100	116	114	109	110	109	110	5.9	9.5			
	Average	140,113	1,655	85	100	100	100	100	100	6,133	100	-4.3	-3.7	13.1	-14.8
1995	Q1	175,815	1,802	98	122	120	103	105	103	105	-5.3	-4.4			
	Q2	201,271	1,911	105	127	130	114	112	114	112	10.2	5.9			
	Q3	226,139	2,047	110	134	141	122	115	122	115	6.9	3.6			
	Q4	259,275	2,373	109	146	151	128	124	128	124	5.0	7.0			
	Average	215,625	2,033	106	132	135	117	114	117	114	16.6	14.0	11.7	2.1	
1996	Q1	255,893	2,750	93	156	163	118	112	118	112	-7.7	-9.1			
	Q2	296,405	2,943	101	168	182	127	117	127	117	7.4	4.2			
	Q3	339,416	3,136	108	191	223	127	109	127	109	0.6	-6.6			
	Q4	396,233	3,503	113	219	242	130	117	130	117	2.2	7.4	6.2	-5.8	
	Average	321,987	3,084	104	184	202	126	114	126	114	7.7	0.1	6.2	-5.8	
1997	Q1	453,408	6,407	71	337	368	97	89	97	89	-25.6	-24.6			
	Q2	580,164	7,074	82	464	537	90	78	90	78	-7.3	-12.3			
	Q3	660,870	7,375	90	498	570	95	83	95	83	6.2	7.2			
	Q4	852,844	7,839	109	572	604	107	101	107	101	12.3	21.9	-0.1	-23.1	
	Average	636,821	7,174	89	468	519	105	486	105	5,415	-22.5	-23.1	-0.1	-23.1	
1998	Q1	905,783	8,256	110	665	651	98	100	98	100	-8.6	-1.5			
	Q2	1,028,451	8,473	121	729	687	101	107	101	107	3.5	7.6			
	Q3	1,120,460	8,847	127	761	701	106	115	106	115	4.4	6.7			
	Q4	1,240,688	9,947	125	822	729	108	122	108	122	2.4	6.5			
	Average	1,073,845	8,881	121	744	692	103	111	103	111	6.3	26.6	-1.2	28.2	
1999	Q1	1,315,521	12,345	107	900	795	105	119	105	119	-3.1	-2.9			
	Q2	1,484,546	15,265	97	1,045	928	102	115	102	115	-2.8	-3.3			
	Q3	1,619,330	16,113	100	1,137	1,048	102	111	102	111	0.2	-3.3			
	Q4	1,799,549	17,373	104	1,259	1,163	103	111	103	111	0.4	0.1			
	Average	1,354,737	15,274	102	1,085	984	103	114	103	114	-0.3	2.5	5.1	-2.4	
2000	Q1	1,793,678	18,753	96	1,384	1,261	93	102	93	102	-9.4	-8.1			
	Q2	1,941,695	20,403	95	1,495	1,364	93	102	93	102	0.3	0.1			

Sources: National Bank of Romania; National Statistics Commission; and National Commission for Economic Forecasting, staff projections for 2000.

Average growth, from 1995 to 1999:

2.49

Table 14. Romania: Wages and Productivity in Industry, 1995-2000

	Nominal wages (net, in lei)	Exchange rate (in lei/\$)	Wages in US\$	CPI	PPI	Output "Operative" Value-added	Employees (in thousands)		Real wage (index)	Labor productivity (index)		Nominal wage (in percent)	Real wage (in percent)		Nominal ILO-C growth (in percent)	Real unit labor cost growth (in percent)	
							Enterprise	LFS		MI	M2		CPI	PPI		MI	M2	MI	M2
1995	Q1	1,802	96	122	120	105	2,929	99	101	100	100	-0.8	-6.2	-5.3	-5.1	33.4	-9.4
	Q2	207,662	1,911	108	127	130	2,911	113	111	108	108	19.1	14.6	10.2	11.0	31.5	2.7
	Q3	237,270	2,047	116	134	141	2,879	124	117	107	107	14.6	9.1	5.6	15.1	30.1	6.1
	Q4	268,999	2,373	113	146	151	2,843	128	124	112	112	13.4	3.8	5.8	8.4	31.5	1.2
	Average	221,789	2,033	109	132	135	2,640	116	113	117	111	53.5	16.1	13.4	31.3	..	-3.0	2.2
1996	Q1	263,698	2,750	96	156	163	2,804	118	112	112	112	-2.0	-8.3	-9.7	-1.9	35.9	-9.7
	Q2	206,210	2,943	70	168	182	2,816	85	79	122	122	-21.8	-27.5	-29.7	-28.3	-12.2	-35.3
	Q3	375,832	3,136	120	191	223	2,806	137	117	120	120	82.3	60.1	48.6	85.0	41.1	59.8
	Q4	443,482	3,503	127	219	242	2,784	141	127	126	126	18.0	3.3	8.5	12.8	46.8	3.7
	Average	322,303	3,084	105	184	202	2,560	120	109	131	122	45.3	3.6	-3.9	29.2	..	-14.6	-12.5
1997	Q1	492,946	6,407	77	337	368	2,733	102	93	127	127	-16.6	-16.6	-16.6	-17.0	65.5	-17.0
	Q2	635,781	7,074	90	464	537	2,687	95	82	115	115	29.0	-6.5	-11.6	41.4	226.3	-3.1
	Q3	722,872	7,375	98	498	570	2,620	101	88	110	110	13.7	6.0	7.0	18.8	109.5	11.8
	Q4	898,745	7,839	115	572	604	2,486	109	104	126	126	24.3	8.2	17.4	9.2	102.8	3.1
	Average	687,586	7,174	96	468	519	2,631	102	92	120	115	113.3	-15.4	-15.4	134.7	..	-4.9	-10.5
1998	Q1	949,357	8,236	115	665	651	2,410	99	101	112	112	5.6	-9.1	-2.1	18.7	117.7	10.1
	Q2	1,681,011	8,473	128	729	687	2,372	103	109	110	110	13.9	3.8	7.9	15.9	78.4	9.8
	Q3	1,185,950	8,847	134	761	701	2,305	109	118	109	109	9.7	5.2	7.5	10.2	65.5	8.0
	Q4	1,276,314	9,947	128	822	729	2,224	108	122	117	117	7.6	-0.4	3.6	0.8	52.9	-3.0
	Average	1,123,208	8,881	126	744	692	2,338	105	113	112	117	63.4	2.8	22.6	74.3	..	30.8	20.2
1999	Q1	1,345,627	12,345	109	900	795	2,107	104	118	114	114	5.4	-3.7	-3.4	7.7	38.6	-1.4
	Q2	1,530,412	15,265	100	1,045	928	2,026	102	115	116	116	13.7	-2.0	-2.6	12.2	34.2	-3.8
	Q3	1,717,485	16,113	107	1,137	1,048	1,957	105	114	118	118	12.2	3.1	-0.6	10.3	34.4	-2.2
	Q4	1,912,227	17,373	110	1,259	1,163	1,929	106	114	127	127	11.3	0.6	0.3	3.2	37.7	-7.0
	Average	1,626,438	15,274	106	1,085	984	2,005	104	115	119	121	44.8	-0.5	2.3	36.6	..	-3.5	-0.9
2000	Q1	2,063,800	18,753	110	1,384	1,261	1,905	104	114	123	123	7.9	-1.9	-0.5	11.5	42.6	2.8
	Q2	2,112,989	20,403	104	1,495	1,364	1,908	98	108	136	136	2.4	-5.2	-5.3	-7.1	18.0	-14.1

Source:

Table 15. Romania: Population, Labor Force, and Employment, 1993-98

(In thousands of persons; end of year)

	1993	1994	1995	1996	1997	1998
Population	22,748	22,712	22,656	22,582	22,526	22,489
<i>Of which:</i>						
Working age 1/	13,126	13,188	13,228	13,283	13,328	13,365
<i>Of which:</i>						
Labor force	10,245	10,242	9,513	9,049	8,927	8,869
Nonworking age	9,622	9,524	9,428	9,299	9,198	9,124
<i>Of which:</i>						
Labor force 2/	982	993	979	987	977	968
Total employment	10,062	10,011	9,493	9,379	9,023	8,813
<i>Of which:</i>						
In the state and cooperative sector 3/ (in percent)	56.3	50.8	49.3	48.5	42.5	38.2
Total unemployed	1,165	1,224	998	658	881	1,025.0
Percent of labor force						
<i>Of which:</i>						
Receive benefits (in percent)	9.5	9.5	7.4	4.6	6.6	8.1
Recipients of unemployment benefits	1,066	1,068	774	462	656	793
Civilian labor force (total)	11,227	11,235	10,491	10,037	9,904	9,838
Labor force						
Participation rate in percent 4/	78.1	77.7	71.9	68.1	67.0	66.4

Sources: Data provided by the Ministry of Labour and Social Protection and the National Commission for Statistics

1/ Includes women age 16 to 54 and men age 16 to 59; women age 55 to 56 and men age 60 to 61 working in the agricultural sector, women age 55 to 56 and men age 60 to 61 who are still employed; women age 55 to 56 and men age 60 to 61 who are still employed.

2/ Excluding military personell and staff of public organizations, but including nondependent and private sector employment

3/ State and cooperative sector include the following type of ownership: public, co-operative and community

4/ Working age labor force as a proportion of population of working age.

Table 16. Romania: Monthly Consumer Price Index, 1996-2000
(October 1990 = 100)

		CPI	Food	Non-food	Services	Monthly Inflation (in percent)
Weight (percent)	1996	100.0	47.1	40.9	12.0	
	1997	100.0	47.9	40.3	11.8	
	1998	100.0	47.9	40.3	11.8	
	1999	100.0	50.4	37.3	12.3	
1996	December	17,052	18,634	16,331	15,035	10.3
1997	January	19,386	20,609	19,121	17,205	13.7
	February	23,025	25,804	21,482	20,079	18.8
	March	30,097	33,914	27,392	27,795	30.7
	April	32,174	35,775	29,556	30,656	6.9
	May	33,545	36,770	31,442	31,384	4.3
	June	34,316	37,156	32,187	33,459	2.3
	July	34,553	36,981	32,747	33,997	0.7
	August	35,768	38,408	33,637	35,612	3.5
	September	36,952	39,215	34,710	38,375	3.3
	October	39,346	41,548	36,807	41,990	6.5
	November	41,026	43,264	38,316	44,144	4.3
	December	42,872	45,769	39,619	45,685	4.5
1998	January	44,960	47,814	40,729	51,003	4.9
	February	48,193	51,494	43,573	54,187	7.2
	March	50,002	52,780	45,843	56,257	3.8
	April	51,365	53,892	46,889	59,446	2.7
	May	52,536	54,281	48,823	60,771	2.3
	June	53,196	54,259	50,087	61,725	1.3
	July	53,908	53,737	51,390	64,503	1.3
	August	54,251	53,206	52,357	65,705	0.6
	September	55,717	54,625	53,272	69,076	2.7
	October	57,878	55,499	56,006	73,599	3.9
	November	58,984	56,492	57,052	75,276	1.9
	December	60,265	57,888	58,141	76,843	2.2
1999	January	62,079	59,312	59,583	81,446	3.0
	February	63,863	60,782	61,601	83,636	2.9
	March	67,925	63,630	67,043	87,862	6.4
	April	71,222	66,942	69,549	93,748	4.8
	May	75,006	69,043	71,909	108,909	5.3
	June	78,827	69,356	77,130	121,803	5.1
	July	80,129	68,557	79,107	129,073	1.7
	August	81,105	68,580	80,880	131,140	1.2
	September	83,691	71,058	83,241	134,920	3.2
	October	87,174	73,489	86,235	144,164	4.2
	November	90,651	75,990	90,834	147,768	4.0
	December	93,297	79,127	93,131	149,643	2.9
2000	January	97,318	84,476	95,329	154,597	4.3
	February	99,427	87,056	96,595	157,754	2.2
	March	101,209	89,137	97,769	160,433	1.8
	April	106,051	91,178	102,993	174,709	4.8
	May	107,982	92,919	104,968	177,253	1.8
	June	111,042	96,357	108,117	178,671	2.8
	July	115,791	101,386	112,334	184,211	4.3
	August	117,918	102,580	114,672	189,209	1.8

Source: Data provided by the Romanian authorities.

Table 17. Romania: Industrial Producer Prices, 1996-2000 1/

(1992=100)

	PPI	Extractive industry	Processing industry	Electricity production	Monthly PPI inflation (in percent)
1996 December	1,579	1,221	1,692	1,169	2.4
1997 January	1,720	1,237	1,871	1,182	8.9
February	2,013	1,269	2,246	1,183	17.0
March	3,071	3,793	2,976	3,079	52.6
April	3,232	3,877	3,164	3,136	5.2
May	3,419	4,469	3,282	3,424	5.8
June	3,571	5,276	3,371	3,438	4.4
July	3,626	5,279	3,439	3,449	1.5
August	3,648	5,284	3,466	3,452	0.6
September	3,737	5,285	3,581	3,456	2.5
October	3,801	5,288	3,663	3,458	1.7
November	3,932	5,327	3,796	3,652	3.4
December	4,014	5,331	3,898	3,673	2.1
(1996=100)					
1997 January	138	126	141	126	
February	159	130	167	127	15.0
March	240	352	216	317	51.2
April	252	357	229	329	5.1
May	262	369	237	355	4.1
June	269	401	241	356	2.5
July	274	402	247	357	1.9
August	277	402	251	358	1.0
September	282	402	257	359	1.9
October	286	403	263	359	1.6
November	295	410	269	380	2.9
December	300	410	275	387	2.0
1998 January	309	413	286	390	3.0
February	318	415	296	394	2.7
March	323	416	302	395	1.7
April	330	421	310	400	2.2
May	335	418	313	417	1.4
June	337	418	315	425	0.8
July	338	395	317	429	0.2
August	340	395	320	430	0.7
September	345	410	324	430	1.3
October	349	388	331	437	1.2
November	355	399	337	438	1.7
December	360	403	342	438	1.5
1999 January	369	422	351	441	2.5
February	383	445	361	483	3.9
March	409	503	380	528	6.7
April	431	534	404	530	5.4
May	446	541	422	534	3.5
June	478	631	438	630	7.2
July	492	650	450	652	3.0
August	510	706	466	658	3.7
September	527	717	486	659	3.3
October	548	783	503	681	4.1
November	564	787	519	701	2.9
December	585	814	544	702	3.8
2000 January	599	822	559	704	2.3
February	616	842	578	706	2.8
March	632	881	595	712	2.7
April	651	928	614	713	3.0
May 2/	664	936	629	714	2.0

Source: National Statistics Commission.

1/ The data for the period 1995-97 have been calculated for the total output delivered to the domestic market and to exports; for the year 1998, the data refer to the output delivered to the domestic market.

2/ Provisional data

Table 18. Romania: Private Sector Share of GDP, 1993-99

(In percent of GDP)

	1993	1994	1995	1996	1997	1998	1999
GDP, total	34.8	38.9	45.3	54.9	60.6	61.0	61.5
<i>Of which:</i>							
Industry	5.8	14.2	9.8	12.8	13.0	12.5	13.5
Agriculture and forestry	17.2	25.5	17.6	17.3	17.4	14.0	13.5
Construction	1.4	5.5	3.8	4.5	4.0	4.1	3.8
Trade, other	10.4	30.4	21.0	24.4	27.5	31.2	31.7

Source: National Statistics Commission.

Table 19. Romania: Private Ownership in Selected Sectors, 1993-99

(In percent)

	1993	1994	1995	1996	1997	1998	1999
Agriculture	83.5	89.3	89.0	90.1	96.8	95.9	97.2
Industry	17.4	23.3	29.9	38.5	42.1	45.6	48.7
Construction	26.8	51.6	57.8	69.3	76.6	77.9	78.0
Services	29.3	39.1	58.1	66.7	71.5	72.7	73.0
Total private sector share of GDP	34.8	38.9	45.3	54.9	60.6	61.0	61.5

Source: National Statistics Commission.

Table 20. Romania: Ownership Structure of the Enterprise Sector, 1994-96

	1994	1995	1996
Total	672,620	720,899	615,307
Private companies	421,676	440,603	548,873
Family businesses	38,346	63,367	82,533
Self-employed	162,454	162,497	172,497
State-owned companies	6,963	5,143	7,811
Régies autonomes	81	83	82
Foreign investors	43,100	49,206	48,330

Source: Data provided by the Romanian authorities.

Table 21. Romania: Market Privatizations of Enterprises, 1993-1st. Semester 2000

Size of Companies	Total Original Companies 1/	Original No. of Employees	Companies presently held by SOF 2/ (1st sem.2000)	Companies privatized by years 3/							Total privatized companies	
				1993	1994	1995	1996	1997	1998	1999 1st sem. 2000		
Total	6,381	4,040,757	8,482	264	595	620	1,245	1,163	1,267	1,401	602	7,164
Small	3,124	497,096	7,244	238	472	322	984	952	912	906	458	5,244
Medium	2,549	1,753,828	994	24	110	269	236	165	276	425	137	1,642
Large	708	1,789,833	244	2	13	29	25	46	79	70	14	278

Source: State Ownership Fund.

1/ Number of original companies to be offered for privatization.

2/ The increased number of companies in State Ownership Fund portfolio is due to inclusion of new companies resulted from division of some original companies and from spinning-off from the Regies Autonomes.

3/ The listed data are from the annually reports drafted by the end of each year.

Table 22. Romania: Summary of Consolidated General Government , 1993-99

(In billions of lei)

	1993	1994	1995	1996	1997	1998	1999
Total revenue	6,700	15,537	22,642	31,597	72,386	111,000	173,634
Current	6,652	15,476	22,580	31,443	71,802	110,867	173,337
Tax	6,269	14,042	20,804	29,257	67,000	103,992	164,026
Direct tax	4,332	10,028	14,117	19,523	44,248	63,467	100,813
Profits	754	1,911	2,811	3,548	10,780	11,067	17,037
Wages & Salaries 1/	1,325	3,221	4,583	6,656	13,946	18,577	28,312
Social security 2/	2,137	4,602	5,885	8,186	17,671	29,940	47,188
Other direct tax	116	295	838	1,132	1,852	3,882	8,276
Indirect tax	1,937	4,014	6,687	9,734	22,752	40,525	63,213
VAT 3/	726	2,268	3,779	5,359	11,681	22,493	32,471
Customs	269	562	1,043	1,674	3,353	5,741	7,847
Excises	744	775	1,054	1,485	4,289	8,431	16,958
Other indirect tax	198	409	811	1,216	3,429	3,859	5,937
Nontax	383	1,434	1,776	2,186	4,802	6,875	9,311
Capital 4/	48	61	62	154	584	133	297
Total expenditure	6,771	16,643	25,061	36,810	85,639	131,123	193,567
Current	5,786	13,757	20,840	30,783	71,859	115,394	177,835
Goods and services	2,335	5,924	9,078	12,873	26,774	42,738	68,800
Wages and salaries	1,333	3,236	4,694	6,568	12,344	18,671	26,259
Other	1,002	2,688	4,384	6,305	14,430	24,067	42,542
Interest	188	672	989	1,840	9,659	17,450	28,796
Subsidies and transfers	3,262	7,161	10,773	16,070	35,426	55,206	80,239
Subsidies and bonuses	1,366	1,913	2,972	4,729	6,364	6,211	9,303
Transfers	1,895	5,248	7,801	11,341	29,062	48,995	70,936
Capital	844	2,729	3,802	5,682	12,106	13,530	15,015
Lending minus repayments	141	157	419	345	1,674	2,198	717
Overall balance	-71	-1,106	-2,419	-5,213	-13,253	-20,123	-19,933

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes a 7 percent tax on payroll earmarked for the Health Fund.

2/ Comprises the State Social Security Fund, the Unemployment Fund, the Risk and Accident Fund, the Supplementary Pension Fund, the Farmers Social Security Fund, the Health Fund, and the National Health Insurance House.

3/ The value added tax was introduced in July 1993 to replace the turnover tax.

4/ Excluding privatization receipts.

Table 23. Romania: Summary of Consolidated General Government, 1993-99

(In percent of GDP)

	1993	1994	1995	1996	1997	1998	1999
Total revenue	33.4	31.2	31.4	29.2	28.6	30.1	33.3
Current	33.2	31.1	31.3	29.0	28.4	30.1	33.2
Tax	31.3	28.2	28.8	27.0	26.5	28.2	31.4
Direct tax	21.6	20.1	19.6	18.0	17.5	17.2	19.3
Profits	3.8	3.8	3.9	3.3	4.3	3.0	3.3
Wages & Salaries 1/	6.6	6.5	6.4	6.1	5.5	5.0	5.4
Social security 2/	10.7	9.2	8.2	7.6	7.0	8.1	9.0
Other direct tax	0.6	0.6	1.2	1.0	0.7	1.1	1.6
Indirect tax	9.7	8.1	9.3	9.0	9.0	11.0	12.1
VAT 3/	3.6	4.6	5.2	4.9	4.6	6.1	6.2
Customs	1.3	1.1	1.4	1.5	1.3	1.6	1.5
Excises	3.7	1.6	1.5	1.4	1.7	2.3	3.3
Other indirect tax	1.0	0.8	1.1	1.1	1.4	1.0	1.1
Nontax	1.9	2.9	2.5	2.0	1.9	1.9	1.8
Capital 4/	0.2	0.1	0.1	0.1	0.2	0.0	0.1
Total expenditure	33.8	33.4	34.7	34.0	33.9	35.6	37.1
Current	28.9	27.6	28.9	28.4	28.4	31.3	34.1
Goods and services	11.7	11.9	12.6	11.9	10.6	11.6	13.2
Wages and salaries	6.7	6.5	6.5	6.1	4.9	5.1	5.0
Other	5.0	5.4	6.1	5.8	5.7	6.5	8.2
Interest	0.9	1.4	1.4	1.7	3.8	4.7	5.5
Subsidies and transfers	16.3	14.4	14.9	14.8	14.0	15.0	15.4
Subsidies and bonuses	6.8	3.8	4.1	4.4	2.5	1.7	1.8
Transfers	9.5	10.5	10.8	10.5	11.5	13.3	13.6
Capital	4.2	5.5	5.3	5.2	4.8	3.7	2.9
Lending minus repayments	0.7	0.3	0.6	0.3	0.7	0.6	0.1
Overall balance	-0.4	-2.2	-3.4	-4.8	-5.2	-5.5	-3.8
GDP (in billions of lei)	20,036	49,773	72,136	108,391	252,926	368,261	521,726

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes a 7 percent tax on payroll earmarked for the Health Fund.

2/ Comprises the State Social Security Fund, the Unemployment Fund, the Risk and Accident Fund, the Supplementary Pension Fund, the Farmers Social Security Fund, the Health Fund, and the National Health Insurance House.

3/ The value added tax was introduced in July 1993 to replace the turnover tax.

4/ Excluding privatization receipts.

	1993	1994	1995	1996	1997	1998	1999
Total expenditures	6,771	10,043	25,061	36,810	85,039	151,123	193,307
General public services	322	516	918.3	764.2	1750.4	3725.2	5582.8
Defense affairs	470	1125	1525	2042	5272	2404	2415.0
Recreational, cultural affairs	52	179	384	586	1341	2121	2680
Social security and welfare	1814	4495	6730	9682	24178	39314	58800
Housing and community services	351	890	1461	2078	4444	6196.7	9307.7
Environment	0	...	...	0	159.1	282.1	649.8
Industry	818	1279	1744	2364	2737.5	2694.1	4065.9
Agriculture, forestry, fishing	588	1234	1658	2665	3647	4512	5091.7
Other expenditures	148.0	58	1023	1758	3023.5	6493.3	9830
Interest payments	188	672	989	1840	8582	16772.7	27119.6
General public services	1.6	1.0	1.3	0.7	0.7	1.0	1.1
Defense affairs	2.1	2.4	2.1	1.9	2.3	2.3	1.6
Recreational, cultural affairs	0.3	0.4	0.5	0.5	0.5	0.6	0.5
Social security and welfare	9.1	9.0	9.3	8.9	9.6	10.7	11.3
Housing and community services	1.8	1.8	2.0	1.9	1.8	1.7	1.8
Environment	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Industry	1.1	1.0	1.0	1.0	1.1	1.0	1.0
Agriculture, forestry, fishing	0.8	1.0	1.0	1.0	1.0	1.0	1.0
Other economic affairs and services	1.3	1.6	1.2	1.5	1.5	0.5	0.5
Research affairs	0.0	0.7	0.5	0.4	0.3	0.3	0.2
Other expenditures	0.7	0.1	1.4	1.6	2.0	1.8	1.9

Sources: Ministry of Finance; and Fund staff estimates.

Table 25. Romania: Summary of Consolidated General Government Balances, 1993-99

(In billions of lei)

	1993	1994	1995	1996	1997	1998	1999
1991 Program definition							
1. Central government	-521	-2,070	-2,970	-5,359	-9,062	-10,401	-13,656
2. Local government	17	32	72	43	98	73	378
3. State social security fund 1/	140	51	-165	-187	-58	-3,207	-1,243
4. Supplementary pension fund	86	133	77	-5	-42	...	...
5. Self financing bodies	-3	45	...	...	...	...	...
Total 1991 deficit (lines 1-5)	-281	-1,810	-2,986	-5,507	-9,064	-13,535	-14,521
in percent of GDP	-1.4	-3.6	-4.1	-5.1	-3.6	-3.7	-2.8
1992 Program definition							
7. Education fund	6	8	18	...	...	...	130
8. Health fund	12	13	2	24	38	-24	53
9. Research fund	14	2	-34	...	...	...	...
10. Unemployment fund	196	583	705	885	331	-646	-2,047
Total 1991 deficit (lines 1-10)	-53	-1,203	-2,295	-4,599	-8,695	-14,205	-16,385
in percent of GDP	-0.3	-2.4	-3.2	-4.2	-3.4	-3.9	-3.1
Current definition							
12. Local budget investment fund	...	...	...	...	...	...	...
13. Farmers social security fund	42	4	-51	0	0	...	...
14. Customs fund	32	103	188	129	451	317	453
15. Risk and accident fund	0	-21	-11	1	0	3	56
16. Energy fund	...	10	7	-15	45	8	43
17. Road fund	2	13	-5	8	197	-154	154
18. Agricultural fund	23	-11	...	...	...	...	...
19. Stock reevaluation fund	-2	...	...	...	...	...	...
20. Gold/silver reevaluation fund	-73	...	...	...	...	...	...
21. Restructuring fund	...	...	...	...	...	...	...
22. Counterpart fund, BOP loans	-70	...	...	...	...	...	...
23. External loans to ministries	-21	-186	-239	-386	-2,571	-5,603	-7,431
24. SOF	45	94	298	448	780	3,418	-188
25. Protection of insured people fund	...	...	...	3	6	14	28
26. Health Social Insurance fund	...	...	...	...	...	969	2,479
27. Special fund for tourism development	...	...	...	...	...	19	35
28. Special fund for civil aviation	...	...	...	...	...	...	95
29. Special fund for solidarity	...	...	...	...	...	...	15
Total broad definition (lines 1-29)	-74	-1,196	-2,108	-4,412	-9,787	-15,215	-20,649
Adjustments	3	90	-311	-801	-3,465	-4,908	716
in percent of GDP	-0.4	-2.2	-3.4	-4.8	-5.2	-5.5	-3.8
Memorandum item:							
GDP	20,036	49,773	72,136	108,391	252,926	368,261	521,726

Source: Ministry of Finance and Fund staff estimates.

1/ Including subsidies from the state budget.

Table 26. Romania: NBR Refinancing Practices, 1994-99

		(In billions of lei)					(In percent)					
	Q3	2,064	1,822	600	0	0	1,183	88.3	31.3	0.0	0.0	37.3
	Q4	2,331	2,153	800	0	34	1,672	92.4	34.3	0.0	1.5	71.7
1995	Q1	2,074	1,940	790	0	0	1,502	93.5	38.1	0.0	0.0	72.4
	Q2	2,146	1,601	825	186	14	1,165	74.6	38.5	8.7	0.7	54.3
	Q3	2,790	1,968	1,050	398	0	1,653	70.6	37.6	14.3	0.0	59.2
	Q2	4,413	2,196	485	256	1,734	1,746	49.8	11.0	5.8	39.3	39.6
	Q3	5,029	2,883	380	0	1,866	2,292	57.3	7.6	0.0	37.1	45.6
	Q4	8,024	4,335	2,315	0	1,871	3,689	54.0	28.9	0.0	23.3	46.0
	Q3	2,720	781	0	0	1,885	784	28.7	0.0	0.0	69.3	28.8
	Q4	2,517	578	0	0	1,885	580	23.0	0.0	0.0	74.9	23.0
	Q4	556	556	0	0	0	504	100.0	0.0	0.0	0.0	90.6
1999	Q1	5,237	555	0	0	4,682	503	10.6	0.0	0.0	89.4	9.6

Sources: National Bank of Romania; and Fund staff estimates.

Table 27. Romania: Balance Sheet of the National Bank of Romania, 1994-2000

(In billions of lei, end of period)

	1994	1995	1996	1997	1998		1999		2000
					June	December	June	December	June
Assets	9,291	12,760	15,969	36,165	37,024	41,927	47,981	69,729	82,867
Foreign assets	2,742	2,839	5,647	26,508	27,874	25,207	20,093	45,455	58,001
Gold	1,704	2,011	3,429	8,998	9,340	10,155	10,245	17,629	17,801
Convertible FX	1,027	828	2,198	17,510	18,534	15,052	9,848	27,826	40,200
Other				0	0	0	0	0	0
Claims on government	1,906	3,520	0	3,271	3,116	9,142	12,183	21,412	20,039
State budget	1,771	3,299	0	0	0	0	0	0	0
Treasury bills				843	307	3,898	630	0	33
T-bills in foreign currency				0	0	0	1,489	4,573	2,029
Other claims on central government	135	221	0	2,428	2,809	5,244	10,064	16,839	17,977
Claims on DMBs	2,334	4,515	8,822	5,251	5,346	5,532	9,138	4,383	2,935
Refinancing credits	2,331	3,678	8,024	2,516	2,441	2,470	7,628	4,383	2,935
Memo: litigious debtors				1,885	1,885	1,914	1,950	1,950	1,680
FX deposits with DMBs	3	836	798	2,735	2,905	3,062	1,509	0	0
Other assets (net)	2,311	2,722	1,500	1,134	689	2,046	6,567	-1,521	1,893
Liabilities	9,291	12,760	15,969	36,165	37,024	41,927	47,981	69,729	82,867
Reserve money	3,245	4,691	7,877	10,587	15,764	19,090	20,097	35,982	44,177
Currency outside NBR	2,398	3,951	5,902	9,627	10,888	12,297	14,805	18,646	22,787
DMB current accounts at NBR	848	739	1,975	960	4,876	6,793	5,292	17,336	21,389
Deposit auctions				6,792	1,871	2,223	2,847	2,662	404
NBR FX liabilities to DMBs	564	1,260	1,131	3,926	4,792	4,427	7,738	13,797	12,970
Foreign liabilities	2,243	2,889	7,094	13,678	14,067	15,970	13,128	14,195	16,787
Government deposits	2,163	3,800	-275	670	1,688	23	3,892	2,847	7,880
Deposits				0	0	0	0	0	5,383
General account of Treasury				670	1,688	23	3,892	2,847	2,497
Capital accounts	1,075	120	141	512	-1,157	194	278	246	650
Capital and reserves	81	120	141	193	193	194	196	246	246
Profits	994	0	0	318	-1,351	0	82	0	-403
Gold revaluation deposits	0	0	0	0	0	0	0	0	0

Sources: National Bank of Romania; and Fund staff estimates.

Table 28. Romania: Commercial Banks' Specific Provisions, 1995-99

	1995		1996		1997		1998		1999	
	June	December	June	December	June	December	June	December	June	December
	(In billions of lei)									
Actual provisions made by banks	519	1,785	2,412	2,514	5,046	7,313	12,895	16,208	16,034	11,056
Provisions needed according to NBR	989	2,550	3,370	4,218	8,903	10,001	15,991	20,950	16,418	9,793
Remaining gap	470	765	958	1,705	3,858	2,688	3,096	5,742	384	-263
Memorandum items:										
Non-performing loans and interest arrears, gross	3,801	7,793	10,780	11,499	21,122	21,075	30,228	39,148	32,520	21,038
of which: with guarantees or collateral	2,731	5,138	7,285	7,187	12,163	10,682	14,084	16,985	16,035	11,459
Non-performing loans and interest arrears, net	1,070	2,655	3,495	4,311	8,959	10,393	16,144	22,163	16,485	9,579
(In percent)	(In percent)									
Ratio, of provisions made to provisions needed	52.4	70.0	71.6	59.6	56.7	73.1	80.6	73.8	97.7	102.7
Ratio of provisions made to gross portfolio	13.6	22.9	22.4	9.4	12.8	18.2	24.8	24.2	24.2	16.9

Source: National Bank of Romania.

Table 29. Romania: The Role of the Major State Banks in the Banking System, 1994-99
(End of period; bank share as percent of total)

	Total credit to Non-government sector					Total deposits					Total assets							
	1994	1995	1996	1997	1998	1999	1994	1995	1996	1997	1998	1999	1994	1995	1996	1997	1998	1999
Total	81.3	76.1	76.0	73.0	67.5	53.3	73.9	71.3	72.8	70.3	68.9	59.8	73.7	72.8	71.8	68.3	66.5	57.0
Banca Agricola	37.8	27.8	20.1	5.3	5.2	2.1	11.7	11.3	13.7	9.9	8.1	4.4	22.7	19.0	15.7	9.7	7.3	4.2
Romanian Commercial Bank	23.5	20.2	18.9	20.6	19.6	29.7	17.4	19.3	21.1	24.1	24.9	28.7	19.5	18.9	16.9	18.8	19.8	29.1
Romania Bank for Foreign Trade (Bancorex)	13.3	20.6	29.1	34.7	30.5	-	18.2	16.8	18.0	14.8	15.0	-	16.4	19.6	25.7	23.9	23.6	...
Romanian Bank for Development	6.5	7.4	7.6	10.3	9.8	18.5	10.2	8.8	8.9	9.6	9.3	14.1	7.4	6.7	7.1	7.5	7.7	13.1
Subtotal	0.2	0.1	0.3	2.1	2.4	3.0	15.9	15.1	11.1	11.9	11.6	12.6	7.7	8.6	6.4	8.4	8.1	10.6
Savings Bank (CEC)	0.2	0.1	0.3	2.1	2.4	3.0	15.9	15.1	11.1	11.9	11.6	12.6	7.7	8.6	6.4	8.4	8.1	10.6

Source: National Bank of Romania.

Table 30. Romania: Foreign Assets and Liabilities of the Banking System, 1993-2000

(In millions of U.S. dollars; end of period)

	1993	1994	1995	1996	1997		1998		1999		2000 June
					June	Dec.	June	Dec.	June	Dec.	
National Bank of Romania											
Foreign assets	903	1,612	1,371	1,633	2,750	3,358	3,311	2,272	1,531	2,458	2,830
Gold 1/	858	1,016	1,036	1,081	1,113	1,158	1,202	904	912	932	940
Convert. foreign exchange (liquid)	40	536	278	542	1,646	2,208	2,117	1,374	623	1,530	1,893
Participation in foreign banks and other	4	60	57	5	0	0	0	0	0	0	0
Nonconvertible FX, net						-8	-8	-6	-4	-4	-3
Foreign liabilities	1,065	1,651	1,371	1,966	1,852	1,927	1,839	1,880	1,343	1,616	1,696
Use of fund resources	1,065	1,421	1,051	682	682	716	658	519	433	452	536
Short term						100	100	0	107	114	0
Medium and long term						1,111	1,081	1,065	314	294	296
Net foreign assets	-162	-39	0	-333	898	1,431	1,472	392	188	842	1,134
Commercial banks											
Foreign assets	1,020	1,545	1,310	1,618	1,184	1,674	1,211	1,574	1,278	1,250	1,363
Convertible foreign exchange	1,007	1,551	1,316	1,627	1,193	1,688	1,219	1,579	1,283	1,252	1,367
Liquid	806	1,494	1,245	1,552	1,114	1,610	1,132	1,493	1,204	1,161	1,270
Other	201	57	71	75	79	78	87	86	79	91	97
Nonconvertible foreign exchange, net	14	-6	-6	-9	-9	-14	-8	-5	-5	-2	-4
Foreign liabilities	553	678	790	1,226	1,007	1,135	1,150	801	740	610	523
Short term	355	273	212	604	333	267	300	188	243	221	226
Medium and long term	198	405	578	622	674	867	850	613	497	389	297
Net foreign assets	468	867	520	392	177	539	61	773	538	640	840
Excl. nonconvertible FX assets	454	873	526	401	186	553	69	778	543	642	844
Banking system											
Net foreign assets	305	828	520	59	1,075	1,970	1,533	1,165	726	1,482	1,974
Excluding nonconvertible FX assets	292	834	526	68	1,093	1,992	1,549	1,176	735	1,488	1,981

Sources: National Bank of Romania; and Fund staff estimates.

1/ Gold is valued at US\$383.55 per ounce.

Table 31. Romania: Stock Market Indicators, 1995-2000 (Q3)
Bucharest Stock Exchange

(Quarterly averages unless otherwise indicated)

	Number of trading days	Number of companies listed at end-quarter	Market capitalization (mill. US\$)	Number of transactions per trading day	Daily turnover (US\$)	Standard deviation of daily turnover
1995	5	9	100	75.800	192,875.000	97,157.340
1996						
Q1	14	13	99	346.143	238,697.000	171,680.900
Q2	23	13	54	216.522	48,793.000	38,811.020
Q3	24	13	53	196.208	22,046.000	12,569.840
Q4	23	17	61	140.739	12,446.000	5,221.789
1997						
Q1	29	25	92	1,528.030	220,117.000	192,813.700
Q2	55	44	618	4,298.600	1,427,315.000	1,257,553.000
Q3	66	62	707	2,573.260	1,566,343.000	778,046.600
Q4	57	75	632	2,749.950	1,116,893.000	559,455.900
1998						
Q1	62	92	785	2,548.190	1,235,012.000	813,501.400
Q2	63	104	652	2,464.760	1,095,174.000	542,752.000
Q3	66	113	330	1,602.610	432,955.000	277,733.100
Q4	64	126	357	1,366.520	305,684.000	172,848.800
1999						
Q1	63	126	275	1,434.430	394,163.000	555,813.300
Q2	64	127	300	992.875	178,935.000	150,626.200
Q3	66	126	434	985.591	484,064.572	166,916.900
Q4	60	126	317	3,084.250	954,330.958	427,274.100
2000						
Q1	63	125	327	2,961.980	327,585.000	253,959.600
Q2	64	122	315	2,114.340	574,587.000	2,523,622.000
Q3	13	123	349	1,428.770	187,590.000	178,343.300

Source: Bucharest Stock Exchange.

Table 32. Romania: Monetary Survey, 1994-2000

(End of period, in billions of lei unless otherwise stated)

	1994				1995				1996				1997				1998				1999				2000						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2					
Net foreign assets (millions of U.S. dollars)	1,110	-88	-379	7	6,886	12,869	15,091	11,954	11,817	11,806	13,820	9,179	10,391	21,105	25,502	28,947	628	-34	-94	1	980	1,692	1,881	1,408	1,363	1,278	1,262	1,280	1,397	1,486	
Of which: Commercial banks 1/	816	455	326	328	216	339	590	321	101	6	692	420	464	495	551	541															
Net domestic assets 2/	9,539	18,366	30,714	37,859	37,070	38,657	47,054	51,856	57,661	63,262	78,710	91,585	93,107	93,066	108,620	107,157															
Total credit	9,183	17,399	31,450	39,839	36,932	41,740	46,508	53,605	60,151	69,806	79,919	95,228	92,441	91,621	101,340	105,710															
Credit to government*	-301	964	4,609	4,457	736	3,523	10,607	12,286	15,010	18,801	20,833	23,089	30,580	34,150	43,621	43,154															
Of which: Bank rehabilitation bonds						3,375	7,875	8,171	8,171	8,171	8,171	8,171	8,171	8,171	8,171	8,171															
Net credit to non-government	9,485	16,435	26,841	35,082	36,196	38,217	35,901	41,319	45,141	51,005	59,087	72,138	61,861	57,471	57,719	62,556															
Of which: Foreign currency credit	2,050	4,860	9,898	18,499	20,606	23,319	19,649	22,823	25,138	28,325	34,814	46,472	37,030	32,660	33,275	36,590															
(percent of total)	21.6	29.6	36.9	52.7	56.9	61.0	54.8	55.2	55.7	0.6	58.9	64.4	59.9	56.8	57.6	58.5															
(millions of U.S. dollars)	1,160	1,885	2,453	2,644	2,932	3,066	2,451	2,688	2,899	3,066	3,179	3,114	2,338	1,981	1,823	1,878															
Other items, net	356	967	-736	-1,680	139	-3,082	546	-1,749	-2,490	-6,544	-1,210	-3,642	665	1,446	7,280	1,447															
Broad Money	10,649	18,278	30,335	37,866	43,957	51,527	62,145	63,810	69,478	75,068	92,530	100,764	103,498	114,171	134,122	136,105															
Currency outside banks	2,201	3,761	5,383	4,741	6,363	8,359	9,200	8,198	10,300	11,231	11,525	11,523	13,888	15,560	17,372	16,070															
Deposits	8,448	14,518	24,952	33,124	37,594	43,168	52,945	55,611	59,178	63,838	81,005	89,241	89,609	98,612	116,751	120,035															
Of which: Lei deposits	6,090	10,386	17,866	19,293	24,519	27,802	35,265	36,166	39,090	41,896	50,803	50,253	50,719	56,450	66,269	68,815															
Sight	2,693	3,819	6,580	4,965	6,172	7,543	11,131	8,728	8,826	8,268	11,988	9,041	9,838	10,094	13,654	11,188															
Time	3,397	6,567	11,286	14,328	18,347	20,259	24,134	27,438	30,623	33,069	38,815	41,212	40,881	46,356	52,615	57,627															
Foreign currency deposits	2,358	4,132	7,086	13,832	13,075	15,366	17,680	19,446	20,088	21,942	30,201	38,988	38,890	42,162	50,482	51,220															
(millions of U.S. dollars)	1,335	1,603	1,756	1,977	1,861	2,020	2,204	2,290	2,317	2,375	2,758	2,612	2,455	2,557	2,765	2,629															
NBR balance sheet	3,245	4,691	7,877	6,438	7,454	9,912	10,587	13,059	15,764	18,561	19,090	19,010	20,097	25,613	35,982	36,353															
Reserve money	2,398	3,951	5,902	5,125	6,838	8,824	9,627	8,746	10,888	11,864	12,297	12,331	14,805	16,580	18,646	17,222															
Currency outside NBR	848	739	1,975	1,313	616	1,087	960	4,314	4,876	6,697	6,793	6,679	5,292	9,033	17,336	19,131															
Bank lei deposits at NBR																															
Net foreign assets (millions of U.S. dollars)	-332	-1,261	-1,695	-2,288	5,369	10,291	10,358	9,229	10,942	11,140	6,920	2,910	3,032	12,822	14,785	18,565															
(millions of U.S. dollars)	-188	-489	-420	-327	\$764	\$1,353	\$1,291	\$1,087	\$1,262	\$1,284	\$570	\$195	\$192	\$785	\$846	\$945															
Net domestic assets	3,578	5,951	9,572	8,726	2,085	-379	229	3,830	4,823	7,421	12,170	161,000	17,065	12,791	21,197	17,789															
NBR refinancing	2,331	3,678	8,024	5,429	3,801	2,721	2,516	2,471	2,441	2,452	2,470	7,160	7,928	2,466	4,383	3,776															
Memorandum items:																															
Exchange rate (Lei per US\$, cop)	1,767	2,578	4,035	6,996	7,027	7,606	8,023	8,490	8,670	9,238	10,951	14,925	15,840	16,488	18,255	19,480															
Real annual broad money growth	47.2	34.4	5.8	-25.9	-26.0	-18.3	-18.5	1.4	2	-3.4	5.9	16.2	0.5	1.3	-6.4	-9.3															
Real annual credit growth	33.2	48.3	15.2	-22.6	-38.1	-35.8	-41.2	-18.4	5.1	10.9	22.2	30.8	3.7	-12.6	-18.1	-25.5															
Velocity:																															
Velocity of broad money	5.54	4.52	4.62	5.91	5.80	5.33	5.13	4.97	4.85	4.70	4.13	4.51	5.1	4.91	4.66	4.96															
Velocity of broad lei money	7.11	5.83	6.03	9.31	8.26	7.60	7.17	7.14	6.83	6.65	6.13	7.36	8.17	7.78	7.47	7.95															
Ratio of foreign currency deposits to broad money	22.1	22.6	23.4	36.5	29.7	29.8	28.5	30.5	28.9	29.20	32.6	38.7	37.6	36.9	37.6	37.6															

Sources: National Bank of Romania; and Fund staff estimates.

1/ A reclassification of MF deposits from foreign liabilities to government deposits was made for Q197-Q1V98 retroactively.

2/ Equal to broad money minus convertible net foreign assets.

Table 33. Romania: Balance of Payments, 1993-99 1/

(In millions of U.S. dollars)

	1993	1994	1995	1996	1997 2/	1998	1999
Current account	-1,239	-516	-1,732	-2,611	-2,360	-3,112	-1,302
Trade account	-1,130	-483	-1,605	-2,494	-1,980	-2,625	-1,092
Exports	4,882	6,067	7,882	8,061	8,431	8,302	8,503
Imports	-6,012	-6,550	-9,487	10,555	10,411	-10,927	-9,595
Services account	-323	-328	-496	-710	-959	-1,104	-836
Receipts	799	1,132	1,510	1,626	1,604	1,472	1,513
Of which: Interest	56	102	59	65	175	204	55
Payments	-1,122	-1,460	-2,006	2,336	2,563	2,576	-2,349
Of which: Interest	-204	-233	-293	345	419	-574	-504
Unrequited transfers (net)	214	295	369	593	579	617	626
Capital account	1,412	1,294	1,298	1,997	3,004	2,263	1,154
Direct investment and capital transfers	97	347	404	608	2,075	2,129	1,051
Medium- and long-term credit received (net)	957	870	627	761	965	437	320
Receipts	1,105	1,165	999	1,209	2,338	1,940	1,818
Multilateral	263	375	254	342	687	351	443
Bilateral	728	529	425	3	0	20	51
Other	343	182	293	864	1,551	1,569	1,324
Payments	-147	-295	-372	448	1,273	1,519	1,497
Multilateral	0.0	-3	-17	39	79	328	331
Bilateral	-84	-154	-176	17	20	17	117
Other	-63	-138	-179	392	1,174	1,174	1,049
Credit extended (net)	-11	24	84	7	35	31	34
Bilateral clearing agreements	-128	-9	-25	-4	19	0	-4
Short-term (net) 3/	498	62	209	625	1,197	293	369
Overall balance	173	778	-434	-614	1,931	-135	473
Financing	-173	-778	434	614	-1,931	135	-473
Net foreign assets NBR (increase, -)	54	-341	202	426	-1,710	222	-673
of which: IMF net	0	217	-315	-356	28	-126	-67
Net foreign assets of commercial banks (increase, -)	-227	-437	231	188	-221	-87	200

Sources: Romanian authorities; and Fund staff estimates.

1/ Excludes transactions in transferable rubles.

2/ Including portfolio investment.

3/ Including errors and omissions.

Table 34. Romania: Composition of Exports, 1993-99

(In percent of total)

	1993	1994	1995	1996	1997	1998	1999
Live animal and animal products	3.3	3.6	2.1	1.9	2.4	1.1	1.4
Vegetable products	1.2	1.0	2.6	4.6	1.9	2.2	2.9
Fats and animal or vegetable edible oil:	1.3	0.8	1.0	0.9	1.5	0.8	0.6
Foodstuffs, beverages, tobacco	1.0	1.1	0.9	1.3	1.2	1.1	0.7
Mineral products	11.7	11.6	9.2	8.6	7.6	6.1	5.9
Chemicals	7.0	7.9	9.1	8.5	6.6	4.0	3.8
Plastic, rubber, and articles	1.7	2.3	2.6	2.4	2.2	2.1	2.1
Wood products, cork, and wattles	3.6	3.6	3.3	3.6	4.0	4.6	5.8
Textiles and textile articles	16.0	18.8	19.8	21.4	23.0	26.0	25.8
Footwear	3.3	5.0	5.4	6.2	6.4	7.3	8.0
Articles of stone, cement, ceramics, glass, etc.	2.0	1.8	1.9	1.9	1.8	1.9	1.9
Basic metals and articles thereof	19.6	17.3	18.2	15.7	18.5	19.1	15.4
Machinery, appliances, and electrical equipment	9.0	8.4	8.3	8.3	8.7	9.5	11.4
Transport equipment	8.3	6.4	5.4	5.4	5.3	5.1	5.5
Other	11.0	10.4	10.2	9.3	8.9	9.1	8.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Romanian authorities; and Fund staff estimates.

Table 35. Romania: Direction of Trade, 1993-99
(In percent of total)

	1993		1994		1995		1996		1997		1998		1999	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Developed countries	48.7	57.6	56.0	60.4	61.7	60.1	62.2	61.6	64.8	62.7	72.2	66.3	72.2	68.5
Of which:														
Austria	1.6	2.5	1.6	2.7	2.0	3.1	2.1	3.1	2.1	2.7	3.0	2.9	2.9	2.9
France	4.5	7.8	5.1	5.1	5.8	5.2	5.7	4.9	5.5	5.7	5.9	6.9	6.2	6.7
Federal Republic of Germany	14.3	15.8	16.1	18.0	18.1	17.5	18.4	17.6	16.8	16.4	19.6	17.4	17.8	17.1
Italy	8.3	9.4	12.9	11.8	15.7	13.3	17.1	15.3	19.5	15.8	22.0	17.4	23.3	19.6
Switzerland	2.4	2.3	0.7	2.1	0.8	1.9	0.5	1.7	0.5	1.3	0.6	1.1	0.7	1.2
United Kingdom	3.8	2.6	3.3	3.1	3.0	2.9	3.1	2.9	3.5	3.4	3.7	3.4	4.9	4.2
United States	1.4	5.7	3.1	6.5	2.5	4.1	2.4	3.8	3.8	4.1	3.8	4.2	3.7	3.5
Developing countries	51.3	42.4	44.0	39.6	38.3	39.9	37.8	38.4	35.2	37.3	27.8	33.7	27.8	31.5
Of which:														
Bulgaria	2.1	1.1	1.7	0.9	0.9	0.7	0.9	0.6	0.7	0.5	0.9	0.4	1.6	0.5
China	8.6	1.4	4.5	0.9	2.3	0.9	1.1	1.0	0.5	1.1	0.3	1.5	0.4	1.4
Czech and Slovak Republics	0.3	0.9	1.4	1.2	0.5	1.1	0.5	1.2	0.5	1.5	0.4	2.5	0.3	2.5
Hungary	2.4	2.6	2.6	2.4	2.2	3.1	2.1	2.5	2.2	3.1	2.6	4.6	3.2	4.0
Poland	0.4	0.5	0.2	0.4	0.5	0.6	0.5	0.7	1.2	0.8	1.0	1.2	1.4	1.5
Former Soviet Union	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Russia	4.5	11.7	3.4	13.8	2.0	12.0	2.0	12.5	3.0	12.0	1.0	9.0	0.6	6.8
Ukraine	2.1	2.0	1.6	2.1	1.7	1.9	0.8	1.6	1.1	1.2	0.6	1.4	0.7	1.0
Moldova	1.9	1.3	1.0	1.3	1.0	1.0	1.2	0.7	1.5	0.6	1.6	0.5	1.2	0.4
Former Yugoslavia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Serbia	0.2	1/	0.3	1/	0.4	1/	1.7	0.3	1.7	0.5	1.4	0.5	1.0	0.5
FYR Macedonia	0.4	0.3	0.4	0.3	0.5	0.2	0.1	0.1	0.1	0.1	0.1	1/	0.1	1/
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Data provided by the Romanian authorities; and Fund staff calculations.

1/ Under 0.1 percent.

Table 36. Romania: Composition of Imports, 1993-99

(In percent of total)

	1993	1994	1995	1996	1997	1998	1999
Live animals and animal products	1.0	1.4	1.3	0.6	0.6	1.8	1.2
Vegetable products, cereals	7.3	2.0	1.5	1.5	1.5	1.9	2.2
Foodstuffs, beverages, and tobacco	6.1	5.5	5.7	5.3	4.0	4.4	4.0
Mineral products	28.7	26.8	24.2	23.5	21.3	14.3	12.0
Chemicals	7.8	7.9	9.0	8.6	8.3	8.7	9.4
Plastic, rubber, and articles	3.1	3.2	3.8	3.9	3.9	4.3	4.6
Crude hides and skins, leather, furs, etc	1.7	2.1	2.1	2.3	2.5	2.6	2.9
Textiles and textile articles	10.1	11.4	11.8	11.7	13.9	15.4	18.6
Footwear	0.7	0.9	1.0	1.1	1.4	1.7	1.8
Basic metals and articles thereof	4.3	4.9	5.3	6.2	5.9	6.7	6.6
Machinery, appliances, and electrical equipment	17.6	20.4	20.6	21.9	23.0	23.0	23.4
Transport equipment	4.3	4.7	3.9	3.6	3.4	4.1	3.0
Other	7.3	8.8	9.8	9.8	10.5	11.1	10.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Romanian authorities; and Fund staff estimates.

Table 37. Romania: Foreign Exchange Market Transactions, 1996-2000

(In millions of U.S. dollars)

		Total Volume	Daily Average Volume	Total Volume between Banks
1996	January	349.3	16.6	22.5
	February	302.9	14.4	32.2
	March	314.0	15.0	36.4
	April	341.7	16.3	17.6
	May	360.8	16.4	32.0
	June	354.6	17.7	35.6
	July	404.8	17.6	74.3
	August	371.0	16.9	29.1
	September	386.9	18.4	92.8
	October	320.0	13.9	26.2
	November	293.8	14.0	13.1
	December	466.4	25.9	104.6
1997	January	272.4	13.6	12.2
	February	342.9	17.1	69.4
	March	488.0	23.2	158.1
	April	1,042.9	49.7	472.3
	May	858.8	40.9	339.1
	June	690.7	32.9	257.8
	July	881.2	38.3	321.6
	August	759.5	36.2	327.7
	September	698.6	31.8	236.7
	October	889.1	38.7	354.3
	November	789.8	39.5	307.5
	December	962.1	48.1	388.6
1998	January	947.8	47.4	435.2
	February	849.9	42.5	389.6
	March	1,172.4	53.3	572.3
	April	1,117.1	53.2	556.2
	May	980.8	49.0	442.1
	June	933.3	42.4	422.6
	July	1,177.3	51.2	605.3
	August	1,228.1	58.5	679.0
	September	1,513.6	68.8	890.0
	October	1,768.4	80.4	1155.8
	November	1,719.6	81.9	1085.1
	December	2,220.2	105.7	1462.6
1999	January	1,644.0	82.2	1140.2
	February	2,302.7	115.1	1816.7
	March	1,838.9	80.0	1219.4
	April	1,287.3	61.3	737.1
	May	1,854.9	88.3	1365.4
	June	1,455.7	66.2	939.5
	July	1,692.6	76.9	1082.4
	August	1,557.8	70.8	965.1
	September	1,824.9	82.9	1154.2
	October	1,953.0	93.0	1342.9
	November	2,501.9	113.7	1817.6
	December	1,853.1	88.2	1093.6
2000	January	1,753.0	87.7	1155.2
	February	1,668.6	79.5	1047.7
	March	2,091.1	90.9	1391.2
	April	1,900.9	95.0	1275.2
	May	1,901.6	86.4	1217.0
	June	1,637.7	74.4	939.1

Source: National Bank of Romania.

Table 38. Romania: Exchange Rate Against the U.S. Dollar
and Transferable Ruble (TR), 1990-2000

	(Lei per U.S. dollar)		(Lei per TR 1/)	
	End of Period	Period Average	End of Period	Period Average
1990	34.7	22.43	22	20
1991	189.0	76.39	...	...
1992	460.0	307.95	...	...
1993	1,276.0	760.05	...	...
1994	1,767.0	1,655.09	...	...
1995	2,578.0	2,033.26	...	...
1996	4,035.0	3,082.60	...	...
1997	8,023.0	7,167.94	...	...
1998	10,951.0	8,876.60	...	...
1999	18,255.0	15,333.81	...	...
1997 I	6,996.0	6,365.00	...	...
1997 II	7,032.0	7,103.84	...	...
1997 III	7,613.0	7,379.44	...	...
1997 IV	8,023.0	7,823.50	...	...
1998 I	8,490.0	8,243.80	...	...
1998 II	8,670.0	8,475.40	...	...
1998 III	9,162.0	8,840.62	...	...
1998 IV	10,951.0	9,939.39	...	...
1999 I	14,925.0	12,559.37	...	...
1999 II	15,840.0	15,262.31	...	...
1999 III	16,488.0	16,127.12	...	...
1999 IV	18,255.0	17,382.91	...	...
2000 I	19,480.0	18,753.78	...	...
2000 II	21,358.0	20,394.11	...	...
1997 December	8,023.0	7,960.25	...	...
1998 January	8,248.0	8,293.40	...	...
1998 February	8,105.0	8,230.90	...	...
1998 March	8,490.0	8,207.09	...	...
1998 April	8,345.0	8,379.62	...	...
1998 May	8,511.0	8,477.25	...	...
1998 June	8,670.0	8,569.36	...	...
1998 July	8,744.0	8,699.43	...	...
1998 August	8,924.0	8,781.24	...	...
1998 September	9,162.0	9,041.19	...	...
1998 October	9,592.0	9,380.68	...	...
1998 November	10,082.0	9,908.86	...	...
1998 December	10,951.0	10,528.64	...	...
1999 January	11,614.0	11,353.60	...	...
1999 February	12,774.0	12,271.00	...	...
1999 March	14,925.0	14,053.52	...	...
1999 April	14,992.0	14,792.62	...	...
1999 May	15,622.0	15,237.81	...	...
1999 June	15,840.0	15,756.50	...	...
1999 July	16,037.0	15,920.95	...	...
1999 August	16,220.0	16,100.95	...	...
1999 September	16,488.0	16,359.45	...	...
1999 October	16,870.0	16,705.57	...	...
1999 November	17,893.0	17,446.73	...	...
1999 December	18,255.0	17,996.43	...	...
2000 January	18,465.0	18,352.55	...	...
2000 February	18,892.0	18,701.71	...	...
2000 March	19,480.0	19,207.09	...	...
2000 April	20,076.0	19,758.50	...	...
2000 May	20,697.0	20,393.18	...	...
2000 June	21,358.0	21,030.64	...	...

Source: Data provided by the Romanian authorities.

1/ The NBR stopped quoting the lei/TR rate since the beginning of 1991.

Table 39. Romania: Stock of Direct Foreign Investment 1997-1999
(Cumulative from 1990)

Country (Financial Organization)	Foreign Capital 1/			Number of Foreign Investors		
	1997	1998	1999	1997	1998	1999
Total	2,780,018	3,648,490	4,500,283	53,203	63,255	65,817
European Union	1,540,987	2,140,476	2,696,678	20,372	23,936	27,016
Austria	110,804	174,128	236,747	1,406	1,727	1,990
Belgium	18,432	37,973	39,416	588	684	783
Denmark	5,815	6,642	7,182	135	163	193
France	214,862	273,620	305,363	1,592	1,865	2,012
Finland	720	1,813	8,777	30	35	42
Germany	338,131	376,267	536,386	6,926	7,905	8,601
Greece	67,436	85,476	131,314	1,407	1,603	1,739
Ireland	10,130	12,664	13,340	95	100	113
Italy	196,962	292,198	345,737	5,780	7,081	8,334
Luxembourg	123,304	138,063	168,290	109	127	161
Netherlands	275,286	480,324	582,517	806	967	1,158
Portugal	1,067	1,735	1,782	27	35	40
Spain	27,091	27,808	28,940	231	268	309
Sweden	31,397	48,703	50,938	506	524	579
United Kingdom	119,550	183,062	239,950	734	852	962
Other countries:	724,043	833,758	983,324	11,495	13,163	14,597
Korea, Rep. of	234,037	234,064	234,070	46	60	72
U.S.A.	254,532	242,375	339,117	2,280	2,483	2,715
Turkey	126,268	176,885	193,162	4,427	5,343	6,117
Switzerland	89,782	72,950	101,671	671	751	821
Canada	48,026	51,609	56,087	521	584	635
Syria	53,079	55,875	59,218	3,550	3,942	4,237
E.B.R.D.	324,665	403,691	820,281	16,446	20,722	24,204
Israel	24,094	24,986	25,447	1,369	1,512	1,651
Hungary	51,155	84,451	152,103	2,175	2,712	3,075
Cyprus	69,199	85,398	383,139	385	534	745
Lebanon	24,733	31,019	35,774	2,038	2,274	2,477
China	37,350	40,782	42,663	3,176	4,697	5,550
Iraq	24,726	28,451	30,731	2,880	3,807	4,781
Liechtenstein	17,475	17,596	36,116	110	123	135
Iran	14,858	15,444	15,866	1,688	1,902	2,075
Britain Islands	4,139	13,132	22,893	53	83	114
Bulgaria	7,878	8,052	8,844	199	236	293
Egypt	8,001	9,269	9,375	765	967	1,111
Rep. of Moldova	6,874	10,344	20,352	594	760	964
Australia	10,996	10,900	11,133	282	297	325
Saudi Arabia	592	597	732	55	69	76
Panama	15,228	16,284	16,291	92	97	101
Yugoslavia	4,652	4,792	4,840	486	534	599
Poland	2,715	2,194	3,980	99	118	132

Source: Data provided by the Regional Development National Agency.

1/ In thousands US dollars

Table 40. Romania: National Bank of Romania's Borrowing from Capital Markets, 1995-99

Lead Manager or creditor	Amount 1/	Maturity (in years)	Spread 2/	Currency	Date	Date of Withdrawal
Citibank Syndicated Loan	110	1.50	225	U.S. dollar	December 7, 1995	December 13, 1996
Union Bank of Switzerland	60	2.00	50	U.S. dollar	December 29, 1995	December 29, 1997
Union Bank of Switzerland	20	2.00	50	U.S. dollar	January 12, 1996	August 29, 1996
Merrill Lynch	25	3.00	200	U.S. dollar	February 15, 1996	February 15, 1996
Merrill Lynch	25	5.00	225	U.S. dollar	February 15, 1996	February 15, 1996
Sanwa Bank	90	1.25	175	U.S. dollar	April 26, 1996	May 8, 1996
Nomura Securities	480	3.00	280 3/	Yen	May 28, 1996	May 28, 1996
Merrill Lynch	225	3.00	225	U.S. dollar	June 12, 1996	June 25, 1996
Nomura Securities	269	5.00	307 4/	Yen	September 20, 1996	October 9, 1996
ABN AMRO-Citibank	175	3.00	188	U.S. dollar	September 26, 1996	October 23, 1996

Sources: Romanian authorities; and Fund staff estimates.

1/ In millions of U.S. dollars. Liabilities in yen valued at exchange rate prevailing at the closing date.

2/ Over LIBOR in case of floating rate debt, and over equivalent government bond yield for fixed rate debt (Samurai and Eurobond).

3/ Fixed interest rate (5.20).

4/ Fixed interest rate (5.05).

Table 41. Romania: Outstanding External Debt in Convertible Currencies, 1993-99
(In millions of U.S. dollars, end of period)

	1993	1994	1995	1996	1997	1998	1999
Medium- and long-term	3,357	4,597	5,482	7,209	8,584	9,323	8,529
Official creditors	3,123	4,260	4,971	6,230	7,053	7,517	6,869
Multilateral Institutions	2,037	2,715	2,787	2,720	3,392	3,689	3,882
<i>Of which</i> : IMF	1,041	1,313	1,039	651	642	539	459
Government and government guaranteed credits 1/	1,086	1,544	2,184	3,509	3,661	3,828	2,986
<i>Of which</i> : China	137	89	57	36	15	16	14
Commercial creditors 2/	212	337	512	980	1,532	1,806	1,660
Trade-related credits	212	290	415	485	577	289	203
Commercial banks	0.0	0	0	0	80	74	37
Non-guaranteed suppliers' credits	0.0	47	97	495	875	1,443	1,421
Ex-CMEA banks 3/	22	0.0	0.0	0	0	0	0
Short-term	892	966	1,000	1,136	918	577	385
<i>Of which</i> :							
Documents in transit	85	62	172	475	471	232	160
Letters of credit	431	504	546	410	258	151	128
Total	4,249	5,563	6,482	8,345	9,503	9,899	8,915

Source: Romanian authorities.

1/ Includes guaranteed supplier credits, guaranteed credits from private banks, bonds issued in 1996 and 1997 and syndicated loan dating to 1928.

The figures do not include the disputed obligations to Sweden dated 1928

Table 42. Romania: Currency Composition of Medium- and Long-Term
External Debt, 1993-99

(In percent; end of period)

	1993	1994	1995	1996	1997	1998	1999
U.S. dollars	31.5	39.5	42.4	47.5	51.4	52.7	58.7
Swiss francs	4.0	2.4	1.6	0.9	1.7	1.7	1.6
Deutsche marks	4.8	5.1	11.1	11.9	15.6	16.1	15.1
SDRs	31.0	29.0	19.3	9.0	6.0	5.8	5.4
Pounds sterling	0.0	0.0	0.0	0.1	0.1	0.1	0.1
French francs	3.5	4.3	4.5	3.9	3.8	4.1	3.7
ECU	16.1	14.0	14.7	11.3	9.1	7.7	7.5
Other currencies	9.1	5.7	6.4	15.4	12.3	11.8	7.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Data provided by the Romanian authorities.

Table 43. Romania: Summary of Export Restrictions, 1994-97 I/
(Products subject to export quotas)

1994	1995	1996	1997
<p>II. Grains and Technical Crops</p> <p>Double and crossed maize hybrids (1 pos.)</p> <p>Triple crossed hybrids (1 pos.) (2,120 tons)</p> <p>Simple hybrids (1 pos.) (5,995 tons)</p> <p>Sunflower seeds for sowing (1 pos.) (230 tons)</p> <p>Raw sunflower oil (1 pos.) (15,000 tons)</p> <p>VI. Non-Ferrous Minerals, Fuels</p> <p>Copper-based alloys (3 pos.) (12,500 tons)</p> <p>Lead-based alloys (1 pos.) (1,000 tons)</p> <p>VIII Wood and Wood Products</p> <p>Different kinds of timber (9 pos.)</p> <p>Not-processed or semi-processed wood products (7 pos.)</p>	<p>II. Grains and Technical Crops</p> <p>Wheat for seeds and common wheat (2 pos.) (590,500 tons initially, but changed)</p> <p>Maize and maize hybrids (6 pos.) (total 1,008,830 tons)</p> <p>Sunflower for seeds (1 pos.) (382 tons)</p> <p>Raw sunflower oil (1 pos.) (10,000 tons)</p> <p>IV. Other Agriculture</p> <p>Raw sheep skins and hides (4 pos.) (315,000 pcs.)</p> <p>Cattle hides (2 pos.) (200,000 sq. m.)</p> <p>Sheep skins without hair (7 pos.) (185,000 pcs.)</p> <p>VI. Non-Ferrous Minerals, Fuels</p> <p>Copper and copper-based alloys (3 pos.) (10,100 tons)</p> <p>Aluminium-based alloys (1 pos.) (10,000 tons)</p> <p>Refined lead (1 pos.) (4,000 tons)</p> <p>Zinc (1 pos.) (5,000 tons)</p> <p>VIII Wood and Wood Products</p> <p>Coniferous timber (7 pos.)</p> <p>Beech tree timber and other timber (7 pos.)</p> <p>Semi-processed and different wood products (excl. furniture) (10 pos.)</p>	<p>II. Grains and Technical Crops</p> <p>Wheat for seeds and common wheat (2 pos.) (1,510,000 tons)</p> <p>Maize and maize hybrids (6 pos.) (1,024,000 tons)</p> <p>Sunflower seeds (1 pos.) (2,000 tons)</p> <p>Raw sunflower oil (1 pos.) (75,000 tons)</p> <p>IV Other Agriculture</p> <p>Raw sheep skins and hides ((4 pos.) (320,000 pcs.)</p> <p>Raw cattle hides (2 pos.) (300,000 sq. m.)</p> <p>Sheep skins without hair (7 pos.) (250,000 pcs.)</p> <p>Raw wool (2 pos.) (4,000 tons in semi. II only)</p> <p>VI Non-Ferrous Minerals, Fuels</p> <p>Products made of copper alloys (1 pos.) (100 tons)</p> <p>Aluminium-based alloys (1 pos.) (10,000 tons)</p> <p>Refined lead (1 pos.) (4,000 tons)</p> <p>Zinc (1 pos.) (8,000 tons)</p> <p>VI Wood and Wood Products</p> <p>Coniferous timber (8 pos.)</p> <p>Beech tree timber and other timber (6 pos.)</p> <p>Semi-processed and different wood products (excl. furniture) (9 pos.)</p>	<p>II. Grains and Technical Crops</p> <p>Wheat and maize hybride (6 pos)</p> <p>Barley (1 pos)</p> <p>Flour (2 pos)</p> <p>Sunflower seeds for crops (1 pos)</p> <p>Raw sunflower oil (1 pos)</p> <p>Bread (1 pos)</p> <p>Wheat's extraction (1 pos)</p> <p>Soya beans' extraction (1 pos)</p> <p>Sunflower's extraction (1 pos)</p> <p>IV. Other Agriculture</p> <p>Snails, other than sea snails (1 pos)</p> <p>Raw cattle and horse skins and hides (7 pos) - (2,500 tons)</p> <p>Raw sheep skins and hides 4 (pos) - (1,530 tons)</p> <p>Other raw skins and hides (1 pos) (700 tons)</p> <p>Other cattle skins (2 pos), (2,735 tons)</p> <p>Sheep skins without hair (2 pos) (564 tons)</p> <p>V. Ferrous metals</p> <p>Raw wool (2 pos); (4,000 tons)</p> <p>Iron and steel trash (3 pos) (250,000 ton)</p> <p>VI. Non-ferrous minerals, metals, fuels</p> <p>Copper trash (1 pos) - 3,000 tons</p> <p>Copper and copper based alloys, copper products (3 pos); (4,200 tons)</p> <p>Aluminium based alloys (2 pos) (10,000 tons)</p> <p>Lead, lead alloys (2 pos); (6000 tons)</p> <p>Zinc (1 pos); (10,000 tons)</p> <p>VII Wood and wood products</p> <p>Coniferous timber (9 pos); (972,000 m³);</p> <p>Beech tree timber and other timber (9 pos); (310,000 m³)</p> <p>Wood products:</p> <p>1 pos = 1,000 m²</p> <p>1 pos = 10,000 m³</p> <p>1 pos = 2,000 m³</p>

Source: Ministry of Industry and Trade

Table 44. Romania: Energy Prices, 1993-99 1/
(In domestic currency)

	Jan. 1993	Feb.-Aug. 1993	Jan. 1994	Feb.-Aug. 1994	Jan. 1995	Feb.-Apr. 1995	May-Sep. 1995	Oct. 1995- June 1996	July-Nov. 1996	Dec. 1996	Jan.-Dec. 1997	Jan.-Apr. 1998	1998	1999
Liquid bottled gas 2/ (Households)	150	836 3/	2,500	3,572	4,100	4,758	6,565	6,639	10,647	11,112	27,667	33,977	34,793	69,222
Premium gasoline Households	140	184	400	436	452	494	600	742	989	991	2,764	3,599	4,175	8,153
Enterprises	93	118	264	284	287	316	380	474	612	612	1,423	1,305	1,207	1,846
Diesel fuel Households	110	156	290	334	355	377	432	497	679	680	2,256	2,902	3,191	5,316
Enterprises	75	101	197	225	237	249	270	316	431	429	1,282	1,356	1,225	1,683
Light fuel type P Households	16,890	96,847 3/	229,192	274,372	295,540	314,706	361,882	361,882	566,948	566,948	1,747,478	2,045,948	2,150,510	3,453,940
Enterprises	102,700	139,573	275,300	318,107	273,140	289,451	338,382	338,382	494,755	534,748	1,461,454	1,851,786	1,771,899	2,505,663
Heating oil (light) Households	10,170	61,330 3/	146,000	208,490	229,770	249,193	293,890	295,830	485,250	486,920	1,205,310	1,521,790	1,600,540	2,880,610
Enterprises	31,700	46,375	74,800	107,383	127,160	139,593	172,065	172,000	269,457	270,000	651,719	859,753	812,502	1,190,571
Crude oil	34,625	47,825	84,565	104,754	113,448	124,521	149,713	179,097	315,638	315,948	863,238	966,110	918,992	1,586,058
Natural gas Economic units & population	11,437	14,883 3/	38,799	45,366	50,886	50,886	50,886	50,886	81,232	81,639	394,875	471,250	515,475	801,835
Economic units	...	...	...	...	...	...	...	...	...	...	608,333	712,500	714,700	854,713
Used as fuel	3,700	15,300	24,000	30,860	34,000	34,000	38,640	40,000	62,850	63,000	188,330	230,000	316,250	749,310
Coal (lignite) Households	1,980	8,963 3/	24,588	27,988	38,990	39,262	41,486	44,167	58,496	61,781	142,933	267,088	291,251	391,910
Enterprises	5,078	7,143	12,970	17,762	19,740	19,726	22,053	26,250	35,893	35,992	88,773	106,751	107,098	170,653
Electricity 4/ Households	6	19 3/	28	36	40	40	45	46	73	73	161	187	321	553
Economic units & population	...	...	52	67	78	78	84	88	137	140	365	436	430	553
Economic units	17	22	48	62	71	72	78	81	127	127	325	385	400	568

Source: National Statistics Commission.

1/ Delivery prices, including VAT from July 1, 1993.

2/ 12.5 kg. bottles, delivered for households.

3/ Exempted from VAT.

4/ Explicit subsidies for households were eliminated from May 1, 1993.

Table 45. Romania: Energy Bill, 1996-99

	Natural Gas		Electric Power		Mineral Fuel		Crude Petroleum		Petroleum Products		TOTAL US\$ thousands
	(millions of cu. metres) Quantity	Value I/ Value J/	(thousand kw hours) Quantity	Value I/ Value J/	(tonnes) Quantity	Value I/ Value J/	(tonnes) Quantity	Value I/ Value J/	(tonnes) Quantity	Value I/ Value J/	
1996 Exports f.o.b.	0	0	0	0	490	32864	0	0	2944	563361	598025
Q1	0	0	0	0	126	8436	0	0	823	155067	163503
Q2	0	0	0	0	116	8393	0	0	816	160950	169343
Q3	0	0	0	0	128	8432	0	0	569	96377	107809
Q4	0	0	0	0	122	7403	0	0	894	147967	155370
1996 Imports c.i.f.	7148	611900	749	16707	4843	324074	7156	1039932	3219	400583	2390196
Q1	1850	153063	341	7881	1025	68952	2429	323609	961	116713	670138
Q2	1638	130924	324	6814	967	65455	1499	209164	862	102586	519863
Q3	1645	141381	84	2012	1191	78765	1106	173684	627	75093	472145
Q4	2015	181612	0	0	1680	109902	2032	330345	769	108191	728050
1997 Exports f.o.b.	0	0	556	13058	418	24699	0	0	2659	480025	517782
Q1	0	0	84	2028	112	6922	0	0	768	145517	154466
Q2	0	0	98	2239	106	6673	0	0	897	156375	167287
Q3	0	0	57	1268	126	7018	0	0	691	120985	128882
Q4	0	0	317	7625	74	4085	0	0	303	55438	67048
1997 Imports c.i.f.	4685	446075	777	17469	5462	370169	6245	838301	3815	456764	2130618
Q1	1498	141981	151	3376	913	60845	2042	303242	865	84639	968083
Q2	850	80284	155	3631	1695	115765	1852	226046	902	96578	522203
Q3	820	76376	396	8924	1161	78946	853	121332	1702	189145	473725
Q4	1718	150434	72	1659	1723	114631	1398	185662	626	86402	536807
1998 Imports f.o.b.	0	0	337	11065	376	19274	0	0	3001	362882	363211
Q1	0	0	126	4086	90	5886	0	0	566	81500	81182
Q2	0	0	50	1807	115	5870	0	0	751	90822	98259
Q3	0	0	26	790	69	3175	0	0	679	77094	81059
Q4	0	0	135	4562	104	4633	0	0	1095	113468	122661
1998 Imports c.i.f.	4736	350406	724	26709	4014	245870	5974	560787	2716	256780	1480532
Q1	1328	112240	86	2509	1032	69767	1448	140482	605	58725	363623
Q2	1136	89949	267	10875	1240	74378	1222	114823	814	81100	370925
Q3	1058	70746	324	12072	966	56821	1256	110095	604	58969	308643
Q4	1213	77371	27	1253	776	44804	2048	165627	633	57868	367141
1999 Imports f.o.b.	0	0	2237	72678	291	21193	0	0	1937	320489	414260
Q1	0	0	632	26998	111	5985	0	0	504	50225	83106
Q2	0	0	449	14590	37	2672	0	0	384	56683	74056
Q3	0	0	528	17081	69	4958	0	0	517	98648	120687
Q4	0	0	430	14001	74	7678	0	0	542	114523	136202
1999 Imports c.i.f.	3208	196588	1412	48075	2730	161522	4294	478162	1613	166842	1051219
Q1	888	52848	289	9502	613	34973	1201	89907	332	30418	217648
Q2	540	30563	621	20214	631	40374	535	60848	228	25205	167304
Q3	461	26799	309	10653	804	46048	1090	118214	454	42630	243844
Q4	1319	88378	194	6306	682	40127	1468	219123	499	68389	422323

Source: National Bank of Romania
I/ Thousands of U.S. dollars.

Table 46. Romania: Energy Balance, 1996-98

Units	1996 Actual		1997 Actual		1998 Actual	
	Natural units	Thousand toe 1/	Natural units	Thousand toe 1/	Natural units	Thousand toe 1/
Energy Sources - Total		53,941	51,261	46,204		
Production						
Coal 2/	thousand tons	35,135	31,401	28,796		
Hydrocarbons		8,065	6,600	5,149		
Natural gas	million m ³	20,464	18,512	17,610		
Crude oil	thousand tons	13,764	11,908	11,195		
Hydroelectric power	Gwh	6,700	6,604	6,415		
Nuclear power	Gwh	1,579	2,916	3,009		
Other		139				
		4,888	3,373	3,028		
Import						
Coal	thousand tons	18,806	19,163	15,148		
Hydrocarbons		2,773	3,429	2,495		
Natural gas	million m ³	15,788	14,291	12,485		
Crude oil	thousand tons	5,654	4,030	3,773		
Oil products	thousand tons	7,153	6,243	6,000		
Heavy fuel oil	thousand tons	2,981	4,018	2,712		
Electric power	Gwh	193	89	101		
Stocks at the beginning of the period	thousand tons					
Destination - Total						
Consumption		50,365	45,505	40,983		
Population		10,618	9,673	9,412		
Export						
Stocks by the end of the period						

Source: National Commission for Statistics

1/ Tons of oil equivalent (10,000 Kcal/kg).

2/ Without coking coal.

*) Data are not yet available

Table 47. Romania: Primary Supply and Consumption of Petroleum Resources, 1980-99

	1980	1985	1989	1990	1995	1996	1997	1998	1999
Oil									
Domestic production									
Crude oil	11.5	10.7	9.2	7.9	6.4	6.4	6.4	6.3	6.1
Natural gas - liquids	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.2	0.2
Subtotal	11.9	11.1	9.6	8.3	6.8	6.8	6.8	6.5	6.3
Imports - crude oil	16.2	14.6	21.8	16.1	8.8	8.8	8.8	6.0	4.3
Exports - petroleum products	8.9	9.1	12.0	8.4	2.3	2.3	2.3	3.4	...
Net domestic consumption	19.2	16.6	19.6	16.0	13.3	13.3	13.3	12.8	...
<i>Of which</i> : Domestically produced (in percent)	62.0	66.9	49.0	51.9	51.1	51.1	51.1	79.7	...
Net import (in percent)	38.0	33.1	50.0	48.1	48.9	48.9	48.9	20.3	...
Natural gas									
Domestic production									
Non-associated gas	25.5	31.9	25.3	17.5	12.8	12.8	12.8	9.1	8.8
Associated gas	7.0	7.0	7.0	5.3	5.3	5.3	5.3	5.3	5.7
Subtotal (bcm) 1/	32.5	38.9	32.8	22.8	18.1	18.1	18.1	14.4	14.5
Imports	1.6	1.8	7.0	5.8	7.3	7.3	7.3	4.7	3.2
Exports	0.2	0.0	0.0	0.0	0.0	0.0	0.0	...	...
Net domestic consumption (bcm)	36.6	40.9	39.8	28.6	25.4	25.4	25.4	18.6	...
Net domestic consumption (million toe)	30.5	34.1	33.2	23.8	21.2	21.2	21.2	14.8	...
<i>Of which</i> : Domestically produced (in percent)	88.8	95.1	82.4	79.7	71.3	71.3	71.3	77.7	...
Net import (in percent)	3.8	4.4	17.6	20.3	28.7	28.7	28.7	22.3	...
Total net domestic consumption (In millions of toe)	49.7	50.5	52.7	39.8	34.5	34.5	34.5	24.3	...

Sources: World Bank; and Ministry of Industry.

1/ 1 bcm of natural gas is equivalent to 1.2 million tons of oil equivalent (toe).

Table 48. Romania: Production, Domestic Consumption, Export
and Import of Oil and Oil Products, 1980-99

(In thousands of tons)

	Crude Oil		Total Refined Product			
	Domestic Production 1/	Import	Total Supply	Total Production	Export	Domestic Consumption
1980	11,865	15,961	27,826	26,929	8,754	18,175
1981	12,012	12,915	24,927	24,777	8,124	16,653
1982	12,112	10,924	23,036	22,986	6,543	16,443
1983	11,974	12,395	24,369	24,037	9,116	14,921
1984	11,835	13,534	25,369	24,859	10,193	14,666
1985	11,092	14,626	25,718	24,987	9,689	15,298
1986	10,520	17,047	27,567	27,081	10,374	16,707
1987	9,846	21,366	31,212	30,250	11,829	18,421
1988	9,713	20,957	30,670	30,253	13,248	17,005
1989	9,573	21,809	31,382	29,821	13,375	16,446
1990	8,135	16,058	24,193	22,790	5,120	17,670
1991	6,941	8,634	15,575	15,293	2,496	12,797
1992	6,770	6,572	13,342	13,073	2,560	10,513
1993	6,830	7,581	13,771	13,111	2,676	10,453
1994	6,860	8,122	14,982	14,390	4,069	10,321
1995	6,951	8,657	15,608	13,796	4,690	9,106
1996	6,852	7,156	14,008	13,602	3,730	9,872
1997	6,750	6,245	12,995	13,166	2,882	10,284
1998	6,553	5,974	12,527	13,233	3,169	10,064
1999 2/	6,154	4,294	10,448	10,303	1,957	8,346

Source: Data provided by the Romanian authorities.

1/ Includes a small amount of by-products from natural gas wells.

2/ Preliminary data.

Table 49. Romania: Electric Power Balance, 1995-99

(In gigawatt hours)

	1995 Actual	1996 Actual	1997 Actual	1998 Actual	1999 Estimates
Total resources	60,022	63,592	58,187	54,677	51,230
Domestic production	59,267	61,350	57,148	53,496	50,049
Thermal power plants	42,573	44,209	34,239	29,310	26,562
Coal	20,594	20,471	16,862	14,485	...
Hydrocarbons and secondary energy resources	21,979	23,738	17,377	14,825	...
Hydropower plants	16,694	15,755	17,509	18,879	18,289
Nuclear plants	0	1,386	5,400	5,307	5,307
Import	755	2,242	1,038	1,181	1,181
Total destinations	60,022	63,592	58,187	54,677	51,230
Gross domestic consumption - total	49,475	54,974	50,504	46,235	43,329
Population 1/	7,401	8,447	8,296	8,296	8,296
Export					

Source: National Commission for Statistics.

1/ Without public illumination.

Romania: First and Second Reviews Under the Stand-By Arrangement, Request for Waivers, and Modification of Performance Criterion—Staff Report; Staff Statement; News Brief on the Executive Board Discussion; and Statement by the Executive Director for Romania

In the context of the first and second reviews under the Stand-By Arrangement, Request for Waivers, and Modification of Performance Criterion with Romania, the following documents have been released and are included in this package:

- the staff report for the first and second reviews under the Stand-By Arrangement, Request for Waivers, and Modification of Performance Criterion, prepared by a staff team of the IMF, following discussions that ended on **July 17, 2002** with the officials of Romania on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on August 13, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **August 28, 2002** updating information on recent developments.
- a News Brief summarizing the **views of the Executive Board as expressed during its August 28, 2002 discussion** of the staff report that completed the review.
- a statement by the Executive Director for Romania.

The documents listed below have been or will be separately released:

Letter of Intent by the authorities of Romania*
Supplementary Memorandum on Economic and Financial Policies by the authorities of Romania*
Technical Memorandum of Understanding*

*May also be included in Staff Report.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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EXHIBIT T

NEW PRIVATE FIRM CONTRIBUTIONS TO STRUCTURAL CHANGE IN THE ROMANIAN ECONOMY

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- Abstract -

Ten years ago, when practical questions were raised on how best to proceed in order to transform centrally planned economies into market economies, economists realized that they did not have a guiding “theory of transition” and consequently had little to offer as policy recommendations. A loose consensus emerged however, based on neoclassical economic theory, on two practical measures to be taken in order to initiate the change--*forcing a structural ownership change* through the privatization of state assets, and the *liberalization of prices*. Different “models of transition” were derived from that basic scheme, distinguishing themselves on the details of practical solutions and the sequencing of events. But a growing mass of evidence is accumulating after the first ten years of the transition showing that the results achieved by different countries depart in many cases from the prescriptions and predictions conventional reform models proclaimed. Some failures are too serious to be simply dismissed as due to “good policies being poorly implemented” and a growing number of economists are taking a critical position.

One of the areas being now re-examined concerns the paths and methods used to achieve the structural shift in ownership. Most governments and their advisors were focusing on privatization as the main route to achieving structural change. But the results were frequently disappointing: it turns out privatization is a slow process, complicated by political interference. In addition, it became evident that privatization in itself is not sufficient for markets to function and, without a proper institutional setting to foster competition, the expected gains in efficiency do not materialize.

At the same time, countries like Poland or even China, which were never acclaimed as champions in divesting state assets, achieved the highest growth rates. Part of the secret to their performance is most likely related to the vibrant sector of new private firms. New private firm contributions to creating a genuine proper market environment should probably be reconsidered and this is the perspective from which the present paper is examining the Romanian case.

The first part of the paper is aimed at tracing a comprehensive and consistent portrait of the private sector in Romania. Based mainly on statistical data, the development and the main characteristics of the private sector are identified, compared and commented. Two factors determine, in the author's opinion, the performance and the significance of the private sector for the economy of the country: the quality of the entrepreneurial class and the quality of the business environment. Each of these factors is examined in the paper within the Romanian context.

Finally, conclusions are drawn on the development perspectives of the private sector in Romania and some general policy recommendations are derived.

Introduction

While the gains in political democracy over the ten years after the fall of the Berlin Wall are significant, the progress in reforming the economies of former socialist countries is less obvious. For many people living in Eastern Europe and the CIS, the transition was an experience similar only to the 1929-1933 Great Depression, a "human crisis of monumental proportions", as a recent UNDP report calls it (UNDP, 1999). Even now, a decade later, many countries in the region cannot get back to 1989 levels of production. According to the same report, the number of people living on an income of USD 4 a day in the region has risen from 4 percent in 1988 to 32 percent in 1994.

Is hardship inevitable in the transition process, or was there something wrong with the way in which policy-makers tackled the issues of economic reform and transition? Perhaps the basic principles of the "transition" were themselves inadequate. Ten years ago, when practical questions were raised on how to best proceed in order to transform centrally planned economies into market economies, economists realized that they did not have a guiding "theory of transition" and consequently had little to offer as policy recommendations. A loose consensus emerged however, based on neoclassical economic theory^[1], on two practical measures to be taken in order to initiate the change: *forcing a structural ownership change* through the privatization of state assets, and the *liberalization of prices*. Different "models of transition" were derived from that basic scheme, distinguishing themselves on the details of practical solutions and the sequencing of events.

A growing mass of evidence is accumulating after the first ten years of the transition, showing that the results achieved by different countries depart in many cases from the prescriptions and predictions conventional reform models proclaimed. Some failures are too serious to be simply dismissed as due to "good policies being poorly implemented^[2]" and a growing number of economists are taking a critical position. Joseph Stiglitz, Senior Vice President and Chief Economist at the World Bank, is one of the most prominent critics of the "Washington consensus" set of policy recommendations, observing that there are both examples of countries with an impressive

record in achieving development through non-conventional policies (China and other Asian countries) as well as countries which failed in spite of their more or less orthodox policies (Russia and other former Soviet Union countries). The reasons are not simple to explain, but in general, they are connected to

“reform models based on conventional neoclassical economics” that are “likely to underestimate the importance of informational problems, including those arising from the problems of corporate governance; of social and organizational capital; and of the institutional and legal infrastructure required to make an effective market economy.” (Stiglitz, 1999, Abstract)

Privatization versus Greenfield Choice

The role of the privatization process in nurturing the development of the private sector and prompting the crucial structural transformation of transition is now being re-examined [Nellis 1999; Havrylyshyn / McGettigan, 1999; Earle, 1999]. Conventional wisdom maintains that a rapid transfer of state assets into private hands is the single most important measure to be taken in order to create a proper market-driven functioning of the economy. But experience tends to demonstrate that economic performance is not directly related to the speed of the privatization process, but depends heavily on its “quality”. Russia is the most blatant example, but even the Czech republic is not praised anymore for its innovative privatization schemes that produced the most rapid and radical change of ownership. On the other hand, Poland is the most successful transition economy (considering it is the only one having achieved a 17 percent GDP growth in 1998 over 1989) - without distinguishing itself as a privatization champion (over 400 “hard core” key industrial enterprises are still state-owned (Blaszczyk, 1999)). China is an even more striking example: in spite of its ideological restrictions on the sale of state assets, China has a vibrant private sector and the world's longest record of years with two digits growth rates in the last two decades.

For many years, the merits of different privatization methods and schemes were debated, with authors pondering factors like speed, social and political feasibility, or the impact of alternative privatization methods on corporate governance and on the economic viability of firms. I myself contended that the issue was overstated and I tried to demonstrate, based on an application of the Coase theorem (Dochia, 1996), that the privatization method is not so important, eventually even irrelevant. Indeed, if transaction costs are low, an optimal ownership structure (that is one using assets in the most efficient way) will ultimately result through transfers on the capital markets, irrespective of the initial distribution determined by the application of a particular privatization method.

Experience proves that, however, because of the imperfect nature of emerging markets, transaction costs are high. The initial distribution resulting from a particular privatization method will not be changed for a long period of time and assets get locked into less than optimal utilization.

Empirical evidence from a large number of countries^[3] suggests there is a correlation between the efficiency of economic organizations and their ownership structure: state-owned firms tend to be less efficient than privately owned firms, and closely controlled private firms are more efficient than dispersed ownership structures. Also, companies controlled by foreign investors tend to be more efficient than domestic ones. These findings strongly support the allegation that the privatization method matters and that mass privatization is not conducive to the most efficient corporate governance^[4].

But the same empirical studies found that country institutional background is of paramount importance for the performance of economic organizations. Some authors even conclude that

...there are many cases where privatization has not led to efficiency improvement; these are generally associated with situations

where the degree of competition has remained unchanged before and after the privatization... (Tandon, 1995, p. 329-330)

and that

...the further east one travels, the less likely is one to see rapid or dramatic returns to privatization. (Nellis, 1999)

with numbers of examples from Russia, Georgia, Armenia or Mongolia to exemplify the assertion^[5].

Why is that happening? Basically, economists are brought to admit that

...capitalism is revealed to require much more than private property; it functions because of the widespread acceptance and enforcement in an economy of fundamental rules and safeguards that make the outcomes of exchange secure, predictable, and of reasonable widespread benefit. Where such rules and safeguards, such institutions, are absent, what suffers is not just fairness and equity, but firm performance as well. That is, in an institutional vacuum the chances are high that no one in a privatized firm is interested in maintaining the long-run health of the assets.

(Nellis, 1999, p.17)

Finally, new light is shed on the “building from scratch” path for creating the private sector through start-ups, or greenfield firms. In many countries, while efforts and resources were devoted to privatize the “dinosaurs” inherited from socialism, a silent revolution took place through the contribution of millions of entrepreneurs that ceased waiting for the state to perform the reforms and did their own transition. The outcome is so impressive that many authors now believe that the fundamentals of the reform process should be re-examined: **instead of a top-down, government driven reform centered around privatization, a bottom-up approach should be encouraged, based on genuine entrepreneurship and resulting in a substantial and dynamic small and medium-sized enterprise sector.**

This alternative path to transition has already worked remarkably well in many instances. It is widely recognized that

In Poland, for example, small and medium-sized enterprises played a far more important role in the move toward a market economy than the privatization program, which lagged behind other economic reforms.

and

One study of Russia concludes that governments should concentrate more on the development of small and medium size enterprises than on privatization itself.

(Havrylyshyn,

McGettigan, 1999 p.5)

The same may be concluded in China, but start-ups have played a role in practically all transition countries, from Estonia to Vietnam. Analysts recognize new firms have a wider impact than originally anticipated.

- ◆ New firms have substantially contributed to expanding the size of the private sector, their impact being usually more rapid and more considerable than the privatization programs.
- ◆ Start-ups have contributed to efficiency gains in the economy – all studies indicate that the efficiency of the new firms is higher than that of ancient ones, state-owned or privatized.
- ◆ New firms had a decisive contribution to fostering the competitive environment in the economy; start-ups have put an effective pressure on existing firms to achieve efficiency gains and contributed to price

stabilization.

- ◆ By giving consumers a wider range of choices, new firms have also directly improved welfare.
- ◆ New firms are a main source of economic growth; entrepreneurs have the ability to identify market niches and to adjust production to the specific needs of these markets. Unlike old firms, whose resources cannot be easily redirected to other uses, greenfields are adapted to contemporaneous technologies and markets structures.
- ◆ It is hard to minimize the importance of the new firms in restructuring transition economies in multiple dimensions (sectoral, dimensional, products range, organizational, financial etc.). The creation of new firms, most of them small and medium-sized, is part of the restructuring process, and at the same time facilitates the restructuring of large state-owned firms by providing alternative uses for resources (assets and personnel).
- ◆ Last but not least, new firms bring some fresh “entrepreneurial spirit” into economic and social settings where initiative was deterred for decades by the central-planning approach. Managers of state-owned enterprises are unlikely to turn into good entrepreneurs even after their companies are privatized.

Many authors have also emphasized the social and political importance of the new private firms in the stabilization of democratic political structures or in spreading more open and less bureaucratic cultural models.

Romania is not among the most successful transition countries. Unlike other countries in the CEE region, Romania is not firmly established on an economic stability and growth trajectory -- 1999 is the third consecutive year of contraction in GDP and the per capita income is still inferior to the 1989 level. The private sector's share of GDP (currently around 60 percent) is lower than in other CEE countries. But more important is the fact that the current share of the private sector is not the outcome of the privatization process (only 20 percent of the state assets have been divested as of the beginning of 1998), but the result of the activity of hundreds of thousands of new firms, most of them small and medium-sized.

This is a remarkable achievement, considering that Romanian authorities have focused on privatization – as already noticed by early authors:

In Romania, as in other Central and East European Countries, when dealing with transition strategy until now the governmental bodies have placed a major emphasis on the problems related to the privatization (or “de-étatisation”) of the state-owned sector, while those connected to the development of the small and medium enterprises have been considered of secondary importance in the economic policy agenda. In other words, the dominant attitude is that the development of SMEs should come as a secondary consequence of the policy of privatization: in fact the two types of objectives have been almost identified, and even unified under the heading of the National Agency for Privatization (NAP). (Frateschi, 1993, p.33)

- and that the starting conditions were not very favorable.

In Romania, the entrepreneurial tradition is very weak and general public awareness of the economic importance of SMEs very low: worse, small business – especially in retail trade and still more in wholesale trade – is often associated with fraud, speculation and profiteering.

(Idem, p.34)

But unlike their Polish siblings, the new Romanian firms did not succeed to produce a positive impact powerful

enough to overturn the downward trend of the economy. What happened?

Some Basic Facts about the Creation and Expansion of Private Firms

In 1998, the private sector was producing between 70 and 80 percent of the GDP in countries like the Slovak Republic, Hungary, Poland and the Czech Republic, while in the other CEE countries (Romania, Croatia, Slovenia and Bulgaria) the share was between 50 and 60 percent (see Chart I and Appendix 1). The difference between the two groups of countries is due to different starting levels and to the effectiveness of their national privatization programs. Poland and Hungary, who had an important private sector before 1990, achieved a doubling of their shares of GDP (1.7 and respectively 2.4 times more). The Czech and Slovak Republics were notoriously operative in switching ownership status for the bulk of their state assets^[6] and succeeded in quadrupling the share of their private sectors over the period. Romania (with an increase of 2.5 times the share of the private sector in GDP) performed better than Croatia (2.2 times) but less well than Bulgaria (2.8 times) or Slovenia (3.4 times). It should be noted that Romania started in 1990 with a private sector larger than countries like Slovenia, the Czech Republic or Bulgaria.

The same general picture is offered when comparing the employment in the private sector (Chart II and Appendix 1). It is worthwhile mentioning that in Romania the private sector employment was consistently and substantially higher than the GDP produced by the private sector – reflecting a lower labor productivity, due to a large extent to the high proportion of agriculture in the Romanian private sector’s output.

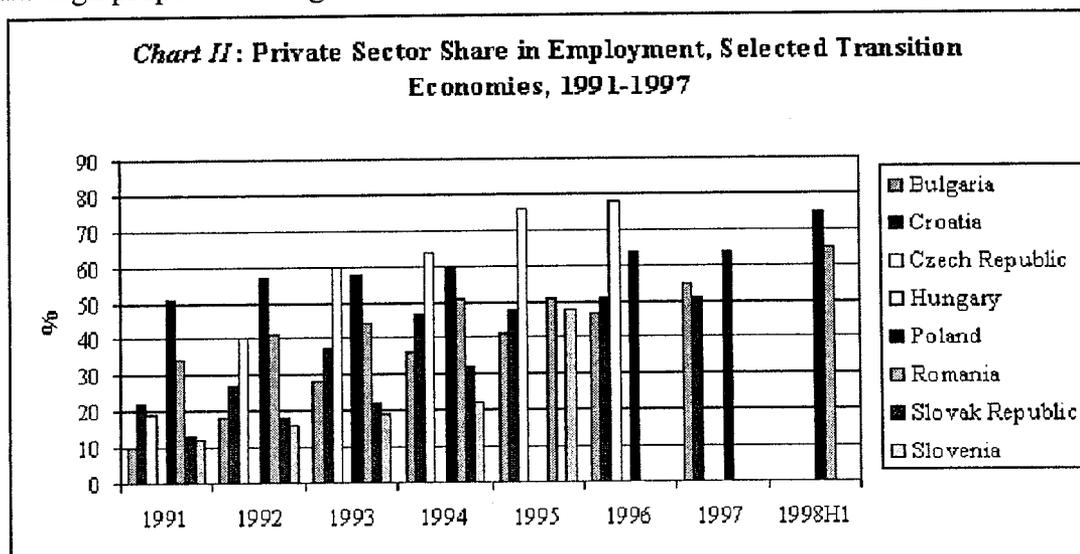
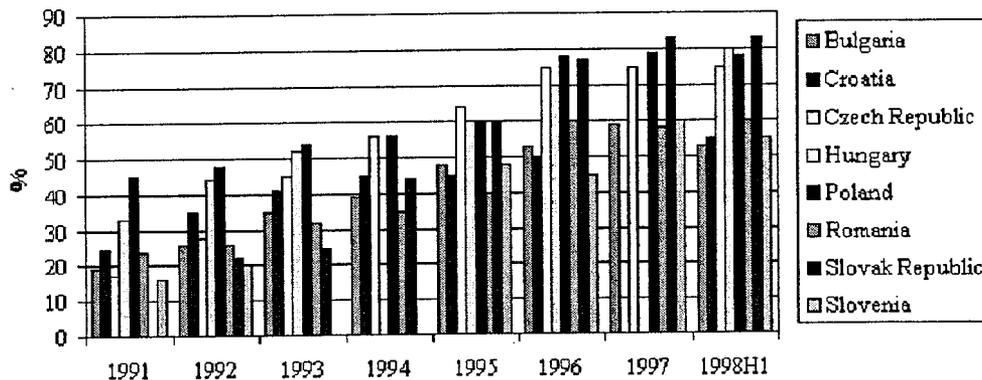


Chart 1: Private Sector Share in GDP, Selected Transition Economies 1991-1997



Box 1 The Missing Private Sector

In many parts of Romania, especially in and around the large cities, relative prosperity is discernible from the large number of expensive cars and new houses ("villas") – an image in stark contrast with the bleak statistics indicating a permanent deterioration of the level of living. This is clear evidence, for most analysts, that an important share of the revenues of the population comes from the un-official, un-accounted for "black" economy. As by definition this is a "private" endeavor, it results that the official statistics are understating the size and impact of the private sector – but there is wide disagreement on the "by how much".

Apart from pure guesses (more or less educated), few reliable estimates are available. The Romanian Intelligence Agency has published estimates periodically on the size of the "underground economy", going from around 30 to over 40 percent of the GDP – but their methodological basis is not revealed.

A recent report by the US Treasury (Cercelescu, 1999) makes a thorough analysis (based on monetary aggregates) of the "hidden" economy and comes out with surprising results. In the period between 1993 and 1996, the underground economy was less than 20 percent of the official GDP; it amounted to 25 percent in 1997 and to an astonishing 49 percent in 1998! While the official economy declined in real terms by 3.6 percent between 1993 and 1998, the underground sector was booming with over 400 percent growth. If the 33 percent growth of the underground economy was accounted for, the decline in GDP recorded by statistics for 1998 would turn into a healthy 3.2 percent growth. The largest part of the underground economy is related to illegal imports that have increased by 640 percent since 1993; in 1998, the volume of illegal imports was 12 percent higher than the official imports.

There is a sharp contrast, evidenced by the findings of the study between the constantly declining official sector and the flourishing underground economy. Considering its underground component, the size of the private sector in Romania is around 73 percent - substantially higher than the official figures. The significance of its existence is contradictory. The underground sector produces many disturbances in the allocation of resources; at the same time, it illustrates the huge growth potential existing in Romania. While officials take a hostile position regarding the underground economy, it is evident that for many families it offers a living, maybe the only one they can afford – as much as 5 million persons in Romania probably obtain some revenues from employment in the underground sector.

Other authors (Johnson, Kaufmann, McMillan, Woodruff, 1999) try to understand what the causes are that favor the expansion of the underground sector in certain countries and identify four groups of factors:

- ◆ excessive fiscal burden – prompting entrepreneurs to avoid reporting part of their operations;
- ◆ bureaucracy and corruption in the public administration – in order to avoid them, private companies tend to go underground for some of their activities;
- ◆ power of the criminal organizations - firms tend to hide their real revenues in order to avoid becoming

tend to go underground for some of their activities;

- ◆ power of the criminal organizations - firms tend to hide their real revenues in order to avoid becoming targets for racketeering and extortions;
- ◆ weak legal systems that do not properly guarantee contract enforcement, discredit contracts and encourage firms to use other instruments and methods for conducting business.

Based on investigations of firms in Poland, Romania, Russia, the Slovak Republic and Ukraine, the same authors conclude that corruption is higher in countries like Russia and Ukraine (90 percent of the managers declared they bribe officials) and lower in Romania and Poland (20 percent of the managers have to bribe officials).

Data suggests the private sector was an effective buffer against the decline in production that accompanied the initial phases of the reform in all transition countries. Countries having a more vigorous private sector seem to be better prepared to overcome economic slump, having shorter and less deep recessions (*Table 1*).

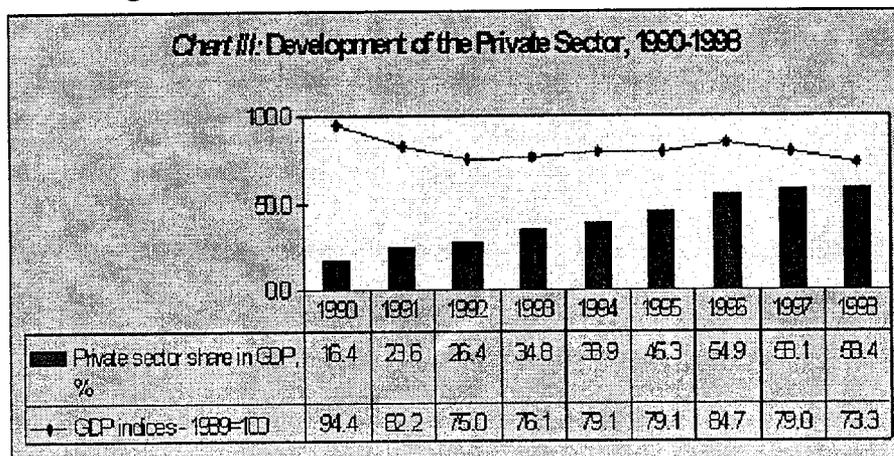
Table 1. Cumulative Changes in GDP in Selected Transition Economies, 1989-1997

(In percent)		
	1989-97	Peak Decline 1/
Albania	-20.3	-40
Bulgaria	-36.8	-37
Czech Republic	-8	-21
Hungary	-9.6	-18
Poland	11.8	-18
Romania	-19.3	-26
Average (unweighted)	-13.7	-27

Source: IMF Staff Country Report No.99/26, *Bulgaria. Recent Economic Developments and Statistical Appendix*, Table 18

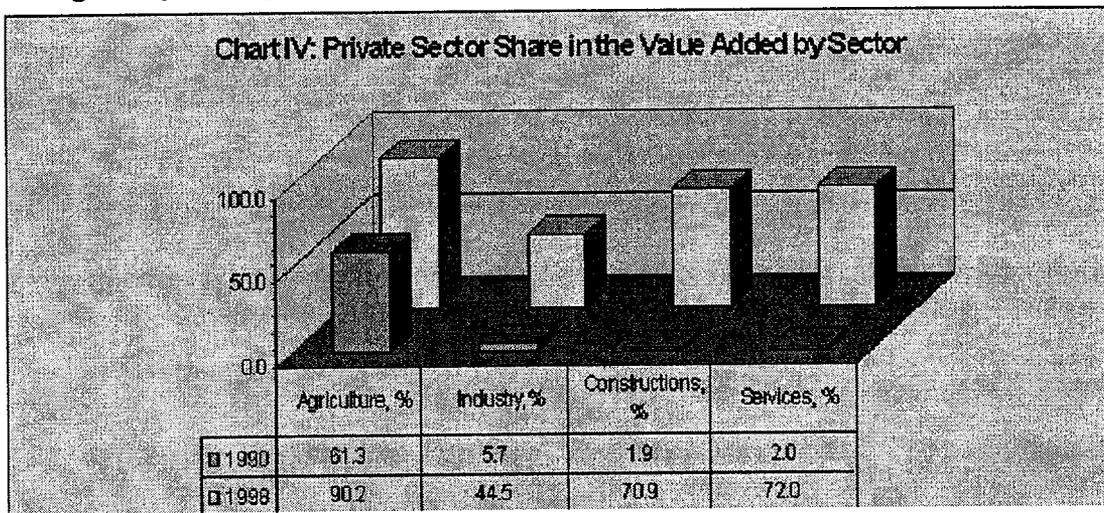
1/ Indicates the Lowest Level of GDP Since the Beginning of Transition

The private sector is more resilient than the economy in general – it continued to improve its position in the GDP even during downturns (see Chart III).

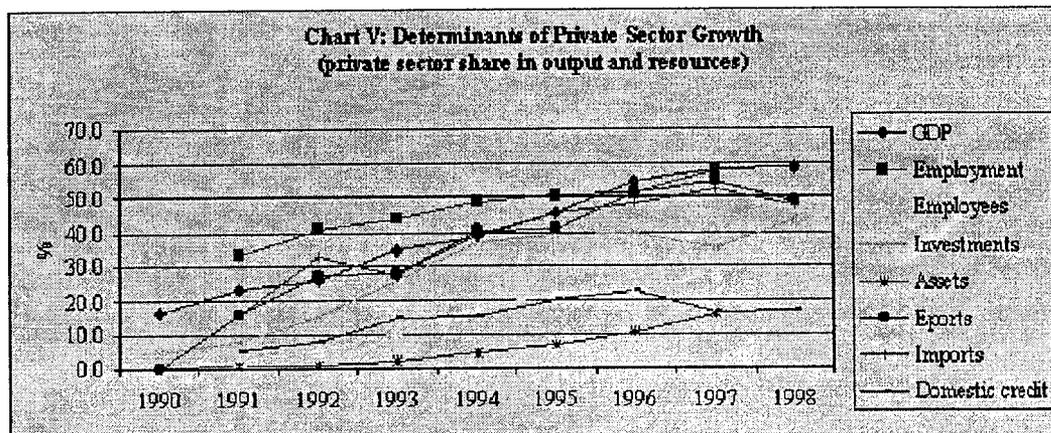


At the same time, there are wide disparities in the participation of private firms to the economic activity in different sectors: agricultural production dominates at over 90 percent of the private sector since 1990 (and for certain products even before), followed by services and construction. Industry remains behind, with only a 44.5 percent contribution to the value added by the sector.

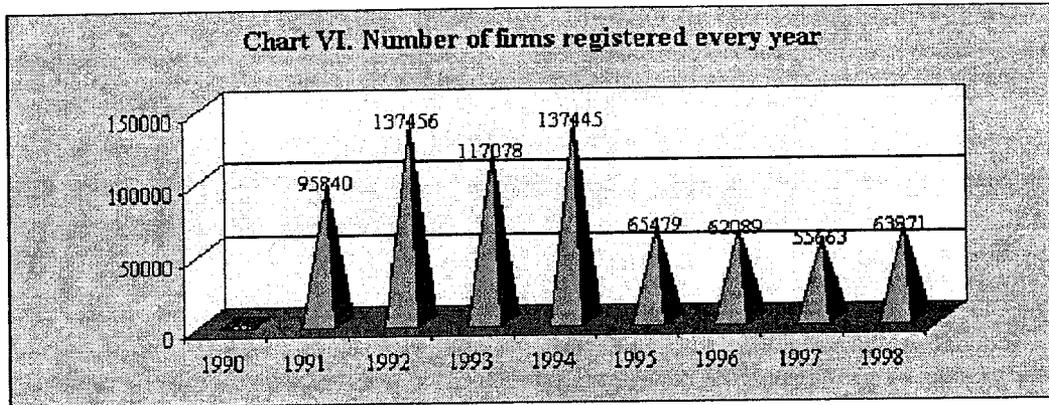
Private sector development (as reflected by its growing share of GDP – see Chart V) is strongly correlated with the rise of employment in the private sector and with the private sector’s participation in foreign trade (both imports and exports). The growth of the private sector is also related to its investments. However, the private sector is still utilizing a very small proportion of



the resources in the economy - less than 20 percent of the fixed assets and of the domestic credit. Employees in the private sector represent only 27 percent of the total number of employees, as most of the agricultural production is obtained using family labor.



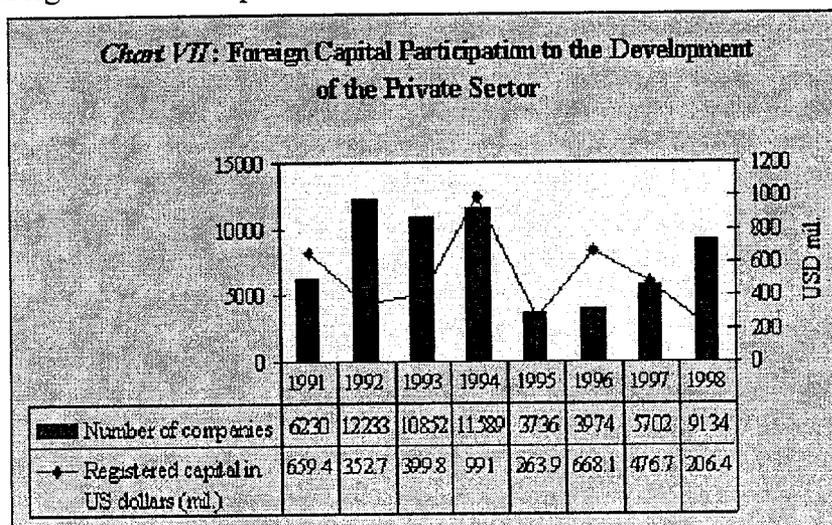
The private sector is clearly dominating by number - an overwhelming majority of 98.4 percent of the total of 761,842 economic agents registered with the National Trade Register between 1990 and May 1999 are private^[7]. Most of these private entities (641,163) are organized as commercial companies, but there are also over 100,000 self-employed entrepreneurs and 5,000 cooperative organizations. The majority of these firms were set up in the period between 1991 and 1994 (see Chart VI).



It should be noted, however, that the total number of registered private economic agents is to be considered cautiously. It is a well-known fact that many of the registered companies are in reality economically inactive – only half of the registered firms regularly submit their financial statements as required by the law and, on many of them, the basic identification data is missing or inaccurate. More than 230,000 limited liability companies failed to increase their capital to the minimum level imposed by a 1997 amendment to the Company’s Law – an indication that these firms are in fact defunct.

The number of economic agents is not an accurate measure for the “entrepreneurial spirit” either. Many private entrepreneurs were prompted to create a series of firms in order to extend the fiscal facilities granted to new firms until 1995. Sometimes, new “clean” firms were created in order to obtain credit from banks. And there is no doubt that firms were set up as a mere shell for underground activities.

There are over 66,000 foreign owned companies that invested over USD 4 billion since 1991 (Chart VII).



Most firms, both domestic and foreign, are dedicated to wholesale and retail sales activities, but the largest proportion of capital is invested in industry.

Typically, private firms are small (Table 2); micro-enterprises (less than 10 employees) account for more than 92 percent of the total number of private companies. However, the activity is concentrated in the medium and large companies, which make up for 36 percent of the total turnover of the private sector, although it represents only 1.3 percent of the number of firms.

Table 2: Distribution of Private Companies (Number and Turnover), by Size Categories (in Percent)

	1994		1995		1996		1997	
	Number	Turnover	Number	Turnover	Number	Turnover	Number	Turnover
Total , of which:	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
- Micro (0-9 employees)	95.1	54.5	94.7	49.0	93.1	40.9	92.2	37.2
- Small (10-49 empl)	4.0	19.7	4.3	21.1	5.7	24.8	6.5	27.2
- Medium (50-249 empl)	0.7	13.7	0.8	14.0	1.0	15.6	1.1	17.9
- Large (over 250 empl)	0.2	12.1	0.2	15.9	0.2	18.7	0.2	17.7

Source: Comisia Nationala pentru Statistica, *Evolutia Sectorului Privat in Economia Romaneasca (1990-1997)*, Editia 1998

While small firms' share in total turnover declined between 1994 and 1997, large firms increased their share in the total turnover. As a result, a major structural shift took place in 1998 when privately owned companies outnumbered the state owned ones in the *Romania Top 500* companies classification (CEMATT, 1999). But with very few exceptions, all private firms in the Top 500 are either former state companies recently privatized or owned by foreign capital: **domestic new firms remain typically small and very small.**

In general, small firms tend to achieve better economic performance (Table 3), especially in labor-productivity related indicators. This is related to the fact that the private firms are more profitable than the state-owned ones: in 1997, 60 percent of the private firms concluded the year with a profit and 29 percent with losses, while among the state-owned firms a similar proportion (57 percent) of firms ended the year with a profit, but a substantially higher proportion (41 percent) registered losses.

Table 3: Economic Performance and Size of companies (relative position, national average = 1)

Classification By Size of Firms	Turnover/Employee		Gross profit/Employee		Turnover/Investment	
	1996	1997	1996	1997	1996	1997
	National average	1.00	1.00	1.00	1.00	1.00	1.00
- Micro (0-9 Employees)	2.46	1.41	2.61	1.33	1.51	1.18
- Small (10 – 49)	0.63	1.51	2.17	1.96	0.35	0.68
- Medium (50 – 200)	0.90	0.86	1.14	1.28	0.82	0.68
- Large (over 200)	0.68	0.83	0.54	0.67	0.89	1.28

Source: [ZAMAN, VILCEANU. 1999a]

The discrepancy between the private and the state firms is even more evident when the volume of profits and losses is considered (Table 4). State firms produce only 7.4 percent of the profit in the Romanian economy and 21 percent of the losses, while private firms contribute 80 percent of the profits and 43 percent of the losses. If the balance for the total economy ended positively, this is due exclusively to the private sector which compensated for the negative balance of the state and mixed sectors.

**Table 4: Distribution of the Profits and Losses
among Private and State firms in 1997**

	Gross Profit		Gross Losses		Difference
	ROL bln.	%	ROL bln.	%	ROL bln.
Total Companies, of	29221.3	100.0	23165.6	100.0	+6055.7
which:	23429.3	80.2	10081.2	43.5	+13349.1
Private	2169.8	7.4	4786.4	20.7	-2616.6
State	3622.2	12.4	8298.0	35.8	-4675.8
Mixed					

Source: [Zaman, Vilceanu, 1999b]

The better financial performance in private firms is related to generally lower wages (Table 5).

**Table 5: Wage Differentiation Between the Private and Public Sector
Mean Private Sector wages, as a Percent of the Corresponding Mean Values in the Public
Sector, 1996**

	Public Sector Wages = 100
Industries	-
Agriculture	96
Extractive Industries	52
Manufacturing	84
Power, Gas, Water	66
Construction	99
Trade and Tourism	78
Transport, Communication	87
Finance	82
Real Estate	132
Education	77
Health Care	80
Social Services	88
Main Occupational Groups in the Manufacturing Sector	94
Managers, Intellectual Occupations	102
Technicians, Clerical Staff	
Manual Jobs:	89
- Machine Tool Operators, etc.	83
- Other Specialized Workers	87
- Unskilled Workers	

Source: *OECD Economic Surveys Romania*, February 1998, p.129

A much more comprehensive and nuanced portrait of the private sector firm may be drawn from the statistical survey performed by the National Commission for Statistics (see Appendix 5). Private firms are not only smaller in terms of employment (the average number of employees is four times lower in private industrial firms, as compared to state firms), but also in terms of capital (the registered capital in industrial state firms are, on average, 18 times higher than the share capital in a private company). On average, turnover of state firms is five times higher than that of private firms – but the turnover per employee is only 33 percent higher. State firms outperform the private ones in exports and in the value added. They do also spend more per employee – wages in private firms tend to be lower than in state ones. In exchange, private firms are more profitable (their operating surplus is 13 percent higher than state-owned firms) and invest more out of their own resources. The same findings do apply (with some adjustments) to other sectors – construction, trade, services and even agriculture.

The Ingredients of Economic Success: Entrepreneurs...

Whatever progress Romania has achieved until now in transition, it is due to a large extent to the struggle, initiative and risk-taking attitude of hundreds of thousands of individuals who chose the adventurous path of building a new, different future for themselves and their families. The entrepreneurs are largely recognized today as the driving force of economic progress and, in transition countries, they are also supposed to be on the frontline of reform.

But along with the merits, the Romanian entrepreneurial class is also sharing the responsibility for the failures of economic reform and an accurate view of their role should account for both the merits and failures.

But who exactly are the entrepreneurs we are talking about? Throughout the present section, we will focus on a sub-division of the entrepreneurial class, loosely defined as “those who count” in shaping the functioning of the economic system and who influence its evolution. A large number of the “entrepreneurs” as defined by statistics—like the agricultural family-farmers, some small economic organizations and a good part of the self-employed - are not directly our subject here.

The entrepreneurs’ position and role in the development of the private sector in Romania is the result of specific circumstances that presided their emergence as a socially distinct group and the particular features of their subsequent evolution. Early studies (Costariol, 1993, p.23) noticed two basic differences between Romanian entrepreneurs and typical West European entrepreneurs: a) different social origins of the entrepreneurs, and; b) the different approach, attitude and expectations they have towards business^[8].

Because the chain of familiar handicraft tradition was broken during the communist regime in Romania and the number of entrepreneurs who had been trained in the field as workers or junior technicians in large-scale enterprises is very limited, the two main categories that form the backbone of Western European entrepreneurs (sons of traditionally entrepreneurial families and former blue-collar workers employed in the large scale industry) are almost completely missing. Instead,

the typical private entrepreneur in Romania is a first-generation person, middle aged, mainly with previous experience in a managerial position with large scale state-owned companies or, if he is young, usually with a University education. (Costariol, 1993, p.24)

This is due to the fact that workers and technicians in large state companies were given little personal

responsibilities as to the performance achieved by their units and therefore they now know how, organizational skills and decision capabilities needed when undertaking entrepreneurial activities. At the same time, white-collar personnel had better access to the key business knowledge with

Information concerning strategic factors like the market, clients, suppliers of raw materials, financing, etc., accompanied by low salaries in their declining companies, give former managers a better chance to start an often profitable business. This is especially true in a rapidly changing and very troubled system where a client is of greater use than any technical ability. (Idem, p.24)

There are several important consequences deriving from that structural feature of the entrepreneurial class in Romania:

- a) On the whole, the entrepreneurial class in Romania benefits from a higher educational level compared to other European countries. But at the same time, it is rather short on practical experience in real industrial work and is therefore lacking in manual and technical abilities. This implies that the Romanian entrepreneur does not look forward to embarking upon a manufacturing venture, where he usually feels a stronger vocation towards commercial and sometimes also speculative activities (one of the reasons manufacturing companies are a minority among the newly established enterprises)
- b) Because of their higher social class origins, Romanian entrepreneurs are somewhat insensitive to the issue of mutual solidarity and reluctant to associate with one another. Private entrepreneurs lack an associative spirit in general and are scarcely inclined to group themselves into strong, well-organized associations. There is a profusion of competing business and professional associations, each claiming to be the “authentic” representative of the business community.
- c) Most private businessmen perceive the business environment as being absolute competition and see, though every other enterprise was a dangerous adversary, rather than a potential partner. This attitude frequently prevails within the enterprises themselves, where personal ambitions and mistrust between partners generate conflicts and leads to splits and break-ups. Vertical and horizontal integration and consolidation in general is hindered, contributing to the weakness of the Romanian private sector.

But by far the most significant consequence of the white-collar, managerial origins of the Romanian private entrepreneur is its special relation with the state and state companies:

- a) Many private ventures were from the start conceived to gravitate around a state company. Although some of them are legitimate and respectable businesses, in a very large number of cases they are devices aimed at siphoning profits and assets from state companies into private hands. The simplest and best known mechanism is the “tick firm”:

Two SRL (limited liability companies), usually having deep roots in the political environment, were placed on the “outputs” circuits of a state enterprise. The first one is selling the raw materials at higher prices. The second one is buying the production cheaply. The “tick firms” are prospering, and the guest company becomes, in a few years, a true “beneficiary” (Cercescu, 1999)

Some authors go even further and consider that:

after 1989 the capitalist class was formed mainly on the account of the state by rape of real estate, fixed assets and the capital of state enterprises and organizations. ... From state plants’ directors that tacitly transferred to their wives’ titles, equipment, raw materials, contracts and bank loans guaranteed with state property, to managers of import-export or

privatized overnight to continue the operations and cash the dollars into their own accounts, to the relatives of former CPEx (Communist Party Political Executive Committee) members and directors in the old financial institutions promoted as heads of the new banks, they all demonstrated an extraordinary business ingenuity that procured them billions. (Brucan, 1999, p.37)^[9]

b) The “special relation” is not limited to state companies but is spilling over to all state institutions

the only form of survival (for the private entrepreneur) was, during the last ten years, the alliance with the political-administrative apparatus. The entrepreneurs that resisted in time did comply with that unwritten rule. (Margarit, 1999)^[10]

prompting some analysts to declare that

Romanian capitalists are a product of the Romanian State and, as such, they are an annex of the state. (Boari, 1999)

c) When the political dimension is added to the list of “special relations” between the private sector and the state, the resulting picture is what is usually called “crony capitalism”. In fact, “crony capitalism” is the continuation of the old “kinship socialism”:

The practice of the old *nomenklatura* of promoting its interests through the politization of economic activities takes, in post-communism, the form of the so-called “crony capitalism” – deeply related to the kinship socialist economy that generated it. The old economic order is therefore shaping the power relations that define the new “order”. (Palade, 1999)

Other authors see the private sector more like a victim of a battle between the “industrial elite” and the “financial elite” for controlling political power.

The private sector was too dependent on the (public) administration, whose approvals and decisions were indispensable for any successful business, to be in a position to assume a political conflict with it. (Instead, the private sector) preferred to accommodate, trading the uniformity of economic rules and mechanisms for the singularity of the decision bought through bribery. This allowed them to continue their business and maintain their profits even without getting a first ring position in the power system. So they finally turned out as an unreliable and duplicitary ally. A similar position adopted the foreign capital, capable of accepting any rules, including the one of breaking any rule if this can secure the success. (Pasti, 1995, p.309)

An extremely severe diagnostic is derived from this analysis.

Today, in Romania, we are dealing with a **closed economy** that relies in its functioning on the collusion of interests between the state apparatus and an exclusive category of “entrepreneurs”. **This alliance sets the structural conditions for the functioning of the economy in Romania.**

(Boari, 1999)

Understanding the basic, structural relation established between the state and the entrepreneurial class helps explain some otherwise surprising facts. The ambiguous attitude of Romanian entrepreneurs towards the state is one example: the state is to blame for almost all bad things that happen to the business, but it is the state they turn to when looking for solutions. And the solutions demanded are not of a liberal type as one might expect from private entrepreneurs (the “minimal state” perspective), but are strongly interventionist (the state should actively protect specific interests – bakeries, poultry farms, furniture producers etc. - by extending subsidies, increasing import tariffs, allocating funds and other resources to specific groups etc.). Every meeting organized by the different entrepreneurial associations is concluded by a document proposing solutions for a turnaround of the national economy; but these “solutions” are nothing more than “wish lists”.

...almost all schemes that, at least in intention, aim at stimulating the economic growth, are based on facilities, exemptions, discrimination, subsidies, protection against competition etc., that is on all elements needed for rent-seeking to remain a *modus*

vivendi in the economy. (Croitoru, 1999)

In general,

Against a background of absence of an anti-state spirit, we do find an activism dedicated to promoting and concluding “deals” with the state to reap privileges, favors, protectionism and rents. (Munteanu, 1999)

The collusion between the state and the private sector also accounts, at least partially, for the aggravation of the crisis during the downturn after 1997. Because of its dependency on the state, the private sector was not capable of taking over and playing a locomotive role in restructuring. Instead, the private sector was itself severely hit and contributed to the economic contraction.

The affinity of the private sector to state firms makes the two almost indistinguishable in their manners; many state companies take the liberty of behaving like private firms and some private entities enjoy the privileges of state protection and support. *Credit Bank*, a “private” financial institution having state companies as the main shareholders, was such a strange combination whose private character was related mainly to the interests it served (see the Dossier in the Appendix). *Banca Dacia Felix*, another private endeavor in the very lucrative financial sector, succeeded to get around 2000 billion lei from the National Bank before going bust.

But maybe the most harmful consequence of the “state capitalism” system that dominates economic life is that it makes it very hard for many other entrepreneurs who are not “part of the system” to survive and prosper and for free markets to function properly. The media has recorded hundreds of examples of Romanian or foreign entrepreneurs who give up or are defeated in the battle with the “state capitalism” system. Genuine success stories are rare, but very precious because they give reason for hope (see Europharm Dossier in the Appendix).

... and Business Environment

A minister of the Romanian Government recently remarked that:

The business environment in Romania is extremely hostile to investors. It is rendered hostile by corruption and by the bureaucratic system of approvals for any action an investor takes. I have no doubts now that Romania is offering today such a hostile environment. (Minister Traian Basescu, quoted by Oanta, 1999)

Romanian and foreign entrepreneurs have long complained about it. Up to a point, these complaints are not unusual – businessmen everywhere tend to grumble about taxes or cumbersome regulations. Transition economies, confronted with the huge task of re-building the whole institutional system in a very short period of time, have explicable difficulties in harmonizing all the different aspects of the business environment and in making it work. Therefore, the situation in Romania should be treated with a certain tolerance.

But what is really disturbing in Romania’s case is that over the last few years, instead of an improvement, the business environment seems to have deteriorated. The latest *Economist Intelligence Unit* survey on the issue is placing Romania among the most “toxic” environments to business, after Russia, Indonesia and Pakistan (*The Economist*, 1999 p.138). A similar conclusion was reached by a study prepared for the Romanian government: out of 130 countries analyzed, Romania is among the 20 most constraining fiscal and administrative regimes.

Practically all elements that compose the business environment are inadequate. We will not insist here on more general aspects like macroeconomic stability, competitive markets, hard budget constraints, property rights, etc. that have been examined in various instances and by different authors. My aim here is to present the business

environment as it is perceived by private entrepreneurs, focusing on the problems most important to them.

A clumsy and extremely volatile **legislative framework** is, according to many business owners, a major source of uncertainty in business. There is a profusion of laws, government decisions, instructions and regulations that create confusion because of their ambiguity, contradictory provisions and frequent changes. Legal norms that are crucial for business are modified again and again: a title like “Law of the Government’s Emergency Ordinance no. 50/1998 for the modification and supplementing of Law no. 82/1997 regarding the level of the excise duties and other indirect taxes” is a common reading in the *Romanian Official Gazette*. The excessive use of government ordinances as legislative instruments is itself a major source of uncertainty – such an ordinance is abruptly passed, without due review and reaction from interested parties, and is almost certainly changed later on by the Parliament. To add to the confusion, the legal systems (the pre-war, the socialist and the transition one) coexist, with many laws that were never explicitly abrogated invoked by bureaucrats when an initiative is to be obstructed.^[11] The approximation to EU law – an obligation Romania assumed as a candidate to integration – was never addressed in a systematic manner. A well-known journalist was summarizing the situation:

One of the reasons foreign investors bypass Romania is the legislative instability. We do not have laws, the ones we have are not adequate for the times Romania is traversing, the ones we make are wrong. When they are not wrong from the outset they do not conflict with old, non-abrogated ones, even though they are conceived with best intentions among others. In order to harmonize the Romanian legislation with the European one, they do leave too many doors open and tricks (that can be used in order to defy them, the instructions for application are poor and we do nothing in order to implement them. (Munteanu, 1999)

The cluttered legislative framework is putting a lot of pressure on the **judicial system**, which is itself not equipped to handle the task. Lack of instances, judges and lawyers specialized and experienced in business matters is part of the problem. Long, complicated and therefore costly procedures push interested parties to devise side arrangements, often creating a favorable environment for corruption. Private firms, especially the small ones, do not have the resources to fight long legal battles, while large state firms are practically immune to the execution of sentences.

But the situation in the legislative and judicial area is only creating conditions for the **public administration bureaucracy** to develop the most elaborate anti-business practice. A combination of incompetence, apathy of public servants to assume responsibility, widespread mistrust in their loyalty and correctness, and political interference in decision-making—reinforced by strong residues of the old communist hyper-centralized system—the individuals’ and institutions’ memories and conduct—confront entrepreneurs with the most absurd, often nightmarish situations.

To set up a firm, an entrepreneur has to obtain 95 signatures of approbation from 15 different institutions; of these, 5-6 sets of documents have to be presented and, as usually something is missing or has an inadequate form, certain steps are repeated several times (Pais, 1999). Local authorities have a heavy hand in running these procedures and are frequently accused of inhibiting private initiative. A private entrepreneur who endeavored to build a USD 1.2 million hotel in the Danube Delta declares:

The Tulcea district is still communist. The local authorities would do anything to block private initiative. Why? Because money can be plundered more easily. I do note down every outlay when there is a matter of protocol, as well as when (officers) from the (Financial) Guard come to have a meal. They even asked me what I do, why do I note it down and I told them that everything is to be registered in the papers, because I do not want to pay from my own pocket for their meals. The building permit took one and a half years to obtain, while the construction itself was done in just one year and two months. The reason is Tulcea authorities’ mentality, they want to block any private initiative. I had to pay bribes in order to obtain the legal documents. They were asking me all kind of absurd things. For example, in order to get the license for using water from the Danube (to supply the hotel), I had to submit the written consent of the owner of the dam that I used. Well,

was built by myself. They wanted me to write down a paper mentioning that Mr. Gaina is consenting to use the dam made by himself for water supply.

(Marinescu, 1999)

The onerous and inefficient bureaucracy is accompanying the private firm throughout its life; any change in the firm's legal status or activities entails repeating the same procedures, with another set of documents (the old ones are rarely found in the inadequately organized and poorly housed archives of different institutions). Even closing down a company becomes a complicated matter.

Cosmos Development SRL was a small firm set up in 1992 in Bucharest, dedicated to consulting, editing and publishing different economic periodicals. Its single partner, a foreign natural person, decided to close the firm because its business interests moved to different horizons. He started the required procedures in May 1998, pretty confident that for a single partnership, without any third-party liabilities, it should be a simple matter. 18 months later he was still jammed in the process. The stumbling stone was the fiscal certificate that is to be delivered by the fiscal authorities. After many meetings between the accountant of the firm and the tax officer, where some questionable but minor critical remarks resulting in around USD 50 due payments were solved, the delivery of the certificate was still delayed. The tax officer proposed a "private meeting" to finalize the operation, but the owner of the firm refused. Meanwhile, the tax office was re-organized and moved to a different location – all previous files became impossible to trace. The firm is now one of the several hundreds of thousands of "dead-alive" private firms that are cluttering the trade register records.

Taxation and the fiscal system are among the main causes of discontent for private entrepreneurs. The high level of taxation is suffocating business – that is a recurrent complaint (and of course not an original one) on which all entrepreneurs, small or large, domestic or foreigners, share a common judgment. Entrepreneurs claim taxes take up more than 50 percent of their revenues. Ministry of Finance experts counterattack by showing that, compared to other European countries, the level of taxation (around 30 per cent of GDP) is moderate. Although it seems paradoxical, both figures are correct. The average taxation is around 30 percent of GDP, but the average involves a lot of exemptions and non-payments (due mainly to large state enterprises); therefore, a private company may well be paying more than 50-60 percent of its net income or of its value added as taxes. The heaviest taxation is applied to the most efficient, highly value added activities, where wages are taxed at the marginal rate of 45 per cent.

The dispute over the tax level is lately confused by an innovative approach to taxation adopted by the authorities – the "special funds". "Special funds contributions" are *ad-hoc*, special-purpose taxes levied directly by ministries or other public institutions. They are approved by law or (usually) by government ordinances and have a disruptive character – they come unexpectedly and can derail the most cautiously prepared business plan. One of the first such special funds was the "agricultural workers pension fund," a contribution aimed at providing former cooperative workers with a pension after cooperative farms were dismantled. As the contribution is paid for by the agricultural, food producer and distributor chain, an estimated 10 percent increase in food prices results from this tax.

During the last two years as the constraints on the state budget deficit increased because of strict conditionalities imposed by the IMF agreements, different Ministries set up their own, independent budgets fed by newly devised taxes and contributions. The Economic Reform Fund, the National Cultural Fund, the Social Solidarity Fund for Handicapped Persons, the Fund for Development and Modernization of Customs, the Fund for Film Production, etc. – according to some estimates, over 20 such funds exist now but nobody, including the Ministry of Finance, knows exactly how many such funds exist.

The special fund is one of the greatest tricks ever invented in the domain of fiscal legislation. Not sufficient resources in the budget for education? We create a special fund. Now, all employers have to pay a wage-related contribution for education. The

Romanian tourism is agonizing? A special fund, to which all those having the slightest relation with tourism should contribute, is the rescue solution.... The special fund is a direct consequence of the restructuring in the public administration. Instead of cutting down the number of bureaucrats, the ministries create a special fund. As the fund has to be administered by someone, a special direction, a department, an agency or any other institution is set up, with a resonant name. In many cases, half of the money collected in the special fund is spent on paying salaries for the administrators, on offices, cars, materials and pens. In other cases, the special funds indicate a poor management of the state budget revenues. Professor remuneration is an example. It is the State's obligation to pay professors in the state schools out of the taxes it collects. Because the state is not capable to do so, it institutes a special fund for education. In other words, we pay twice for the same worthless result: schools with no water, professors living on miserable remuneration and classrooms with no desks. (Rosca, 1999)

In addition to frequently being a double taxation, the noxious character of special funds is related to the fact that they are escaping the usual political and even administrative controls.

The fiscal environment is also made difficult by frequent changes in regulations. A law is passed granting certain fiscal facilities to investors and, only months later, it is repealed through the state budget law. Excise duties and value added regulations have been changed several times in one year.

Accounting rules and changes in accounting norms also have a dramatic impact on taxation. Romanian firms pay "taxes on inflation" as the accounting norms (prepared by the Ministry of Finance) are not in line with the provisions of the IAS 29 standards (International Accounting Standards for hyperinflationary economies). Therefore, many firms get decapitalized by paying taxes on apparent revenues.

Besides the level of taxation and the ever-changing and inadequate fiscal regulations, the fiscal regime is aggressive to business in its practical, daily application by the bureaucrats in the fiscal administration. Tax officers have a deeply rooted attitude of suspicion, especially in relation to private firms that are presumed, by default, to have fraudulent intentions and practices. Internal regulations in the Ministry of Finance and within the Financial Guard prompt inspectors into having a biased approach when investigating a firm. If they conclude an investigation with sanctions and penalties, 15 percent of these penalties are contributed to a fund used to supplement the compensations received by the Ministry of Finance personnel. Recently, the Minister of Finance issued an order which imposed minimal targets on revenues resulting from sanctions and penalties applied to economic agents for every regional fiscal administration. Failure to realize the minimal target prompts pecuniary penalization for the personnel in the fiscal administration and even layoffs. In these circumstances, entrepreneurs do frequently hear from tax inspectors coming to investigate their firm with the statement: "I will not leave until I find something".

Abuses are frequently reported – but they are quite difficult to prove. The most common is excess investigation. According to a survey made by the Confederation of Private Entrepreneurs in the Timis county, several private firms complained they had been investigated several times successively within a short period (30-45 days), on the same issues, and every time fines were applied. There are reports of firms being investigated 250 days in one year by the many different, independent and uncorrelated institutions. As again Minister Basescu states:

Public institutions may kill a business if they want to. It only takes to be a disagreeable businessman and you have 15 inspections that will destroy your business. (Mediafax)

The ambiguities in the norms and regulations leave plenty of room for fiscal officers to place sanctions and fines. When several interpretations are possible on a specific norm, the one less favorable to the firm is applied.

Few entrepreneurs attempt to fight fiscal administration decisions. Procedures are long, complicated and costly. Before going to Court, several settlements are provided for in the fiscal administration system itself. During the

first six month of 1999, the General Directorate for Complaints Resolution in the Ministry of Finance received 2,390 petitions. Until September, only 1,523 have been solved (and only 583 companies received a favorable resolution). (Preoteasa, 1999). Many claims get lost in the bureaucratic system before a resolution is reached – time is playing in favor of the administration.

Societe Generale Corporate Finance Advisory is the Romanian subsidiary dedicated to investment banking of the multinational bank Societe Generale. After one year of activity, the firm asked for the restitution of the value-added tax it had paid during the year on goods and services acquired. Two inspectors spent two weeks checking all company books that were kept by the accounting and auditing firm KPMG. In their final report, the tax officers contested almost half of the VAT claimed. SG-CFA and the KPMG accountants prepared and submitted their “objections” to the report conclusions as provided by the law. Although the law provides an answer should be given within 30 days, the financial administration never replied. At the insistence of the claimant, the tax officers said that the answer had been sent by mail – but they could not produce any evidence. As the next steps of the procedure cannot be initiated prior to having a solution to the first “objections”, the firm was practically blocked from pursuing his rights. In the meantime, the value of the sum involved is reduced to half by devaluation.

No wonder many private firms prefer “shortcuts” – if not straight bribery, then at least more sophisticated arrangements, by which tax officers are paid as “accountants” or “tax consultants” by the firms they are supposed to investigate.

Restricted access to institutional financial services is another obstacle to private firms. Because of the high and variable inflation rates, interest rates on lending are prohibitive for many businesses. To cover risks, banks tend to have very large spreads. As long as the treasury is hungry for money to finance the fiscal deficit, banks have no appetite to lend to the companies. Many companies lack collateral and so are frequently denied access to necessary financing. While financial intermediaries are often reluctant to lend to small private enterprises for sound financial reasons (such as the high transaction cost of monitoring), badly functioning financial systems, ineffective laws on collateral and poor enforcement of financial contracts also limit access to credit. Once again, the most effective method to obtain credit is not a good business plan, but a good introduction to the bank. Several banks have now failed because of their crony lending practices.

The lack of **adequate governmental policies** for the private sector, and particularly for the small and medium enterprises, is also mentioned by private entrepreneurs and their organizations as one of the major impediments to growth and expansion. Special laws and provisions were passed at different moments (Government Ordinance 25/1993 and, recently, Law 133/1999) aimed to support private firms through subsidies, fiscal incentives and other preferential treatments. But their effect was almost null – the legal provisions were much too general to have a practical impact and, when more specific, they were not supported by adequate resources.

The governmental policies based on preferential treatment for certain sectors or groups of companies have rarely produced positive results. Instead, they contributed to the creation of a distorted system of incentives, encouraging SMEs to become dependent on subsidies and inhibiting their growth. But very few entrepreneurs, not to mention politicians, in Romania do realize that. By asking for special treatment and favors, they open the back door for bureaucrats to get back in business.

Conclusion: From State Socialism to State Capitalism

The conditions of the new private firms in transition are a good illustration of what has been achieved in Romania after ten years of economic reform. The collapse of the old socialist central planning mechanism and the

emergence of new privately owned firms were not sufficient to put in motion a fully market-driven economic system. Instead, a hybrid system seems to form in which bureaucrats in state institutions have an important role in allocating economic resources and distorting competition in favor of their protégés. Entrepreneurs whose main capital was made through relations now dominate the business. All the others are struggling to survive by adjusting to the conditions.

Instead of creating a truly independent and self-reliant private sector, the Romanian transition has produced a state-compliant and state-dependent private sector. But this may be an inevitable stage of the transition. What is really worrying in Romania's case is that the process seems to have stopped here:

Romania got stuck in the first stage of the transition. A certain sector, formed either by people from the old *nomenklatura*, or by individuals who oriented themselves very rapidly in the interstices, created and knew how to take advantage of the opportunities of the initial period, produced a zone of economic and social supremacy, acquired sufficient economic strength and has no interest in generating a second phase where competition may lead to losing its monopoly. (Tismaneanu, 1999).

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Appendix 1

Estimated Private Sector Share in GDP and Employment in Selected Transition Economies, 1991-1998

	1991	1992	1993	1994	1995	1996	1997	1998H1	1991	1992	1993	1994	1995	1996	1997	1998H1
	% in GDP								% in employment							
Bulgaria/1	19	26	35	39	48	53	59	53	10	18	28	36	41	47	55	...
Croatia/2	25	35	41	45	45	50	...	55	22	27	37	47	48	51	51	...
Czech Republic/3	17	28	45	56	64	75	75	75	19	40	60	64	76	78	...	...
Hungary	33	44	52	...	60	70	...	80	...	...	...	...	...	...	...	...
Poland	45	48	54	56	60	78	79	78	51	57	58	60	...	64	64	75
Romania	24	26	32	35	40	60	58	60	34	41	44	51	51	...	...	65
Slovak Republic/4	...	22	25	44	60	77	83	83	13	18	22	32	...	...	...	...
Slovenia/5	16	20	...	...	48	45	60	55	12	16	19	22	48	...	...	...

Source: IMF Staff Country Report No.99/26, *Bulgaria. Recent Economic Developments and Statistical Appendix*, Table 33

1/ According to the Revised National Classification of Economic Activities from 1996. The change in definition resulted in a step increase of 3.5 percentage points in the share of GDP in that year

2/ End-of-year data; employment data for the period before 1993 includes only 100 percent privately owned firms; from 1993-1994 mixed firms with more than 50 percent private ownership and transformed firms are also included. Data for 1996-1997 is according to the revised definition of the labor force. Tentative estimates.

3/ Shares of GDP estimates are for the "non-state sector"; private sector employment includes mixed ownership.

4/ Before 1994, firms with mixed ownership were excluded from the definition of the private sector. Since 1994, such firms were included in the definition of the private sector.

5/ Excluding socially managed enterprises.

Appendix 2

The Private Sector in the Romanian Macroeconomic Context

	1990	1991	1992	1993	1994	1995	1996	1997	1998
GDP, bln. ROL	857.9	2203.9	6029.2	20035.7	49773.2	72135.5	108916.6	250480.2	338670
Private Sector Share of GDP, %	16.4	23.6	26.4	34.8	38.9	45.3	54.9	58.1	58.4
GDP Indices - 1989=100	94.4	82.2	75.0	76.1	79.1	79.1	84.7	79.0	73.3
Private Sector Share of the Value Added in:									

Agriculture, %	61.3	73.9	81.7	83.5	89.3	89.0	90.1	92.2	90.2
Industry, %	5.7	9.2	11.8	17.4	23.3	29.0	38.5	43.4	44.5
Constructions, %	1.9	16.1	21.0	26.8	51.6	57.8	69.2	71.9	70.9
Services, %	2.0	16.8	18.8	29.3	39.1	58.1	66.7	70.8	72.0
Employment, Thousands of Persons	10840	10786	10458	10062	10011	9493	9379	9023	
Employment in the Private Sector, Thousands of Persons		3621	4284	4402	4923	4815	4828	5186	
Employees, thousands of Persons	8155.6	7573.8	6887.5	6671.7	6438.4	6160.4	5938.7	5597.0	
Employees in private sector, thousands of Persons				727.0	1129.0	1361.0	1366.0	1559.0	
%	0.7	2.4	5.3	10.9	17.5	22.1	23.0	27.9	
Investments, bln ROL	168.0	314.0	889.0	2822.0	8005.0	12995.0	20945.0	44135.0	45343
of Which, Private Investments, %	4.3	8.1	15.6	26.0	36.8	39.3	39.7	35.4	43
Fixed Assets, bln. ROL	3498.0	4505.0	23217.0	26583.0	33811.0	169866.0	188934.0	242714.0	
Private Ownership, bln.ROL	22.0	49.0	282.0	597.0	1523.0	11230.0	20380.0	36939.0	
Foreign-owned, bln.ROL				1.0	16.0	118.0	523.0	1751.0	
Exports FOB, USD mil.	5775.4	4265.7	4363.4	4892.2	6151.3	7910.0	8084.5	8431.1	8302
of Which, Private Sector, %	0.2	15.9	27.5	27.9	40.3	41.2	51.4	54.8	49
Imports CIF, USD mil.	...	5793.4	6259.6	6521.7	7109.0	10277.9	11435.3	11279.7	11838
of Which, Private Sector, %	...	16.1	32.8	27.2	39.2	45.4	48.3	52.4	48
Trade Balance, USD mil.	...	-1527.7	-1896.2	-1629.5	-957.7	-2367.9	-3350.8	-2848.6	3536
of Which, Private Sector, %	...	16.8	45.1	25.0	31.9	59.4	40.7	45.2	47
Domestic Credit, mil ROL, End of Year	610208	1321288	1778368	4263611	9183376	17399015	31450022	47431996	81288969
Non-government Credit, mil ROL, End of Year	683955	1375159	1912770	4901977	9484528	16435380	26841440	35900662	59086517
Credit to Private Sector	...	64379	141702	641919	1403754	3513833	7225435	7808985	13901667
- Short-term	...	45028	104972	529515	1176675	2801363	5648703	6169448	11463601
- Medium and Long term	...	19351	36730	112404	227079	712470	1576732	1639537	2438066
Exchange Rate ROL/USD (Year Avg.)	22.4	76.4	308.0	760.1	1655.1	2033.3	4035.0	8023.0	10951

Source: Various publications of the National Commission for Statistics and the National Bank

Appendix 3								
The Private Sector Position in the Romanian Economy								
Share in:	1990	1991	1992	1993	1994	1995	1996	1997
Gross Domestic Product	16.4	23.6	26.4	34.8	38.9	45.3	54.9	58.1
Industrial Production	...	1.3	3.2	6.2	12.9	20.7	24	26
Agricultural Land	12.6	69.8	70.3	69.9	70.1	72.3	72.3	70.5
Under Crop land	28.4	78.9	80	78.5	79.5	81.4	80.9	81.6
Agricultural Production	56.1	79.3	80.8	84.5	86.4	86.1	86.3	89.5
- Vegetable	56	81.6	80.9	86.8	87.4	88.1	87.6	90.2
- Animal	56.3	74.8	80.5	80.6	84.9	83.2	84.4	88.2
No. of Tractors	4.8	16.5	26.5	35.2	47.1	55.2	59	69
Fertilizers Used	9.2	49.6	49.8	56.3	60.8	65.1	65.1	70.8
Cattle	44.4	80.4	81.7	84.8	87.8	89.6	90.3	92.6
Swains	28.9	49.8	54.6	53	56.9	57.9	57.9	65.8
Sheep	62	86.1	87.1	89.2	90.1	91.2	92.5	94.7
Poultry	35.5	49.9	52.7	57.5	66.1	63.2	69.2	81.4
Investments	4.3	8.1	15.6	26	36.8	39.3	39.7	35.4
Construction Works	3.1	4.5	13	30.2	55.5	70.8	75.5	70.5
Dwellings Stock	67.3	78.7	88.3	90.4	91.8	92.3	93	94
New Dwellings	11.9	23	50.2	63.9	70.5	74.7	85.5	87.4
Goods Hauling	...	0.7	1.4	2.6	1.2	16.5	23.5	37
Passenger Transport	...	0.3	0.4	1	2.2	2	3	3
Retail Trade	0.8	21.7	45.8	65	71.1	74.3	76.7	81.9
Consumer Services	3.9	20.1	35.4	42.6	54	58.4	59.8	62.9
Hotel Capacity	...	...	...	18.2	24.9	26	24.9	25.1
Number of Hotel Guests	...	...	...	18.5	27.2	30.6	30.3	32.8

Exports FOB	0.2	15.9	27.5	27.9	40.3	41.2	51.4	54.8
Imports FOB	0.4	16.1	32.8	27.2	39.2	45.4	48.3	52.4
Trade Deficit FO/FOB	0.7	16.7	49.1	24.1	22.2	66.4	38	42.1
Trade Deficit FOB/CIF	...	16.8	45.1	25	31.9	59.4	40.7	45.2
Employees	0.7	2.4	5.3	10.9	17.5	22.1	23	27.9
Students in Private Univ.	...	...	26.5	30.7	31	25.4	26.4	30.7
Radio Stations				3	33.2	44.1	52.1	53.3
TV Stations				3.7	31.1	40.4	47.7	53.2

Source: CNS, *Evolutia Sectorului Privat in Economia Romaneasca (1990-1997)*

Appendix 4

Number of Active Enterprises in Industry, Construction, Trade and Other Services, by Activities and Ownership

	1996			
	Total	Private	Mixed, >50% Private	Co-operative
Total	312067	304713	1453	1621
Mining	169	94	8	0
Manufacturing	32084	29683	376	537
Electric and Thermal Energy, Gas and Water	276	46	8	0
Construction	7046	6512	94	60
Trade, Repair	226038	223583	684	864
Hotels and Restaurants	10886	10547	110	41
Transport and Storage	10215	9614	67	0
Post and Communications	374	365	4	0
Real Estate, Rental, Companies Services	11202	10685	80	46
Education	515	476	1	1
Health and Social Assistance	2684	2683		1
Other Collective, Social Aid and Personal Services	10578	10422	21	71
	1997			
	Total	Private	Mixed, >50% Private	Co-operative
Total	316751	309038	2189	2094
Mining	201	128	19	0
Manufacturing	35962	33445	688	671
Electric and Thermal Energy, Gas and Water	267	45	14	0
Construction	9470	8914	220	70
Trade, Repair	226101	223542	763	1169
Hotels and Restaurants	10122	9800	128	39
Transport and Storage	11305	10685	127	0
Post and Communications	474	464	5	0
Real Estate, Rental, Companies Services	12229	11598	177	58
Education	546	511	20	1
Health and Social Assistance	3536	3531	0	2
Other Collective, Social Aid and Personal Services	6538	6375	28	84

Source: The National Commission for Statistics, *The Romanian Statistical Yearbook 1998*

Appendix 5

Private Company Performance in 1997

(Companies with More than 50 Employees)

		Industry			Construction			Trade		
		Total	Private	Relative	Total	Private	Relative	Total	Private	Relative
Number of Companies		4027	2779	0.69	1363	1135	0.83	1495	1160	0.78
Social Capital	ROL bln.	113095	12471	0.11	4313.0	2549	0.59	6877.0	3542	0.52
- per Company	ROL mil.	28084	4488	0.16	3164.0	2246	0.71	4600.0	3053	0.66
Number of Employees (Year Average)	Persons	2433445	907951	0.37	362888.0	264828	0.73	242049.0	169432	0.70
- per Company	Persons	604	327	0.54	266.2	233	0.88	161.9	146	0.90
Turnover - Total	ROL bln.	194993	60267	0.31	21992.0	17268	0.79	53142.0	31384	0.59
- per Company	ROL mil.	48421	21687	0.45	16135.0	15214	0.94	35546.0	27055	0.76
- per Employee	ROL thou.	80131	66377	0.83	60604	65206	1.08	219551	185231	0.84
Direct Exports	ROL bln.	45304	13854	0.31	1021	888	0.87	1946	1693	0.87
- per 1000 ROL Turnover	ROL	232	230	0.99	46	51	1.11	37	54	1.46
- per Employee	ROL thou.	18617	15259	0.82	2814	3352	1.19	8040	9992	1.24
Gross Value Added at Factor Costs	ROL bln.	74035	21525	0.29	8008	6226	0.78	6601	4649	0.70
- per 1000 ROL Turnover	ROL	380	357	0.94	364	361	0.99	124	148	1.19
- per Employee	ROL thou.	30424	23707	0.78	22068	23511	1.07	27271	27439	1.01
Personnel Expenses	ROL bln.	36417	10819	0.30	4705	3423	0.73	2765	1871	0.68
- per Employee	ROL thou.	14965	11916	0.80	12966	12924	1.00	11423	11043	0.97
Gross Operating Surplus	ROL bln.	28057	8882	0.32	3086	2711	0.88	3213	2516	0.78
- per 1000 ROL Added Value	ROL	379	413	1.09	385	435	1.13	487	541	1.11
Investments	ROL bln.	19700	8107	0.41	2097	566	0.27	1527	1300	0.85
- per 1000 ROL Added Value	ROL	266	376	1.41	262	91	0.35	231	280	1.21
- per Employee	ROL thou.	8095	8929	1.10	5779	2139	0.37	6309	7673	1.22

Source: Comisia Nationala pentru Statistica, *Rezultate si performante ale intreprinderilor din industrie si Rezultate si performante ale intreprinderilor din constructii, comert si servicii*, Editia 1999

Appendix 6

The File Of The Lost Money**The Credit Bank Dossier**

By Tiberiu Vilcu

Published in the magazine "Banii Nostri", June 1999

The story of the bank "Renasterea Creditului Romanesc - Credit Bank" is a typical Romanian soap opera of the post December '89 period, starring spruce billionaires and directors acquainted with all sorts of bribes to many elements - somnolent authorities, a bewildered system of justice and countless deponents. In September '98, following a heart attack which occurred in circumstances that are not elucidated, the

president of the bank, Emil Cioflan, was found dead in the office of the university he was teaching at... A soap opera with a lot of figures and with no moral, with the exception of the financial one.

The Eye of the State Fattens the Bank of the Private

Credit Bank was known as a private bank (one of the first founded after 1989), but the actual situation was different. The bank “Renasterea Creditului Romanesc - Credit Bank” was founded in December 1991 and started to operate in February 1992, with a registered capital of 3.4 billion lei, later increased to 5 billion. In the beginning, three-quarters of the registered capital was owned by autonomous bodies and state companies - from SNCFR (with 18.6%) to Fulger Bragadiru (with 8.6%) or Vulcan S.A. (with 2.7%) - which were state companies, investing state money - our money. It is interesting how these companies were able to invest in the Renaissance^[12] bank, even though their own economic situation was precarious. Actually, many of them later came close to bankruptcy. Meanwhile, the management of the bank was “very private” and knew how to use the resources, financial or not, brought by the generous shareholders. SNCFR offered spaces in the train stations for Credit Bank agencies and did all their operations through the bank, the circulated sums being enormous, with likewise gains.

The activity of Credit Bank started off in force, with a rapid growth of business volume and a rapid expansion in territory. The profits from the operations were only gathering in the accounts of the bank, a situation probably considered unsatisfactory by the bank’s management who tried - and succeeded - to pocket substantial gains. Paradoxically, the gains were larger as business became worse for the bank - massive credits given to “cardboard billionaires” who had no real collateral and no intention of returning the money.

The Accused Bench and the Armchairs of the Management

The bubble burst in January 1995 through the arrest of Marcel Ivan, the president of Credit Bank, accused of fraudulent bankruptcy, forgery and the taking of bribes. He had asked Gheorghe Vasile (“Gigi Kent”) and Gheorghe Bica for 10 percent of the loans they had gotten from the bank. Also, he had transferred a few tens of thousands of dollars from the bank’s accounts to his own account in Germany. The investigations showed that Marcel Ivan drained the bank of over 130 billion lei. His arrest led to a lack of confidence in Credit Bank, one of the largest banks of the moment. To avoid the crisis the National Bank intervened to support Credit Bank - NBR’s (National Bank of Romania) first attempt to help a commercial bank in distress. But the problems of the bank worsened. Other leaders of the bank were arrested on similar charges: the economic director of the bank, the chief of the credits department, a number of heads of local agencies from all over the country. At the same time it became apparent that the bank’s financial situation was not solid, as a result of non-performing credits given preferentially. To cover the vulnerable position Credit Bank had in the banking system, the NBR decided in the summer of 1995 to give it a credit of 600 billion lei, supplemented in the autumn by another 600 billion to cover the massive withdrawals of deposits by the population.

Another battle was waged on the corridors of the bank in a bid to take control. Presidents and members in the administrative councils were investigated and then revoked, by means including the justice system. An important character in these struggles was Steriu Popescu, founding member of the bank and honorific vice-president, pushed aside however by Marcel Ivan when he was president. Steriu Popescu is himself under investigation in six penal dossiers (some of them in connection to Marcel Ivan!) for giving illegal credits worth 60 billion lei. After a short comeback as vice-president, Steriu Popescu was placed under guard, but he lived in the United States until he died in February 1998.

During this time, the holes from the Credit Bank's accounts grew continuously, and the attempts to cover them by attracting new shareholders failed. The capital of Credit Bank remained at 11 billion lei, and the bank's financial situation worsened in the unstable climate created, among others, by the justice system. This emitted contradictory decisions in which it recognized Emil Cioflan as president of the bank sometimes, and other times Marcel Ivan. The same uncertainty surrounded the administrative councils, and even the shareholders. In 1997, the National Bank decided to dismiss a number of people from the head of Credit Bank, including Marcel Ivan, Steriu Popescu, Peter Blum, Ilie Alexandru and even Emil Cioflan.

NBR Steps In

Under these circumstances, the National Bank announced in June 1996 that it was withdrawing its support to Credit Bank - basically withdrawing the credits it had given the previous years. Interminable lines formed at the agencies, the bank being unable to give the depositors more than a few hundred million every day. In April 1997 the National Bank decided to revoke the banking licenses of the two banks in major difficulty: Dacia Felix and Credit Bank.

On paper, Credit Bank was not doing too badly: it had debts of 600 billion lei, but it had credits to recover worth 1300 billion lei. The big problem, however, was that most of the money was forever "buried" in all sorts of businesses and companies run by more or less famous characters, from Gigi Kent (the "Cota 1400" Hotel) and Alexandru Raducanu (owner of the Sanca company and of the "Odobesti" Restaurant) to Ilie Alexandru (the owner of the Slobozia "Dallas" with its pocket size "Eiffel Tower"). Not to mention the debts to the bank of the companies owned by Marcel Ivan and Steriu Popescu—over 100 billion lei!

Even though it had started in June 1996, the procedure to declare the bank in a cease of payments situation had not been finalized until the summer of 1998. It was necessary for the Extraordinary General Assembly of shareholders to meet in October 1998 to accept the procedure of reorganizing the bank in compliance with the law of bankruptcy. This recognition of the de facto state of things meant that only from that time were the deponents able to recover their money, and not entirely, only to the limit of 10 million, in turn affected by inflation. What the Credit Bank crisis meant only those affected can say. And they are not few, since the deposits of the population summed up to 150 billion lei. Their numbers got larger with victims from other, equally famous bank crashes (the last saved one being Bancorex, and the last one to get over it being Albina).

Apendix 7

EUROPHARM DELIVERS DRUGS AND RECIPES FOR SUCCESS

by Mariana Ionescu

Published in the "Invest Romania" magazine no. 12, Spring/Summer 1999

Europharm is one of the well-established names on the pharmaceutical market, both as a medical drugs producer and a distributor. The 1998 sales amounted to USD 52.3 million on the domestic market and exceeded USD 1.2 million on the foreign markets. It is a success story, with a strong will as the main character.

Looking for a Market

The company was established after 1990 in Brasov and competed successfully with the state-owned companies that had a much longer business history. Europharm Trading SA, the first venture, was established in 1992 with a

launching investment of 2 million lei, and is active in trading and producing various medical drugs. In 1993, because it wanted to extend its production and distribution, Europharm Trading SA found a partner in the US – Largo Import Export Florida Inc. – and together they established the Romanian-American joint venture Europharm-Largo SA Brasov. In 1994, Europharm Holding SA and Europharm SA were established, both with headquarters in Brasov. The former focused exclusively on distribution, while the latter was involved mostly in production. In 1995, a new association with Farmaco Kishinev from the Republic of Moldova took place, the result being the establishment of the Europharmaco Kishinev joint venture. Its purpose is to produce medical drugs and pharmaceutical goods and to distribute them in the Republic of Moldova and in the other members of the Community of Independent States.

Network and Diversify!

Production began with two antibiotics, but over time the Europharm range of products has amplified and diversified. Currently it encompasses 78 products in 9 therapeutic classes: antibiotics and anti-virus; analgesics, antipyretics and anti-inflammation drugs; medication for the respiratory apparatus; dermatological medication; medication for the digestive apparatus; medication for the cardiovascular apparatus; medication for the central nervous system; medication for the uro-genital apparatus; and multivitamins. Irrelevant in addition, it produces herbal teas, medical instruments, and cosmetic goods. The distribution network ensures the wholesale and retail sale for Europharm goods, together with other domestic and foreign similar products, through its 17 warehouses and 28 pharmacies located in the most important Romanian cities and in Kishinev, Moldova. “Europharm warehouses offer a large range of products, including the cosmetics ointments commonly associated with drugstores. At the same time, we deliver drugs for hospitals and more than 200 private pharmacies. For the future, we want to provide special-order deliveries for any kind of pharmaceutical good,” says Rodica Ionita, Vice-President of Europharm Group.

Since its establishment, Europharm has had a very dynamic evolution and the workforce has increased to 1,300. The production is mainly located in Brasov, where it employs about 300 people. Currently, there are 5 production halls in Brasov: antibiotics, non-antibiotics, suppositories, cosmetics, ointments and medical herbal teas. The pill production is located in Ploiesti, especially the analgesics and antipyretics (like aspirin and paracetamol); the production of medical goods like bandages and sterilised tissues is located in Hemeiusi (Bacau County); the production of capsules, compressed tablets, syrups, powders for injection solutions and perfusion solutions is located in Kishinev (Moldova). In 1998, the amount of Europharm goods produced for the domestic market had a total value of USD 24 million, while the foreign market (including Europharmaco-Moldova) absorbed over USD 1.2 million.

Beating the Bureaucrats

Since its establishment, Europharm has faced many difficulties. Among these were the blocking of significant money amounts because the payment transfers for the free-of-charge prescriptions and the compensated ones were not made in due time by the Health Ministry.

There were also groundless delays in the release of production authorizations, sanitary endorsements or the registration certificates for the new products. Despite these obstacles, Europharm had continuous development out of its own resources and by reinvesting the profit. Because the investment loan legislation was fuzzy, the long-term credits, which bear low interest rates, were used only as working capital.

“All equipment had to be brought from abroad because Romania is not producing this kind of stuff. But then,

there is no fiscal facility yet for importing new equipment, even if lower custom duties or a custom duty exemption could be very efficient incentives for the domestic medical drug production. We had to import second-hand equipment and, only when we could afford it, new equipment with GMP certification.” Most of the raw materials are from abroad too, the main source being the European Union. The amounts to finance the production for this year were projected at about USD 10 million. “More than 90 percent of the raw materials are imported because we could not find them domestically. The few domestic materials available do not offer a convenient quality/price ratio. The only materials produced in Romania which we use on a large scale are alcohol and amidin.”

SmithKline Beecham Jumps in

In 1998, the American partner sold the shares it had owned, but on September 25, the same year, Europharm and British giant SmithKline Beecham concluded a strategic partnership for Romania. “This partnership offers both financial and technical benefits. We would like to invest ourselves, but with our scarce resources it is more feasible to get sound financial support from a company with a real expertise in the field.” The new investments will be made in production: a new plant for medical drugs and a warehouse for raw materials and finished goods (final term – June 1, 1999), both of them located in Brasov. “Another new plant will be started this year. It will probably take about 2 years to make it operational because it is a large unit. The investment will exceed USD 10 million because the new plant must comply with the GMP international standards.”

The question about how a young company became successful in a crowded marketplace comes naturally. “We had to work in tough competition with the high quality imported medical drugs that have a good package and efficient marketing. I think Europharm’s success relied mainly on our will to be leaders in the field of medical drugs; the company was actually established by three pharmacists and that helped a lot. We wanted to prove that the medical drug sector belongs to us. In order to turn opportunities into a nice account, we have a good recipe – hard work, strong will and the ambition to do something,” believes Ionita.

[1] In essence, neoclassical theory asserts that the existence of a large number of independent competing firms and prices resulting from individual decisions of buyers and sellers, acting freely based on their interests and the information available to them, are the necessary and sufficient conditions for competitive markets to work and to function to achieve an optimal allocation of resources.

[2] Talking about Russia’s failure, Stanley Fischer, Vice-president of the IMF, recently stressed that “the main problem was not the omission of any important element in the reforms package proposed to the Government in Moscow . The inadequate implementation of fund policies, corruption and the lack of interest by Russian politicians for a real recovery in the economy were the causes of the crises the former Soviet state has been facing in the last years.” – quoted by Paul Welfens in *The Financial Times*, October 5 1999.

[3] Comprehensive references and comments on these studies are in Nellis, 1999 and Havrylyshyn, McGettigan, 1999.

[4] It should be noted, however, that mass privatization programs were very popular, even with international financial institutions. “The international financial institutions must bear some of the responsibility for the poor outcomes, since they so often insisted on the primacy of economic policy. That is, they requested and required transition governments to privatize rapidly and extensively, assuming that private ownership by itself would provide sufficient incentive to shareholders to monitor managerial behavior and push firms to good performance. (...) The prima facie assumption was that to build capitalism, one needed capitalists; lots of them, and fast.” (Nellis, 1999, p.17)

[5] In spite of the many shortcomings or even failures that may be related to privatization in different countries, I’m strongly sympathetic with John Nellis’s argument that “states that botch privatization botch public ownership of enterprises as well” (Nellis, 1999, p.4) and therefore perpetuation of public ownership is just an illusory alternative to poor privatization.

[6] Statistics in all countries, including Romania, do not distinguish between the private sector increases resulting from the sale of state companies/assets and the increases resulting from start-ups. Therefore, statistics do not accurately account for new firm contributions to GDP – with inter-country comparisons being particularly affected. In Romania, as privatization was slow (it is only in 1998 that the share of capital transferred to private investors attained 20 percent of the initial State Ownership Fund holdings), it may be considered that the “private sector” reported by statistics is quite accurately describing the new private firms’ situation. This statistical approximation will be used throughout the present paper.

[7] Source: *The Chamber of Commerce and Industry of Romania and of the Bucharest Municipality – The National Trade Register Office: Monthly Statistics Bulletin no. 90*

[8] The study mentioned is focusing on the Small and Medium Enterprise Sector, but its conclusions are valid for the entire private sector in Romania which is dominated by SME’s.

[9] The same author observes that the same process occurred in all post-communist countries and concludes that it must be “a historically objective and necessary process”.

[10] The author utilizes a case where a good business project did not take off until local officials (one director in the bank, the head of the agricultural directorate, others from the city-hall, police, and financial administration) were co-opted as partners.

[11] The Legislative Council started to clean up the system but the task is immense.

[12] “Renasterea Creditului Romanesc”, the name of the bank is in translation “ The Renaissance of Romanian Credit”

EXHIBIT U

MAIN PROVISIONS OF THE CURRENCY REGULATION

I. Rights of residents and non-residents

Residents and non-residents may:

- acquire, hold, and use any foreign exchange-denominated assets (full retention right);
- open accounts in both foreign exchange and lei with banks licensed to operate in Romania;
- perform foreign currency transactions freely and without restrictions;
- non-residents may transfer their foreign exchange deposits abroad without restrictions;

II. Access to the forex market

- Ensuring the convertibility of current account operations for both residents and non-residents;
- Free access of both residents and non-residents to purchasing and selling foreign exchange against lei;
- Purchases and sales of foreign exchange shall be made only through intermediaries (dealers) licensed by the NBR;
- Purchases of foreign exchange by resident legal entities and non-residents shall be made only against documents;
- Purchases of foreign exchange by resident individuals via exchange bureaux and banks are unlimited.

III. Foreign exchange capital account operations

The following capital operations are subject to prior licensing by the NBR unless they are related to foreign public debt:

- (a) admission of securities and units of foreign collective investment undertakings on the Romanian market;
- (b) residents' transactions in securities and units of foreign collective investment undertakings;
- (c) transactions in securities and other instruments currently traded on the money market;
- (d) financial loans and credits granted by residents to non-residents less short-term financial leasing operations;
- (e) short-term financial loans and credits granted by non-residents to residents;
- (f) sureties granted by residents to non-residents;
- (g) operations in deposit and current account operations opened by residents abroad;
- (h) operations in ROL deposit accounts opened by non-residents in Romania;
- (i) personal capital transfers in the form of loans granted by residents to non-residents;
- (j) import and export of financial assets - payment instrument in the form of cash.

For statistical purposes, capital operations generating external obligations arising from borrowings with maturity longer than one year, other than those pertaining to external public debt, are recorded at the NBR in the "Romania's External Private Debt Register".

Banks are excepted from licensing procedures, in the case of the following capital operations performed on their own account:

- (a) transactions in securities and other money market instruments;
- (b) granting sureties, less sureties in favour of non-residents in cases without direct connection with international trade or international capital movements or when no resident is participating in the guaranteed primary operation;

- (c) operations in foreign exchange deposit and current accounts, opened abroad;
- (d) short-term financial loans and credits.

IV. Receipts and payments among residents

Receipts and payments among residents may be made:

- in domestic currency, "leu" (ROL);
- in foreign currency, as stipulated in the currency regulation (no licensing required)
 - Banks - for foreign exchange operations specified in the licence;
 - Legal entities - for payments arising from foreign trade contracts (import and export of goods) carried out on commission and for foreign exchange operations arising from the provision of external services (transport, tourism)
 - Physical entities - for incidental foreign exchange operations among themselves;
 - Physical and legal entities - that benefit from express legal provision or for foreign exchange operations arising from trading in free zones, harbours, airports, border checkpoints, international trains, airships and ships - on external routes.
- in foreign exchange, among residents, authorised by the NBR (by licence issuing).

V. Operations in domestic currency performed by non-residents

Current foreign exchange operations in ROL between residents and non-residents, as well as among non-residents are forbidden;

Exceptions:

- payments made by residents to non-residents in the form of profit, dividends, interests and other incomes achieved in accordance with the legal provisions in force;
- payments made by non-residents to residents in the form of taxes, duties, commissions and charges;
- payments made by non-residents, physical entities, to residents during their stay in Romania;
- current foreign exchange operations between residents and non-residents indicated under Art. 1, para. 1.2., letter a.2 (embassies, consulates, agencies of other countries and of international bodies in Romania)

VI. Foreign exchange control

- Banks are responsible for the proper implementation of the Currency Regulation.
- The NBR monitors and controls observance of provisions under the Currency Regulation.
- The maximum amounts in cash per person and per trip that may be taken out or brought into Romania are the following:
 - in foreign currency: USD 10,000 (or the equivalent amount);
 - in lei: lei 500,000.
- The obligation of residents, according to Romania's Government Ordinance No. 18/1994, to repatriate the amounts in hard currency deriving from operations performed abroad, meeting the deadlines stipulated by the said Ordinance.

VII. Main features of the Currency Regulation

Regulation No. 3/23.12.1997, issued by the NBR, on currency operations consists in a "body" that includes

EXHIBIT V

Foreign companies in Romania estimate that their operations will improve

More than half of the international companies which operate in Romania estimate that in the third quarter of the year their operations will improve, and only 4% of them foresee a fall of their activities, according to the quarterly barometer of KPMG Romania taken among 80 foreign capital companies.

The number of foreign investors who consider with optimism their operations in Romania rose 15% vs. the second quarter of the year, while the weight of the foreign companies which foresee a worsening of the operations has decreased by half.

A similar evolution was registered also in regard to the companies' perception of their financial situation. Almost half of the consulted companies estimate that their financial situation will improve, while those who consider that their business will deteriorate financially represents 8%. Those who changed their opinion were mainly the foreign investors which register a stable financial situation in the second quarter.

The predictions regarding investment level suffered significant changes compared to the second quarter. Thus, the number of those which estimate that their investments will go up in the next period rose from 27% to 41%, concurrently also with a rise of the percentage of those who estimate a decrease of investment value, from 15% to 24% of the interviewed. Although they do not expect a decrease in the number of employees, most of the interviewed think that the number of jobs will not rise in the next period. Over 60% of the companies participating in the survey intend to maintain the same number of employees, while 27% of them consider that the number of the available jobs will rise.

(source: *Nine O'Clock*)

Interconnecting the power grid with the EU's costs \$500 M

The interconnection of the national power grid (SEN) with that of the European Union (UCTE) will be achieved on February 1st, 2003 and will cost about \$500 M, states a report drawn by Transelectrica power operator, which was presented in the National Conference of Energy - CNE 2002. Since February 1st, SEN is interconnected with the second region of UCTE, which includes five Balkan states. Until the beginning of next February, an UCTE technical committee is monitoring the function of power transport systems in the region, as Transelectrica will become a full-rights member of the European organisation after this moment. To comply with UCTE standards, Transelectrica needs investments worth \$450 M until the year 2005, of which it has already invested over \$65 M in rehabilitating transformer stations placed on the energy transport routes between the EU and Balkan countries.

Besides the investments made by the national transport company, the companies Termoelectrica and Hidroelectrica allotted funds worth \$44 M to upgrade equipment in the power generating facilities that will secure the connections between SEN and UCTE. Experts estimate that, following the interconnection, Romania will be able to import, since February next year, electricity at a price of about 30 euro/MWh, while industrial consumers currently pay about 50 euro/MWh. The amounts of imported energy will however be limited, as transport lines only allow the transit of 400 MWh, while domestic consumption tops an approximate 5,000 MWh in the summer and 9,000 MWh in winter.

(source: *Nine O'Clock*)

BNR envisages full convertibility of leu by 2007

Romania's national currency (the leu) will become convertible after 2004, but not later than 2007 - the year when Romania might be invited to join the European Union. Vice-Governor of Romania's National Bank (BNR) Cristian Popa made this statement upon submitting the country report on Romania at the EBRD annual meeting in Bucharest. "The leu has a limited convertibility at present, yet according to the timetable established by the central bank, it would become fully convertible in 2004, once the capital account is completely liberalized.

The full convertibility of the national currency, annual inflation rates measurable in one figure, a better balance of payments and the correlation between pay rises and labor productivity are important conditions to be met in view of EU accession. Romania is already using a capital account liberalization timetable that will allow an unrestricted capital in- and outflow.

BNR has chosen a gradual liberalization process that should protect the economy from the risks that a rapid opening of financial markets involves. Starting this year, Romanians have no more restrictions on making real estate investment abroad. Full liberalization also offers the possibility to make direct investments in company shares listed on foreign stock exchanges.

(source: *Romanian Business Journal*)

EXHIBIT W

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**Transparency International
Corruption Perceptions Index 2002**

Corrupt political elites and unscrupulous investors kill sustainable growth in its tracks, highlights new index

The TI Corruption Perceptions Index 2002 ranks 102 countries, the highest number ever. Seven out of ten countries ranked score less than 5 out of a clean score of 10

Berlin, 28 August 2002

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- Statement by Peter Eigen, Chairman of Transparency International, on the launch of the Corruption Perceptions Index 2002
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- Media contacts
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- Sources contributing to the assessment of each country (PDF)
- previous indices

"Political elites and their cronies continue to take kickbacks at every opportunity. Hand in glove with corrupt business people, they are trapping whole nations in poverty and hampering sustainable development. Corruption is perceived to be dangerously high in poor parts of the world, but also in many countries whose firms invest in developing nations," said Peter Eigen, Chairman of Transparency International, speaking today on the launch of the Corruption Perceptions Index 2002 (CPI).

"Politicians increasingly pay lip-service to the fight against corruption but they fail to act on the clear message of TI's CPI: that they must clamp down on corruption to break the vicious circle of poverty and graft. Seven out of ten countries score less than 5 out of a clean score of 10 in the CPI 2002, which reflects perceived levels of corruption among politicians and public officials."

"Corrupt political elites in the developing world, working hand-in-hand with greedy business people and unscrupulous investors, are putting private gain before the welfare of citizens and the economic development of their countries," said Peter Eigen. "From illegal logging to blood diamonds, we are seeing the plundering of the earth and its people in an unsustainable way."

http://www.transparency.org/pressreleases_archive/2002/2002.08.28.cpi.en.html

The new index, published today by Transparency International (TI), the world's leading non-governmental organisation fighting corruption, ranks 102 countries. Seventy countries - including many of the world's most poverty-stricken - score less than 5 out of a clean score of 10. Corruption is perceived to be rampant in Indonesia, Kenya, Angola, Madagascar, Paraguay, Nigeria and Bangladesh, countries with a score of less than 2. Countries with a score of higher than 9, with very low levels of perceived corruption, are predominantly rich countries, namely Finland, Denmark, New Zealand, Iceland, Singapore and Sweden.

Some changes highlighted in the CPI were identified by Peter Eigen. "In the past year, we have seen setbacks to the credibility of democratic rule. In parts of South America, the graft and misrule of political elites have drained confidence in the democratic structures that emerged after the end of military rule. Argentina, where corruption is perceived to have soared, joins Panama, Honduras, Guatemala, Nicaragua, Venezuela, Bolivia, Ecuador, Haiti and Paraguay with a score of 3 or less in the CPI 2002."

While some countries in transition from communism - most notably Slovenia, which has a cleaner score than EU member countries Italy and Greece - are perceived to be increasingly less corrupt, many countries in the former Soviet Union remain ridden with corruption. "The recent steps by President Vladimir Putin to introduce tax reforms and new laws fighting money-laundering are beginning to show the prospect of a lessening in perceived corruption in Russia," explained Peter Eigen, "but the CPI 2002 indicates that Russia has a long way to go and remains seriously corrupt, together with Uzbekistan, Georgia, Ukraine, Kazakhstan, Moldova and Azerbaijan, all of which score less than 3 out of 10."

The CPI is a poll of polls, reflecting the perceptions of business people and country analysts, both resident and non-resident. First launched in 1995, this year's CPI draws on 15 surveys from nine independent institutions. A rolling survey of polls taken between 2000 and 2002, the CPI includes only those countries that feature in at least three surveys. "It is important to emphasise that the CPI, even with 102 countries, is only a snapshot and covers barely half the more than 200 sovereign nations in the world," said Peter Eigen. "There is not sufficient data on other countries, many of which are likely to be very corrupt."

The CPI 2002 complements TI's Bribe Payers Index (BPI), which addresses the propensity of companies from top exporting countries to bribe in emerging markets. The BPI 2002, published on 14 May 2002, revealed high levels of bribery by firms from Russia, China, Taiwan and South Korea, closely followed by Italy, Hong Kong, Malaysia, Japan, USA and France - although many of these countries signed the OECD Anti-Bribery Convention, which outlaws bribery of foreign public officials.

Tunku Abdul Aziz, TI Vice-Chairman, speaking in Malaysia on the launch of the CPI 2002, said: "The CPI has once again confirmed that corruption is a malady afflicting not only the developing countries, but also the developed world. Corruption is neutral. It is no respecter of nations, big or small, rich or poor. It is all the more critical, therefore, that both the North and the South buckle down to confront corruption much more vigorously and decisively."

"Developed countries have a special humanitarian responsibility," he continued, "given the resources at their disposal, to investigate and prosecute the companies within their jurisdictions that are bribing. Their bribes and incentives to corrupt public officials and politicians are subverting the orderly development of poor nations, already trapped, as they are, in a vicious circle of crippling poverty, hunger and disease."

Tunku Abdul Aziz said: "Corruption continues to deny the poor, the marginalised, and the least educated members of every society the social, economic and political benefits that should properly accrue to them, benefits that are taken for granted in societies that have managed to shake off the yoke of corruption."

Before leaving for the United Nations Johannesburg Summit on Sustainable Development, Peter Eigen stressed that "the summit in Johannesburg must lead to action. Corruption impedes sustainable development and robs the children of today of the resources they will need to survive tomorrow. When the leaders sign the Johannesburg Declaration, they must make pledges they can keep, not raise false hopes."

"The New Partnership for Africa's Development has set out some bold aims, which I applaud. Good governance and transparency are essential to sustainable development," he continued. "Just as international institutions and donor bodies must now insist on transparency and good governance, so must politicians grasp the challenge at the national level. The new CPI makes it clear that an enormous task lies ahead of them. They must set the framework for investment such that the rule of law is applied and enforced fairly, not arbitrarily, so that for instance extractive industries, such as oil-drilling, are

sustainable both for the natural environment and the development of the local economy."

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Table 1:

Country Rank	Country	CPI 2002 score	Surveys used	Standard deviation	High-low Range
1	Finland	9.7	8	0.4	8.9 - 10.0
2	Denmark	9.5	8	0.3	8.9 - 9.9
	New Zealand	9.5	8	0.2	8.9 - 9.6
4	Iceland	9.4	6	0.4	8.8 - 10.0
5	Singapore	9.3	13	0.2	8.9 - 9.6
	Sweden	9.3	10	0.2	8.9 - 9.6
7	Canada	9.0	10	0.2	8.7 - 9.3
	Luxembourg	9.0	5	0.5	8.5 - 9.9
	Netherlands	9.0	9	0.3	8.5 - 9.3
10	United Kingdom	8.7	11	0.5	7.8 - 9.4
11	Australia	8.6	11	1.0	6.1 - 9.3
12	Norway	8.5	8	0.9	6.9 - 9.3
	Switzerland	8.5	9	0.9	6.8 - 9.4
14	Hong Kong	8.2	11	0.8	6.6 - 9.4
15	Austria	7.8	8	0.5	7.2 - 8.7
16	USA	7.7	12	0.8	5.5 - 8.7
17	Chile	7.5	10	0.9	5.6 - 8.8
18	Germany	7.3	10	1.0	5.0 - 8.1
	Israel	7.3	9	0.9	5.2 - 8.0
20	Belgium	7.1	8	0.9	5.5 - 8.7
	Japan	7.1	12	0.9	5.5 - 7.9
	Spain	7.1	10	1.0	5.2 - 8.9
23	Ireland	6.9	8	0.9	5.5 - 8.1
24	Botswana	6.4	5	1.5	5.3 - 8.9
25	France	6.3	10	0.9	4.8 - 7.8

	Portugal	6.3	9	1.0	5.5 - 8.0
27	Slovenia	6.0	9	1.4	4.7 - 8.9
28	Namibia	5.7	5	2.2	3.6 - 8.9
29	Estonia	5.6	8	0.6	5.2 - 6.6
	Taiwan	5.6	12	0.8	3.9 - 6.6
31	Italy	5.2	11	1.1	3.4 - 7.2
32	Uruguay	5.1	5	0.7	4.2 - 6.1
33	Hungary	4.9	11	0.5	4.0 - 5.6
	Malaysia	4.9	11	0.6	3.6 - 5.7
	Trinidad & Tobago	4.9	4	1.5	3.6 - 6.9
36	Belarus	4.8	3	1.3	3.3 - 5.8
	Lithuania	4.8	7	1.9	3.4 - 7.6
	South Africa	4.8	11	0.5	3.9 - 5.5
	Tunisia	4.8	5	0.8	3.6 - 5.6
40	Costa Rica	4.5	6	0.9	3.6 - 5.9
	Jordan	4.5	5	0.7	3.6 - 5.2
	Mauritius	4.5	6	0.8	3.5 - 5.5
	South Korea	4.5	12	1.3	2.1 - 7.1
44	Greece	4.2	8	0.7	3.7 - 5.5
45	Brazil	4.0	10	0.4	3.4 - 4.8
	Bulgaria	4.0	7	0.9	3.3 - 5.7
	Jamaica	4.0	3	0.4	3.6 - 4.3
	Peru	4.0	7	0.6	3.2 - 5.0
	Poland	4.0	11	1.1	2.6 - 5.5
50	Ghana	3.9	4	1.4	2.7 - 5.9
51	Croatia	3.8	4	0.2	3.6 - 4.0
52	Czech Republic	3.7	10	0.8	2.6 - 5.5
	Latvia	3.7	4	0.2	3.5 - 3.9
	Morocco	3.7	4	1.8	1.7 - 5.5
	Slovak Republic	3.7	8	0.6	3.0 - 4.6
	Sri Lanka	3.7	4	0.4	3.3 - 4.3
57	Colombia	3.6	10	0.7	2.6 - 4.6
	Mexico	3.6	10	0.6	2.5 - 4.9
59	China	3.5	11	1.0	2.0 - 5.6
	Dominican Rep.	3.5	4	0.4	3.0 - 3.9
	Ethiopia	3.5	3	0.5	3.0 - 4.0
62	Egypt	3.4	7	1.3	1.7 - 5.3
	El Salvador	3.4	6	0.8	2.0 - 4.2
64	Thailand	3.2	11	0.7	1.5 - 4.1
	Turkey	3.2	10	0.9	1.9 - 4.6
66	Senegal	3.1	4	1.7	1.7 - 5.5
67	Panama	3.0	5	0.8	1.7 - 3.6
68	Malawi	2.9	4	0.9	2.0 - 4.0
	Uzbekistan	2.9	4	1.0	2.0 - 4.1

70	Argentina	2.8	10	0.6	1.7 - 3.8
71	Cote d'Ivoire	2.7	4	0.8	2.0 - 3.4
	Honduras	2.7	5	0.6	2.0 - 3.4
	India	2.7	12	0.4	2.4 - 3.6
	Russia	2.7	12	1.0	1.5 - 5.0
	Tanzania	2.7	4	0.7	2.0 - 3.4
	Zimbabwe	2.7	6	0.5	2.0 - 3.3
77	Pakistan	2.6	3	1.2	1.7 - 4.0
	Philippines	2.6	11	0.6	1.7 - 3.6
	Romania	2.6	7	0.8	1.7 - 3.6
	Zambia	2.6	4	0.5	2.0 - 3.2
81	Albania	2.5	3	0.8	1.7 - 3.3
	Guatemala	2.5	6	0.6	1.7 - 3.5
	Nicaragua	2.5	5	0.7	1.7 - 3.4
	Venezuela	2.5	10	0.5	1.5 - 3.2
85	Georgia	2.4	3	0.7	1.7 - 2.9
	Ukraine	2.4	6	0.7	1.7 - 3.8
	Vietnam	2.4	7	0.8	1.5 - 3.6
88	Kazakhstan	2.3	4	1.1	1.7 - 3.9
89	Bolivia	2.2	6	0.4	1.7 - 2.9
	Cameroon	2.2	4	0.7	1.7 - 3.2
	Ecuador	2.2	7	0.3	1.7 - 2.6
	Haiti	2.2	3	1.7	0.8 - 4.0
93	Moldova	2.1	4	0.6	1.7 - 3.0
	Uganda	2.1	4	0.3	1.9 - 2.6
95	Azerbaijan	2.0	4	0.3	1.7 - 2.4
96	Indonesia	1.9	12	0.6	0.8 - 3.0
	Kenya	1.9	5	0.3	1.7 - 2.5
98	Angola	1.7	3	0.2	1.6 - 2.0
	Madagascar	1.7	3	0.7	1.3 - 2.5
	Paraguay	1.7	3	0.2	1.5 - 2.0
101	Nigeria	1.6	6	0.6	0.9 - 2.5
102	Bangladesh	1.2	5	0.7	0.3 - 2.0

Explanatory notes

A more detailed description of the CPI 2002 methodology is available at <http://www.transparency.org/cpi/index.html#cpi> or at www.gwdg.de/~uwwv/2002.html

A CPI 2002 Score

relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts, and ranges between 10 (highly clean) and 0 (highly corrupt).

A Surveys Used

refers to the number of surveys that assessed a country's performance. A total of 15 surveys were used from nine independent institutions, and at least three surveys were required for a country to be included in the CPI.

Standard Deviation

indicates differences in the values of the sources: the greater the standard deviation, the greater the differences of perceptions of a country among the sources.

High-Low Range

provides the highest and lowest values of the different sources.

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EXHIBIT X

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Document ID: EUP20020902000141

Entry Date: 09/02/2002

Version Number: 01

Region: East Europe

Sub-Region: Balkan States

Country: Romania

Topic: DOMESTIC ECONOMIC, DOMESTIC POLITICAL

Source-Date: 08/31/2002

Romania: Daily Says Corruption Ingrained in Politics, Society

EUP20020902000141 Bucharest Evenimentul Zilei in Romanian 31 Aug 02 p 6

[Commentary by Emil Hurezeanu: "I Am Corrupt, Therefore I Am?"]

[FBIS Translated Text]

On the two lists published by Transparency International on the status of world corruption in the past year, Romania is in last place among the European countries seeking EU membership. They found that the corruption index became even more alarming than in 1997. The report filed by the European Commission last fall also denounced "institutionalized corruption" in Romania, for the first time since the accession talks began in 1999.

Corruption has become a general phenomenon, all over society; both Romanians and foreigners are guilty of corruption. It comes from the past, the east, and the west, having vigorous ramifications along the north-south routes. Corruption has become the second nature of the transition to a market economy, and, at a certain point, it appears as inevitable as an "opportunistic infection" -- this is what they call the diseases you catch at a hospital where you go to treat your lungs and come out (or you never get out) with hepatitis.

There is talk about "big-time" corruption or "state" corruption, where the person who corrupts others is an official working as a representative of the state, and "small-time" corruption, or, let us call it the sub-civic corruption of daily survival between patient and doctor or between student and teacher. The classic definition of corruption is abuse use of power for personal gain (Senturia, "Corruption, political" [preceding two words published in English], 1931). It mainly regards politicians. The judiciary accompanies corruption, rather, and it assists corruption, just like a safe and flexible net placed under it. Under Communism, corruption was often a method of survival, and a legitimate one at that, considering the alternative: the

ideology that crushed the individual under the [Communist] party and the Securitate. This is why the party and the Securitate rapidly became the most corrupt elements in society. "Balanced reciprocity" quickly became "negative reciprocity." This is what ethnologists call exchange forms: I give you, and you give me... The former is specific to traditional, closed societies of the rural type, which are still dominant in Romania today: according to it, any service must be paid back immediately [by giving something, or rendering another service] equal in value. When A, by virtue of his power or post, expects or imposes a reward he is not entitled to for a promised or delivered service, B (the beneficiary) gives a bribe, and the official is corrupt. In traditional communities, services and services to pay back ensure social peace by facilitating a decent subsistence. But the general complicity of the state institutions -- the judiciary, political parties, and the police through their top, middle-level, or low-level officials -- break the social solidarity and the security of the state in question, as the SRI [Romanian Intelligence Service] reports never forget to mention, but to no avail.

However, the most serious aspect of Romanian corruption is, as Nicolae Manolescu puts it, the fact that "there is corruption without corrupt people."

Just like during the revolution [December 1989], when there was terrorism without terrorists, part of the same genealogy of Romanian originality has pushed it to the maximum.

In recent years in Romania the big-time corrupt people, no matter how notorious or proven, even if there were sometimes charged or convicted, either got away or have been pardoned. The mountains and peaks of corruption have always remained uninvestigated. In valleys and meadows, the Financial Oversight Body and the police, sometimes even the judiciary, sometimes find some poacher or some small fish. The sharks and the brown bears play joyfully and freely.

The impression is that, regardless of any election results, the "protocracy" [protocratie] has come to power. This is the word by which sociologists refer to interest groups that control the state and within which there is a maximum of self-discipline contemporaneous with the existence of a minimum of legal constraints. The Romanian rulers, of one color or another, quickly and convincingly took up their roles of "protocrats" [protocrati], receiving and giving gifts, bribing other people and allowing themselves to be bribed, and corrupting other people and allowing themselves to be corrupted. The phenomenon, which exists all over the free market economy, must be controlled and punished by the state, rather than tolerated.

In Romania it is stimulated and rewarded... In a country where half the population lives below the poverty threshold, in a country lacking a functional market economy, where the state is inefficient and macro-managing things, and where **privatization** is politically inspired -- which makes large foreign investors stay away -- corruption can always detonate into an Argentinean scenario: people rush on banks and destroy them, because money no longer has value, and the courts become fortresses, besieged by the victims of inequality.

[Description of Source: Bucharest Evenimentul Zilei in Romanian -- popular, privately owned daily; known for investigative journalism and criticism of the political establishment without regard to political orientation]

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EXHIBIT Y

[\[Go To Best Hit\]](#)

Unclassified



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Entry Date: 10/23/2002

Version Number: 01

Region: East Europe**Sub-Region: Balkan States****Country: Romania****Topic: DOMESTIC POLITICAL, LEADER****Source-Date: 10/21/2002****Romania: Daily Says Corruption 'State Policy'***EUP20021023000164 Bucharest Romania Libera in Romanian 21 Oct 02 p 2*

[Report by Ion Traian Stefan: "The Barons' Disease"]

[FBIS Translated Text]

The post-December [1989] history will mention the PSD [Social Democratic Party] as one of the most corrupt political parties in Romania, because more than 70 percent of the scandals about the presence of the corruption phenomenon among Romanian politicians refer to the incumbent ruling party's members. So far, there have been three distinct intervals, namely 1990-1992, 1992-1996, and 2000 to date, when the PSD raised corruption to the level of state policy. The radicalization of the corruption phenomenon brought along a new character of the transition phenomenon. This is the "harmless baron." This term has become an ordinary notion for politicians who have turned their public positions into personal deals, meant to bring them huge profits. Despite the existing data, the PSD leaders manufacture ridiculous excuses: we are clean, the press is the one that makes us devilish!

In Romania, the political year 2002 started under the auspices of the fight against corruption! With great hubbub, the rulers initiated a so-called campaign aimed at combating corruption. It culminated with the establishment of the National Anti-Corruption Prosecuting Magistracy. *"The PSD does not grant protection to opportunists or to corrupted people. It is not a political umbrella for such people,"* the prime minister thundered. He voiced this position during one of the meetings he held with the members of the party he currently leads. In turn, Romanian President Ion Iliescu, full of redeeming ardor, recommended that Romanians take corrupt people by their collars, irrespective of the political protection the latter are being granted. More than that, the ruling party set up oversight teams that were to monitor [the activity carried out by] potentially corrupted people. The teams' precise goal was to expel the

guilty persons from the party's ranks. The party's activists in the headquarters, legislators that are members of the parliamentary commission for abuses, and the party's vice-presidents and executive secretaries, have started very detailed analyses at PSD branches throughout the country. This happened after the press had often demonstrated that the ruling party is eroded by corruption. The press launched the topic for the public debate. Together with the country's NATO integration candidacy, the respective topic made the headlines of most articles: this was "the barons," namely those who use public positions in a discretionary manner, to build their financial empires.

"The Operative Anti-Corruption Groups" -- Party Propaganda

Over the summer, the PSD had kept its commandos in check. They were "the eight operational groups" that should have conducted assessments on the corruption accusations published by the media, about their party colleagues. The teams also included three or four members from the Bucharest headquarters. The "liquidators" first task was to draft the press reviews for the 2001-2002 period. Each "inspector" was given a file with press clippings, with the articles published about the people that were to be subjected to control. During the stage following the initial checks, the headquarters should have held individual talks with the "barons" and with the leading teams of the PSD county branches in the field. During the third stage, the possible "evidence" obtained by the "operative groups" was supposed to be transformed into bills of indictment, which would have set the grounds for possible...expulsions of the guilty persons from the party. No member of the Permanent Delegation was allowed to be included in the inspection team that was to conduct the investigation in the respective member's county. For example, [Senators] Alexandru Athanasiu, Florin Georgescu [former finance minister], and Ioan Rus [Interior Minister] dealt with [the problems in] Vrancea County. Uncle Nicu Vacaroiu [Senate chairman] dealt with the most minute details in Bihor County, which reportedly belongs to the Tarau clan. The *Romania Libera* daily has fully proven Vacaroiu's "innocence." Perhaps, instead of looking into the trafficking in gasoline in which the Tarau family was involved, Uncle Nicu propped himself up right next to the still with Bihor palinca [Transylvanian plum brandy]. The Senate chairman's "vigilance" was doubled by [that of Senators] Rodica Stanoiu [Justice Minister] and Mihai Tanasescu [Finance Minister]. Cozmin Gusa [PSD's secretary general], Dan Ioan Popescu [Industry Minister], and Marian Sarbu [Minister of Labor and Social Protection] went to Constanta County. However, the net they were equipped with did not help them make any significant catch, even if it were possible to catch several fat fish there.

As they were frightened by the negative consequences at the image level, which could have damaged the party, the PSD leaders mimicked the intransigence. They promised they would be merciless. Nevertheless, their actions were pure propaganda. The agitation of the investigation commissions was a big nothing. The PSD's justice is blind, deaf, lame, and has dysentery. It is simply dead. It gets stronger only when the Mafiosi rings within the party are exposed, even by the very people who are familiar with them from the inside. This is the case of the four people that were expelled from the party: Bancescu, Naidin, Zavoianu, and Bar. They were instantly punished and sentenced, by dictatorial fiats.

The hunt for "barons" has come to an end these days. The conclusion drafted by the "operative anti corruption groups" is the following. The PSD does not have any "barons." Gusa answered the accusations in the press, "it is you who have made them devils!"

In other words, the PSD leader considers the facts exposed by the press to be just simple stories! Can Gusa still believe that the hundreds of villas, the hundreds of cars, and the

hundreds of [existing] companies were accomplished with money received from grandmother [reference at the prime minister's statement, who said the extremely expensive school fees for his two children are paid by his mother-in-law]?

The PSD's Barons Club Lists More Than 30 Members

The PSD's "barons" acquire governmental funds in their own moneyboxes. They acquire PHARE [Economic Reconstruction Aid for Poland and Hungary] funds. They traffic in oil. They purchase the newspapers that criticize them. They acquire factories by means of rigged bids. They receive money from "dubious" loans. They have outstanding debts to the state. Like any other barons they have huge properties, in accordance with their personal abilities. Mr. Gusa, this is what the press has written about your colleagues. They are Romania's owners. They are Senators, MPs, prefects, mayors, and chairpersons of county councils. The list can include the following names. Nicolae Vacaroiu (the Senate's chairman), Viorel Hrebenciuc (PSD vice president), Dumitru Sechelariu (Bacau mayor), Doru Ioan Taracila (Senator for Calarasi County), Iosif Armas (Calarasi County MP), Nicolae Mischie (chairman of the Gorj County Council), Trita Fanita (Senator for Buzau County), Marian Oprisan (chairman of the Vrancea County Council), Ioan Rus (Alba County prefect), Constantin Nicolescu (Senator for Arges County), Aurel Gubandru (MP for Buzau County), Ion Vasile (Buzau County prefect), Gheorghe Savu (chairman of Ialomita County Council), Marian Balan (Ialomita County prefect), Gheorghe Martin (Constanta County prefect), Culita Tarata (PSD MP), Constantin Nita (MP for Brasov County), Cornel Mondea (Dolj County prefect), Aurelian Seraficeanu (Hunedoara County prefect), Ioan Timis (MP for Hunedoara County), Bebe Ivanovici (chairman of Ilfov County Council), Viorel Gheorghiu (MP for Ilfov County), Liviu Bechis (Maramures County prefect), Eugen Nicolicea (MP for Mehedinti County), Aurel Tarau (Romania's future consul in Szeged, Hungary, after having been removed from office, due to his son, Adrian Tarau's alleged involvement in trafficking in gasoline), Horia Anderco (Satu Mare mayor), Gavril Marza (chairman of Suceava County Council), Mihai Grozavu (vice president of the Suceava County Council), Ilie Platica Vidovici (Senator for Galati County), Teodor Nitulescu (Teleorman County prefect). Do you still need other names Mr. Gusa? There is room left on the list, perhaps you should think it over...

The Person and the Deed

Some percentage of the "barons" stands for the old clients of the pages carrying investigative reports in the newspapers. The newspapers dealt with some of them as far back as 1990 (Bebe Ivanovici -- "certificate" [allegedly involved in cases of issuing counterfeited revolutionaries' certificates], or Viorel Hrebenciuc -- "commission fee" [allegedly involved in many dubious deals]). Other "barons" are newcomers to the spacious location of the party's deals, such as Iosif Armas' case. "Iosumita" is an MP for Calarasi County. He has already taken control of two counties (Calarasi and Caras Severin). He is about to take a portion from a third county, too (Timis). Culita Tarata took over the ubiquity fashion, too. Culita is a boyar in Neamt County. However, he was not so shy as to miss the opportunity of getting hold of Braila's Large Island [Insula Mare a Brailei -- huge agricultural property], too.

Gavril Marza and Mihai Grozavu are other clever Moldovans [from the Romanian historical province of Moldova], who have replaced the peasants' trousers with Versace suits. Following the critical remarks addressed to Marza, Nastase rapidly expelled Ioan Bancescu, the MP for Suceava County, from the party. Marza "administers" the forestry and game funds of Suceava County. Well, Suceava County is the favorite location of the country's first hunter [reference to Prime Minister Adrian Nastase]. This is a reason that is "strong" enough to be

able to ruin the political career of a person who dared raise his voice.

Vrancea County is an open book. This is an educational county for those who want to initiate themselves in the secrets of corruption. The city of Galati is drowned in the thick smoke of furnaces, which makes it impossible to see Platica Vidovici's parasite companies.

Gheorghe Martin, the Constanta County prefect, is the luckiest participant of all those in the bids organized by APAPS [Romania's Privatization Authority -- Privatization Authority and Management of State Shareholding]. His companies, some of which have huge debts to the state budget, are thriving. Monitoring Martin's activity is among Gusa's duties.

In the southern part of the country currently under Mr. Gusa party's governance, Teodor Nitulescu is a person among the persons...who have high regard for themselves. Nitulescu's companies "draw" public money, paid for by various activities. We are talking about a lot of money. Nitulescu catches the journalists who criticize him by the neck. He also humiliates his political opponents. However, the citizens feel most humiliated of all other beings, when they look at Mr. baron, sorry, prefect, as if they were looking at the Teleorman County's variant of the Sultan of Brunei.

"The barons' disease" has also contaminated Nitulescu's neighbors in Ialomita County. They are Gheorghe Savu and Marian Balan. Savu is extremely fond of canned food. That is why he purchased Horticons Fetesti [factory that cans vegetables] for very little money. He gave the slip to the employees in the factory, who were also interested in acquiring the unit. Prefect Balan also owns an IAS [former state agricultural farm], like everybody else. He paid only 8 billion lei for it, after a previous debt amounting to 200 billion lei had been struck off!

It is futile to mention anything about Ilfov County. Bebe Ivanovici's turpitude (he is one of President Iliescu's reliable persons) is famous. He allegedly issued counterfeit revolutionaries' certificates, he was charged with rape, he reportedly issued dubious ownership certificates for land plots located in the area where a future highway is to be built, and so on.

We shall review the Prahova County very briefly, because the number of the party villas is so great that it would be difficult for us to count them at any time. Brasov is not too bad, either. This is also valid, because MP Nita, accompanied by his colleagues Dutu and Sechelariu, is simply full of SRLs [limited responsibility companies] and SAs [stock companies]. He allegedly "self suspended" himself from these companies' [management boards].

Even the poor people in Hunedoara County have their own baron. He is Aurel Seraficeanu. The opulence of the "palace" in which Seraficeanu lives has stirred the anger of some ordinary thieves. During their first incursion to the prefect's home they became rich. If he has such exorbitant sums of money in the moneybox he has at home, how much money could he have in his bank accounts?

No more than the Gorj County chairman's Nicolae Mischie. The PHARE funds lose their way through his pockets. According to his size, Mischie should be promoted to a higher ranking. The ranking of a baron is too insignificant for Mischie's "possibilities."

Mayor Anderco in Satu Mare could also be a baron. The controversial deal "Sala Polivalenta" is tied to his name. The deal amounts to approximately \$1 million. This is next to nothing. At least Anderco is very generous with journalists. The local publications that

praise the PSD receive a central headquarters for a handful of US dollars. We do not want to give you too many details, to avoid inciting again our colleagues, who live due to kissing Mircea Pascu's [Defense Minister] hands.

We are certain that we have "neglected" quite a few "barons" in our presentation. However, we are ending the examples at this point. None of the aforementioned cases is new. And, despite all these, the top leaders in the PSD pretend they do not hear and do not see anything...

If, following the articles published in the press, the PSD's investigators were unable to find the slightest trace of corruption among its members, I take myself the liberty of suggesting the following to Messrs. Gusa and Nastase. Next time perhaps they should also read the Romanian press, not only the one published in Bulgaria, as they have probably done this time.

[Description of Source: Bucharest Romania Libera in Romanian -- respected, privately owned, centrist daily]

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EXHIBIT Z

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Bucharest Daily Agrees With EU Criticism of Romanian Economy, Corruption

EUP20021019000038 Bucharest Adevarul (Internet Version-WWW) in Romanian 18 Oct 02

[Editorial by Ion M. Ionita: "Corruption Masking"]

[FBIS Translated Text]

Although Romania has again been rated as having an "ineffective market economy" by the European Union this year, the fact has not disturbed the Romanian authorities too much, who have given some inconclusive explanations to the population. Prime Minister Nastase admitted that there were, of course, some failures, but he pointed out the remarkable successes obtained by his government: the diminishing of inflation; sustainable economic growth. Other senior officials counted the negotiation chapters that have been opened, those that have been closed, and promised to exceed the negotiation plan immediately after having solved the NATO problem in Prague.

The fact that Romania remains the only candidate for European Union integration with an ineffective market economy was mentioned less by the Bucharest rulers. There was only one minister who analyzed the problem and came to the conclusion that Bulgaria -- our eternal competitor for last position in Europe -- has already developed its market economy for only two reasons. Firstly the number of its population is half of Romania's and secondly it hardly has any economy at all. Our rulers helped us get rid of the Bulgarian complex and invited us to stay quiet and let them worry about taking us into the EU, according to the Romanian model. A model which the same European Commission remarked to include -- beside the market economy failure -- as the subordination of the legal system to the ruling party. The European authorities concluded by unanimously remarking on the high level of corruption in Romania.

The government of Adrian Nastase praises its achievements in the meantime, and treats its little failures in a "sectoral" manner. Strategies are cooked up for industry and for agriculture. Programs are devised for the reform of the legal system. A tough battle is fought against corruption, the last victory being the establishment of the PNA [National Anti-Corruption Program], which caught a corrupt man with three hundred dollars in his pockets and is determined to catch some more. The only problem is that, for the time being, it has no office, no computer, and no employees.

The period of time that has elapsed since the present government assumed power proves that the programs and strategies meant to resolve the difficult problems which face Romanian society and keep us out of Europe are only dust in the eyes of the European authorities, not an attempt to convince them that we are really determined to take action. In brief, a functional market economy is characterized by the existence of transparent and equal rules that are to be observed by all economic actors. It is a game in which the best player wins, and the most efficient one gets rich. There is no need to wait for dozens of years to adopt such rules. The rules in our country are neither transparent nor equal for all, because the economic principle guiding our rulers is "money for us and for our party" -- a principle which has little to do with the market economy.

The state became the ideal instrument used to rob the many and give to the few who are in power. The financial supporters of the party and state oligarchy benefit from pseudo-auctions, by which they take hold of whole economic sectors, which bring them huge profits -- based not on their efficient activities, but on their failing to pay their debts to the state. These debts lead to immense losses and to an ever-growing hunger of the state for the citizens' money. One of the sources of such money is the health funding, which the government has simply confiscated, instead of protecting. No one should therefore be surprised that there is not enough money left to assure the compensation for medicines so necessary for old retired citizens.

Economic protection is paired for ruling party members with protection from justice. The case of Tarau, one of the main party sponsors, is a typical one. He was arrested for smuggling, but was set free within 24 hours, following some discreet hints dropped by Prime Minister Nastase. Later on, because the gravity of his case was all too obvious, he was allowed to leave the country and no one knows anything about him any more. Viorel Gheorghiu also paid his tribute to the party and the party protected him no matter what he did. The same was true about Gabriel Bivolaru. The situation is even more dazzling in the case of Senate Chairman Nicolae Vacaroiu, accused of having had close relations with the dirty businesses of SOV [Sorin Ovidiu Vantu -- businessman accused of many illegal activities], from which he obtained large profits. The solidarity with this "poor man harassed by the press" is so strong, that it makes you think that the party has had its share of these profits.

It is therefore no surprise that PSD [Social Democratic Party] is undermining the laws promoting transparency. A big fuss was made about the adopting of the law on citizens' free access to public information. Most of those who ask questions, which refer especially to the management of public money, are told that the relevant information is not covered by the provisions of the law. The legal commission of the Senate has not even bothered to waste time with formalities. The venerable senators decided that dignitaries' assets are more secret than state secrets and put an end to the discussion. The country's rulers and their clients can continue at ease. The system works for them, but not for us, unfortunately. As long as corruption remains at such high levels, Romania will never have a market economy. And if

the country does not have a real market economy, we can say goodbye to EU accession, even in 2007, no matter how many successes the Adrian Nastase government will report.

[Description of Source: Bucharest Adevarul (Internet Version-WWW) in Romanian -- large, influential, privately owned daily, with a centrist perspective]

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