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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Publié également en français.

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BASIC STATISTICS OF ROMANIA (2000 unless noted)

THE LAND

Area (sq. km)	238 391
Agricultural land (in per cent of total area)	62.3

THE PEOPLE

Population (thousands, mid-year)	22 435
Life expectancy at birth:	
Male	67
Female	74.2
Infant mortality (per thousand live-births)	18.6
Registered unemployment (percentage of the labour force, April 2002)	11.1
Labour force survey unemployment (percentage of the labour force, Q4 2001)	6.4
Recipients of pensions (excluding disability; thousands)	5 500

Employment (thousands)	8 629
Employment by sector (percentage of total):	
Agriculture	41
Industry (including construction)	27
Services	32

PARLIAMENT (NOVEMBER 2000 ELECTIONS)

Two chambers:	Chambers of deputies (345)	Senate (140)
Party of Social Democracy in Romania (PSDR)	155	65
Greater Romania Party (GRP)	84	37
Democratic Party (DP)	31	13
National Liberal Party (NLP)	30	13
Hungarian Democratic Union in Romania (HDUR)	27	12
Others	18	0

PRODUCTION

GDP (2001, billion lei, current prices)	1 154 126
GDP per capita (2001, US$, purchasing power parity exchange rate)	6 170
Gross fixed capital formation (2001, percentage of GDP)	19

PUBLIC FINANCE

General government budget balance (2001, percentage of GDP)	–3.3
General government revenues (2001, percentage of GDP)	30.5
General government expenditures (2001, percentage of GDP)	33.8
Public debt (end-year, percentage of GDP)	29.1

FOREIGN TRADE AND FINANCE

Exports of goods and services (2001, percentage of GDP)	33.5
Imports of goods and services (2001, percentage of GDP)	41.6
Foreign exchange reserves (mn US$, May 2002)	6 351.5
Gross medium and long-term external debt (mn US$, May 2002)	13 017.9

CURRENCY

Monetary unit: Leu	
Currency units per US$ average of daily figures:	
Year 2001	29 060.9
June 2002	33 392.3

The Secretariat's draft report was prepared in the Economics Department *by* Joaquim Oliveira Martins *and* Rudiger Ahrend, *under the supervision of* Silvana Malle.

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This Survey was first released on internet as a draft under the title OECD Economic Assessment 2002 Romania. *It is now published on the responsibility of the Secretary-General of the* OECD.

Assessment and recommendations

Romania continued to experience a troubled transition process…

After the failed stabilisation plan of 1997, Romania went through a second deep transitional recession with the GDP declining by over 12 per cent during three consecutive years while inflation continued to be consistently higher than in comparable transition countries of Central and Eastern Europe. The privatisation process and economic restructuring also lagged. In 1999, the country had to weather a payment crisis and since then it has been looking for a new path to economic policies. In 2001, macroeconomic performance improved somewhat with 5.3 per cent GDP growth and inflation showing a declining trend, though with pressures on the external balance. Overall, looking back to a decade of transition in Romania, the impression is that precious time has been lost.

… reflecting the lack of a comprehensive approach to reforms

Against this background, the OECD has consistently advised Romanian governments to adopt a more comprehensive approach to reforms (see table of follow-up on previous recommendations). The message has been that macroeconomic stabilisation cannot be durable without sufficient progress in the restructuring of the financial and enterprise sectors and the creation of an environment favouring the expansion of new private businesses. Implementing a comprehensive policy package requires strong policy co-ordination. In this respect, the successive governments failed to deliver. Several co-ordinating units were created in the past but they never succeeded in bringing together *ad hoc* policies into a coherent framework. The decision process remained fragmented, subject to conflicting political influences. Without a co-ordinated approach, the authorities were left to muddle through short-term shocks.

A new government announced its commitment to reforms

Following the general elections of end-2000, a new government came to power in Romania. It has not yet fully addressed the co-ordination problems noted above; nevertheless, it has announced its strong commitment to put Romania firmly on track for membership in the EU and NATO – a process which has strong political levers, but is also closely linked to an effective implementation of economic reforms. The stakes are higher than in 1997, but so are the chances to succeed if the appropriate policy measures are taken. Indeed, while the 1997 stabilisation programme failed its primary objectives, it made some important breakthroughs. Freeing prices and the exchange rate, cutting off some of the most notorious channels of soft lending to the enterprise sector and starting the financial sector restructuring made room for improved fiscal and monetary policies. Decisive structural reforms can now be pursued.

How can a more comprehensive approach to reform be implemented?

Underlying a comprehensive approach to reforms is an understanding of the main linkages and feedback between different areas of economic policy. The framework proposed in this *Assessment* encompasses five major blocks: *Liberalisation*, *Stabilisation*, *Financial sector reform*, and mechanisms of *Exit* and *Entry* in the enterprise sector. Positive or negative policy interactions relate these areas of reform. The key message is one of policy synergy: most of the gains from the reform process come actually from mutually supportive policy interactions rather than from going ahead with reform in one single area.

Liberalisation should be pursued in connection with other reforms

Along these lines, the effort towards *liberalisation* initiated in 1997 should be pursued. The main remaining area for reform are energy prices. The current government aims at making energy prices in Romania converge towards international levels by 2003, while at the same time building a proper regulatory framework and protecting the lower income segments of the population. Liberalisation also means making more use of market prices and market mechanisms in all policy areas. For example, monetary policy is moving towards market-based mechanisms. Liberalisation also entails reducing state interference in the economy, which is still very high compared with OECD countries.

With a more coherent policy approach, the objective of price stabilisation could be firmly pursued

The objective of price *stabilisation* needs to be firmly pursued, though steady progress is more important than rapid results. The conduct of monetary policy has been complicated by a number of special circumstances: very high interest rate volatility driven by fluctuations in Treasury bill issuance; occasional requirements to inject temporary liquidity in carrying out lender of last resort functions; concerns about external competitiveness in the context of the weak balance of payment position; and the need to build-up foreign exchange reserves. As a result, the central bank had little choice but "muddle through' among conflicting objectives. At this stage, and without a more active support from structural policies, a move towards inflation targeting would be premature. A moderate real exchange rate appreciation, which is pursued by the central bank, can be used as a temporary anchor to help disinflation. But the pace of appreciation should be carefully gauged in terms of total factor productivity growth (not only labour productivity), taking into account that the export sector is dominated by highly price sensitive products. At the same time, operations in the domestic money market should be oriented at avoiding large fluctuations in liquidity so that evolution of interest rates will continue to depend mainly on government borrowing policies. Over the medium term, growth and investment will be better supported by progressive and steady disinflation.

Sustained fiscal stabilisation depends on the restructuring of the enterprise sector

The fiscal framework has improved. A number of quasi-fiscal items have either been cleaned or appear more transparently in the budget. The number of off-budget funds has also been reduced. While the quasi-fiscal deficits are still at around 1 per cent of GDP in 2000-01, this ratio is much lower than in 1996. Nevertheless, fiscal consolidation remains hostage of the unrestructured enterprise sector. Expenditure control is complicated by large losses and undue wage increases in state-owned enterprises. Tax revenues are difficult to project in the context of large payment arrears. Under these conditions, the government's objective of increasing tax revenues in proportion of GDP can hardly be achieved by increasing contribution rates. As in the past, this would only create more arrears and develop the shadow economy. The burden on the formal economy could become excessive, as the ratio of tax revenues to "formal" GDP is already around 38 per cent. Streamlining the tax system would be a better policy both to broaden the tax base and to help reduce the administrative burden to enterprises. This would require enhanced co-ordination in the fiscal administration as currently different ministries, social funds and agencies are collecting their own taxes and contributions separately.

Financial sector reform will continue to contribute to stabilisation and the hardening of budget constraints

Progress in *financial sector reform* has been achieved in recent years through the privatisation, restructuring or liquidation of large state-owned banks. Their portfolio of bad loans has been transferred to an Asset Recovery Agency. This process will be nearly completed with the privatisation of the largest bank (B*anca Comerciala Romana*), which the government is committed to finalise by early 2003. This financial restructuring is a cornerstone for both improving the effectiveness of monetary policy and for enforcing hard-budget constraints in the economy. But new private banks cannot do sound business without a restructured enterprise sector. Bank lending under state guarantees can also be a source of contingent liabilities to the budget. Over the medium term, the development of financial intermediation will require further institution building through improved bankruptcy procedures and creditor protection.

The "exit" of non viable firms needs to be completed

E*xit* mechanisms need to be enforced. The only way to know if state-owned enterprises have a viable market demand is to impose hard-budget constraints. The levels of negative value-added in some of the unrestructured companies are staggering. Wages in these enterprises also often tend to be above the national average and increases are decided on a political basis. This compromises the predictability of fiscal targets. The lack of restructuring in the enterprise sector also contributes to widespread financial indiscipline (arrears are still around 40 per cent of GDP). A new Law passed in March 2002 can accelerate the privatisation and liquidation process: it establishes no minimum price and provides new financial arrangements concerning past arrears to the state budget. But its effects will depend on the way it is implemented. For example, the "special administration" period allowed by the Law can be a good or a bad way to prepare an enterprise for privatisation, depending on how administration is run. The same applies for the transfer of the enterprises from the Privatisation Authority to the line ministries. Their management can improve, but nothing really ensures that privatisation will be speeded up.

Reform of the energy sector is key to the whole economy

The energy sector has been the primary element in the chain of inter-enterprise indebtedness. The government's policy of unbundling the energy utilities goes in the right direction, but this is not enough. Price increases have to be followed by effective payment discipline of energy bills and all bad-payers should suffer disconnection. Because of the lack of restructuring the waste of resources in the energy sector is very large. Notably, the production and distribution of heating is affected by huge inefficiencies. In this area, the time needed to increase prices up to the level needed to finance new investments will probably be much longer. In this context, the opportunity costs of new public capacity investments (*e.g.* the use of the Fund for Energy Development) have to be carefully assessed against the benefits of increasing energy efficiency of the installed production capacities.

The new private sector is the main engine of transformation…

Because of delays accumulated in the restructuring of the large-enterprise sector, the E*ntry* of new enterprises will be the main engine of economic transformation. It would be important to remove all possible barriers for new businesses. Following recent legislative changes the regulatory environment is now relatively liberal, at least on paper; although it should be noted that these changes perhaps have not yet had enough time to become effective. At the same time, the continuing heavy involvement of the state in the economy inevitably restrains the scope for the private enterprise to develop autonomously. Enterprise creation has occurred mainly in export sectors, notably subcontracting activities in the textile sector, but these enterprises will have to adjust to tougher competition from other regions (noteworthy, the international Multi-Fibre Agreement will end in 2005). In this context, it would be important to use the potential for employment creation in the service sector, as for example retail distribution in the inner cities is still not very developed in Romania. The latter would benefit from land and property reform.

… and the administrative burden for the "entry" and development of new businesses should be reduced

The enterprise sector perceives the legal framework as uncertain, discouraging both for domestic and foreign investment. A certain legalistic approach to reforms tends to exacerbate this problem. It is widely recognised that administrative "harassment" related to tax obligations is very heavy and induces micro-corruption. Corruption as a whole, notably in the judicial area, needs to be firmly addressed. This is recognised as one of the most serious barriers for a good business environment in Romania. The government has proclaimed its determination to fight corruption, but the real implementation test is still ahead.

Other framework conditions need to be in place

Other areas which are not discussed in detail in this report would also need to be co-ordinated within a comprehensive policy framework. First, social policies need to be supportive of the structural reform process. They should be designed to avoid excessive social strain, but should also not be over-protective and thereby undermine incentives for enterprise creation and employment. Another important issue is administrative capacity. The status of civil servants is low. Salaries are below average in the economy and management practices do not favour initiative or reward competence. As a result, public services tend to be inefficient and a source of corruption. The reform of the Romanian Civil Service could be an important step to acquire the capacity to implement reforms and enhance the level of trust in the public authorities that is much needed.

Summing up

The 1998 OECD *Economic Survey of Romania* demonstrated that the gradualist approach of the early years of transition was ill-designed and precious time was lost. Romania cannot really afford to continue without a comprehensive approach to reform. Credibility, which is only slowly improving, could be badly affected. The current window of opportunity is narrow, as the government is already in the middle of its political cycle. While the macroeconomic framework has improved, it is difficult to make rapid progress in all areas. In this regard, a comprehensive approach to policies can help to go forward with the most relevant reforms. This *Assessment* focuses on the key policy interdependencies that the government should keep in mind, notably in designing and implementing new legislation. Indeed, laws are important, but so is appropriate implementation. Romania has suffered for too long from over-involvement of the state in economic activity and it is now time to push for a more market-based adjustment of the economy. Notably, economic restructuring should be done as much as possible via transparent market mechanisms. This requires strong political commitment on the part of the government, whose determination will be crucial to improve the image of the country in the international community. Clarity in policy objectives and timely implementation are crucial. The stakes seem too high to forego the present opportunity, because slippage would severely compromise the chances of successfully pursuing the EU and NATO accession process, and further retard a sustained rise in the living standards of the Romanian people.

Table 1. **A summary of follow-up on previous OECD policy recommendations to Romania**

Summary of OECD 1993 and OECD 1998 recommendations	Follow-up of the 1993 recommendations in the 1998 Economic Survey	Follow-up in the Economic Assessment 2002
I. Co-ordination of the reform process		
The legislative process tends to be overwhelming	(–) While there is an ongoing need for institution building, a problem of excessive legislative activity remains.	(–) Legislative process continues to be "frenetic". The adoption *acquis communautaire* of the EU may be exacerbating this tendency, but over the long run could provide an "anchor' to the legal system.
There is poor co-ordination among Ministries and excessive minutiae in the decisions of the Council of Ministers. The 1993 Assessment suggested the creation of a Ministry of Economic Reform to help improve co-ordination among the different agencies dealing with privatisation.	(–) In 1997, the Council for Economic Reform and related Agencies were under restructuring.	(–/+) Government meetings are known to be excessively long and not adequately underpinned by mechanisms to structure decision-making. There is a plethoric number of state-secretaries. In 2001, the Council for Economic Reform and related Agencies were suppressed. In June 2002, a new co-ordinating unit was created under the Prime Minister office. This unit has a broad horizontal mandate dealing with a range of economic and financial institutions.
There is a tendency for the different Ministries to be secretive with each other, and there are information transmission problems within the government.	(–) The level of information diffusion in the Administration was low.	(+) The presence of a majority party in the Parliament may also have improved somewhat co-ordination within the government.
II. Price liberalisation and competition		
In 1993: Reduce monopoly power, enhance competition. Remove administrative allocation of goods and services. In 1998: – Competition Law should be enforced. In 1998: There is a need to co-ordinate, possibly streamline, the activities of the Competition Council and the Competition Office (under government authority).	(+/–) Most of the administrative allocations were removed only in 1997. A new Competition Law passed in 1996 and a Competition Office and Council were created. Agricultural and energy prices were liberalised in February 1997.	(–) There are still two agencies dealing with Competition Policy, Competition policy enforcement is weak (no resources and lack of political will). (+) Regulated energy prices were further adjusted in 1998, but only by mid-2001 they were once again adjusted for inflation. The adjustment has continued in 2002.
III. Fiscal policy		
In 1993: Start planning for future pressures on social expenditures and the decline of tax revenues related to lower inflation. In 1998: Close monitoring of the Social Security Funds (the number of beneficiaries was increasing and the contribution base had been eroded).	(–) Collection of taxes was poor. The taxation of overall income was planned for January 1999.	(+/–)The accumulation of arrears is pervasive. Better collection for the Unemployment Fund, but the Pension Fund remains problematic. The latter Fund is the major source of arrears for the state budget.
Reform the accounting and tax systems in order to increase depreciation allowances and lower taxes on inventory valuation profits from inflation	(+) In 1997 the accounting system was reformed to allow accelerated depreciation allowances. The FIFO method for evaluation of stocks was still in place.	(+) The Government is planning to reform the accounting system to adopt the IAS standards.

Table 1. **A summary of follow-up on previous OECD policy recommendations to Romania** (*cont.*)

Summary of OECD 1993 and OECD 1998 recommendations	Follow-up of the 1993 recommendations in the 1998 Economic Survey	Follow-up in the Economic Assessment 2002
VAT should account for a larger share of tax revenues. The number of exemptions should be reduced. The exemptions in custom duties and profit taxes are not effective in promoting FDI and exports.		(–) The government continued to use VAT and custom duties exemptions to promote SME development. Under the pressure of the IMF, these exemptions were abolished in 2002 and will be replaced by a uniform investment tax credit. This has created some uncertainty in the investment environment for SMEs. The shadow economy is also eroding the tax base. According to official estimates, the shadow economy accounts for 20 per cent of GDP (but may be as high as 40 per cent).
Improving the budget management system: Prioritisation, more decentralisation, firm budgetary ceilings.		(+/–) Some progress was achieved in the budget process. The authorities are considering the implementation of the programme budgeting, but the administrative infrastructures are weak.
The authorities should aim towards a more neutral tax treatment of the different economic activities and incomes.		(–) Some activities continue to be perceived as more strategic or sensitive than others.
IV. Monetary policy		
Financial discipline, enhanced role of price mechanism and full convertibility for current account transactions are the basic ingredients for reform of the exchange rate policy.	(+) A market-oriented exchange rate regime was implemented early 1997.	(+) The monetary policy framework has clearly improved. The NBR has also gained credibility.
A more active role of interest rate policy is needed.	(+) A new National Bank Law was passed in 1998, which allows for a more active role of interest rate policy.	
The disinflation process should focus on sustainability rather than rapidity.		(+/–) Between 1996-1998, inflation accelerated, but since end-1999 the rate has been displaying a downward trend.
The National Bank of Romania (NBR) interventions in the foreign exchange market are reasonable, providing that they do not compromise the disinflation process – The NBR should avoid being perceived as backing a particular level of the exchange rate level and, thus, supporting one-way bets from investors.	(–) In 1997, the NBR carried out an explicit policy of avoiding an excessive appreciation of the real exchange rate.	(+/–) Officially, the NBR targets money base growth, but continues to be seen by the market as having an implicit exchange rate target. The NBR is considering the possibility to move towards inflation targeting.
V. Banking sector		
Banca Agricola and *Bancorex* need immediate restructuring due to their large non-performing loans to the agricultural and energy sectors. Use the expertise of foreign investors for the privatisation of banks.		(+) *Banca Agricola* was privatised and sold to a foreign investor. *Bancorex* was liquidated and some assets merged with BCR, which is set for privatisation in 2002.

Table 1. **A summary of follow-up on previous OECD policy recommendations to Romania** (*cont.*)

Summary of OECD 1993 and 1998 recommendations	Follow-up of the 1993 recommendations in the 1998 Economic Survey	Follow-up in the Economic Assessment 2002
VI. Privatisation and Restructuring		
In 1993: The privatisation process should remain decentralised. MEBOs (Management-Employee buy-outs) may help to speed up privatisation. In 1998: A more standardised and decentralised approach could be implemented for the privatisation of small and medium-sized companies (provided that local administrations have the competencies to handle such privatisations).	(+/–) An attempt was made to accelerate the privatisation process in 1996 via the Mass Privatisation Programme. MEBOs were used, but the experience was mixed. The decentralised approach was in practice difficult because the State Ownership Fund played a major role in selling state assets.	(+/–) The government has only recently decided to decentralise part of the SME privatisation in the public utility sector to local authorities, but this is not yet fully implemented. The SMEs in the Privatisation Authority's portfolio have been privatised by its local branches since 1998. (+) A new Law on the Acceleration of the Privatisation was passed in March 2002. Some provisions in the law require close implementation follow-up.
Banks should be involved in restructuring.	(–) Banks were reluctant in initiating action against debtors or making use of equity vs. debt swaps.	
In 1993: Identify and close down the small number of large loss-making companies. In 1998: In the industrial sector, the *Régies Autonomes* (RAs) and "strategic enterprises" contribute heavily to the widespread lack of financial discipline. These companies need to be privatised. Together with privatisation, the option of liquidation should be considered.	(–) Economic restructuring took place rather slowly during the period 1993-96. The restructuring of the mining and petrochemical sectors were underway. Liquidation/privatisation procedures were announced in early-1997. Ordinance on restructuring of *Régies Autonomes* in July 1997.	(–) The measures decided in 1997/98 were not fully implemented. Limited progress has been achieved in the privatisation of the large-enterprise sector. Very few liquidations occurred in the large loss-making enterprises.
The large state-owned enterprises in the agricultural sector need to be restructured (notably a list of loss-making pig and poultry farms).		(+) The liquidation of the loss-making enterprises in the agricultural sector progressed.
However, speed of privatisation is not the only criterion. Notably, in the case of public utilities the appropriate regulatory framework needs to be in place before privatisation.		(+) There was some progress on the recognition of the need for a regulatory framework. Regulatory agencies have recently started their activities. They are formally independent, but there have been cases where their decisions were overruled by the government.
Do not use "golden shares". They diminish the value of the company and it is preferable to address regulatory issues through an appropriate framework.		(–/+) The "golden share" option is still applied, but in the context of the negotiation of the EU acquis communautaire the authorities are committed to withdraw this provision both in the old and new contracts.
Need better co-ordination of the privatisation process, as too many governmental agencies are involved in privatisation. In this regard, it is important that privatisation is not captured by the line Ministries.	(–) In 1997, the Council for Economic Reform and related Agencies were under restructuring.	(–/+) In 2001, the Council for Economic Reform and related Agencies were suppressed. The new government was expected to streamline the privatisation framework, but responsibility for the privatisation of the main public utilities was given back to the line Ministries, This was agreed with the World Bank under the new Public sector Adjustment Loan (PSAL-II). The main argument for this change in policy relates to inefficiencies of the Privatisation Authority (former State Ownership Fund). The issue of co-ordination of the whole process remains somewhat unclear.

Table 1. **A summary of follow-up on previous OECD policy recommendations to Romania** (*cont.*)

Summary of OECD 1993 and 1998 recommendations	Follow-up of the 1993 recommendations in the 1998 Economic Survey	Follow-up in the Economic Assessment 2002
Implementation of management contracts.	(+) A new Law on management contracts was adopted in August 1997.	
In the area of privatisation, the legal system is confusing and unstable.		(–/+) The legal environment continues to be characterised by a strong instability. For example, the provision in the Privatisation Law eliminating a minimum price was cancelled. In the new Law for the acceleration of Privatisation (137/2002) the minimum price was set to 1 €.
In 1993: Remove the substantial barriers to the development of SMEs. In 1998: The development of the SME sector is critical for the restructuring process. Entrepreneurship needs to be promoted and policies on SMEs need to be better co-ordinated. The administration is still not very "friendly" towards private entrepreneurs.	(–) Substantial administrative barriers still hamper the development of SMEs.	(+/–) A Ministry for SMEs was created in 2001, but with mixed results. On the paper, the administrative delays for enterprise creation were reduced (to 20 days). At least, there is a recognition of the important role of SMEs in the economy.
Effective implementation of bankruptcy law is needed.	(+/–) Progress still to be made on the implementation of the bankruptcy law. New bank bankruptcy law passed in 1998.	(–) Weak implementation of bankruptcy and protection of creditors.
Remove protection of foreign exchange credits in case of bankruptcy.	(+) The protection of foreign exchange credits was removed.	
Make prudent use of export promotion policies.	(+) The implicit subsidisation of certain energy intensive exports was terminated in 1997. Export promotion policies are hampered by tight budget policy.	(+) The government is envisaging the creation of an Exim Bank.
Trade liberalisation should continue to be used as a tool for economic restructuring.		(+) The trade regime is rather liberal. In the agricultural sector, the EU accession process is actually preventing lower trade barriers.
FDI is also key for the restructuring process, but the authorities should focus in providing a sound legal and economic environment for foreign investors rather than special incentives or overly attractive legislation.		(+) Rather favourable stance towards FDI, but still tendency to focus on tax advantages and preferential treatment. A new Law on FDI was passed in June 2001.
Emphasis should be given to the present enterprise performance rather then to the stock of accumulated financial arrears (because these arrears were generated under distorted price conditions).	(–) The stock of arrears was around 36 per cent of GDP in 1997.	(+) Under the New Privatisation Law, past debts are frozen and budget constraints focus on the flows of new debts. The government is expected to redeem partly the stock of past arrears before privatisation. By 2001, the stock of arrears to GDP was estimated to be around 40 per cent of GDP.

Table 1. **A summary of follow-up on previous OECD policy recommendations to Romania** (*cont.*)

Summary of OECD 1993 and 1998 recommendations	Follow-up of the 1993 recommendations in the 1998 Economic Survey	Follow-up in OECD(2000) and Economic Assessment 2002
VII. Social policies		
In 1993: Use the surplus of the Unemployment Fund to promote labour mobility rather than to support the budget. With unemployment risks being concentrated on new entrants, youth unemployment has to be addressed specifically.	(–) No specific measures were taken concerning the Unemployment Fund.	(+) The financial accounts of the Unemployment Fund seem better managed.
Streamline the system of social protection in order to free-up financial resources for investment. Target social benefits rather than consumption subsidies.	(+) All consumption subsidies were removed in 1997, except basic household heating services and electricity.	
Social policies should support the process of economic adjustment.		
Severance payments are relatively generous and should be temporary. They are conceived for mass redundancies in a limited set of enterprises and can only address part of the social problems associated with transition.		(+/–) New regulations in 1999 (Emergency Ordinance 98) permit paying severance benefits regardless of enterprise ownership. Following OECD(2000) the rules ought to be clarified: it is inappropriate to pay more than ordinary unemployment benefits when lay-offs occur under normal market conditions. Severance benefits should only be a temporary measure. There is a need to reduce them once the large state-owned enterprises begin to restructure.
The authorities should not encourage early retirement and disability pensions. These ease unemployment pressures in the short-run, but entail long-term costs. The benefits should be used to encourage job seeking.		
Social policies should encourage a longer stay in the education system.		
Active labour market policies should be concentrated in counselling and job-search assistance.	(+/–) Active labour market policies have been limited in scope.	(+) The need for job counselling and placement increased as a result of the severance benefits. Other active labour market programmes are implemented only on a small scale, as the OECD has recommended.
In alleviating extreme poverty, child allowances should not be used as a target mechanism.	(–) The main social measures accompanying the 1997 stabilisation plan were indexation of low revenues and child allowances.	(+/–) Many municipalities don't implement the means-tested social assistance benefit scheme, for lack of resources or because they have different priorities. OECD (2000) noted that there is need for such a scheme as a last resort, but also needs effective implementation. In-kind forms of social assistance such as social canteens, are useful in the meantime.

N.B.: (+) stands for a qualitative improvement and (–) for no improvement; (+/–) stands for a mixed development.

I. Overview of transition and policy framework

Background: the second transitional shock of 1997-99

The early stages of the transformation process in Romania were described in the 1993 OECD *Economic Assessment*. The first transitional shock – a close to 30 per cent fall in GDP, one of the deepest amongst Central and Eastern European countries– was analysed and the gradualist policy adopted to manage the transition discussed. A more comprehensive approach to reforms was advocated in the *Assessment*, as macroeconomic stabilisation policy seemed doomed to fail without a better co-ordination with structural reforms. Indeed, during 1993-96 Romania experienced a volatile economic environment characterised by positive growth, but high inflation and growing macroeconomic imbalances.

Following general elections of end-1996, a new government came to power. This government announced and started to implement a bolder approach to reform (see Box 1). Prices and the foreign exchange market were liberalised. A number of direct credit and other forms of subsidisation of loss-making enterprises in agriculture and industry were abolished or reduced. As a result of these measures, the budget and current account deficits were reduced but inflation soared. The OECD *Economic Survey* published in 1998 stressed once again the need for a comprehensive approach to the reform process. Nevertheless, despite its commitment to reforms, the government was not able to come about.

Tighter budget and monetary policy induced a strong credit crunch in the enterprise sector. The most affected were the large state-owned enterprises (hereafter, SOEs) which had previously benefited from easy financing. By mid-1997, the monthly industrial output had fallen by 20 per cent compared with previous year. The impact of this second transitional shock surprised the government, which began to back track from the announced structural reform plan as from the second half of 1997. Large-scale restructuring of large SOEs was postponed and towards the end of 1997 monetary policy was relaxed.

During 1997-98, following the Asian and Russian crises, the international environment sharply deteriorated. This induced a serious drying-up of capital flows to emerging markets in general and transition countries in particular. Despite some progress in reducing inflation and controlling the state budget, the external

Box 1. The 1997 stabilisation plan

In February 1997, the then new elected government put in place a "shock therapy" programme intended to break with the previous gradualist approach and accelerate the process of structural reforms. Reflecting both the necessity of building up a legal framework and a somewhat legalistic approach to economic reforms, the centrepiece of the government plan was a package of so-called 100 Laws.

The first priorities were full liberalisation of prices (energy, agricultural products and public services), reducing tariffs, removing subsidies and phasing out directed credits to the agricultural sector. The central bank tightened monetary policy and a lower budget deficit target of 3.5 per cent of GDP was announced. The government put in place some partial indexation rules in order to protect low incomes from the inflationary effects of price liberalisation. The main structural reform priorities were (OECD, 1998):

a) Strengthening financial discipline by privatising or liquidating the major loss-making state-owned companies and preparing the restructuring plan for the large public utilities, *Régies Autonomes* (RAs);

b) Accelerating the privatisation programme by selling a cumulative total of 60 per cent of the companies from the initial portfolio of the State Ownership Fund (SOF) by end-1997. Transforming the *Régies Autonomes* into commercial companies in preparation for their privatisation and starting the privatisation process of banks. Streamlining the institutions dealing with privatisation;

c) Reforming the agricultural sector by reducing subsidies, price liberalisation and further privatisation; development of a land market; tightening the financing mechanisms and measures for the re-deployment of labour to non-agricultural jobs. Reduction of external trade barriers affecting agricultural products.

d) Promotion of foreign investment: adoption of new laws eliminating restrictions on repatriation of earnings, guarantee of free transfers of foreign currency for the purchase and sale of assets, and elimination of bureaucratic barriers and other regulations.

An *ex post* assessment of this ambitious plan shows that most directed credits to the agricultural sector were phased-out and the subsidies appear in the budget, improving transparency. The budget deficit was brought under control. The government put in place a rather favourable legislation concerning FDI, but actual foreign investments remained subdued. However, the restructuring of the large enterprise sector continued to lag behind.

deficit of 6-7 per cent of GDP for the 1996-98 period became unsustainable. The fall in foreign reserves and a peak in the reimbursement of the external debt brought the country close to a payment crisis in early 1999. Through a further reduction of the fiscal deficit, tight income policies and a large exchange rate correction, the

Table 2. **Main macroeconomics indicators, 1997-2002**

	1997	1998	1999	2000	2001	2002p
GDP growth (%)	–6.1	–4.8	–1.2	1.8	5.3	3.5-4.0
Inflation (%)						
(end-year)	151.4	40.6	54.8	40.7	30.3	22.0
(average)	154.8	59.1	45.8	45.7	34.5	..
Unemployment rate (%)						
(registered)	7.5	9.3	11.4	11.2	9.0	11.0
(LFS)	6.0	6.3	6.8	7.1	6.6	7.0
Fiscal balance[1] (% of GDP)	–3.3	–3.0	–1.9	–4.0	–3.3	–3.0
Including quasi fiscal[2]	..	..	..	–4.8	–4.3	..
Current account						
($ billion)	–2.1	–3.0	–1.5	–1.4	–2.3	..
(in % of GDP)	–6.1	–7.0	–4.1	–3.7	–5.9	–5.5

1. Fiscal balance refers to consolidated general government.
2. Including the quasi-fiscal items related to the losses of state-owned enterprises (see Box 5, main text).
Source: INSSE, NBR, Ministry of Finance and OECD projections for 2002.

current account deficit was brought down to around 4 per cent of GDP in 1999. Supporting this adjustment, in the same year, a stand-by loan was negotiated with the International Monetary Fund.

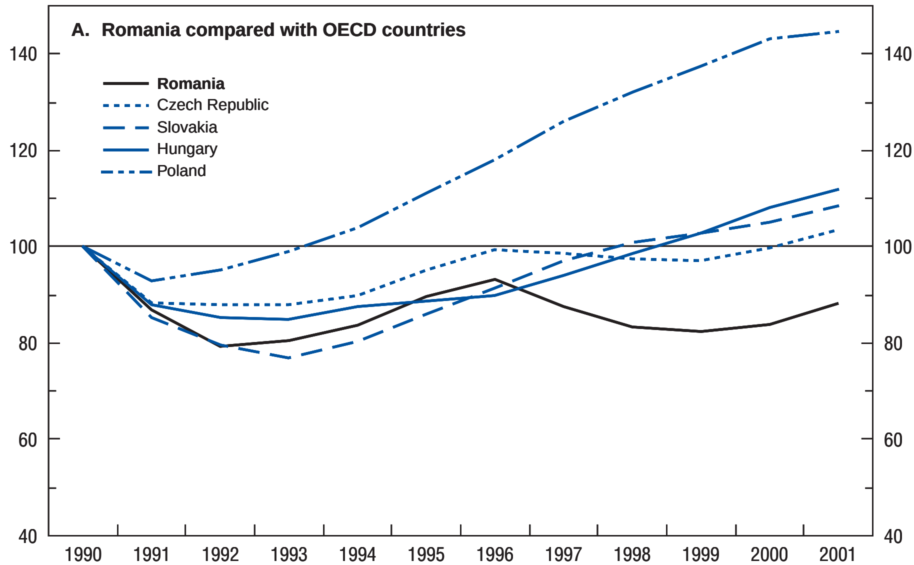
Overall, between 1997 and 1999, GDP fell by over 12 per cent (Table 2). The response to financing constraints was increasingly pervasive financial indiscipline. Total (gross) arrears in the economy peaked at above 40 per cent of GDP by end-1999. These arrears were concentrated in the large enterprise sector, especially in the firms with state ownership or public *Régies Autonomes* (see Chapter III). The informal economy increased significantly during this period (Dochia, 2000). Combined with the effects of the economic recession, increasing arrears produced a further deterioration in the portfolio of the banking sector. Nevertheless, by freeing prices, stopping some of the most notorious channels of soft lending to the enterprise sector and starting the financial sector restructuring in 1999, the "failed" stabilisation plan of 1997 has created some irreversible conditions that made room for improved fiscal and monetary policies. Decisive progress in the structural reform area can now be pursued.

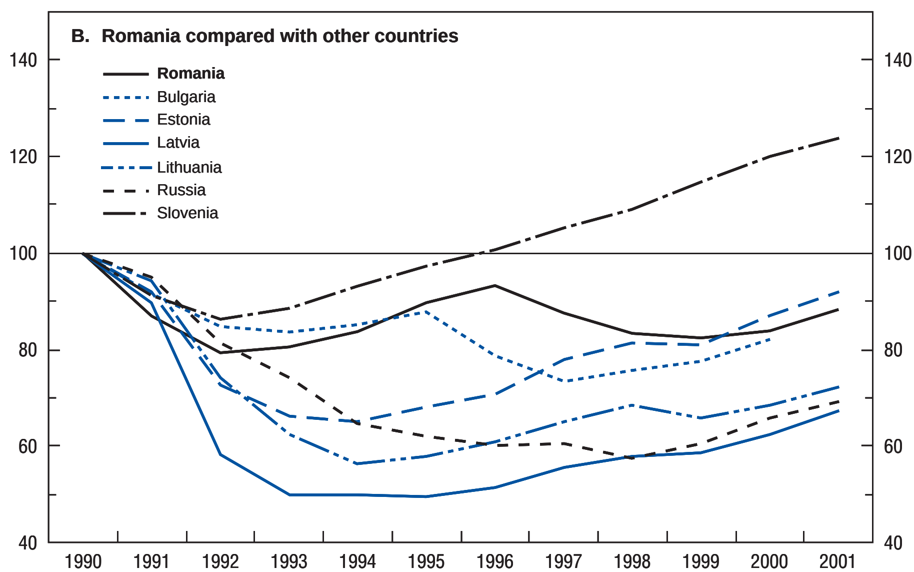
The Romanian transition process in a comparative perspective

Reflecting the volatile economic environment and delays in the implementation of a broader reform process, the GDP level of Romania ranks unfavourably compared to the four Visegrad countries that have became members of the OECD (Figure 1, panel A) and Slovenia (panel B). The gap is notably due to the fact that the postponement of reforms in Romania induced a second transitional

Figure 1. **GDP trends in transition countries**

1990 = 100





Source: INSSE, OECD.

Table 3. **Inflation trends in transition countries**
End year growth rate, per cent

	Dec.-93	Dec.-94	Dec.-95	Dec.-96	Dec.-97	Dec.-98	Dec.-99	Dec.-00	Dec.-01
Romania	295.5	61.7	27.8	56.9	151.4	40.6	54.8	40.7	30.3
Czech Republic	18.2	10.3	7.9	8.5	10.1	6.7	2.6	3.9	4.2
Hungary	21.1	21.2	28.3	19.8	18.4	10.3	11.2	10.1	6.8
Poland	37.7	29.4	22.3	18.6	13.0	8.4	9.8	8.7	3.6
Slovakia	25.1	11.6	7.2	5.4	6.3	5.6	14.2	8.4	6.7
Bulgaria	63.9	121.9	32.9	311.6	547.7	1.6	7.0	11.3	4.8
Estonia	35.5	41.6	28.9	14.9	12.5	6.4	3.8	5.0	4.2
Latvia	34.8	26.2	23.2	13.2	7.0	2.8	3.2	1.8	3.2
Lithuania	189.0	45.2	35.8	13.0	8.4	2.4	0.3	1.4	2.0
Russia	831.6	215.3	131.7	21.9	11.0	84.4	36.6	20.1	18.8
Slovenia	22.8	19.6	9.0	9.0	8.8	6.5	8.0	8.8	7.0

Source: OECD.

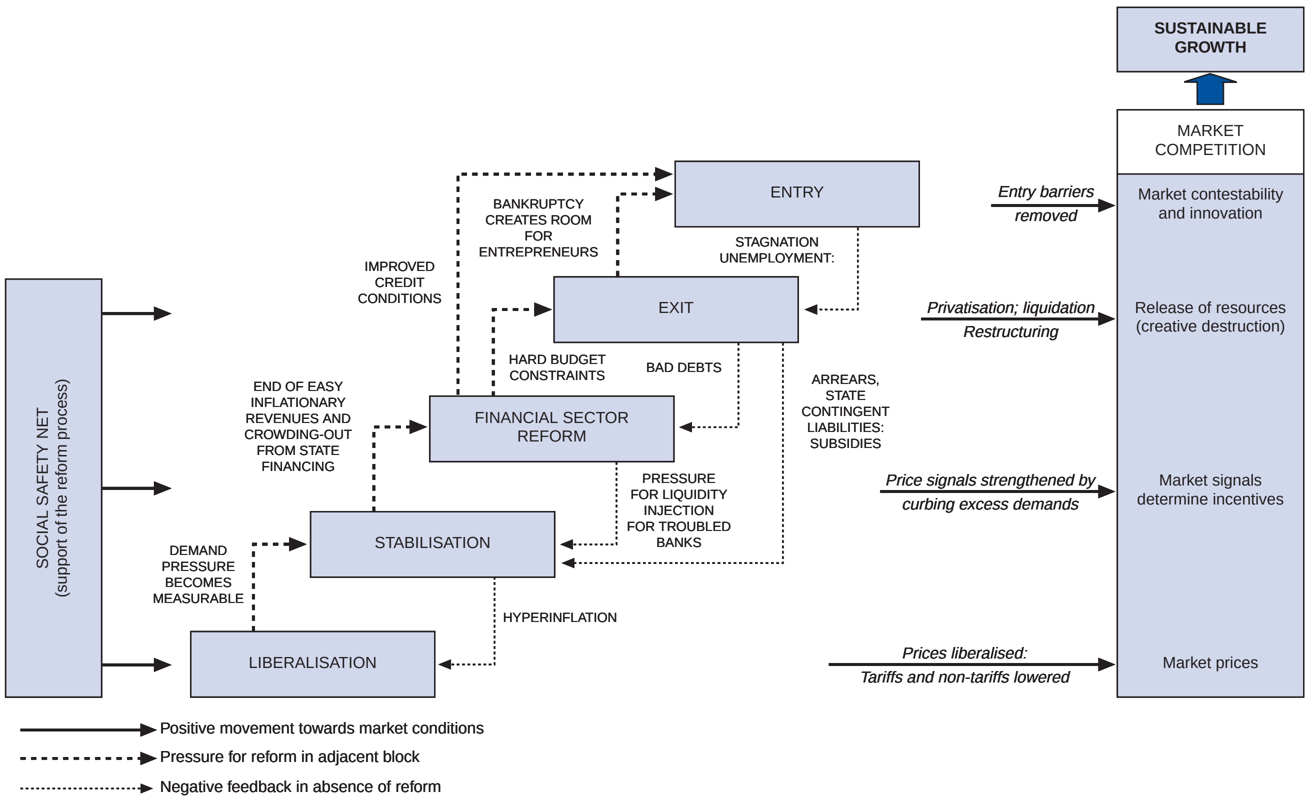
shock in 1997-99. Nevertheless, the GDP trends in Romania appear less unfavourable when compared with former Soviet Union countries (Russia, the Baltics) and Bulgaria. Concerning inflation trends, Romania still displays the highest rate by year-end 2001 compared with other countries in the sample (Table 3).

Policy interdependence during the transition

In order to better understand the need for policy coherence discussed above, it seems useful at this point to identify the key linkages. Those can be schematically grouped into five building blocks representing the main macroeconomic and structural policies.[1] *Liberalisation*, *Stabilisation*, *Financial Sector Reform*, the mechanisms of *Exit* and *Entry* of enterprises (Figure 2). First of all, most transition countries liberalised trade and a large number of prices (while price liberalisation in energy, housing and transport usually lagged behind). Typically, this was associated with a "corrective" inflation as excess demand was eliminated and relative prices adjusted to relative scarcities. In this situation, tight monetary and fiscal policies are essential to avoid the risk of this price shock becoming ingrained as high and accelerating inflation.

However, macroeconomic stabilisation can only be sustainably achieved if there is significant and steady progress in the area of structural reform. Developments in Romania over the last decade have illustrated this link. Government efforts to achieve and maintain budget discipline were undermined when enterprises faced weak budget constraints that ultimately led to higher quasi-fiscal deficits in the public sector. In addition to direct subsidies from the budget, firms obtained easy access to bank credit or were allowed to accumulate pervasive arrears. These soft budget constraints persist until the banking sector is restructured

Figure 2. **Policy interdependence: a framework for transition**



Source: OECD.

and non-viable firms are forced out of the market. In transition economies, privatisation and restructuring are supposed to stimulate this process. But often insufficient use of liquidation, ineffective bankruptcy procedures and weak creditor rights have held back results.

Uneven progress on different fronts is a source of instability. For example, large enterprise restructuring is undermined by the lack of external financial discipline, typically imposed by the banking sector. Often, under political pressure to resume lending to unrestructured enterprises, the banking sector bears the brunt of lack of adjustment, itself becoming insolvent. Recapitalisation and privatisation of the banking sector has been a pivotal point in the transition process in almost all transition countries. Typically, the newly privatised banks are more reluctant to continue lending to their former clients without state guarantees. But when new lending of privatised banks to unrestructured companies is granted under state guarantees, the budget will be burdened by contingent liabilities. According to official sources, in Romania more than 80-90 per cent of credit to enterprises granted under state guarantees is ultimately paid by the budget. Likewise, if bankruptcy procedures are not effective, banks cannot both provide credits and impose financial discipline at the same time. In some sense, the latter are the type of institutional shortcomings that take time to overcome and characterise the state of transition.

More generally, positive structural interactions need policy coherence. When exit mechanisms are enforced through liquidation but the conditions for entry of new enterprises are not in place, the pace of restructuring may become politically unsustainable as unemployment rises and opportunities for the reallocation of resources fail to materialise.

Time dimension versus sequencing

An often neglected feature in the management of the transition process has been the recognition that the timing of, and the time needed to implement, different policies varies widely across the structural reform spectrum. Some reforms can be put at work rather quickly and have an almost immediate impact on the economy. Others, typically the ones that require institutional capacity building, need more time to become effective. While the time dimension of these interactions is still not well understood in transition economics, it matters for the success of economic transformation well beyond the somewhat inconclusive debate between shock therapy and gradualism that dominated in the early years of transition.

Accordingly, the nesting of the four policy blocks depicted in Figure 2 intends to reflect the time needed to implement reforms rather than suggesting an optimal sequencing. Indeed, liberalisation of prices and foreign trade has immediate effects. This was illustrated by the rapid shift of domestic demand towards foreign products and re-orientation of trade flows in most transition countries. Macroeconomic stabilisation and financial sector reform require a longer time, notably to build monetary credibility and adjust tax and fiscal policies to the needs of fiscal consolidation. The exit mechanisms are accompanied by social strains and resisted by vested interests. For this reason, they strongly interact with the political developments. Sometimes the election cycle falls short of the timeframe needed to pursue the reforms firmly and consistently. Finally, the entry of new firms is a truly long-term process, which involves sunk costs associated with the large and concomitant creation and destruction of firms.[2] Reducing entry barriers and creating an entrepreneurial spirit also takes time. Market-oriented institution building, education and health care policies are supportive of this process, but again they cannot be expected to deliver in a short time period. A social safety net makes adjustment costs politically feasible, but also requires time and careful balancing of cost and benefits, and private *versus* public financing.

Recent economic and policy developments

Following the severe financial difficulties and socially painful adjustment, a new government was appointed in December 1999. Under the impulse of corrective measures approved under the previous government and an exceptionally favourable international economic environment, GDP growth resumed in 2000, mainly driven by export demand.

At end-2000 there were general elections (see Box 2). The new government appears committed to accelerate the reform process and to catch-up with the more advanced transition countries. This political process has two main levers: NATO accession and EU integration. In this regard, the government intends to open in 2002 the remaining chapters for negotiation of the EU *acquis communautaire*. The new government's initial programme[3] was prepared against the more favourable economic conditions in 2001. The main points of the programme were: *i*) an annual average growth rate of 4.5-6 per cent in 2001-04; *ii*) an inflation target of 22-25 per cent in 2001, with progressive reduction to single digits by 2004; *iii*) a consolidated budget deficit of 4 per cent of GDP in 2001 (subsequently revised to 3.5 per cent), falling to 3 per cent of GDP in 2002; *iv*) a reduction of the value-added tax rate (VAT) on basic items of consumption and energy to 9 per cent to alleviate the tax burden on poor families; *v*) an exemption from customs duties and VAT for imports of technology; *vi*) the creation of a National Restructuring Fund to introduce new technology in companies being prepared for privatisation, funded by 60 per cent of privatisation receipts; *vii*) the creation of a Ministry of Development and Prognosis to co-ordinate government economic strategy and to formulate a national development plan; *viii*) attracting US$1.8 billion foreign direct investment annually.

Box 2. Chronology of recent important political events in Romania

November 1996: The Democratic Convention (DC) wins the Parliamentary elections and forms a coalition with the Social Democratic Union (SDU) and the Hungarian Democratic Union in Romania (HDUR). Emil Constantinescu (DC) is elected president. Victor Ciorbea is appointed Prime Minister.

January 1997: A new economic programme is launched, inspired by a shock therapy policy approach. International Financial Institutions (IMF and World Bank) renew their financial support.

July 1997: Romania is not included in the first wave of NATO and EU enlargement.

April 1998: A new coalition government is formed. Radu Vasile replaces Victor Ciorbea as Prime Minister.

December 1998: A new anti-crisis programme is adopted under the support of the IMF.

December 1999: A new government is appointed. Radu Vasile is replaced by Mugur Isarescu (governor of the National Bank of Romania). The EU Council of Ministers decides to open the negotiation process for the accession of Romania to the EU.

November 2000: Legislative elections take place. Two main parties of the former government coalition do not reach the threshold for a representation in the Parliament. The Party of Social Democracy in Romania (PSDR) returns to power, with the largest single representation in the Chamber of Deputies and Senate. The nationalistic Greater Romania Party (GRP) emerges as the second political force in the Parliament. The Parliamentary composition is as follows:

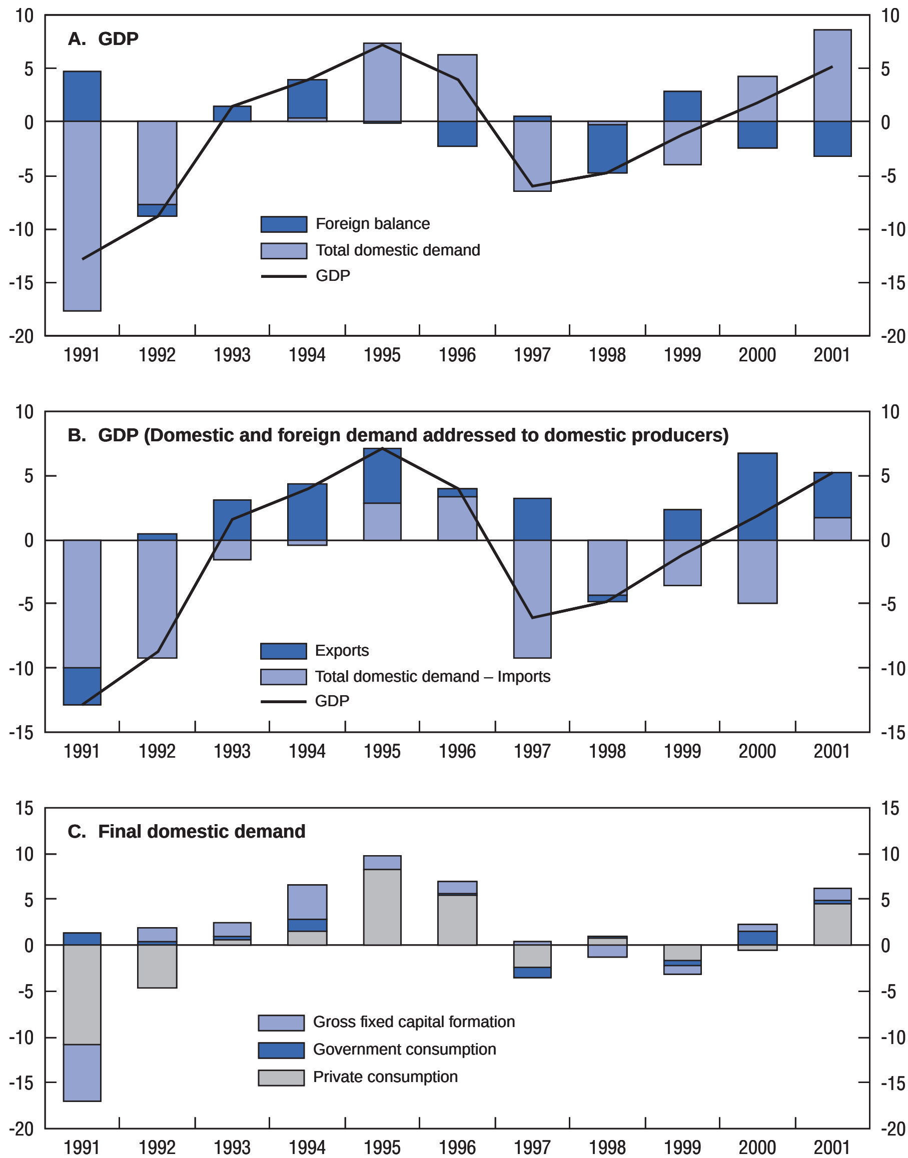
	Chamber of Deputies	*Senate*
Party of Social Democracy in Romania (PSDR)	155	65
Greater Romania Party (GRP)	84	37
Democratic Party (DP)	31	13
National Liberal Party (NLP)	30	13
Hungarian Democratic Union in Romania (HDUR)	27	12
Others[1]	18	0
Total seats	345	140

1. National minorities (other than the Hungarian Democratic Union) receive one seat each in the Chamber of Deputies. In November 2000, they had 18 seats in the Chamber of Deputies.

December 2000: Ion Iliescu – who had been President during the 1990-96 period – is elected President with a comfortable majority against the candidate of the Greater Romania Party. The PSDR forms a new minority government, but having a tacit support of the centrist parties. Adrian Nastase is appointed Prime Minister.

December 2002: A NATO Conference is planned to take place in Prague, where a decision is expected on Romania's possible accession.

Figure 3. **Contributions to GDP growth**
As a percentage of GDP in previous year



1. 2001 provisional.
Source: INSSE.

Macroeconomic conditions have improved in the last two years. After three years of recession, growth finally resumed in 2000 (Figure 3). At the beginning, growth was export led but afterwards broadened to domestic demand (both final consumption and investment). A round of real wage increases was initiated before the elections of end-2000, starting notably in the state enterprise sector and propagating to a smaller extent to the rest of the economy. The real net wage increase (on average 4.5 per cent in 2001), together with a freeze on energy prices, resulted in a substantial rise of real income in the first half of 2001 and induced a strong consumption push. A number of fiscal export incentives granted to small and medium size enterprises, though being distortive in terms of the desired uniformity of the tax system, has also led to a rise in investment in 2001.

Confronted with a rise in real expenditures and a lower than expected increase in revenues in the first-half of 2001 (due notably to tax exemptions and payment arrears), the government tried to regain control of the slippage in the budget deficit and cut current expenditures. By the end of the year, the budget deficit was brought to 3.3 per of GDP. Overall, GDP grew by 5.3 per cent in 2001, but continuation of strong growth not yet fully supported by economic restructuring, is likely to lead to growing external imbalances. Already in 2001, the current account deficit deteriorated from 3.7 to 5.9 per cent of GDP.

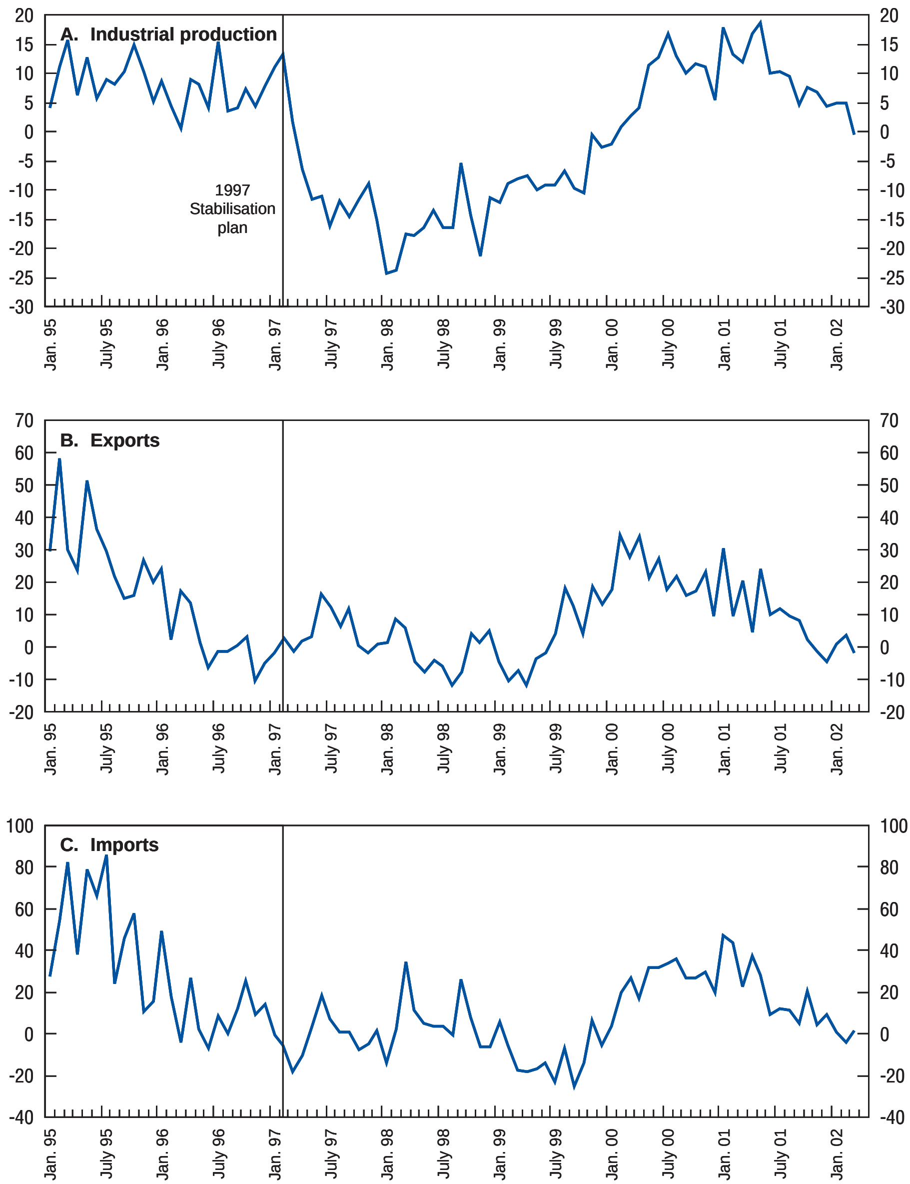
For 2002, the government is projecting growth above 4 per cent, but that seems rather optimistic in light of the less favourable international environment and the continuation of a restrictive fiscal policy. Since 2000 there has been a visible slowdown in the growth rate of exports and industrial production (Figure 4). Moreover, in 2002 the tax exemptions on VAT and custom duties for imports of technology introduced earlier by the government programme were cancelled, making in the short-run business environment and investment incentives less favourable. It could be noted here that the management of the budget process improved (see Chapter II). Notably, the present administration was able, for the first time since the beginning of the transition, to pass the 2002 budget on time.

In this context, monetary policy has been moderately supportive of growth. While targeting base money growth, the National Bank of Romania has managed to achieve a relative stability of the real exchange rate in order to maintain external competitiveness. But as a result, progress in disinflation has been moderate – the end-year inflation rate was still around 30 per cent in 2001.

There has been significant progress in the restructuring of the banking sector. Two major loss-making banks were either privatised or liquidated and a third large bank (the *Banca Comerciala Romana*, BCR, accounting for one-third of banking sector assets) is in line for privatisation this year (see Chapter II). The total cost of this restructuring process amounted to around 8 per cent of GDP. However, this relatively sounder financial base cannot by itself ensure the hardening of economy-wide budget constraints. Although the volume of credits to the

Figure 4. **Growth rates of exports and imports in US$ and production**

Year-on-year growth rates in %



Source: INSSE.

private sector is increasing, if banks continue to lend to loss-making state-owned companies under state guarantees the volume of state contingent liabilities will continue to increase. Moreover, a number of smaller banks remain fragile and probably need to be consolidated.

Restructuring in the large state enterprise sector has been delayed. While the privatisation of the small-size enterprise sector is nearly completed, the privatisation and restructuring of large enterprises and public utilities has lagged, as noted above. This has resulted in continuing payment arrears, wage pressures (excessive wage increases in the *Régies Autonomes* put pressure on public expenditure) and diversion of resources from the potentially dynamic sector of small and medium sized enterprises, which has been increasingly contributing to growth and exports.

The large-scale enterprise restructuring, at the core of the transformation process, is largely still to be completed. So far, the current government was able to privatise some large enterprises, notably the important steel producer Sidex, and the restructuring of the energy sector was pursued. But the transaction for the privatisation of Sidex was linked to somewhat controversial and costly tax exemptions; and the effective restructuring of the energy sector is requiring substantial price increases – a very difficult and unpopular measure given the low level of average wages in Romania. Consequently, further enterprise restructuring will be the main test of the current government's determination, especially as its social implications have to be carefully managed in the context of high politicisation of large-enterprise managers and trade unions, and a significant representation of the extreme right in Parliament.

Finally, trade policies are presently shaped by WTO commitments and the efforts to join the EU. By 2001, the average tariff rates for non-agricultural goods was 16 per cent, while for agriculture the average rate was nearly 34 per cent. Concerning domestic price liberalisation, the current government is committed to progressive convergence of energy prices towards international levels (see Chapter III).

Back to the 1997 dilemmas?

As discussed throughout this Survey, the current government now faces some of the same tough choices, notably in the field of enterprise restructuring, that characterised the situation in 1997-99. But the stakes seem too high to forego the current window of opportunity (some aspects on the political economy of reforms are discussed in Box 3). Slippage could severely compromise the chances of successfully pursuing EU and NATO accession within the timeframe currently envisaged. At the present juncture, clarity in policy objectives and timely implementation are crucial. In several areas, it is rather difficult to clearly appraise the priorities of the current government. One of the main recommendations arising from this report, which focuses on the structural aspects of the reform process, is

Box 3. Some political economy thoughts on the reform process

There are two puzzling features that have been observed in a certain number of countries. Firstly, reform is sometimes successfully implemented by politicians and parties not considered *a priori* as reformers. Secondly, the political elite sometimes undertakes reforms that might seem to worsen their individual welfare compared with the situation before the reforms. The explanations found in the literature are related to the fact that, at some juncture of the political and economic process, the lack of reforms will end-up in an even worse situation for the elite groups.

A theoretical explanation for the first phenomenon is given in an article by Cukiermann and Tommasi (1998). They consider the example of the market-oriented stabilisation and reforms enacted in Argentina and Peru during the 1990s under presidents who came to power on explicitly populist election platforms. They claim that the logic behind the successful implementation of strong market-oriented reforms by declared populists is that when voters are not fully informed, the identity and political orientation of the party proposing reforms contains important information. The idea is that if a politician proposes reforms that are far from his own preferences, this proves to the population that there is urgent need for these changes. Once the electorate understands the crucial importance of the reforms on the agenda, there will be much less opposition. As a consequence, *a priori* less reform-oriented politicians have under certain circumstances a much higher chance of successfully implementing painful reforms. Arguments along this line can equally rationalise why politicians while in opposition block reforms that they intend to implement once in office (see Lopez-Murphy and Sturzenegger, 1996).

With respect to the second phenomenon, *i.e.* an elite who in a crisis situation initiates "reforms from within", which apparently actually worsen their situation compared to the *status quo ante*, a theoretical explanation is provided by Tornell (1998). A crisis situation would be the outcome of a common pool problem where the competing elite have "over-extracted" rents from society. In such a crisis situation, however, reform occurs not because some of the ruling elite expect to be better off after reform. Rather, once it has become clear that the status quo is no longer tenable, reforms are used as a defence mechanism against other powerful groups, since without reform some of the elite groups may end up in an even worse situation. Trade liberalisation in some Latin American countries is an example for such a "reform from within". Following Tornell's analysis, these reforms were supported by the elite that dominated the inefficient manufacturing sector, in spite of the fact that it was going to lose under foreign competition. The rationale for this support was that the trade reforms were considered as the only way to tame the power of the trade unions, and thus avoid far worse outcomes.

that economic restructuring should be pursued as much as possible via transparent market mechanisms. For example, once hard-budget constraints are imposed, specific plans for layoffs or investments should be left to economic agents, avoiding government interference to the greatest extent possible.

To face these challenges, together with the costs of the EU accession process (*e.g.* in areas such as infrastructure and environmental regulations), Romania will need major international financing. The country has a good record of debt servicing and still has a comparatively low public debt to GDP ratio (close to 30 per cent). Recently, the international credit ratings of Romania have improved. Being one of the largest markets in Central and Eastern Europe, Romania could become attractive for important foreign investments. But perceived weakness in administrative capacity and still uncertain "rules of the game" have held back foreign investors. Improved administrative capacity will also be needed to manage the pre-accession EU funds. The reform of the public administration is progressing, albeit at a slow pace. But in order to advance with reforms it will be necessary to achieve a certain "de-politicisation" of economic life and make inroads against pervasive corruption. Supporting this process, the main international financial institutions continue a close monitoring of the Romanian economy.

The 1998 OECD *Survey* demonstrated that the gradualist approach of the early years of transition was ill-designed and precious time was lost. The focus of the present Report are the key policy interdependencies in the design of reforms. There is still an over-involvement of the state in economic activity and a more comprehensive, market-based adjustment of the economy is needed. This will require strong political leadership and commitment on part of the government.

II. Macroeconomic and financial stabilisation

The present formulation and implementation of macroeconomic policies in Romania was designed within the framework of the Government Programme for the period 2001-04 in line with the orientations of the Medium-term Economic Development Strategy worked out together with the European Commission in March 2000. Policy goals and specific measures were spelled out in the Pre-Accession Economic Programme for Romania presented to the European Commission in August 2001 and the Policy Memorandum agreed with the International Monetary Fund in the context of the recent Stand-by Agreement.

The fiscal policy framework has improved

Improving the fiscal policy framework is typically one of the areas where time is needed for institution building and convergence towards international standards. As a result of the "policy shock" of 1997 (see Chapter I), the budget was cleaned of a series of hidden or quasi-fiscal items, such as the directed credits to the agricultural sector, indirect subsidisation to heavy industry from exchange rate restrictions, and consumer subsidies through regulated prices in the energy and agricultural sectors. The remaining subsidies and transfers now appear in a more transparent way in the state budget. In particular there is a comprehensive and consolidated budget for general government on a suitable basis.

The budget management system was noted by the 1998 *Survey* as being a weak point in the fiscal framework. For example, poor control of public spending over the year tended to create an erratic pattern for Treasury operations that complicated the conduct of monetary policy. The Survey stressed a need for better prioritisation, more decentralisation and firm budgetary ceilings. Romania has made progress in this area. For example, in 2001, the control over budgetary expenditure was streamlined by reducing the number of budgetary funds (from 18 to 9). Some of these special Funds have been a way of directing resources to wage increases in the public sector, which should be replaced by a more transparent wage policy. In addition, the 2002 budget Law was the first passed on time by the government, a symbolic and important achievement. The authorities are also considering the implementation of programme budgeting that is supposed to

Box 4. The key reform of the Romanian civil service

A law on the Statute of Civil Servants (188/1999) was passed in December 1999 by the previous Government and a National Agency for Civil Servants (NACS) was established to manage its implementation. After the November 2000 general elections, a Ministry of Public Administration (MoPA) was created and the NACS subordinated to this Ministry. Since then, some civil service secondary legislation has been produced. However, the present government is conscious that the basic legal and institutional framework now in place remains unsatisfactory and incomplete. A new law is under preparation to take into account the European principles governing the civil service in EU Member States. This new law is expected to be adopted in Autumn 2002. Important policy decisions concerning the respective roles and means of the MoPA and the NACS for managing the Civil Service and secondary legislation remain to be taken.

For the moment, personnel costs are controlled only in terms of salary ceilings and the number of positions, and not in terms of existing staff. A personnel information system is to be set-up. In 2000, the Romanian civil service comprised about 130 000 staff at the central level. Reductions in staff have been carried out through 2001 in many administrative branches. The stated objective of the government was a 30 per cent reduction over the medium-term.

In spite of all these legal, institutional and other efforts, *de facto*, the civil service needs to have a higher level of professionalism. The administration is still highly open to politicisation and will continue to be so until the new procedures for recruitment and promotion and a fair remuneration system are designed and implemented in practice in the whole administration.

There is a clear need to introduce more transparency, including basic guarantees for citizens and mechanisms to adequately control legality in administrative decision making. Administrative decisions often still seem to be based on other factors than substantive laws. The ability of civil servants to stand up against unlawful orders is limited. In this respect, the Government plans to make a Code of Administrative Law that would include a Law on Administrative Procedures.

Accountability mechanisms are not in place. Civil servants liability is still more geared towards narrowly defined discipline at the workplace than towards their professional responsibilities in relation to law and policy requirements. A procedure for administrative redress exists, but it does not meet European standards yet. Judicial review is possible, but the court system needs a deep reform and judicial independence is not guaranteed.

Management practices do not stimulate public servants to perform well. Work conditions are not very attractive. An eroded seniority-based career system limits staff development and perspectives. Salaries for civil servants remain very low. Some wage bonuses related to performance are allotted, but often on a discretionary basis. The adoption and implementation of the new civil service legal framework, which is currently under preparation, together with an appropriate regulation of salaries should improve the situation.

Box 4. The key reform of the Romanian civil service (*cont.*)

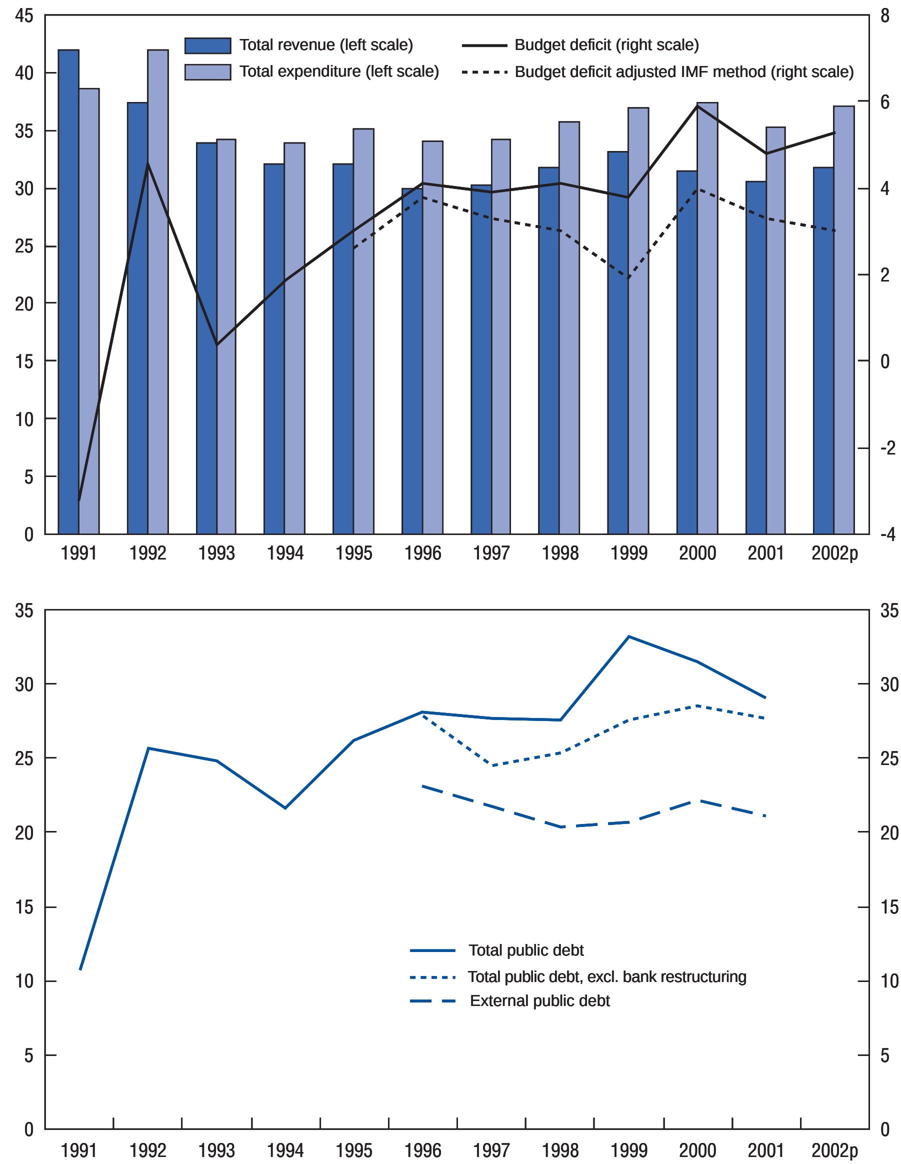
Corruption is considered by citizens and recognised by the Government as a major problem (see Chapter III). A code of ethics has been produced. The new Law on the Statute of the Civil Servants, subsequent policy decisions and other efforts will be necessary to give life to such a Code and to bring about a preventive framework against corruption and other abuses of power. A clear definition of corrupt practices in the penal code would also help. The Government has recently adopted an anticorruption strategy but it is too early to judge the effectiveness of its implementation.

The MoPA, which is in charge of public administration reform still needs many additional resources to fulfil its current and future competences, particularly concerning the State administration. The awareness on the need to tackle public administration reform is highly recognised by the Government. However, there is less awareness that these reforms are systemic, not only incremental ones. The notion of a professional, not politicised, public administration is often difficult to accept in practice by many Romanian politicians. However, positive steps are being taken in the right direction. In order to overcome obstacles to reform, the Prime Minister has recently set up under his authority an Inter-Ministerial Committee for Public Administration Reform (IMCAR) composed by the relevant ministers. The Ministry of Public Administration (MoPA) shall provide secretarial support to the Committee and a Unit for Administrative Reform has been created within the MoPA. The Committee met in May 2002 and has given priority to the Civil Service Reform. This move is made within the framework of a broader strategy for accelerating public administration reform adopted by the Government in 2001. These initiatives are positive steps, but it is still too early to assess their actual impact.

include policy priorities in the budget structure, though to reach such an ambitious objective the administrative infrastructure will need to be strengthened. The reform of the Civil Service would be an important step in this regard (Box 4).

Progress in the fiscal policy framework is reflected in a better control of deficits and the level of the public debt. The upward trend of public deficits of the 1993-96 period was halted subsequently, and up to 1999 this was achieved in the context of a serious recession. The fiscal deficit slippage of 2000, corresponding to a pre-election period, was also reversed afterwards (Figure 5). Overall, fiscal policy in Romania has been to some extent pro-cyclical, but the amplitude of the fluctuations has stabilised over time. Reflecting these trends, and despite a strong financing pressure in 1999 due to the restructuring of the banking sector, the level of the public debt has remained moderate, reaching close to 30 per cent of GDP by end-2001.[4]

Figure 5. **Consolidated government balance and public debt**
In per cent of GDP



1. Data for 2002 are projections.
Source: Ministry of Finance.

Structure of the budget

In 2001 revenues and expenditures were close to 31 and 35 per cent of GDP, respectively (Table 4). Roughly one third of revenues were collected through indirect taxes, another third through social contributions and the rest through direct taxes and other non-tax revenues. While income tax revenues are low compared with other taxes, this tax structure is not atypical in emerging or transition economies. As already noted in the previous Survey, the VAT continues to display a low return compared with its base rate of 19 per cent, reflecting the large share of the informal sector and a number of tax exemptions. In contrast, the share of social contributions is comparable with more developed countries, suggesting that there is little scope to increase either rates or their relative weight in the budget.

Social transfers, health and education dominate the expenditure side, followed by interest payments on the public debt (Table 5). An important point to be noted is the substantial and welcome reduction in the expenditure channelled directly to economic sectors, such as agriculture and industry. Their share in total expenditure decreased from above 17 per cent in 1995 to around 6 per cent by 2001.

As regards the budget balance, the central state budget deficits have accounted for only part of the overall deficit in recent years. The pension fund also recorded significant deficits, despite transfers from the state. And the deficit was further increased by servicing the external loans done directly by line ministries. Local authorities also require an important transfer from the central government in order to balance their budgets. The causes of the structural deficit of the pension funds were analysed in the previous *Survey*. They are mainly related to a dramatic surge in the number of pensioners (mainly in the agricultural sector) related to the provisions in the early 1990s, allowing for early retirement with full benefits. Most farmers and other self-employed persons did not contribute, but many retired farmers are entitled to pensions because they were employees under the communist regime. By 2001, the ratio of pensioners (including farmers) to workers was above 100 per cent. Since 1997, the central government has managed to contain the progression in the deficit of the Pension Fund, basically by re-channelling surpluses from other funds, such as the unemployment Fund (Figure 6). But reform is still ahead.[5]

It is important to highlight a key macroeconomic link between the need for continued fiscal consolidation and the external position. The latter is related to the savings/investment balance. Indeed, given the structural financing gap in the private sector, the improvement of the external balance depends critically on the adjustment of the fiscal position (Table 6).

Table 4. **Structure of the general consolidated budget (in per cent of GDP), 2001**

	State budget	Local budget	Pension fund	Unem-ployment fund	Health fund	Other off-budget funds (*)	Authority for privati-sation	External loans to Ministries	**TOTAL**	Intra-budget transfers	Conso-lidated budget	Adjust-ments IMF Method-ology	**TOTAL, inc. adjust-ments**
TOTAL REVENUE	**12.8**	**6.2**	**6.6**	**1.2**	**3.6**	**1.0**	**0.1**		**31.5**	**–1.0**	**30.5**		**30.5**
Taxes	11.9	5.1	6.0	1.0	3.5	0.9			**28.4**	–0.1	28.3		**28.3**
Profit	1.9	0.0							**1.9**		1.9		**1.9**
Wage and Income taxes	0.7	2.5							**3.2**		3.2		**3.2**
Social security contributions	0.5		6.0	1.0	3.5				**11.0**	–0.1	10.9		**10.9**
Other direct tax	0.4	0.7				0.0			**1.1**		1.1		**1.1**
VAT	4.5	1.9							**6.4**		6.4		**6.4**
Other indirect taxes	3.8	0.0				0.9			**4.8**		4.8		**4.8**
Current non-tax revenues	0.9	0.6	0.4	0.2	0.1	0.1	0.1		**2.3**	–0.3	2.1		**2.1**
Intra-budget transfers and subsidies		0.4	0.2		0.1				**0.7**	–0.7			
Capital and grants	0.0	0.0		0.0			0.0		**0.1**	0.0	0.1		**0.1**
TOTAL EXPENDITURE	**15.9**	**6.1**	**7.2**	**0.8**	**3.2**	**0.8**	**0.1**	**2.1**	**36.3**	**–1.0**	**35.3**	**–1.4**	**33.8**
Wages and salaries	2.4	2.6	0.0	0.0	0.0		0.0	0.0	**5.0**		5.0		**5.0**
Other goods and services	1.7	1.6	0.2	0.0	3.2	0.4	0.0	0.0	**7.2**	–0.1	7.0		**7.0**
Interest payment for the public debt	4.4	0.0	0.0	0.0					**4.5**		4.5	–0.6	**3.9**
Subsidies	1.4	0.7						0.0	**2.1**		2.1		**2.1**
Transfers	4.4	0.3	6.9	0.7		0.0	0.1	0.9	**13.3**	–0.9	12.4	0.0	**12.4**
Capital	0.8	0.8	0.0	0.0	0.0	0.3	0.0	1.2	**3.2**	0.0	3.2		**3.2**
Lending	0.0	0.0		0.1					**0.1**		0.1		**0.1**
Repayment of domestic and international loans	0.9	0.0	0.0	0.0		0.0			**0.9**		0.9	–0.9	
SURPLUS (+)/DEFICIT (–)	**–3.1**	**0.0**	**–0.6**	**0.4**	**0.4**	**0.2**	**0.0**	**–2.1**	**–4.8**		**–4.8**	**1.4**	**–3.3**

(*) Comprising two large off-budget funds: the Special Fund for Developing the Energy System and the Special Fund for Road Modernisation; and four smaller funds: the Special Fund for Insurance Protection, The Romanian Agricultural Development Fund and the Fund "Romania". Memorandum item: GDP in 2001 = 1 154 126.4 billion Lei.

Source: Ministry of Finance, OECD calculations.

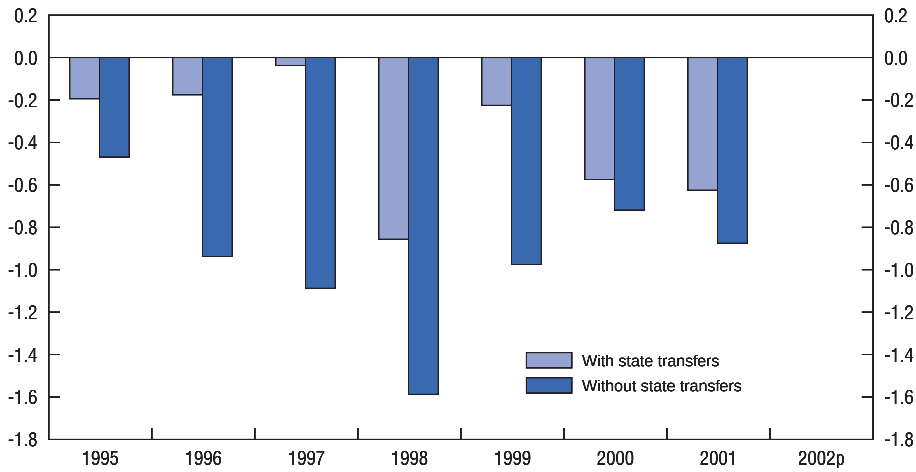
Table 5. **Structure of priorities for consolidated public spending by functional categories**

In per cent of total expenditure

	1995	1996	1997	1998	1999	2000	2001
TOTAL	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Social welfare, children allowances and pensions	26.9	26.3	28.4	30.5	31.1	27.9	29.3
Health	8.3	8.2	7.5	8.6	10.3	10.4	11.9
Interest and other expenditures for public debt	3.8	4.7	10.2	11.4	14.4	12.9	10.4
Education	9.9	10.5	9.7	9.4	8.7	8.8	9.5
Transportation and communication	6.8	6.7	6.9	6.8	7.8	7.6	7.9
Community amenity affairs and housing	5.8	5.7	5.2	4.8	4.9	5.4	5.7
Public order and national safety	4.4	4.3	3.4	4.2	4.1	5.7	5.3
Defence	6.1	5.6	6.9	6.6	4.2	4.7	4.6
Public authorities	3.6	3.3	3.1	3.9	3.8	4.3	4.5
Agriculture, forestry	6.6	7.2	4.3	3.5	2.7	3.3	2.9
Industry (including mining)	7.0	6.4	3.2	2.1	2.1	2.3	2.3
Culture and sport activity	1.5	1.6	1.6	1.6	1.4	1.6	1.6
Other expenditures (including special destination)	1.3	1.4	1.2	1.2	1.4	1.5	1.6
Other economic affairs and services	3.5	4.3	4.3	1.6	1.4	0.9	0.9
Research affairs	1.7	1.2	0.9	0.8	0.5	0.5	0.7
Environment	0.5	0.5	0.2	0.2	0.3	0.4	0.7
Lending	0.4	0.8	1.7	1.7	0.4	1.3	0.3
Expenditure from government disposal fund	1.0	0.1	0.0	0.3	0.1	0.0	0.0
Other social expenditures	1.0	1.0	1.0	0.6	0.1	0.1	0.0
Other transfers	0.0	0.0	0.0	0.2	0.0	0.5	0.0
Reserve funds	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments of loans	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Memorandum item:							
Total expenditures (in billion Lei)	25 060.9	36 809.6	85 067.9	129 046.0	189 186.2	283 140.4	389 320.6

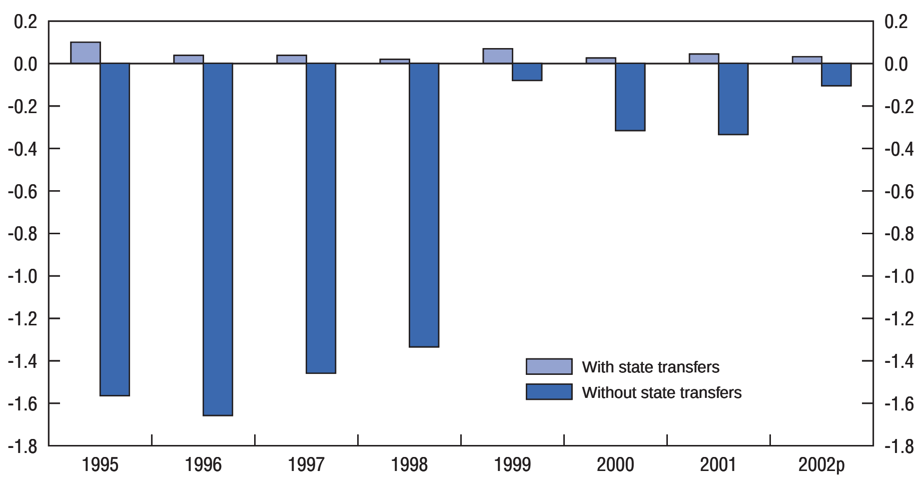
N.B.: Ranked according to expenditure shares in 2001. Expenditures adjusted for IMF methodology.
Source: Ministry of Finance and OECD calculations.

Figure 6. **Pension fund balance**
In per cent of GDP



Source: Ministry of Finance.

Figure 7. **Local budget balance**
In per cent of GDP



Source: Ministry of Finance.

Table 6. **The savings-investment balance in Romania**
In per cent of GDP

	1996	1997	1998	1999	2000	2001
Government sector						
Savings	1.3	0.0	1.4	3.3	*n.a.*	*n.a.*
Investment (GCF)	5.1	3.3	4.4	5.2	*n.a.*	*n.a.*
Budget deficit	–3.8	–3.3	–3.0	–1.9	–4.0	–3.3
Non-Government sector						
Savings	17.2	14.5	9.3	8.6	*n.a.*	*n.a.*
Investment (GCF)	20.7	17.3	13.4	10.9	*n.a.*	*n.a.*
Financing gap	–3.5	–2.8	–4.1	–2.3	0.3	–2.6
Total economy						
Savings	18.6	14.6	10.6	11.9	16.0	16.0
Investment (GCF)	25.9	20.6	17.7	16.1	19.7	21.9
Current account balance	–7.3	–6.1	–7.1	–4.2	–3.7	–5.9

Source: Croitoru and Tarhoaca (2000), INSSE and OECD estimates.

Fiscal consolidation is still hostage to an unrestructured economy

While the progress towards macroeconomic stabilisation in Romania needs to be acknowledged, it is likely to remain hostage to insufficient progress in economic restructuring. As stressed in the 1998 *Survey*, past efforts to control the budgetary process and the budget deficit have been rendered difficult because of the unrestructured enterprise sector. For example, attempts to increase revenues through improved tax collection have been defeated by mounting tax arrears and an increase in the informal economy. Controlling public expenditure allocated to state-owned enterprises has also proved to be difficult. Notably, there is still a significant share of the labour force in the Romanian economy that is employed in state-owned enterprises producing negative value-added (see Chapter III). The fact that wage increases in loss-making state-owned companies are often decided on a political basis with little connection with the financial performance of the companies is a serious risk for any serious budget planning and control.

In this context, there is a concern that taking into account quasi-fiscal spending would increase significantly the public budget deficit. This was certainly the case in 1996, when the incorporation of quasi-fiscal items and accrual accounting more than doubled the official fiscal deficit figure (OECD, 1998). The situation has nevertheless somewhat improved in this regard. Indeed, according to a rough estimate (see Box 5), the quasi-fiscal deficits for 2000-01 would be in the order of magnitude of 1 per cent of GDP.

Box 5. Estimating the quasi-fiscal deficits in 2000-01

Due to the improvement in the fiscal policy framework noted in the text, the sources of quasi-fiscal items related to directed banking credits and other distortions were abolished in 1997. Therefore, the main remaining quasi-fiscal item would correspond to the losses in the sector of state-owned enterprises that are financed through the accumulation of arrears, or loans under state guarantees, which ultimately will be paid out by the budget.[1]

It is difficult to provide an estimate of the total losses in the state-owned sector. As a first approximation, one can limit the analysis to the group of 86 major loss-making enterprises under special monitoring by the Ministry of Finance (this list was specified in Government's decision 866/2001). In 2000 and 2001, the total *net* losses in these companies amounted to around 1.5 and 2.1 per cent of GDP, respectively.[2] These losses were mostly financed through arrears, as a form of "forced credit". The fact that increase in *net* arrears[3] in these companies is more or less in the same order of magnitude as total losses confirms this point, an issue discussed further in Chapter III.

However, around 50 per cent of the total arrears in these state-owned companies are actually due to the state budget (corresponding to non-payment of taxes, social contributions and contributions to special Funds). If one applies the same share to the increase of net arrears, it is then reasonable to assume that approximately 50 per cent of the losses are also covered by non-paid taxes and contributions. This implies that if public revenues were accounted on an accrual basis (like expenditures), the tax revenues corresponding to the arrears would in principle appear in the budget, as a counterpart to increase the lending to state enterprises. The accrual tax revenues and the quasi-fiscal deficit corresponding to enterprises' losses would cancel out. The bottom-line is that probably a more accurate estimate of the quasi-fiscal deficit from 86 companies would be in the range of 0.8 to 1 per cent of GDP over the period 2000-01.

In addition to the above-mentioned companies there are other enterprises in the portfolio of the Privatisation Authority (APAPS) that also incur losses. Unfortunately, data are not available for the entire year 2001. In 2000, total losses in the portfolio of APAPS where 4.1 trillion Lei. If these losses are distributed according to the share of the state in the capital of each company, this would correspond to 2.5 trillion Lei. Adjustment for these additional losses would add a maximum of 0.3 per cent of GDP quasi-fiscal deficits, but taking into account the correction for double accounting, this figure would probably be lower.

Another potential source of quasi-fiscal deficits could be associated with the subsidisation of energy prices. The direct subsidies[4] appear in the budget, but one could also consider the difference between domestic prices and world prices as a form of subsidisation that should be incorporated in public expenditure. This reasoning could apply for imported energy, but would be less relevant for the fossil-fuels produced in Romania. Indeed, if Romanian energy prices were equal to world prices, the difference would in principle be accounted as profits of the state-owned energy producers that should be transferred to the budget. Moreover, part of

Box 5. **Estimating the quasi-fiscal deficits in 2000-01** (*cont.*)

the subsidisation of energy prices is directed to households. It could be argued that the indirect price subsidies should be replaced by direct transfers. This would improve the allocation of resources, but would be roughly neutral for the budget from any point of view.

1. Note that in the 1998 OECD *Survey*, it was not possible to have an estimate of the total losses in the state-owned sector, thus, this item was partly estimated by the amount of directed credits of the National Bank.
2. Or 11 and 24 trillion Lei in 2000 and 2001, respectively. It is important to use net rather than gross losses given that some companies (*e.g.* Petrom) display profits. In 2001, the net losses were computed by applying the ratio of net to gross losses available for 2000.
3. This is the difference between the increase in arrears and receivables. In this way the eventual double-counting of arrears within the state-owned sector is cancelled out.
4. The difference between the national reference price for electricity, heating and gas, and the break-even production price for production utilities is reimbursed through state transfers.

The budget framework is also conditioned by the EU *accession process*

Fiscal policy faces real challenges in the forthcoming years. Indeed, notwithstanding its benefits, the costs of the EU integration process (or the implementation of the EU *acquis communautaire*) are non trivial. They are estimated at around 4 per cent of GDP over the period 2001-04 and will require a significant contribution of domestic resources. The financing gap linked to this could be on average more than 1 per cent of GDP per year (World Bank, 2002). The possible invitation of Romania to become a member of NATO and its cost implications also raise additional questions.[6]

For this reason, in the context of the EU pre-Accession programmes for the period 2000-04, the Romanian authorities envisage to increase both public expenditure and revenue relative to GDP (Table 7). This parallel increase would be consistent with a consolidated budget deficit stabilised at around 3 per cent of GDP over the same period. That the share of the state budget in GDP is expected to rise is also justified by the fact that Romania has the lowest ratio of tax revenues to GDP among candidate countries (around 32 per cent in 2001) and comparatively important social needs to address.

It should be noted, however, that the large informal economy actually distorts the view according to which the tax burden is still low in Romania. Indeed,

Table 7. **EU pre-accession fiscal programmes, 2000-04**
In per cent of GDP

	Revenues			Expenditure		
	2000	2004	*Change*	2000	2004	*Change*
Romania	**31.5**	**34.0**	**2.5**	**35.4**	**37.0**	**1.5**
Bulgaria	43.5	38.9	–4.6	44.5	40.4	–4.1
Czech Republic	40.6	41.3	0.7	43.8	45.6	1.8
Hungary	45.9	43.1	–2.8	48.9	45.1	–3.8
Poland	39.6	36.9	–2.7	42.7	40.5	–2.2
Slovak Republic	35.3	29.3	–6.0	38.7	31.8	–6.9
Estonia	38.9	37.7	–1.2	39.6	38.1	–1.5
Latvia	30.0	27.0	–3.0	32.7	27.7	–5.0
Lithuania	30.2	28.7	–1.5	33.0	30.1	–2.9
Slovenia	42.8	42.8	0.0	44.1	43.2	–0.9

Source: EU Pre-Accession Economic Programmes and World Bank (2002).

taking into account the output of the shadow economy which is already incorporated in GDP (at around 20 per cent), the "corrected" ratio of tax revenues to value-added of the formal economy sector would be around 38 per cent (rather than 30 per cent). In consequence, the formal economy sector in Romania is already bearing a strong fiscal pressure. This is confirmed by analysis done at the enterprise level (OECD, 2002).

There is little scope to increase the tax pressure

Policies targeted towards increasing tax revenues have to be finely tuned in Romania. Given the pervasive informal economy and financial indiscipline, any increase in tax rates is likely to result in increased tax evasion and mounting arrears. Notably, this has been the case of the pension system where financing pressures induced higher contribution rates,[7] which were followed by reduced collection rates, increased outstanding arrears to the Pension fund and a larger informal labour market. Supporting the development of the new private sector, which is a major engine of growth and structural change, would in fact require a reduction of the tax burden on enterprises.

The possible move towards an increased revenue to GDP ratio would need to be co-ordinated with the streamlining of the tax system, because the administrative costs related to the fulfilment of the tax obligations are very high. Indeed, the Romanian tax system is rather complex and could be simplified (see also Chapter IV). Streamlining this system would reduce enterprise costs without necessarily decreasing tax revenues.

As noted above, indirect taxes could account for a larger share of tax revenues. But in 2001, the government used VAT and custom duties exemptions to promote SME development. As noted in the 1998 *Survey*, these exemptions are not effective and authorities should aim at a more neutral tax treatment of the different economic activities. Under the pressure to maintain tax revenues, these exemptions were abolished in 2002 and are replaced by a uniform investment tax credit. However, this has created some uncertainty in the investment environment for SMEs. To sum up, a greater predictability and co-ordination of fiscal policy will be needed over the next few years in order to meet the challenges ahead.

The financing of the public debt

Over 70 per cent of the public debt in 2001 was in foreign currencies, of which the international financial institutions hold the largest share. This allowed for a longer maturity of the public debt (54 per cent is 10-year or longer) and contributed to more stable financing sources. The total public external debt amounted to US$7.7 billion by end-2001, of which roughly one-third corresponded to state guarantees granted for external loans of ministries and public enterprises (Table 8). The latter are included in the public debt because they will mostly be paid out by the budget. Together with mounting arrears, these guaranteed loans have implicitly financed the losses of public energy companies (Figure 8). In contrast to this long-term financing, the state has intensively used short-term financing from the domestic market. However, the issuance of Treasury bills has been rather erratic and has complicated the conduct of monetary policy (see next section). Only recently has the government moved towards an increasing use of external sources for its liquidity management.

A sounder monetary policy framework

The pre-1997 situation

Until 1997 it was almost impossible for the Romanian central bank to pursue any effective monetary policy in the conventional sense, as its actions were very heavily constrained by the demands that resulted from the government's economic policy. More precisely, during this period the central bank provided large amounts of directed credits to keep the unrestructured and unprofitable parts of the economy afloat, as well as the state banks that had been heavily lending to them. *Banca Agricola*, for example, had a direct account with the central bank on which it could draw to finance the (largely irrecoverable) soft loans it was handing out to the agricultural sector.

As the central bank could not undertake any meaningful anti-inflation policy in such a framework, the government tried to control inflation via administrative measures (mainly controls of prices and foreign exchange transactions). While

Table 8. **Public debt: financing sources and interest payments**

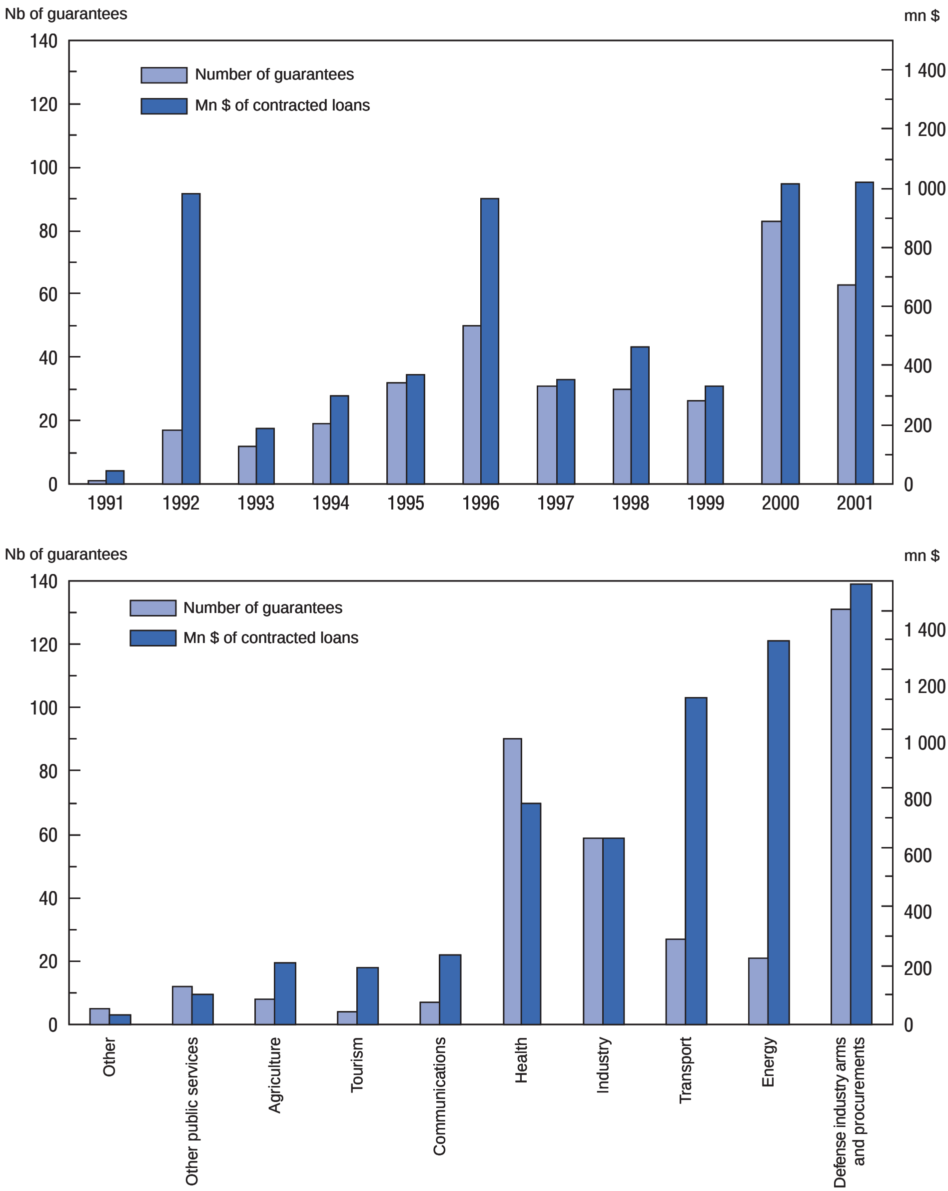
In per cent of GDP

	1996	1997	1998	1999	2000	2001
Total public debt	28.1	27.7	27.6	33.2	31.5	29.1
Domestic public debt	5.0	6.0	7.2	12.6	9.2	8.0
Treasury bills	3.5	2.5	4.0	3.6	4.1	4.1
Foreign exchange bonds/bills/certificates	0.3	0.2	0.9	0.4	0.5	1.1
Bank-restructuring bonds/bills	0.2	3.2	2.2	5.6	2.9	1.4
Other bonds/bills/certificates	1.0	0.0	0.0	2.9	1.8	1.4
External public debt	23.1	21.7	20.4	20.7	22.2	21.1
of which: Guaranteed debt	6.9	6.5	6.3	7.5	7.2	7.4
Interest paid						
Total public debt	2.3	4.0	4.4	5.7	1.0	0.8
Domestic public debt	1.4	2.9	3.4	4.4	0.6	0.4
Treasury bills	0.6	2.4	1.8	2.4	0.2	0.2
Foreign exchange bonds/bills/certificates	0.0	0.2	0.0	0.4	0.0	0.0
Bank-restructuring bonds/bills	0.1	0.1	1.4	1.3	0.3	0.2
Other bonds/bills/certificates	0.8	0.2	0.2	0.5	0.2	0.0
Eternal public debt	0.8	1.1	1.0	1.2	0.4	0.4
Memorandum items:						
External public debt (million US$)	6174.4	6853.7	6966.9	6219.3	6953.3	7715.3
of which: Guaranteed debt (in million US$)	1848.4	2037.8	2152.5	2270.9	2299.7	2731.1
Nominal GDP (in billion Lei)	108 920	252 926	373 798	545 730	800 308	1 154 126

1. The external public debt in ROL was calculated using exchange rates at end of period.

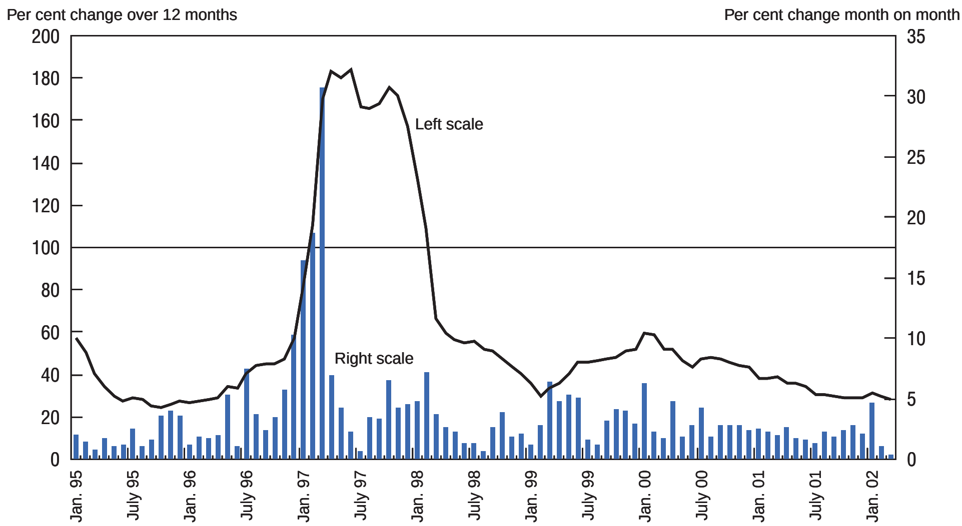
Source: Ministry of Finance.

Figure 8. **Number and amount of State-guarantees issued**



Note: Year correspond to issued of State guarantees.
Source: Ministry of Finance.

Figure 9. **Consumer prices**



Source: INSSE.

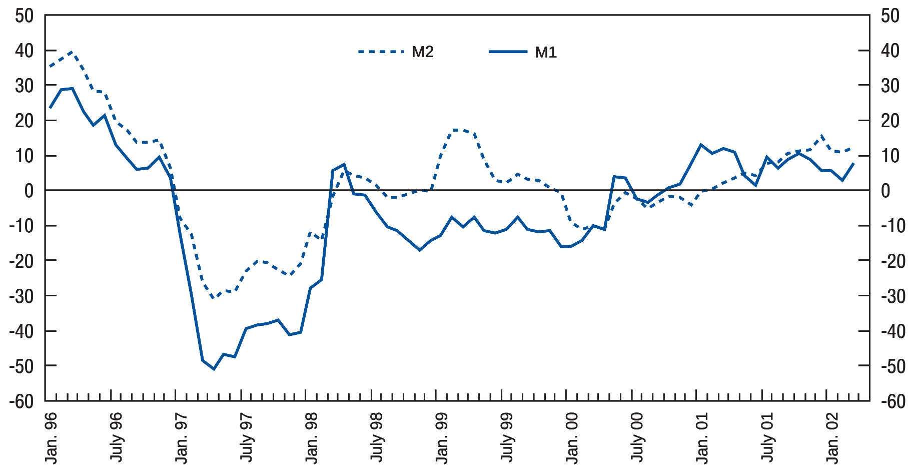
those facilitated the decrease of inflation from 62 per cent end of 1994 to 28 per cent end of 1995, postponing necessary price adjustments to stem inflation proved unsustainable in the long run (Figure 9).

The 1997 shock and its consequences

In 1997 the new government engaged in some major price adjustments. In the first two months of the year gasoline prices rose by more than 150 per cent, the price of rail tickets by 80 per cent, telecommunications by 100 per cent, and electricity by around 300 per cent. At the same time, in an attempt to harden budget constraints for enterprises, the government ended the policy of using the central bank as the main provider of credit to the real sector. This, together with an important reduction of direct subsidisation, led to a credit crunch and liquidity crises in the unrestructured state-owned enterprise sector (see Figure 10). Loss-making enterprises that had been kept alive via directed credit infusions reacted promptly by "financing" themselves via an increased non-payment of budget obligations and suppliers, this in turn resulting in a huge increase in arrears in the economy (see Chapter III).

Figure 10. **Real money growth**

Deflated by CPI, year-on-year growth rate in per cent



Source: NBR, INSSE.

Freeing the central bank from direct financing to the real sector allowed room for the pursuit of monetary policy. Nonetheless, for some time the central bank was forced to act as a lender of last resort (hereafter, LOLR) to a largely insolvent banking sector. This came at a cost to stabilisation policy, as keeping banks afloat while awaiting their privatisation increased inflationary pressures.

While the conduct of monetary policy was complicated by the lack of effective monetary instruments, it also remained exposed to the effects of erratic short term state borrowing on internal financial markets (in the following we will refer to this as "fiscal dominance", see Box 7). The latter occurred in response to unpredictable liquidity needs in the budget sphere. With no room for exchange rate objectives (due to a lack of reserves) or inflation targeting (altogether unfeasible), the central bank officially resorted to monetary targeting between 1997 and 1999. *De facto*, given the constraints it faced and the lack of instruments at its disposal, the central bank "muddled through", trying to control inflation to some degree, while simultaneously preserving the banking system from collapse, and at times pursuing exchange rate objectives (to preserve the external balance).

By the end of 1998, inflation was brought down to 41 per cent from over 150 per cent at the end of the previous year, largely driven by real appreciation of the exchange rate. This fall in inflation was also helped by a significant decline in

Box 6. Evolution of instruments of monetary policy

Until recently, in order to absorb excess liquidity in the banking system, the NBR has been mainly relying on changes in reserve requirements and deposit-taking operations. The extensive use of deposit-taking operations required relatively high reserve requirement ratios to correct temporary fluctuations in liquidity. While this was a costly method of absorbing excess liquidity, it was essential to counter changes in liquidity conditions that originated in the government sphere (see Box 7 on fiscal dominance).

In August 1998, the central bank introduced upper and lower limits for required reserves, and expanded the permissible reserve base. This limited the liquidity-induced high levels of volatility in inter-bank interest rates. As a result, the volume of short-term inter-bank transactions nearly doubled over the year, although part of the increase may be explained by the pressing need of state-run banks to attract funds. Moreover, these regulatory changes allowed the central bank to very significantly diminish its interventions on the inter-bank market.*

During 1999, further improvements in the efficiency and coverage of required reserve ratio were effected. This involved the reduction of the observance and maintenance period from 1 month to 15 days; the inclusion of in-transit foreign exchange amounts; the lowering of the ceiling of fluctuation, and the removal of the floor. Ratios were raised on three occasions, and interest rates for required reserves were increased. The remuneration of required reserves initially reflected an average of lending and deposit rates for non-bank customers, and, subsequently, average interest rates on money market investments. The unification of reserve requirements, while keeping higher reserve requirements on foreign exchange for prudential reasons, also limited dollarisation.

The instruments of monetary policy in the hands of the NBR have been largely harmonised with those of the ECB. The principal changes that have been implemented relate to the diversification of sterilisation instruments, and a shift away from administrative controls to market-based operations (as suggested in the 1998 *Survey*), both of which require a thorough analysis of market developments, as well as the repeal of monetary financing. Moreover, depth of the inter-bank market, and the existence of an effective payments system are crucial prerequisites for the development of indirect instruments with which to control liquidity.

* By the end of 1998, one tenth of inter-bank deposits were taken in by the central bank, as against nearly half earlier in the year.

world prices for oil and raw materials, and the postponement of some administered price adjustment into the following year.

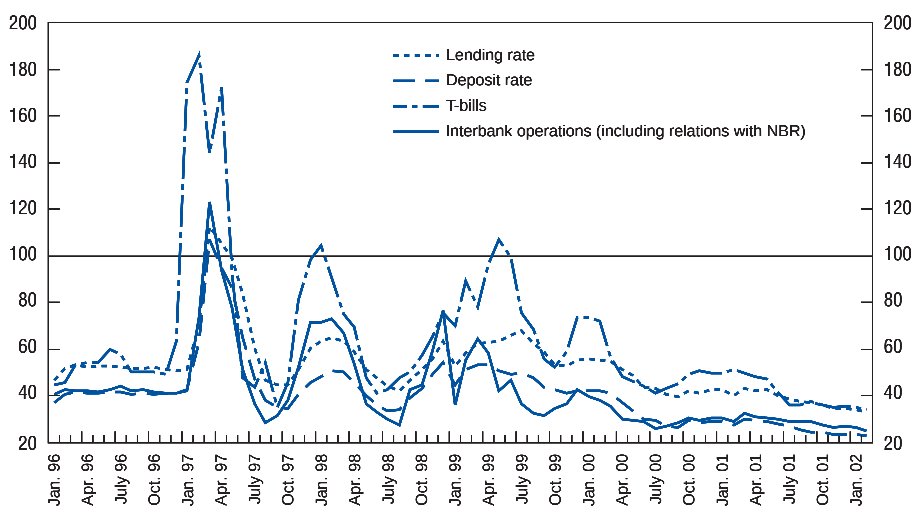
But by the beginning of 1999, to counteract increasing financial market perception of a risk of payment default the government shifted priority to debt

Box 7. The problem of "fiscal dominance"

The government's financing of the budget deficit from domestic sources has represented an important constraint on the conduct of monetary policy in the past. On a number of occasions during 1998 and 1999, *ad hoc* issues of domestic short-term government securities to finance urgent liquidity shortages led, simultaneously, to significant decreases in liquidity conditions, and sharp increases in T-Bill interest rates. In these situations the central bank generally felt obliged to restore liquidity to the financial system in order to try to dampen the impact on other interest rates.

In addition, the government's reliance on domestic bank financing led to the crowding out of the non-government sector. The public debt held by banks was equivalent, in 1998, to more than a quarter of broad money, and four times greater than average bank liquidity. Moreover, in a situation of limited financial deepening (the ratio of Broad Money to GDP has fluctuated around 25 per cent in recent years), even a very small budget deficit might be difficult to absorb and impact heavily on interest rates. This was shown when, at times, the issue of high-yield government securities led to excess demand for funds on the inter-bank market that implied sustained high and volatile interbank and lending rates (see Figure 11). Short-term lending rates are important for the real sector, as due to the shortcomings in the legal system and high volatility in the macroeconomic framework there is little long-term lending to households and enterprises.

Figure 11. **Interest rates and T-Bill yields**



Source: NBR.

service and to restoring adequate foreign exchange reserves. To this end, the NBR adopted a strategy of corrective real exchange rate depreciation (equivalent, year-on-year, to 9.4 per cent) managed through intervention in the foreign exchange markets. The resulting expansion in the monetary base further increased inflationary pressures, requiring extensive sterilisation at the cost of increasing interest rates significantly. Control over monetary aggregates was further weakened by the restructuring and recapitalisation of two main state-owned banks (B*anca* A*gricola* and B*ancorex*) that were on the brink of bankruptcy. By end-1999, inflation was 14 percentage points higher than in 1998.

Fearing that productivity gains would be dissipated through excessive real exchange rate appreciation due to strong capital inflows the monetary authorities focussed on exchange rate policy also during 2000. Although falling, inflation remained stubbornly high. A tighter monetary policy stance finally emerged in the second half of 2000, facilitated by greater diversification in the Treasury's financing towards external sources. In particular, the government was able to tap external financing with an extended maturity (5-year bond issue). New regulations on open market operations and standing facilities granted to banks were adopted in the course of the year, and sterilisation could henceforth be carried out over longer maturities, in an auction format and performed through *reverse repo* transactions.

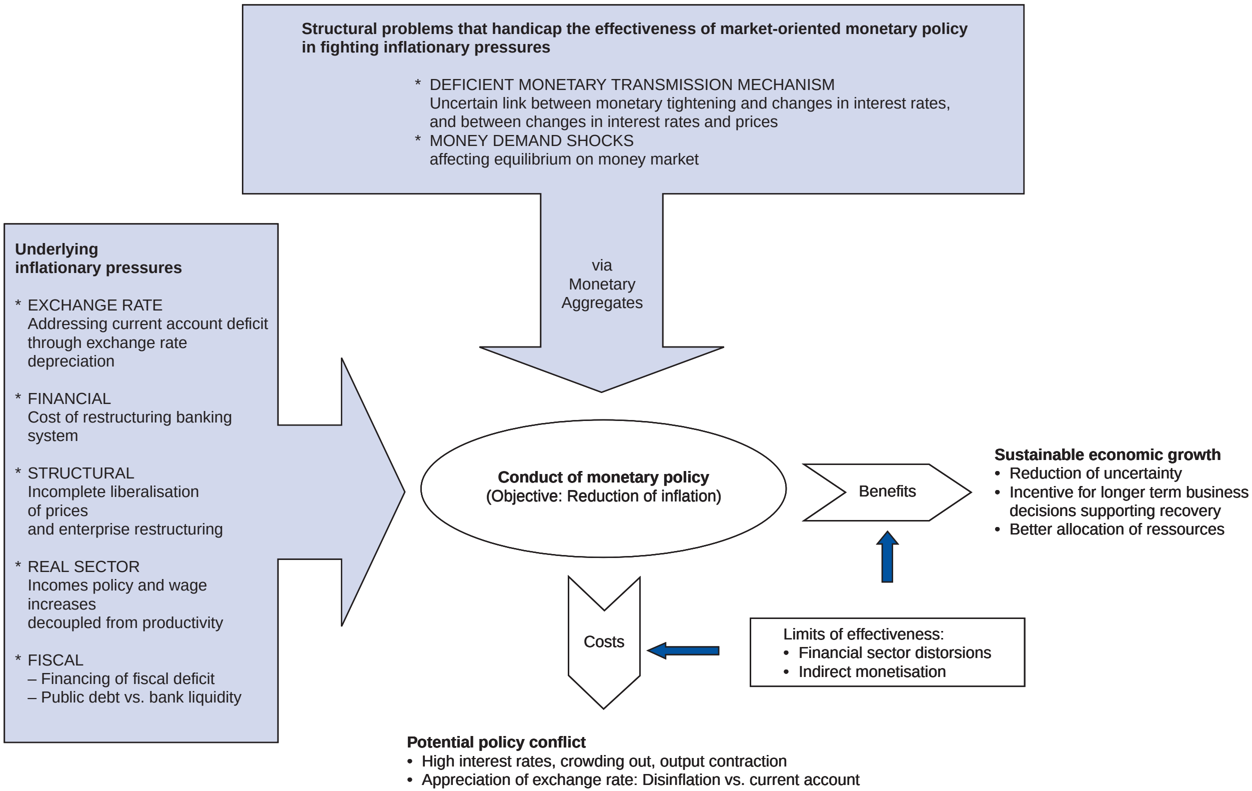
Recently, the pursuit of a tighter monetary policy, which has by and large been freed from the straitjacket of budget and real sector financing, led to some improvement. Inflation has come down from 41 per cent at the end of 2000, to 30 per cent end of 2001. The level of official foreign exchange reserves has reached US$5.2 billion by May 2002 (around 4 months of imports of goods and services). For the first four months of 2002 inflation has been subdued with May 2002 CPI at 24.5 per cent (year-on-year). Assuming that current disinflation trend continues during 2002, this would translate into an end-year inflation rate roughly equal to the announced target of around 20 per cent.

Need for policy coherence

Against this background, one of the main issues on the economic agenda for 2002 remains the imposition of financial discipline on state-owned enterprises and further progress in structural reform. An effective monetary policy requires supportive structural policies and fiscal consolidation for the achievement of sustainable growth (see Figure 12). Weak supply-side policies may reinforce the inflationary impact of monopolistic pricing behaviour and, without an effective incomes policy, the decoupling of real wages from labour productivity may lead to overheating. Therefore, as in the case of fiscal sustainability, reforming the enterprise sector is crucial to the effectiveness of monetary policy.

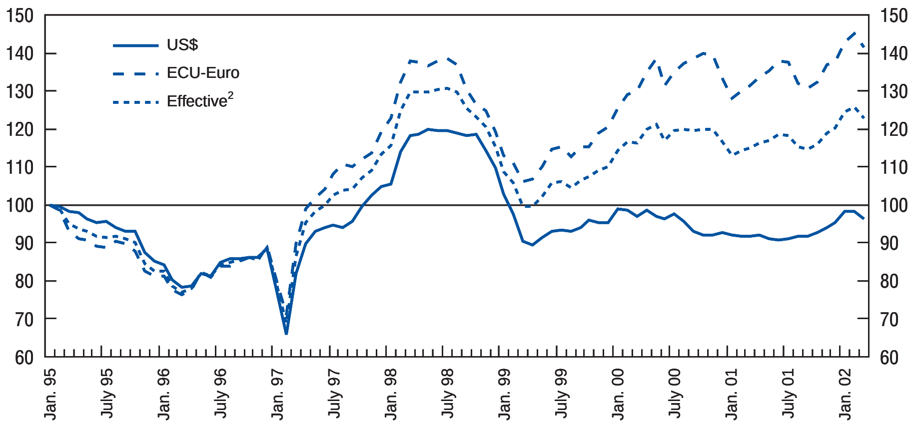
An analysis of the underlying causes of inflation emphasises the importance of macroeconomic policy linkages. These linkages may lead to conflicts

Figure 12. **Macro-structural interactions affecting monetary policy**



Source: OECD.

Figure 13. **Real exchange rate**[1]
Deflated by CPI, Jan.-95 = 100



1. Growth in the index denotes appreciation of the lei and *vice versa*.
2. Effective exchange rate (weighted with currency basket: 60% EURO and 40% US$).
Source: NBR, INSSE.

between different policy areas (Figure 12). For example, while a gradual real appreciation of the exchange rate (see Figure 13) helps in bringing down inflation, it risks harming competitiveness and increasing the current account deficit if not matched by productivity gains. This is a legitimate concern, as the main exporting sectors (textiles, furniture) are highly sensitive to pure price competitiveness. These constraints on the use of real appreciation as an anchor to bring down inflation strengthen further the importance of structural reforms and fiscal restraint in the process of gradual disinflation.

Future challenges

The National Bank of Romania should also seek to develop the secondary market and the quality of financial intermediation. Indeed, the secondary market for government securities is currently underdeveloped (as expressed in a low ratio of secondary market transactions to primary market issues), and the central bank accounts for over three-quarters of the transactions. Several developments are positive in this respect: the participation of non-banks, the issuance of Treasury paper with maturity longer than one year, and various regulatory changes.[8] By developing a secondary market, improving its depth, and extending maturities, there will be a benchmark against which to compare spreads, competition will be stimulated, and marketability of securities will be improved.

The Bank eventually intends to change its official policy from monetary to inflation targeting. There are, however, a number of prerequisites for a monetary policy strategy to be based on inflation targets. These include, again, further progress in structural reforms, the elimination of fiscal constraints, improved price predictability, and the reduction of pressures arising from external imbalances. For the time being, a move to inflation targeting seems premature,[9] and the current central bank policy of a *de facto* managed float, aiming at a moderate real appreciation, appears appropriate. In this context, the evolution of interest rates will continue to depend mainly on government borrowing policies, with central bank operations in the domestic money market mainly oriented towards avoiding excessive fluctuations in liquidity.

There are, however, two important issues with the managed floating policy described above. First, the Bank should continue to accommodate a wide range of fluctuations in the exchange rate according to market-driven influences. Speculative capital inflows can be deterred to some degree if investors perceive downside risks as well as upside risks regarding the exchange rate. In particular, the central bank should avoid being seen as backing a particular exchange rate and supporting "one way bets" from foreign investors. This was already discussed in the 1998 *Survey*. Second, the real appreciation should not be gauged only to increases in labour productivity, but rather to changes in total factor productivity (TFP). Although the latter is difficult to estimate in Romania, as an order of magnitude, changes in TFP typically amount to around one third of GDP growth (very rarely exceeding one half). As the potential for increases in TFP in transition countries is probably at the higher end of the range, real appreciation above these levels risks to become unsustainable.

Strengthening the macroeconomic framework: banking sector restructuring finally started

Bank restructuring really started in 1999, when *Bancorex*, having been in a distressed situation for years, suffered from a bank run and crashed. The authorities decided to merge part of it into *Banca Comerciala Romana* (BCR) and unwind the rest. Some months later the situation for *Banca Agricola* also became untenable. This time, in contrast to *Bancorex*, it was decided to recapitalise the bank.[10] The non-performing assets were written off from their balance sheets, transferred to the *Banking Claims Resolution Agency* (hereafter, AVAB)[11] and replaced by government securities. This resulted in an apparent reduction in the ratio of non-performing loans to total banking sector assets. The central bank also provided special (direct) credit facilities.[12] Moreover, the same year two other large state-owned Romanian Banks (*Romanian Bank for Development*, and *Banc Post*) were sold to foreign investors. So finally

Table 9. **Asset structure of banking system by ownership**
Per cent in total banking system

	Dec.-01
Banks with majority Romanian capital	44.8
Banks with majority public capital	41.8
Banks with majority private capital	3.0
Banks with majority foreign capital	47.3
Foreign banks branches	7.9

Source: NBR.

was *Banca Agricola* in 2001. As a result, by the end of 2001, the majority publicly-owned banks' capital had been reduced to 41.8 per cent of the banking system's total assets (see Table 9), of which BCR accounted for 31.3 per cent. The privatisation of BCR is scheduled for 2002, following which there would remain two state-owned banks in the financial system, namely the *Savings and Loans Bank* and the *Eximbank*.

The asset recovering agency AVAB, established to address the problems of arrears and non-performing loans faced by domestic banks, operates as a loan workout and debt recovery organisation. Its claim structure is set out in Table 10. The transfer of assets onto the balance sheet of the AVAB is the main factor underlying the sharp decline of past, due and doubtful claims in the banking system. In the meanwhile, the central bank also tightened the provisions for eventually new non-performing loans.

Until recently, banks have been mainly involved in state financing, but fiscal consolidation and financial sector restructuring are expected to improve the competition in the provision of financial services and lending to the private sector. Further progress in disinflation, and reduced uncertainty with respect to the future path of economic policy would support this process. In financial services, provision of housing loans, and consumer finance are among the areas of potential growth.

Table 10. **Assets transferred to the Asset Restructuring Agency**
Bn lei

	End-2001
BANCOREX	26 954.3
Banca Agricola	9 584.2
Banca Comerciala Romana	20 155.7
CEC-Casa de Economii si Consemnatiu	300.4
Total	56 994.6

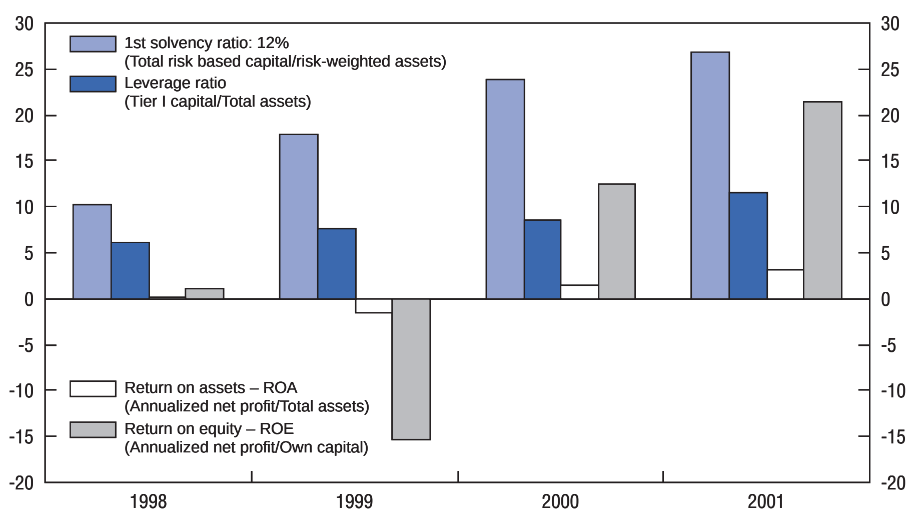
Source: NBR.

The mortgage market is still relatively underdeveloped, however, due to a number of factors including the absence of effective enforcement of bankruptcy legislation and the underdevelopment of structures for establishing credit history.

The strengthening of bank supervision and the adoption of prudential requirements have led to improved capital adequacy and financial performance, as evidenced in Figure 14. When Bancorex became insolvent and collapsed, the decision to arrange for its winding up rather than a bail out may have served to limit moral hazard. The regulatory framework has also been tightened for the non-bank financial sector, particularly following the collapse of the largest Romanian investment fund. To facilitate access to external finance and increase payment discipline for Romanian firms, greater efforts must still be made to improve the legal and regulatory framework for corporate governance. This will include sound and well-regulated financial markets (see OECD, 2001).

Concerning other financial policies, the government of Romania has committed itself to full liberalisation of the capital account in stages, in the context of the adoption of the EU *acquis communautaire*. At the end of 2001, the liberalisation included outward direct investment and real estate purchases by residents. By 2004, liberalisation is scheduled to affect credit and guarantee operations and other capital markets. Short-term flows will only be liberalised on EU accession.

Figure 14. **Financial performance ratios in the banking sector**



Source: NBR.

III. Exit

The restructuring of the large enterprise sector has lagged

Slow restructuring has been a general feature of the large state-owned enterprise sector in Romania. Before 1997, privatisation in industry was mainly oriented to small and medium sized enterprises, which is reflected in the fact that, in spite of a massive wave of privatisation during 1995-96 (see Figure 15), 58 per cent of industrial production still took place in the public sector in 1997. This lack of decisive action on privatisation and restructuring of large companies actually worsened the problems of transition in Romania. Inefficient state-owned enterprises, kept afloat through large direct and indirect subsidies, weighed heavily on state funds. The lack of fiscal stability prevented macro-stabilisation, which, together with the misallocation of resources, significantly impeded sustainable economic growth.

As a substitute for swift privatisation, restructuring of the large enterprises was pursued through "isolation" programmes that were designed to improve operational performance and facilitate the process of privatisation or liquidation.[13] Unfortunately, most isolation programmes failed to deliver. Often the operational performance of "isolated" enterprises worsened, their indebtedness increased, and restructuring efforts in these enterprises were weaker than in non-isolated state-owned enterprises. As a result, according to Djankov (1999), the transfers from the budget to "isolated" firms increased from 5.4 to 12 per cent of total revenues during 1992-96.

In 1997, a new reform-oriented government launched the first serious attempt to tackle the issue of privatising and restructuring of the remaining large state-owned enterprises. In 1998 and 1999 the number of large enterprises that were privatised increased substantially (Table 11). Important results were the sale of a 35 per cent stake in RomTelecom (the Romanian national telephone carrier) to the Greek operator OTE in 1998, and the sale of DACIA (the major Romanian car manufacturer) to Renault in 1999. Moreover, two large Romanian Banks (Romanian Bank for Development, and Banc Post) were sold to foreign investors (see Chapter II for details on bank restructuring). However, the reformist government did not manage to build the necessary support for a programme that was inevitably controversial because it entailed transitional social costs and opposition

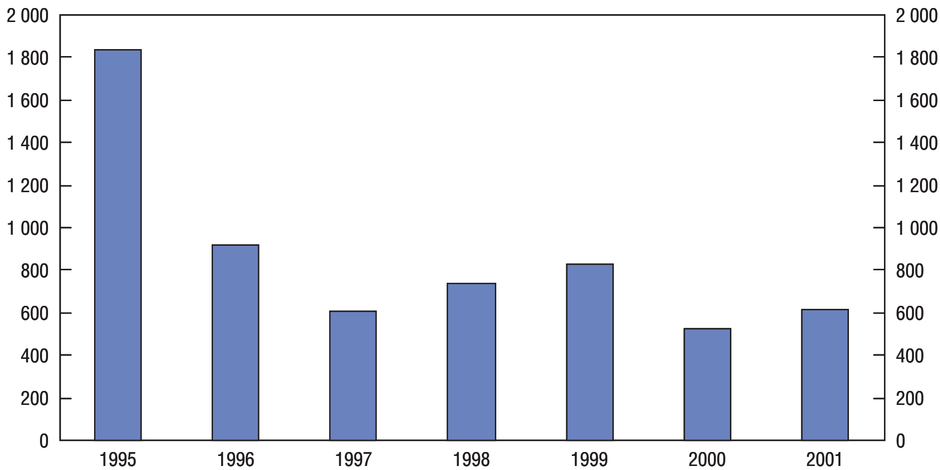
Table 11. **Evolution of the privatisation process**

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Number of companies in SOF/APAPS portfolio, beginning of year[1]	5 937	6 291	7 602	9 010		5 554	4 330	3 149	1 444
Number of companies privatised during the year	265	604	648	1 388	1 304	1 267	1 854	1 341	127
By size[2]									
Large	2	12	30	25	35		82	24	19
Medium	24	110	268	238	150		589	247	19
Small	238	472	322	984	978		1 183	1 070	89
By privatisation method[3]									
MEBO	261	519	43	14					
Direct negotiations	4	85	605	1 006	1 064	244	1 337	1 235	19
Auctions				455	231	991			92
Sales on the capital market					9	32	64	106	16
Sold share by year in constant prices (1995 prices), bn lei	144.3	471.4	1 840.0	920.4	603.3	741.3	824.3	525.9	617.8
Companies sold to foreign investors	1	1	5	4	44	96	83	38	
Proceeds from sale to foreign investors – $mn	2	3.9	15	15.5	403.8	608.1	57.1	7	

1. The SOF was replaced by APAPs in 2001. When the SOF was liquidated, not all of its shareholdings were transferred to APAPS. 809 enterprises were transferred to the corresponding line ministries. The number of companies in SOF's portfolio was fluctuating not only due to privatisation, but also as a result of reorganisations. Companies were split into several smaller units, or sometimes smaller units were rebundled.
2. 1993-97, for some privatised enterprises their size is not reported in the data.
3. Several privatisation methods may be used concurrently so numbers do not necessarily add up.

Source: State Ownership Fund, APAPS, Negrescu (2000).

Figure 15. **Privatisation: sold share capital**
Bn lei, 1995 prices



Source: INSSE.

both from the political opposition and from within the coalition. Following widespread popular discontent the government was replaced in December 1999. In 2000, an election year, the main actions in enterprise privatisation were attempts to sell PETROM SA (the national oil company) and TAROM (the national airline) both failing to raise investors' interest. Nevertheless, that year some progress on restructuring was achieved with the unbundling of Conel (the national electricity company) and RomGaz (the national gas company) along functional lines. Conel was split into two electricity production companies (SC Termoelectrica and SC Hydroelectrica), a company responsible for transporting electricity (CN TransElectrica), and an electricity distribution company (SC Electrica, which itself regroups eight local distribution operators). The gas sector was structured similarly with RomGaz only keeping exploration and storage activities, transportation being transferred to the new company SN TransGaz, and distribution to two new regional distribution companies, SC DistriGaz-Nord and SC DistriGaz-Sud.

Following elections and the formation of a new government, in January 2001 the State Ownership Fund (SOF), which had been perceived as inefficient, was replaced by a new administration, the Authority for the Privatisation and Management of State Assets (APAPS). A number of enterprises that had been under the authority of the SOF, however, were not transferred to APAPS, but to the

Table 12. **Share of the private sector in economic activity: developments by economic sectors**

In per cent

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Gross domestic product	**16.4**	**23.6**	**26.4**	**34.8**	**38.9**	**45.3**	**54.9**	**60.6**	**61.4**	**63.7**	**65.5**	**67.1**
Industry	5.7	9.2	11.8	17.4	23.3	29.9	38.5	42.1	46.0	53.7	57.5	57.7
Agriculture	61.3	73.9	81.7	83.5	89.3	89.0	90.1	96.8	96.3	96.7	97.2	97.8
Construction	1.9	16.1	21.0	26.8	51.6	57.8	69.3	76.6	79.3	81.9	80.9	81.1
Services	2.0	16.8	18.8	29.3	39.1	58.1	66.7	71.5	76.1	76.6	78.3	78.4
Exports (FOB)	0.2	15.9	27.5	27.9	40.3	41.2	51.4	54.8	48.9	65.7	65.7	66.7
Imports (FOB)	0.4	16.1	32.8	27.2	39.2	45.4	48.3	52.4	48.3	72.1	70.1	69.6
Investment	4.3	8.1	15.6	26.0	36.8	39.3	39.7	35.4	40.5	50.5	58.3	..

Note: For 1990-1997 National accounts using ESA 1979.
For 1998-2001 National accounts using ESA 1995.
Source: INSSE.

relevant line ministries. While this move may have helped to improve supervision of these companies, there is a risk it may diminish interest in future privatisation.

Further, albeit limited, progress on large enterprise restructuring has been achieved since 2001. The most significant achievements have been the sale of Banca Agricola to Raiffeisen Austria, and of Sidex Galati to the primarily India-based multinational LMN holdings, one of the world's largest steel producers. The importance of the latter can hardly be underestimated, given that Sidex accounts for roughly three quarters of Romanian steel production, or around 15 per cent of Romanian gross industrial output. Other large companies have been privatised (*e.g.* Alro Slatina, Rafo Onesti, Santierul Naval Constanta). The EU-RICOP programme has also allowed for the restructuring of a number of commercial companies by co-financing severance payments and active labour market policies (for a total of 33 000 redundant jobs).

While the current Romanian government seems committed to seriously accelerate privatisation and restructuring, it will have to prove through concrete results that it is capable of delivering on its promises. The constant delays in the privatisation process have led to a situation where, in spite of limited improvements since 1997, state-ownership in the industrial sector is still pervasive. In 2001 it was still 42 per cent (Table 12), though by May 2002, with the sale of Sidex Galati, it has probably come down to around 35 per cent.

This portrays a situation where overall state activity in the Romanian economy is still significantly above that of its economically more successful neighbours (Table 13). Moreover, the development of the private sector in recent years depends only to a limited extent on the divestment of the state, being rather the result of a shift of economic activity to the service sector that is characterised by a relatively high degree of private ownership.

Table 13. **Share of the private sector in the economy: comparison with other transition countries**

2000, in per cent

	GDP	Employment[1]
Ukraine	60	n.a.
Romania	**65.5**	**70**
Russia	70	n.a.
Poland	70	72
Bulgaria	70	65
Estonia	75	n.a.
Slovak Republic	80	75
Hungary	80	81
Czech Republic	80	65

1. Romania: 1998, Bulgaria: 1999, Hungary: 1998.
Source: INSSE, EBRD.

The lack of restructuring contributes to a widespread financial indiscipline

While the burden has become less visible, the lack of restructuring of the large enterprise sector is still crowding-out resources from the rest of the economy. Direct subsidies from the central and local budgets decreased from 6.9 per cent (including directed banking credits) in 1996 to 2.1 per cent in 2001 (of which roughly 1 per cent were subsidies to industrial enterprises). But while there has undoubtedly been real progress, part of the decrease in subsidisation has been virtual. We estimate that in 2001 state subsidies to enterprises were still around 5 per cent of GDP, with subsidies to state-owned enterprises accounting for roughly 3 to 3½ per cent of GDP (see Box 8). These indirect state subsidies have been provided through subsidised energy prices and state guarantees of companies' bank loans, of which typically 90 per cent are repaid from the state budget. Moreover, unprofitable state-owned enterprises continue to run up large arrears to the budget and state-owned energy suppliers (Figure 16).

In past years, arrears have been pervasive, reaching 42 per cent of GDP in the end of 1999, and stagnating around 40 per cent of GDP since (Table 14). The slight decrease between 1999 and 2000 was mainly due to a fall in arrears to banks following the restructuring of the banking sector. Abstracting from inter-enterprise arrears, where data to some degree are inflated by double accounting, the largest part of payment arrears is to central government and social security funds (Figure 17). Wage arrears (that have been a pervasive problem in many of the former Soviet Union republics) are relatively low in Romania. It is especially noteworthy that a third of inter-enterprise arrears are owed to state-owned companies in the energy sector.

But state-owned enterprises are not only the main victims of low payment discipline, they are also the primary offenders. While by end-2000 fully-private companies had total payment arrears of 14 per cent of turnover, the same figure in companies with state participation was 53 per cent (Table 15). The difference is even more marked for arrears to the state (including state and local budgets, social security, and off-budget funds), where arrears for private companies were 2.9 per cent of turnover, while the figure for enterprises with state participation was 21 per cent. It is interesting to see that the worst offenders were not those enterprises that were fully state-owned (mostly R*egies* A*utonomes*), but those with partial state ownership, suggesting that even a state minority shareholding allows enterprises to enjoy comparatively soft budget constraints.

Part of the explanation for the striking difference between the private and the state sector is that on average fully-private enterprises are smaller. Private enterprises have been more seriously exposed to hard budget constraints that are politically and socially less costly to enforce in smaller entities, and have a more limited ability to diversify into arrears, relative to larger, state-owned firms. But the most important factor for the difference between the private and the mixed

Box 8. Back to the budget: How much subsidisation remained in the Romanian economy in 2001?

As Figure 16 indicates, subsidies to state-owned enterprises have either been channelled directly from the budget, or via the energy sector. Subsidies to state-owned enterprises that come directly from the state budget consist of direct subsidies, guaranteed loans, and tolerated arrears and non-payments to the budget. In addition, state enterprises have been implicitly subsidised via low energy prices and payment arrears to the state-owned energy-suppliers. Low energy prices obviously also benefit final consumers, as well as private enterprises. Noteworthy, with the recent increase of energy prices, this indirect subsidisation has been reduced (see section below on recent progress in the restructuring of the energy sector).

The energy companies, however, would not have been able to provide subsidies on such a large scale if they themselves would not have received massive subsidies from the state. These include again direct subsidies, guaranteed loans, and the tolerance of arrears and non-payments of budget obligations, but also foregone profits and royalties to the state. The latter two result notably from the fact that prices for domestically produced gas are administratively set below prices for imported gas. Foregone profits of state-owned enterprises in the energy sector (which would belong to their owner, the state), and the royalties on natural resource extraction the Romanian government renounced to impose are *de facto* subsidies.

A rough estimation of the order of magnitude of the total subsidies to the economy in 2001 (that is adding up the subsidies from the budget to state-owned enterprises outside the energy sector and the subsidies from the budget to the energy sector) would give a figure of around 8 per cent of GDP.* Very rough estimates suggest that approximately 3 per cent of GDP has gone to households, 3-3½ per cent to the state-owned enterprises sector, and around 1½-2 per cent to privately-owned enterprises.

An important problem resulting from the large amount of subsidisation in Romania is that it has allowed the survival of unrestructured and inefficient state-owned enterprises, even when their value added is actually negative. Moreover, these infusions into declining sectors come at the expense of the more successful sectors of the economy that suffer from a heavier tax burden than otherwise necessary. Subsidising inefficient state enterprises impedes the development of those sectors that create new wealth and employment.

In addition, artificially low energy prices have led to wasteful over-consumption of energy, and sub-optimal investment decisions with respect to the energy efficiency of newly-installed technology. As an example, highly subsidised energy prices have delayed the upgrading of inefficient electricity and heat generation plants, leaking energy transport systems, and the installation of thermostats for heating.

The argument that countries that possess large energy resources have a comparative advantage in energy that should be reflected in internal energy prices below world market levels is highly controversial. Foregone profits are a loss for

Box 8. Back to the budget: How much subsidisation remained in the Romanian economy in 2001? (*cont.*)

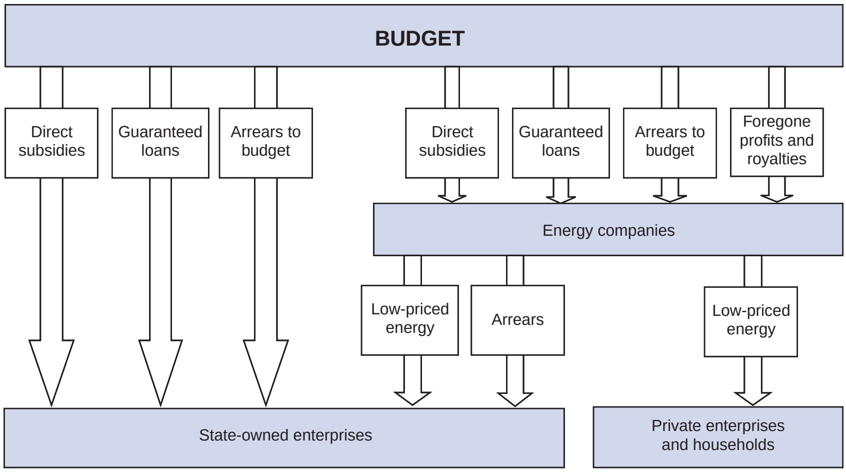
investment not only in the energy sector, but also in the economy as a whole. It is doubtful, at any rate, whether Romania still has a sustainable comparative advantage in energy. Its energy reserves are to a large degree depleted, as witnessed by the increasing level of energy imports. While concerns that energy and heating should be affordable to the poorest segments of society are understandable, it would be preferable to shift from uniform subsidisation to more targeted subsidies to those in need.

* A rough estimate is that in 2001 direct subsidies to enterprises were around 1 per cent of GDP (roughly half of this supporting public passenger transport). Guaranteed credits were 1 bn US$ (approximately half of which went to the energy sector). Assuming that as in the past 90 per cent of guaranteed loans will have to be paid back from the state budget, this implies an indirect subsidy of 2.4 per cent of GDP. Arrears to the budget increased only insignificantly in 2001 as 12 400 Billion Lei (around 1.1 per cent of GDP) of debt from Termoelectrica and its suppliers to the budget were written off. An estimation of the IMF (basically the quantity of domestic gas production multiplied by the difference between the domestic wellhead price and import prices) sees foregone royalties and profits in the gas sector for 2001 at 1 381 bn US$ (3.7 per cent of GDP). Adding this up, one obtains total subsidies around 8 per cent of GDP, out of which roughly 6 per cent are channelled via the energy sector. Taking 40 per cent of this (as somewhat below half of energy consumption is private), and adding the direct subsidies for public transport, one obtains that subsidies to the population have roughly been 3 per cent of GDP. Splitting the remainder of subsidisation via the energy sector equally between the private and state (outside energy) enterprise sector (the private industrial sector is larger, but more energy efficient), and assuming that half of direct subsidies went to state-owned enterprises (outside energy and transport), and adding to this 1.2 per cent of guaranteed loans (outside energy) one may conclude that state enterprises (outside energy) were subsidised in the order of 3-3.5 per cent of GDP. This leaves 1.5-2 per cent of subsidies for the private enterprise sector.

sector is probably that partly state-owned enterprises are often those that have been in the pipeline for full privatisation without full divestiture of the state in the company. In such a situation, managers and workers have little incentives to restructure and hard budget constraints are even more difficult to enforce.

This is also suggested by the different evolution of arrears in the different sectors after most of direct subsidies had been cut in 1997. Arrears (as share of turnover, Figure 18) both in the fully state-owned *Regies Autonomes* and in the partially state-owned companies increased significantly in 1998, in parallel with the general deterioration in the economy. Arrears of the fully state-owned entities did however roughly stabilise afterwards, while those of the partly state-owned entities

Figure 16. **Direct and indirect State subsidies in Romania**



Source: OECD.

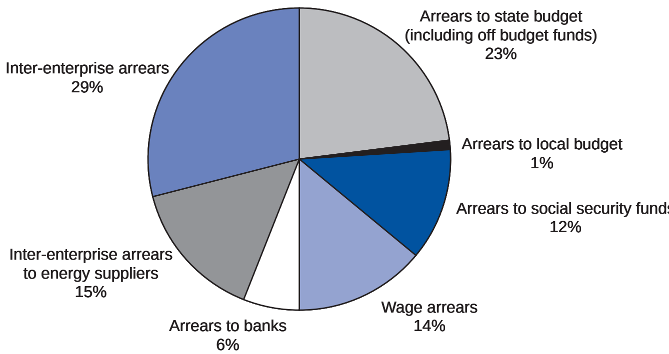
continued to rise sharply. One possible explanation is that supervision by the respective line ministries prevented further slippage of the *Regies Autonomes*. In contrast, the State Ownership Fund did not seem able to reasonably control the several thousand companies under its responsibility, and management and workers exploited this situation to increase their rents. It could be noted that in spite of its large size in the economy, the fully privatized sector accounts for approximately half of the total gross arrears (Figure 18, lower panel).

Table 14. **Evolution of total arrears in per cent of GDP**

	1997	1998	1999	2000
Total	33.66	36.15	42.22	40.67
Budget	8.99	11.52	12.29	12.51
Wage arrears[1]	3.81	3.30	5.22	
Inter-enterprise arrears[1]	15.06	15.27	18.26	24.25
of which: + 3-months	7.70	8.45	10.45	
Banks arrears	5.80	6.06	6.44	3.91

1. Inter-enterprise arrears include wage arrears in 2000.
Source: Ministry of Finance.

Figure 17. **Arrears by type of creditor**
In per cent of total arrears, June 2001
Total arrears = 339971 bn lei



Source: Ministry of Finance.

Table 16 represents a selection of large state-owned commercial companies and documents how companies, in spite of running huge losses over the last years, have been able to keep on producing, partly through direct state subsidies, but mainly by accumulating arrears. Most of these companies have been highly unprofitable over recent years (and still are). Direct subsidisation has been mostly low since 1997, with the notable exception of the mines. In spite of a significant decrease of direct state support after 1997, the mines generally still receive sizeable state subsidies, which, however, has not prevented them from running yearly losses often even above their turnover. While all companies have to some degree suffered from non-payments, their overdue receivables have generally been relatively low, especially when comparing them to the payment arrears they accumulated over the period, and mainly between 1998-2000. It is this build-up of arrears that has allowed them to cover their losses and hence continue to produce. The change in net arrears (that is arrears minus receivables) between December 2000 and 2001 is for most enterprises strikingly close to the loss they incurred in 2001.

Another striking feature is the degree to which some of these companies (that admittedly have been among the most problematic in Romania) have been (and are) adding net negative value. The "true cost' to the Romanian budget of these enterprises is roughly equal to the state subsidies plus the incurred loss (which is mainly financed by arrears to the budget and other state-owned enterprises, in particular the energy sector as shown above). Comparing the "true cost" per employee with the average net wages shows that the former is often a multiple of the latter – especially but not exclusively in the mining companies.

Exit

Table 15. **Comparison: Arrears in private *versus* state-owned enterprises**

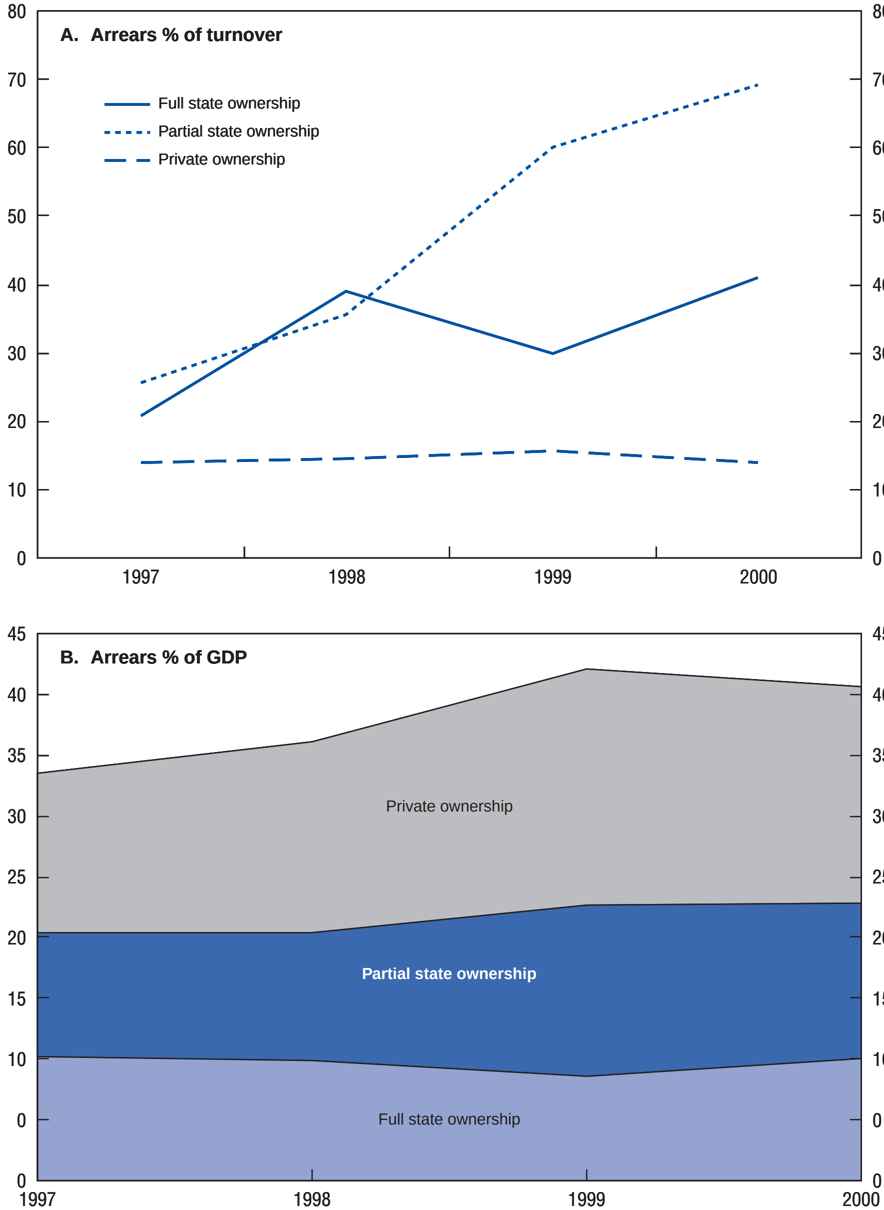
In per cent of turnover

2000	Fully state-owned	Partially state-owned		Fully private	Total state	Total economy
		State < 50%	State > 50%			
Inter-enterprises arrears[1]	21.12	56.34	28.73	9.34	28.80	14.17
Social security arrears	5.30	3.28	9.92	0.94	6.25	2.28
State budget arrears	12.50	4.83	21.91	1.86	13.86	4.86
Local budgets arrears	0.27	0.27	0.91	0.07	0.45	0.17
Banks arrears	1.78	5.07	7.50	1.77	3.87	2.29
Total	40.99	69.80	68.97	13.98	53.23	23.77
1999	**Fully state-owned**	**Partially state-owned**		**Fully private**	**Total state**	**Total economy**
		State < 50%	State > 50%			
Inter-enterprises arrears[1]	15.91	40.02	21.45	9.88	21.27	13.14
Social security arrears	4.84	3.23	9.16	0.73	5.86	2.24
State budget arrears	6.97	5.46	23.04	1.48	11.47	4.39
Local budgets arrears	0.39	0.27	1.14	0.11	0.59	0.25
Banks arrears	1.81	5.47	8.30	3.35	4.28	3.60
Total	29.92	54.44	63.09	15.55	43.48	23.63
1998	**Fully state-owned**	**Partially state-owned**		**Fully private**	**Total state**	**Total economy**
		State < 50%	State > 50%			
Inter-enterprises arrears[1]	12.82	20.73	13.85	9.87	14.47	11.36
Social security arrears	6.44	2.33	5.36	0.43	5.37	2.10
State budget arrears	14.69	5.08	10.52	1.42	11.57	4.84
Local budgets arrears	0.18	0.10	0.29	0.05	0.21	0.10
Banks arrears	4.83	3.93	7.10	2.80	5.56	3.71
Total	38.96	32.17	37.12	14.56	37.18	22.12
1997	**Fully state-owned**	**Partially state-owned**		**Fully private**	**Total state**	**Total economy**
		State < 50%	State > 50%			
Inter-enterprises arrears[1]	8.50	16.35	11.72	10.15	10.52	10.27
Social security arrears	2.58	1.03	2.75	0.23	2.43	1.30
State budget arrears	6.45	3.23	6.19	1.21	5.96	3.50
Local budgets arrears	0.13	0.06	0.20	0.04	0.14	0.09
Banks arrears	3.23	1.43	6.22	2.43	3.96	3.15
Total	20.89	22.10	27.08	14.07	23.02	18.31

1. Including wage arrears.

Source: Ministry of Finance.

Figure 18. **Evolution of arrears by type of ownership**



Source: Ministry of Finance.

Table 16. **Large loss-making State-owned enterprises**

	Employees	Turn-over	Profit/ Loss	Receivables		Arrears			Subsidies			Profit/ Loss	Financing: change in net arrears (arrears-receivables)	Monthly wage per employee (net)	Real loss (loss + subsidies) per employee and month
		bn Lei	% of turnover	% of turnover	% change	% of turnover		% change	% of turnover			bn Lei		Euros	
	2001	2000	2000	2000	2000-01	1997	2000	2000-01	1996	1997	2000	2001	2001	Dec.-01	2000
Lignitului Oltenia (Lignite mining)	20 493	6 361	–35	61	–12	30	114	4	14	4.1	2.1	–2 153	745	213	–485
Huilei Petrosani (Coal mining)	17 711	1 738	–300	36	–85	157	645	50		30.2	42.0	–6 310	6 106	289	–1 367
Cuprului (Minvest Deva) (Metal mining)	10 515	644	–112	56	–14	115	422	38	221	90.0	67.4	–1 151	1 074	151	–379
Remin (Metal mining)	10 854	664	–7	34	–11	n.a.	105	80		n.a.	107.8	–299	577	192	–280
Carbunelui (Coal mining)	6 604	695	–59	65	–12	108	214	–9	102	30.0	30.3	n.a.	–83	157	–374
Tractorul (Agricultural machines)	4 940	945	–64	25	112	46	145	54		0.39	5.06	–450	476	134	–501
Govora Soda (Soda products)	1 485	704	–49	21	16	n.a.	125	22		n.a.	0.00	–266	174	107	–1 002
Faur (Machine building, locomotives)	3 893	299	–97	51	4	17	197	23		0.01	0.09	–290	131	146	–296
Siderurgica (Metallurgy)	8 394	1 593	–14	28	23	48	95	33		0.02	0.00	–361	398	133	–109
Nitramonia (Chemical)	2 220	419	–28	28	68	48	97	26		0.00	0.00	79[1]	26	145	–245
Carom (Chemical)	2 142	750	–15	33	–50	26	73	–12		0.35	0.00	9[1]	62	177	–211
Letea (Pulp, paper, packaging)	1 580	565	–18	3	21	n.a.	95	16		n.a.	0.00	–72	84	146	–259
Rocar (Machine buiding, buses)	1 183	114	–84	17	–29	n.a.	226	12		n.a.	0.00	–146	38	93	–305
Aro (Machine building, 4Wcars)	3 466	360	–23	12	95	39	87	47		0.00	0.00	–109	107	142	–99
Republica (Steel pipes and tubes)	1910	252	–30	66	–17	n.a.	168	40		n.a.	0.00	–110	196	154	–192
Utilaj Greu (CUG) (Metallurgy)	1 216	223	–31	28	144	n.a.	110	75		n.a.	0.00	–122	93	166	–246
Brafor (Timber, forestry)	1 151	193	–20	15	–30	33	75	19		0.04	0.00	–57	36	137	–68

1. First 6 months.
Source: Ministry of Finance, Ministry of Industry and Ressources, APAPS, INSSE.

Table 17. **Large *Régies Autonomes* and State-owned enterprises with public service character**

	Employees	Turn-over	Profit/Loss		Receivables		Arrears			Subsidies	Profit/ Loss	Financing: change in net Arrears (arrears-receivables)	Monthly wage per employee (net)	Real loss (loss + subsidies) per employee and month
		Bn Lei	Bn Lei	% of turnover	% of turnover	% change	% of turnover		% change	% TO	bn Lei		Euros	
	2001	2000	2000	2000	2000	2000-01	1997	2000	2000-01	2000	2001	2001	Dec.-01	2000
Apele Romane SA Water supply	8 966	894	–70.2	–7.85	37	90	6	39	–13	1	n.a.	–341.1	132	–35
CFR Railway (network)	45 130	6 179	2.0	0.03	12	140	43	23	213	18	–14.7	1 944.7	125	–97
CFR Calatori Railway (freight)	22 335	2 937	6.3	0.21	25	–20		13	179	52	–1 207.4	806.3	156	–636
CFR Marfa Railway (passengers)	27 185	9 399	103.5	1.10	12	4		12	7	0	n.a.	24.4	185	14
Drumurilor Roads administration and construction	6 780	2 684	–49.9	–1.86	1	–29	8	13	–94	12	n.a.	–309.9	135	–188
Padurilor Forestry	25 309	4 103	273.7	6.67	6	–1	9	0	0	0	n.a.	1.9	220	29
Posta Romana Post	34 971	2 510	611.7	24.37	1	–20	0	0	0	0	n.a.	2.9	127	73
Romarm Arms production	10 005	101	–289.7	–287.30	213	–21	41	1 260	79	1	–574.0	1 055.8	150	–183
Tarom Airline	2 719	4 008	–735.9	–18.36	17	9		22	6	1	n.a.	–4.0	395	–1 109

1. Only subsidy.
Source: Ministry of Finance, Ministry of Industry and Ressources, APAPS, INSSE.

The financial situation in companies or *Régies Autonomes* outside the energy sector (see Table 17), of at least some public service nature has been relatively better. The main constant exception has been RomArm, where a large part of the employees, recorded as technically unemployed, continued to receive wages for years. Tarom, the national airline, has equally been incurring large losses, especially on domestic flights. The railway companies, as well as the road administration and construction company Drumurilor, have also profited from subsidies, and to a certain extent from payment arrears in years where they were loss-making.

The most problematic point of the public utilities in Romania is that wages are often way above the national average. This feature is especially striking for the companies and *Régies Autonomes* that are under the control of the Ministry of Industry and Resources, and to some degree for those controlled by the Ministry of Transport (see Table 18). It seems highly questionable whether a supposed higher level of qualification of employees of these enterprises can really justify differences of this order, and the alternative that employees of these companies hold the Romanian society hostage in order to extract rents for themselves appears more plausible. The high wages in these companies appear especially out of place when comparing them with the low wages in the police and the judiciary sector, considering that the low wages are often considered to foster corruption.

Table 18. **Comparison: public sector wages with national average**

In January 2002

	Number of employees	Average wage lei/employee	Share of national average wage
Total economy		**3 671 588**	
Public sector	**463 759**	**5 282 203**	**1.44**
Ministry of Industry	256 689	6 253 984	1.70
of which:			
Energy sector	177 518	6 354 152	1.73
Mining industry	67 573	6 137 700	1.67
Ministry of Transport	116 469	4 760 604	1.30
of which: Railways	101 349	4 723 460	1.29
Ministry of Agriculture	39 896	3 137 746	0.85
of which: Padurilor (forestry)	28 959	2 519 254	0.69
Posta Romana	34 976	3 082 970	0.84
Entreprises APAPS (16)[1]	**34 509**	**3 632 527**	**0.99**

1. Enterprises under Authority of APAPS included in the list of 86 enterprises under special supervision by the Ministry of Finance.

Source: Ministry of Finance, APAPS.

Table 19. **Financial and performance indicators in enterprises of the energy sector**

	Employees	Turn-over	Profit/Loss			Receivables		Arrears			Change in net arrears (arrears-receiv-ables)	Subsi-dies	Guaranteed credit		Monthly wage per employee (net)
		bn Lei	bn Lei		% of turnover	% of turnover	% change	% of turnover		% change	% of turnover[4]	% of turnover	mn US$		Euros
	2001	2000	2000	2001	2000	2000	2000-01	1997	2000	2000-01	2000-01	2000	2000	2001	Dec.-01
Electrica Electricity distribution	32 932	16 331	–1 467	–957	–9.0	32.0	35.8		51	54.6	16	0.8	0	0	209
Termoelectrica Electricity production	27 364	13 223	–5 819	–12 320	–44.0	74.0	17.7	21.1[1]	109	90.9[3]	86.0[3]	0.0	85	413	335
Hidroelectrica Electricity production	6 489	1900	38	–4 552	2.0	76.6	–15.1		75	–43.4	–21	0.7	0	0	383
Distrigaz Nord Gas distribution	9 164	3 339	42	n.a.	1.3	71.1	27.2		53	29.4	–4	0.4	0	10	287
Distrigaz Sud Gas distribution	10 264	3 628	4	n.a.	0.1	55.4	119.0		64	87.3	–10	0.4	0	10	171
Transgaz Gas transport	4 601	2 826	511	n.a.	18.1	113.3	20.8		56	1.4	–23	0.5	0	0	287
Romgaz Gas extraction	5 300	2 801	662	n.a.	23.6	163.2	16.4	10.2[2]	65	–68.9	–72	0.0	0	0	230
Petrom Oil and gas production	78 318	52 401	2 229	n.a.	4.3	14.1	7.4		8	–42.7	–4	0.0	0	0	271

1. RENEL (Integrated Electricity company that was split up along functional lines before 2000).
2. ROMGAZ (Integrated gas company that was split up along functional lines before 2000).
3. These numbers include 12 400 bn Lei of arrears of Termoelectrica to the budget and state-owned suppliers that were written off in 2001.
4. Turnover 2000.

Source: Ministry of Finance, Ministry of Industry and Ressources, APAPS, INSSE.

The specific problems of the energy sector

A large amount of the arrears has been concentrated in the energy sector. The problem has been that electricity, gas and heating prices were administratively set below production costs,[14] as political considerations overruled the suggestions of the formally independent regulation authorities to set realistic prices. Compensatory state subsidies were largely insufficient, and not always paid on time. Heat production units were especially affected as their prices, by and large, only covered a fraction of the production costs. As a consequence heat production/distribution units have been running up large arrears to their suppliers, especially the gas distribution companies (Distrigaz Nord and Distrigaz Sud) and Termoelectrica (Table 19).

In addition, payment discipline of consumers of electricity and central heating has been weak. Until recently, this problem was aggravated by the fact that, for social or political reasons, entities related to the state sphere could not be disconnected to enforce payment. While households have been relatively reliable in paying, enterprises and public customers have been less disciplined. Large loss-making state-owned enterprises have been among the worst payers.

By February 2002, the thirty largest debtors among heat production units had run up arrears of more than 3 trillion Lei (or around 0.3 per cent of GDP) to the two gas distribution companies (Distrigaz Nord and Sud). This represented respectively 25 per cent and 65 per cent of the gas distribution companies' turnover in 2000. At the same time, the twelve largest debtors among heat distribution companies had accumulated arrears of 4.2 trillion Lei (0.4 per cent of GDP) to Termoelectrica, this representing 32 per cent of Termoelectrica's turnover in 2000 (Table 20).

Table 20. **Aggregated arrears of the largest debtors to the energy sector companies, January 2002**

	Arrears (bn Lei)	Months overdue
Arrears of heat producing companies		
To Distrigaz Nord	830	3.8
To Distrigaz Sud	2 370	9.8
To Termoelectrica	4 202	4.7
Arrears of other industrial companies		
To Distrigaz Nord/Sud	2 868	7.5
To Electrica	5 230	15.1
of which:		
State Controlled	6 899	12.8
With State participation	312	16.0
Private	279	10.7
Not identified	609	11.1

Source: Ministry of Finance.

From amongst the industrial companies the twenty largest debtors[15] had together accumulated arrears of 0.9, 1.9 and 5.2 trillion Lei, respectively, to Distrigaz Nord, Distrigaz Sud, and Electrica (representing 28 per cent, 54 per cent and 32 per cent of 2000 turnover of the latter). While a couple of the largest bad payers from industry are private companies that have somehow managed to avoid being cut off from further energy supplies, the overwhelming majority are companies where the state is the controlling or at least an important shareholder.

While arrears to the energy sector are enormous, the problem of non-payment is concentrated. A large majority of enterprises and households by and large pay their bills for electricity, gas, and heating, as witnessed by average collection rates of the energy sector companies of between 80-95 per cent. The problem is a core of large, usually loss making, and almost exclusively state-owned enterprises. This is witnessed for example by the fact that only the twenty largest industrial debtors of Electrica account for around 70 per cent of the total overdue receivables of the electricity company (Table 21). The same picture emerges for the gas sector, where the arrears from the thirty largest debtors among the heat production companies and the forty largest industrial debtors already account for around 80 per cent of the overdue receivables of the two gas distribution companies (Table 22).

Recent progress in the restructuring of the energy sector

A number of recent measures have been taken by the Romanian government, mainly in reference to the IMF conditionality of the Stand-By agreement, to improve the situation in the energy sector. The main policy actions were: Firstly, tariffs for electricity and gas have been raised to levels that globally allow for cost recovery. Heating prices have increased since July 2002 to the levels of production costs of efficient heat production units (part of heat production units are, however, inefficient). Moreover, the Romanian government has committed itself not to allow energy prices to be eroded by inflation, but to keep them at least constant in US$ terms.

Secondly, the Romanian government has committed itself to more aggressively allow disconnection of non-paying energy users. Some enterprises among those with the worst payment record were actually disconnected, starting from the second half of April, and most of them have subsequently paid at least part of the arrears to be reconnected. Some of the companies who have failed to pay even for their current consumption have apparently been put on a "technological" minimum supply of electricity. This technological minimum is supposed to maintain equipment and installations functional and ensure safety, without allowing for any production. The credible threat of disconnection has also induced a majority of the large debtor companies to pay at least their current bills. In some cases, enterprises managed to pay not only their current consumption, but also a substantial part of their arrears (*e.g.* one company whose arrears amounted to almost two years of electricity consumption paid for half of them). This suggests that among

Table 21. **The largest debtors of the electricity companies, January 2002**

	Arrears				Employees (2001)	Activity	Ownership
	Total, bn Lei	Number months of consumption	% Turnover 2000	% Profits/Losses 2000			
TERMOELECTRICA							
Heat production plants (12)	4 202	4.7	–	–	–	–	State controlled
ELECTRICA							
Largest industrial debtors:							
MINVEST (7 large mines)	1 441	23.6	224	n.a.	12 716	Mining	State controlled
SNIF	420	24.0	n.a.	n.a.	n.a.	Irrigation	State controlled
SC APATERM GALATI	139	15.5	n.a.	n.a.	n.a.	Water	State controlled
SC CHIMCOMPLEX	131	5.2	16	1 349	2 091	Chemical	State controlled
APA NOVA (RGAB)	112	3.6	73	n.a.	n.a.	Water	State controlled
SIDERCA	80	26.1	83	–652	121	Metallurgy	State controlled
SIDERURGICA Hunedoara	1 044	23.6	66	–463	8 460	Carbon products	State controlled
CUG SA Cluj (Utilaj Greu)	146	16.1	66	–214	1 185	Metallurgy	State controlled
SC IND. SARMEI C.Turzii	281	9.8	22	1 463	5 766	Metallurgy	State controlled
GAVAZZI STEEL Ojelu Rosu	185	12.1	n.a.	n.a.	n.a.	Metallurgy	Private
SC TURNU SA	137	7.1	23	–24	2 385	Fertilizer	State controlled
COS TARGOVISTE	875	15.5	42	4 720	5 732	Metallurgy	State controlled
TRACTORUL	165	10.7	17	–27	5 224	Agricultural machines	State controlled
SC ELECTROCARBON	76	7.4	n.a.	n.a.	n.a.	Carbon products	n.a.
TOTAL Termoelectrica	4 202	4.7	–	–	–	–	–
TOTAL Electrica	5 230	15.1	62	–367	43 680	–	–
TOTAL	9 433	7.6	–	–	–	–	–

Source: Ministry of Finance, APAPS.

Exit

Table 22. **The largest debtors of the gas distribution companies, January 2002**

	Arrears				Employees (2001)	Activity	Ownership
	Total, bn Lei	Number months of consumption	% Turnover 2000	% Profits/losses 2000			
DISTRIGAZ NORD							
Heat production plants (13)	830	3.8	–	–	–	–	State controlled
DISTRIGAZ SUD							
Heat production plants (17)	2 370	9.8	–	–	–	–	State controlled
DISTRIGAZ NORD INDUSTRIAL COMPANIES							
Upsom SA Ocna Mures	168	7.7	n.a.	n.a.	n.a.	Chemical	State controlled
Bicapa SA	111	n.a.	224	–981	304	Chemical	State controlled
Siderurgica Hunedoara	60	3.4	4	–27	8 460	Metallurgy	State controlled
CUG SA Cluj	71	23.7	32	–104	1 185	Machine Building	State controlled
SC IND. Sarmei C.Turzii	74	4.8	6	388	5 766	Metallurgy	State controlled
SC Stipo SA Dorohol	29	11.4	60	770	1 501	Glass and Building Materials	State participation
Gavazzi Steel Ojelu Rosu	22	4.1	n.a.	n.a.	n.a.	Metallurgy	Private
Ampellum SA Ziatna	19	4.6	6	167	1 033	Chemical	State controlled
SC Cogir SA	29	5.5	n.a.	n.a.	3 000	n.a.	n.a.
SC Melana Savinesli	15	n.a.	n.a.	n.a.	n.a.	Textiles	State participation
Letea Bacau	15	1.9	3	–15	1 608	Pulp and paper	State controlled
Rafo SA Onesli	14	2.6	n.a.	n.a.	n.a.	Petrochemical	Private
SC Fortus SA lesi	11	3.8	3	732	3 643	Machine Building	State controlled
Ambro SA Suceava	19	2.6	n.a.	n.a.	n.a.	Pulp and paper	n.a.
Stratusmob SA Blaj	14	2.6	n.a.	n.a.	n.a.	Wood, furniture	State controlled
SC Sticla Turda	11	4.4	n.a.	n.a.	n.a.	Glass	n.a.
Iris SA Cluj	11	25.9	n.a.	n.a.	n.a.	Porcelain	n.a.
Metalurgica Afud	9	4.6	6	–30	1 341	Metallurgy	State controlled
Sofert Bacau	123	n.a.	n.a.	3 066	n.a.	Chemical	n.a.
Azochim Savinesti	101	n.a.	88	–405	652	Chemical	State participation
DISTRIGAZ SUD INDUSTRIAL COMPANIES							
SC Turnu SA	399	4.5	67	–70	2 385	Fertilizer	State controlled
Nitramonia SA	214	6.2	51	–182	1 961	Chemical	State controlled
COS Targoviste	329	13.6	16	1 775	5 732	Metallurgy	State controlled
Viromet	223	4.8	37	1 035	1 426	Chemical	State controlled
Amonil	176	n.a.	n.a.	n.a.	n.a.	Chemical	n.a.
Tractorul	80	9.8	8	–13	5 224	Machine Building	State controlled
Oltchim	40	2.4	1	n.a.	n.a.	Chemical	State participation
Sere Codlea	55	6.9	n.a.	n.a.	1 150	Green house	n.a.

Table 22. **The largest debtors of the gas distribution companies, January 2002** (*cont.*)

	Arrears				Employees (2001)	Activity	Ownership
	Total, bn Lei	Number months of consumption	% Turnover 2000	% Profits/losses 2000			
US Govora	39	3.6	6	–11	1 426	Chemical	State controlled
Republica Bucuresti	46	10.1	18	–61	1 850	Metallurgy	State controlled
Zahar BOD	44	n.a.	45	–77	96	Electricity	State participation
Stirom Bucuresti	69	8.1	n.a.	n.a.	n.a.	Glass	n.a.
Danubiana Bucuresti	26	3.9	4	–76	442	Manuf. of tyres	n.a.
Gerom Buzau	84	n.a.	72	–352	485	Glass and Building Materials	State participation
Colorom Codlea	59	n.a.	n.a.	n.a.	n.a.	Chemical (pigments)	Private
Roman Brasov	9	1.3	n.a.	n.a.	9 176	Machine building	State controlled
Metrom Brasov	2	0.7	n.a.	n.a.	n.a.	Metallurgy, machine building	n.a.
Carfil Brasov	12	4.2	n.a.	n.a.	n.a.	Electrotechn., vehicle parts	n.a.
Stiaz Azuga	n.a.	n.a.	n.a.	n.a.	792	Glass	n.a.
Faur Bucuresti	37	9.8	12	–13	3 904	Machine building	State controlled
TOTAL HEAT PROD. PLANTS	3 200	6.9	–	–	–	–	–
TOTAL INDUSTRIAL COMPANIES	2 868	7.5	17	–166	64 542	–	–
TOTAL	6 068	7.2	–	–	–	–	–

Source: Ministry of Finance, APAPS, RASDAQ.

bad-payers there were also solvent companies exploiting a situation of excessive tolerance towards non-paying customers to their own financial advantage. It would be important that the Romanian government allows the policy of swiftly cutting off non-payers to continue and become the norm for all entities.

Thirdly, to improve financial discipline of companies within the energy sector, escrow accounts have been set up into which payments from heat consumers and state and local budget subsidies are paid directly. The accumulated payments are afterwards allocated between Termoelectrica and the electricity and gas distributors. Fourthly, a social tariff for electricity was introduced for consumers with low revenues. This preferential tariff is accorded for a limited monthly consumption, electricity exceeding this threshold being charged at a significantly higher rate. To the degree that increased energy prices pose social problems for poorer households, the policy of targeted subsidisation should be expanded. In doing so, attention should be given to ensure that these targeted subsidies are compatible with the goal of eliminating over-consumption and waste of energy.

Fifthly, according to the Romanian government, the local heating and electricity generators (CETs) have been transferred from Termoelectrica to the local authorities. However, at the outset several municipalities were reluctant to take over the plants unless they obtain state guarantees for loans needed to upgrade the plants and ensure energy supplies, and forgiveness on the CET's debts.

The transfer of ownership of the CETs has, in principle, the advantage of ending a situation where the benefits of cheap heating were at the local level, while its costs were socialised at the national level. Incentives for localities should thus help improve energy efficiency by reducing waste, to address the problem of non-payments, and generally lead to realistic prices. However, part of these central heating units operate at extremely low levels of energy efficiency, and with distribution networks where losses through leakage are pervasive (up to 50 per cent). It is thus doubtful that costs will be below any level that households could be reasonably charged, at least until massive investments[16] in upgrading the plants and improving the distribution networks (including installations of thermostats in apartments, which has been shown to reduce consumption by between 20-40 per cent) are undertaken. As most localities lack the resources both to finance the necessary investments and to account for the losses, in the meantime, the aforementioned transfer of ownership solves only part of the problem. A possible outcome of this dilemma is either a drastic increase in direct subsidies from the central government for heating, or a shifting around of losses between state-owned enterprises. In the second scenario payment arrears, instead of accumulating in Termoelectrica, accumulate in the gas sector if the latter is forced to supply non-paying heating units during the cold Romanian winter.

More generally, while getting prices right and improving incentives is crucial, this will not solve all problems in the Romanian energy sector. Unless the general energy efficiency has been increased, and all sort of losses and waste have been eliminated (which will necessitate substantial investments), it seems likely that the direct or indirect subsidisation of the sector will continue to some degree. As the resources of the Romanian state or the energy companies for investment are limited and interest of foreign companies' interest may prove insufficient, financing the investments to modernise the Romanian energy sector represents a major challenge.

Privatisation should accelerate, but restructuring will take time

The current government has committed itself to accelerate the process of privatisation. A Law for the Acceleration of Privatisation (No. 137/2002) has been adopted in March 2002. The main aim of this law is to eliminate a certain number of obstacles in the privatisation process (see Box 9).

While accelerating privatisation is obviously of great importance, it will need time to turn loss-making enterprises into performing units. Restructuring, even under private management, is a difficult process, and experience from other transition countries suggests that the turnaround takes a minimum of one or two years to materialise.

In the new PSAL-II negotiation with the World Bank, the government has committed to privatise or liquidate those very large enterprises from the previous PSAL-I agreement that are still state owned (*Alprom*, *Romvag*, *Electroputere*, *Tractorul* to be privatised; *Roman* and *Siderurgica* to be restructured). There are also around five smaller firms to be either privatised or restructured. Moreover, in its current Stand-by agreement with the IMF, Romania has pledged to privatise by early 2003 *Banca Comerciala Romana* (BCR), the largest state-owned bank with more than 30 per cent of assets in the banking sector. In addition, the Romanian government is committed to privatise at least 13 companies with more than 1 000 employees between February and September 2002, to appoint a privatisation advisor for *Petrom* (the Romanian Petrol company), to initiate liquidation procedures for at least 40 smaller non-viable enterprises by end-September 2002, and to start privatisation in the energy sector by putting the gas distribution companies up for sale. By July 2002, seven out of the thirteen companies with more than 1 000 employees will have been privatised.

Implementation of these programmes would not only eliminate a large amount of dead-weight losses in the Romanian economy, but would also give an indication to the international community that Romania is willing to stick to its commitments and in this way increase the government's credibility.

Box 9. The new law on the acceleration of privatisation

In the past, contradictions and gaps in the legal framework have been one of the obstacles to swift and successful privatisation. The vagueness of the legal framework has equally led to a plethora of lengthy litigation during and after a company's privatisation. Moreover, large arrears and debts rendered many enterprises unattractive to investors. The new law for the acceleration of privatisation is intended to cope with all these problems, and thus to speed up the process and scope of privatisation. It provides for procedures that increase the transparency of the privatisation process, and explicitly for equal treatment for investors. It rules out administratively fixed minimum prices, and allows for sales to take place at the market price. It also allows for different kinds of write-off of debts and arrears to state entities.

To facilitate sales, the law shortens the minimum duration for a number of actions that have to be taken in order to change the structure of commercial companies (*e.g.* sales of assets) in which the state is a majority shareholder, and restricts to some degree minority shareholder's rights to oppose changes. While these provisions clearly infringe the rights of minority shareholders in companies that are under privatisation, the importance of completing the privatisation of these enterprises may justify the measures.

Moreover, the law introduces a "special administration" for companies that are in the process of privatisation. The "special administrator" is supposed to keep the company running at current levels during the process, to make sure that current bills are paid, to sell-off non-core assets and use the proceeds to repay debt, and generally to prevent any form of asset-stripping from management or workers. During special administration, utilities (unless they are fully privately-owned) are not allowed to cut their supplies as long as the company pays the current bills on time. While asset stripping obviously is a well-founded concern, and progress in restructuring of companies is clearly welcome, the success of the special administration will depend heavily on the professional qualification, and even more crucially on the personal integrity of the "special administrator".

Finally, the law sanctions the sale of unattractive companies for a symbolic price (1 Euro), when the investor commits to a given volume of investments or to a certain number of job creations.

Restructuring, and especially liquidation, is problematic because of social and political pressures

The Romanian government will face considerable social and political pressures while implementing its ambitious privatisation and restructuring plan, as labour unions are powerful and very politicised in many state-owned companies. This is reflected in the fact that wages in the state sector in general, and sometimes even in unrestructured loss-making state-owned industrial companies,

Box 10. Obstacles to restructuring and privatisation: the cases of *Tractorul* and *Roman*

Tractorul and Roman are, respectively, the largest producers of agricultural machines and trucks in Romania. Both are located in Brasov, an industrial stronghold in communist times, where currently 20 per cent of workers are still employed in companies awaiting privatisation, restructuring and/or liquidation.

Tractorul, in spite of having reduced employment from roughly 13 500 in 1997 to slightly below 5 000 end of 2001, kept accumulating extraordinary losses over the last years. In 2000, while more than 5 per cent of turnover was subsidised, losses amounted to almost ⅔ of turnover. This is equivalent to a yearly loss of roughly 6 000 euros per employee, or roughly four times the yearly average net wage. Losses have been financed by running up arrears to the budget and suppliers. The situation worsened in 2001 when higher subsidies were allocated. More precisely, the Ministry of Agriculture and Forestry promised to subsidise 55 per cent of the sale price of tractors sold by Tractorul to Romanian agricultural enterprises. Production increased, but the financial situation worsened since the subsidies were disbursed with (sometimes large) delays. The volume of receivables rose sharply also because of delays in payment from individual buyers: they more than doubled from 25 per cent of turnover at the end of 2000. Concomitantly, arrears that already accounted for almost 150 per cent of turnover in 2000 increased by more than half.

Tractorul was included in the PSAL-I agreement and has been on the privatisation list for years. The move has however been resisted by vested interests (of trade unions, suppliers, and agricultural lobbyists). To attract investors and curb opposition to privatisation, the company was split into nine different entities in 2000 to be privatised or liquidated separately. However, later on, three core parts have been merged again on the grounds that their complementarities will better meet potential investors' interest and have been offered for sale in March 2002.

Roman, the truck producer, where employment decreased from roughly 13 000 in 1997 to slightly above 9 000 end of 2001, has been making huge losses for a number of years. This is not surprising as international competition in this sector is fierce and producers have typically a global dimension. Obstacles to privatisation are the same as in Tractorul, with the additional difficulty that Roman has become a national symbol, being the only company in Romania that stood up against Ceaucescu by staging a strike. By mid-2002, the company was in the process of being split up.

Following a strong rally of workers of Roman and Tractorul in May 2002 against the government and the ruling party, the government has promised that in 2002 subsidies for tractors will be provided in advance (a substantial share of the promised amount, plus the overdue subsidies from last year have apparently already been paid). Moreover, opening of privatisation bids for the six companies split from "Tractorul" (in a holding scheme with "Tractorul" and APAPS as the shareholders) has been delayed to August 2002. Finally, the government promised that the restructuring and privatisation processes for "Tractorul" and "Roman" will take place with limited job losses, that the Interior and Defense Ministries will order trucks in the near future, and that "Petrom" (in principle a private, listed company, though majority state owned) will buy 300 trucks from "Roman".

Table 23. **Employment in unrestructured firms by county**

County	Number of employees in unrestructured firms[1]	Profit/loss of unrestructured firms	Unemployment rate 31-Dec.-00	Employees in unrestructured firms	
		% of turnover		% of total employees in county	% of total workers in county
GORJ	20 636	–34.5	12.8	23	32
BRASOV	22 651	–1.7	11.4	13	20
CONSTANTA	21 614	–237.6	10.0	13	20
MARAMURES	12 310	–7.6	9.2	13	19
CARAS-SEVERIN	8 279	–5.0	9.7	12	19
HUNEDOARA	11 827	–21.7	16.4	9	13
DIMBOVITA	6 213	–0.2	10.8	7	11
PRAHOVA	12 548	–25.0	13.5	7	11
BUCURESTI	33 733	–10.1	5.7	5	11
DOLJ	7 864	4.7	12.3	6	10
GIURGIU	1 908	17.6	8.0	6	10
MEHEDINTI	2 910	–1.4	10.3	6	9
SALAJ	2 639	–54.2	10.0	6	9
OLT	3 802	–8.2	9.5	5	8
BRAILA	3 818	–1.7	15.3	5	8
NEAMT	4 615	0.1	16.6	5	7
BISTRITA-NASAUD	1 826	–5.8	12.7	4	7
IASI	8 987	–6.1	10.9	5	9
CLUJ	6 352	–7.3	11.3	4	6
VILCEA	2 972	–26.3	12.5	4	6
GALATI	5 062	3.4	12.6	4	6
TULCEA	1 339	–82.2	11.4	3	4
ARGES	4 672	–18.0	7.0	3	4
ALBA	2 440	–5.8	12.9	3	4
ILFOV	1 062	–17.9	6.2	2	4
COVASNA	981	0.0	11.2	2	3
IALOMITA	677	–59.2	13.1	2	3
MURES	1 720	–33.9	7.1	1	2
TIMIS	2 176	–38.7	7.6	1	2
HARGHITA	1 058	–34.2	9.9	1	2
CALARASI	589	–39.4	11.9	1	2
SUCEAVA	1 277	–13.3	12.2	1	2
BACAU	1 654	–18.9	9.5	1	2
BIHOR	1 439	–17.0	4.6	1	2
SIBIU	1 229	–43.7	10.3	1	2
ARAD	1 049	–140.1	8.4	1	1
TELEORMAN	487	–3.7	9.0	1	1
SATU-MARE	531	–30.8	4.5	1	1
VASLUI	385	–15.3	15.4	1	1
BUZAU	359	5.9	12.7	0	1
BOTOSANI	114	–61.7	16.7	0	0
VRANCEA	1	–5 534.7	6.1	0	0
TOTAL	227 805		10.5		

1. Employees from enterprises under authority of line ministries and APAPS (APAPS share of capital > 33%) that can be attributed to a county.

Source: APAPS, INSSE, Ministry of Finance.

are substantially higher than wages in the private sector. As a result, employees in loss-making state-owned companies strongly resist losing their jobs. On several occasions in the past employees' actions have obstructed privatisation by denying the access of privatisation advisors or interested investors to the enterprise's premises or to financial information.

Another obstacle to privatisation comes from the local authorities that usually profit from employment of state-owned enterprises in their locality, even when the latter are loss making. This dependence is higher in distressed regions where alternative employment opportunities are scarce. As evidenced by Table 23, privatisation and restructuring will be especially challenging in a number of regions with a concentration of employment in state-owned enterprises of up to 30 per cent.

There are, however, some measures that can help to render the process of restructuring socially and politically less difficult. Improvements in the business climate for SMEs (as discussed in Chapter IV) increase the dynamics of new enterprise formation, and hence lead to greater job creation. This, together with temporary increases in social protection and retraining possibilities for those losing their jobs in the restructuring process, can to some degree soften the social impact. An adequate system of "fiscal-federalism" that allows for temporary increases in transfers to the localities hardest hit by restructuring will reduce opposition from local politicians.

Moreover, taking explicitly into consideration political economy issues in the design of a privatisation and restructuring programme can equally increase feasibility. Though the process of state divestment should be accelerated as far as possible, the large amount of privatisation and restructuring will still, for technical reasons, necessarily require several years to be completed. International experience has shown that it is politically more difficult and costly to implement necessary and painful reform measures in the run-up to elections. With general elections scheduled for the end of 2004, political economy considerations would suggest focusing immediately, as far as the political capital of the current government allows, on the politically and socially more costly privatisation and restructuring, and leaving the politically easier part, if it cannot be treated simultaneously, for the period starting in second half of 2003.

IV. Entry

The difficulties of reforming the large-scale enterprise sector in Romania have been described in the previous Chapter. Much time was lost during the last decade. While it would be important to accelerate the transformation of the economy and conclude this process, the extent to which restructuring needs to be done in a relatively short period is rather daunting. Realistically, this problem will take several years and strong determination in carrying out the necessary reforms. For this reason, the development of a new private sector becomes especially important and needs to be seen as the main engine of restructuring and growth in the economy.

The new private sector and SMEs are crucial to employment creation and exports

Despite the crowding-out of resources by the unrestructured sectors, Romania has actually a rather dynamic layer of small and medium-sized enterprises (SMEs). Their contribution to employment has grown in an impressive way. By 2001, SMEs accounted for roughly half of total employment compared to 24 per cent in 1995. By the same year, SMEs represented 56 per cent of total turnover in the economy. While this increase in the role of SMEs is significant, there is potential for further development given that this sector has become dominant in the economies of most OECD countries.

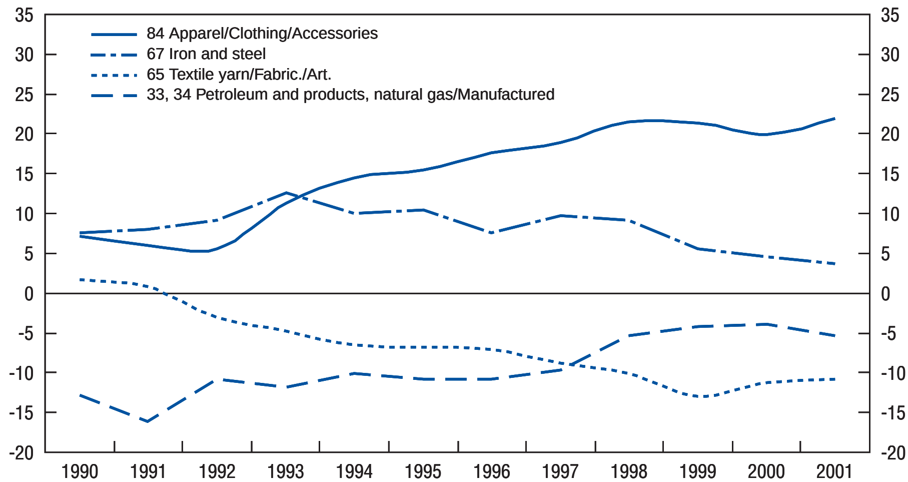
The sectors where SMEs are dominant have also become the main drivers of exports. Table 24 displays the structure of trade flows by revealed comparative advantages (RCA).[17] In one decade there has been a tremendous change in the specialisation of the Romanian economy. In the early years of transition, Romania intensified its specialisation in the heavy industries (*e.g.* iron and steel) "benefiting" from the previous large industrial base and an overvalued exchange rate that favoured cheap imports of energy and raw-materials. But the true forces of comparative advantage of Romania rapidly emerged through increasing specialisation in labour-intensive light-industries. By 2001, the main RCAs were in the apparel and clothing industries, footwear and furniture. These three sectors accounted for 37 per cent of exports in 2001.

Table 24. **Main revealed comparative advantages by sector,[1] 1990-2001**

	1990	1993	1996	1999	2000	2001	Export share, 2001	Cumul		1990	1993	1996	1999	2000	2001	Import share, 2001	Cumul
84 Apparel/clothing/access	7.09	11.36	17.63	21.32	19.99	21.90	24.42	24.42	65 Textile yarn/fabric./art.	1.70	–4.75	–7.11	–12.97	–11.25	–10.82	12.94	12.94
85 Footwear	2.06	2.45	5.13	6.24	5.91	6.98	8.57	32.99	33 Petroleum and products	–7.55	–5.49	–5.46	–2.33	–1.66	–3.27	8.67	21.61
82 Furniture/furnishings	6.16	7.58	5.50	4.55	3.77	3.88	4.39	37.38	61 Leather manufactures	0.00	–1.07	–1.85	–2.54	–2.43	–2.87	3.15	24.76
67 Iron and steel	7.50	12.54	7.53	5.54	4.61	3.73	7.11	44.49	78 Road vehicles	2.04	2.48	–0.98	–1.55	–1.72	–2.40	4.50	29.26
24 Cork and wood	1.02	2.05	2.64	4.39	4.09	3.05	3.11	47.59	54 Pharmaceutical products	–1.07	–1.26	–1.22	–2.47	–2.12	–2.40	2.58	31.84
79 Railway/tramway equipment	3.79	0.75	2.44	2.76	2.30	2.63	3.04	50.63	77 Electrical equipment	–0.51	–1.94	–2.25	–3.20	–5.34	–2.37	7.34	39.18
68 Non-ferrous metals	1.86	1.90	1.99	2.12	2.78	2.02	3.30	53.93	72 Industry special machine	1.52	–2.89	–4.73	–3.11	–2.65	–2.29	3.49	42.68
56 Manufactured fertilisers	1.56	3.38	4.31	0.89	1.35	1.38	1.48	55.41	34 Gas natural/manufactured	–5.30	–6.26	–5.37	–1.86	–2.27	–2.06	2.32	44.99
63 Cork/wood manufactures	1.06	0.87	0.45	0.74	0.67	0.86	1.51	56.92	89 Misc manufactures nes	0.18	–0.42	–1.59	–2.52	–2.07	–1.89	3.39	48.39
00 Live animals except fish	–0.34	1.10	0.83	0.92	0.78	0.51	0.88	57.80	32 Coal/coke/briquettes	–4.38	–3.20	–2.55	–1.30	–1.30	–1.53	1.53	49.92
52 Inorganic chemicals	0.72	0.53	0.90	0.42	0.28	0.50	0.93	58.73	75 Office/dat proc machines	–0.56	–1.61	–1.77	–1.32	–1.08	–1.52	2.22	52.14
28 Metal ores/metal scrap	–2.62	–1.59	–2.07	0.57	1.37	0.47	1.94	60.67	74 Industrial equipment nes	1.52	–0.33	–2.62	–2.43	–1.82	–1.46	4.06	56.21
71 Power generating equipment	0.28	0.72	0.15	0.93	0.78	0.44	1.54	62.21	87 Scientific/etc. instrument	–0.65	–0.87	–1.35	–1.52	–1.53	–1.35	1.64	57.84
35 Electric current	–2.79	–0.86	–0.15	0.42	0.26	0.40	0.55	62.75	59 Chem. material/prods nes	–2.12	–1.47	–1.79	–1.67	–1.32	–1.27	1.38	59.23
83 Travel goods/handbag/etc	0.00	0.16	0.15	0.23	0.23	0.35	0.39	63.15	58 Plastics non-primary form	0.00	–0.39	–0.91	–1.08	–0.91	–1.03	1.16	60.39
21 Hide/skin/fur, raw	–0.93	–0.20	–0.10	0.08	0.21	0.22	0.24	63.39	64 Paper/paperboard/article	0.35	–0.44	–0.98	–1.35	–1.10	–1.02	1.72	62.10
22 Oil seeds/oil fruits	–1.23	–0.25	–0.26	1.07	0.21	0.21	0.40	63.79	55 Perfume/cosmetic/cleans	–0.44	–0.62	–1.16	–1.12	–0.97	–0.99	1.23	63.33
51 Organic chemicals	–0.14	–0.63	0.13	–0.05	0.43	0.14	1.04	64.83	01 Meat and preparations	–2.36	1.61	0.63	–0.53	–0.51	–0.89	1.07	64.39
66 Non-metal mineral manuf.	1.22	2.12	1.33	0.80	0.35	0.14	1.62	66.45	06 Sugar/sugar prep/honey	–1.12	–1.06	–1.36	–0.63	–0.77	–0.87	0.98	65.37
11 Beverages	–0.02	–0.25	0.60	0.15	0.07	0.08	0.21	66.66	12 Tobacco manufactures	–0.29	–1.07	–0.94	–1.13	–0.96	–0.85	0.93	66.30

1. Indicator of revealed comparative advantage (see text).
Source: INSSE.

Figure 19. **Shift in the trade specialisation**[1]



1. Revealed comparative indicator (see text).
Source: INSSE, OECD.

This development of trade flows, mainly with Western Europe, was made possible by the favourable preferential agreements between the EU and the candidate countries, as well as an intense subcontracting with European firms (mostly from Italy and Germany). With this shift in trade specialisation, Romania is now less dependent on energy imports to sustain their export sector. However, the counterpart is that it has to import large volumes of intermediate inputs used in the processing industries (Figure 19), such as textile yarns and leather. Over the medium term, evolving specialisation towards more sophisticated manufactured products tends to be closely related to foreign direct investment (FDI). However, for the time being, FDI in Romania has remained low compared with other Eastern European transition countries.

Induced by trade liberalisation, the changing structure of the Romanian economy is also reflected in the flows of employment and business creation and destruction. Between 1995 and 2000, there was a net decrease of employment in the large enterprise sector (employing more than 250 employees) of over 1.5 million jobs (Table 25). As could be expected, job destruction is concentrated in the traditional sectors, such as machinery and equipment, agriculture, construction, yarn fabrics (which are imported now under the sub-contracting contracts), mining and metal industries. Meanwhile, all of the employment creation in the economy took place in the SME sector, with a net increase of nearly 700 000 jobs.

Table 25. **Net employment and enterprise creation, 1995-2000**

		Change in number of enterprises					Change in number of employees					
		Total	0-9	10-49	50-249	+ 250	Total	Total growth rate in %	0-9	10-49	50 -49	+250
29	Manufacture of machinery and equipment N.E.C.	293	136	127	66	–36	–175 579	–52.18	563	2 768	8 591	–187 501
1	Agriculture, hunting	516	646	476	–416	–190	–158 031	–51.40	4 725	10 403	–64 067	–109 092
45	Construction	4 366	2 939	1 276	326	–175	–86 141	–19.81	9 207	27 746	26 784	–149 878
17	Manufacture of textiles	–485	–635	131	85	–66	–77 138	–41.76	236	3 284	9 149	–89 807
10	Mining of coal and lignite	7	0	3	3	1	–67 815	–59.11	0	79	253	–68 147
60	Land transport, transport via pipelines	2 100	1 734	493	–91	–36	–66 606	–23.07	8 238	10 337	–18 199	–66 982
27	Manufacture of basic metals	134	66	57	18	–7	–59 861	–37.05	206	1 283	1 942	–63 292
24	Manufacture of chemicals and chemicals products	221	74	131	36	–20	–57 767	–44.30	542	2 988	4 232	–65 529
12-13	Mining of uranium, mining of metal ores	–4	0	0	0	–4	–54 842	–96.08	0	0	0	–54 842
40	Electricity, Gas, steam and hot water supply	5	7	5	–8	1	–40 768	–23.65	5	119	–822	–40 070
15	Manufacture of food products and beverages	961	–353	1 202	231	–119	–39 860	–15.98	5 545	25 914	19 990	–91 309
26	Manufacture of other non-metallic mineral products	468	277	155	57	–21	–37 717	–30.05	1 352	3 629	5 328	–48 026
34	Manufacture of motor vehicles, trailers, and semi-trailers	126	55	38	31	2	–30 233	–28.71	177	1 010	3 996	–35 416
28	Manufacture of fabricated metal products, except machinery and equipment	401	12	349	67	–27	–25 735	–24.83	1 724	7 567	6 290	–41 316
73	Research and development	–37	–38	37	3	–39	–25 512	–46.18	51	934	–1 083	–25 414
31	Manufacture electrical machinery and apparatus N.E.C.	182	84	64	31	3	–21 501	–29.07	406	1 613	4 132	–27 652
35	Manufacture of other transport equipment	71	8	36	26	1	–19 559	–22.82	77	777	2 187	–22 600
2	Forestry	234	156	62	20	–4	–17 133	–26.69	672	1 111	1 667	–20 583
23	Manufacture of coke, refined petroleum products and nuclear fuel	14	14	3	–2	–1	–16 047	–53.59	24	78	–454	–15 695
36	Manufacture of furniture, manufacturing N.E.C.	–305	–712	308	121	–22	–15 922	–12.17	449	6 987	12 491	–35 849
63	Supporting and auxiliary transport activities, activities of travel agencies	300	164	113	29	–6	–13 566	–27.77	1 719	2 262	3 810	–21 357
25	Manufacture of rubber and plastics products	479	261	185	47	–14	–12 813	–25.62	1 184	4 153	5 145	–23 295
14	Other mining	84	37	33	17	–3	–9 712	–38.99	159	601	1 799	–12 271
21	Manufacture of paper and paper products	163	86	69	17	–9	–9 581	–34.07	401	1 641	2 267	–13 890
61	Water transport	39	13	21	9	–4	–9 183	–59.39	12	254	1 060	–10 509
33	Manufacture of medical, precision and optical instruments, watches and clocks	180	128	35	24	–7	–6 944	–36.62	363	717	3 035	–11 059
32	Manufacture of radio, television, and communication equipment and apparatus	5	–1	6	4	–4	–5 293	–28.25	43	78	316	–5 730
67	Activities auxiliary to financial intermediation	436	362	75	4	–5	–4 671	–53.73	955	1 386	158	–7 170

Table 25. **Net employment and enterprise creation, 1995-2000** (*cont.*)

		Change in number of enterprises					Change in number of employees					
		Total	0-9	10-49	50-49	+250	Total	Total growth rate in %	0-9	10-49	50-249	+250
20	Manufacture of wood and products of wood and cork except furniture	1 982	1 123	648	198	13	–3 879	–4.17	4 629	13 572	19 354	–41 434
70	Real estate activities	1 451	1 270	150	35	–4	–3 430	–18.98	2 364	2 986	3 116	–11 896
16	Manufacture of tobacco	15	3	6	5	1	–2 023	–29.37	14	136	725	–2 898
62	air transport	11	6	6	1	–2	–1 409	–26.82	14	192	36	–1 651
5	Fishing	59	25	41	–5	–2	–1 242	–26.52	182	921	–1 320	–1 025
30	Manufacture of office, accounting and computing machinery	35	14	19	3	–1	–745	–23.69	166	409	290	–1 610
90	Sewage and refuse disposal, sanitation and similar activities	20	–14	22	14	–2	–194	–1.04	40	521	2 123	–2 878
71	Renting of machinery and equipment without operator and of personal and households goods	69	49	25	–3	–2	–2	–0.10	364	561	–316	–611
80	n.a.	49	47	2	0	0	158	7.37	312	–63	–91	0
64	Post and telecommunications	468	369	60	30	9	1 165	1.22	740	1 257	3 347	–4 179
93	Other service activities	–2 649	–2 703	31	25	–2	1 743	8.66	442	603	2 815	–2 117
37	Recycling	426	346	67	14	–1	2 426	43.24	599	1 489	833	–495
22	Publishing, printing and reproduction of recorded media	359	145	196	21	–3	3 522	14.80	1 289	3 950	1 941	–3 658
41	Collection, purification and distribution of water	53	2	16	27	8	3 621	6.90	9	557	2 331	724
85	Heath and social work	1 160	1098	59	2	1	5 144	236.18	3 095	1 220	225	604
65	Financial intermediation, except insurance and pension funding	895	808	84	2	1	5 510	173.05	2 842	1 504	610	554
72	Computer and related activities	1 633	1 449	163	22	–1	6 202	82.81	2 785	2 870	1 861	–1 314
92	Recreational, cultural and sporting activities	491	369	85	34	3	6 386	32.67	1 146	1 820	3 654	–234
55	Hotels and restaurants	–566	–978	394	30	–12	7 081	10.81	2 297	7 523	1 401	–4 140
11	Extraction of crude petroleum and natural gas	10	4	1	8	–3	12 559	15.79	15	46	1 559	10 939
19	Tanning and dressing of leather; manufacture of luggage, saddlery, harness and footwear	414	17	183	178	36	19 286	25.15	669	5 168	20 191	–6 742
50	Sale, maintenance and repair of motor vehicles and motorcycles, retail sale of automotive fuel	1569	677	804	97	–9	24 315	62.25	10 406	15 953	5 391	–7 435
52	Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods	–18 663	–21 504	2 986	–43	–102	33 599	8.97	70 952	46 816	–8 895	–75 274
74	Other business activities	5 526	4 716	632	165	13	36 860	56.55	11 157	12 841	16 373	–3 511
51	Wholesale trade and commission trade, except of motor vehicles and motorcycles	–940	–3 913	2 745	249	–21	79 861	51.27	32 856	52 970	17 769	–23 734
18	Manufacture of wearing apparel, dressing and dyeing of fur	1 004	–109	508	501	104	113 270	66.05	1372	13 045	56 939	41 914
Total		5 835	–11 164	15 423	2 365	–789	–815 746	–16.86	189 791	308 586	192 259	–1 506 382

Source: INSSE.

Apparel and clothing is the only manufacturing sector contributing heavily to this increase, with a net creation of over 100 000 posts, other jobs being created mainly in the service sectors (*e.g.* distribution, repair and maintenance). The gap between employment creation and destruction, resulted in a net loss of over 800 000 jobs over a five year period (or a decrease of 25 per cent in the number of employees). This has been a source of severe social strain that cannot be addressed only by the social safety net. Economic policy should be geared towards creation of new jobs.

Business environment needs to be improved

Such a large transformation in the economic structure, can only be compensated by an on-going process of sufficient E*ntry* of new firms. To accelerate this process, especially in the context of the large restructuring programme announced by the government, it is crucial to lift as many as possible of the barriers to entrepreneurship and enterprise creation. These E*ntry* processes should become more broadly based. In particular, the service sector (*e.g.* distribution) could provide a reservoir of job creation if the conditions for economic stabilisation and steadily increasing incomes are fulfilled. It would also be important that new firms are not only encouraged to enter the market, but should also find a favourable business environment to grow and prosper.

The dynamism of the SME sector has been associated to a large extent with exports and subcontracting activities. The textile sector has benefited from increased EU quotas, within the framework of Outward Processing Trade (OPT). This special treatment has favoured the de-localisation of apparel processing in all Central and Eastern European countries, and particularly in Romania. But with the end of the Multi-Fibre Agreement on 1st January 2005 it is likely that competition from other regions will become more intense. Not only other economies in the region, but also the Asian and Latin American countries will be able to compete more fiercely with the exports of Central and Eastern European countries in the EU market. Competition from abroad will also intensify due to the real exchange rate appreciation that has been discussed previously (unless it is matched by productivity increases), in line with progress towards disinflation and EU membership.

The main, widely recognised, impediments for business development are: inflation, high taxes, excessive regulations, policy instability, and lack of access to finance (OECD, 2002).[19] These features are more or less common to all transition countries. Some of them were already discussed in previous chapters, notably the ones related to the disinflation process and increased bank competition that should progressively favour access to credit. Moreover, to reduce the heavy tax burden that affects the formal sectors of the economy, the problem of the informal economy needs to be addressed in the way discussed above. Those aspects closely related to institutional and regulatory issues are discussed below.

The regulatory framework in Romania: a comparison with OECD countries

In order to compare the level and extent of the regulatory framework in Romania with the OECD countries, the Secretariat submitted the OECD regulatory framework questionnaire to the Romanian government.[20] This overall result can be decomposed into two main groups: *a*) inward-oriented policies or *b*) outward-oriented policies corresponding to barriers to trade and investment. The inward-oriented policies can in turn be decomposed either into state control and barriers to entrepreneurship or into administrative and economic regulation. The results of this self-assessment are presented in Table 26.

The level of overall product market regulation in Romania is higher than in most other countries in Western Europe, but it is comparable with the level of regulations existing in OECD countries of Eastern Europe (Czech and Slovak Republics, Hungary and Poland) or other emerging economies (Korea, Mexico and Turkey). As could be expected, Romania ranks less favourably in terms of the degree of state control, notably public ownership and the involvement of state in business operations. Legal barriers to entrepreneurship appear to be relatively low, but from the point of view of administrative regulation, the framework is tighter in Romania than other transition countries, especially with regard to regulatory and administrative opacity. Romania also ranks somewhat less favourably in terms of existing economic regulations.

From this comparison, it can be concluded that, while the present regulatory framework could and should be improved, at least on paper it is now relatively liberal. These are positive and appreciable developments. Nevertheless, it should be noted that the latter reflects recent changes in the legislation that perhaps have not yet had enough time to become effective. Nonetheless, beyond general framework conditions, there are peculiarities in Romania that characterise its institutional framework and deserve more consideration (see also OECD, 2002, Chapter 2). These point to a large gap between the adoption of laws on the one side, and their implementation, on the other.

Tax administration and other obligations are a heavy burden to enterprises

A feature that emerged from OECD Secretariat interviews at the enterprise level is the burden associated with the fulfilment of all the obligations *vis-à-vis* the tax administration and other public entities. This seems to represent a real cost to enterprises in Romania that is sometimes estimated as being much higher than the actual tax burden associated with the level of taxes. Enterprises point to a certain "administrative harassment" (see Box 11). While part of it can be justified due to necessary regulation of the economic activity by the state authorities,

Table 26. **Regulatory framework: a comparison of Romania with OECD countries**

	Romania	Eastern Europe[1]	Emerging markets[2]	Eu-15	United States
Scope of public enterprise sector	**4.5**	4.6	3.9	2.9	2.0
Size of public enterprise sector	**5.0**	3.0	2.5	1.9	0.0
Special voting rights	**4.0**	6.0	4.7	3.3	2.0
Control of public entreprises by legislative bodies	**4.5**	4.6	3.4	1.6	0.0
Use of command and control regulation	**3.1**	2.8	2.5	3.2	1.1
Price controls	**2.6**	0.6	1.2	1.2	0.0
Licence and permits system	**4.0**	1.3	3.0	2.9	4.0
Communication and simplification of rules and procedures	**0.0**	0.8	1.2	0.8	0.0
Administrative burdens for corporation	**1.0**	1.8	2.7	2.3	0.5
Administrative burdens for sole proprietor firms	**1.8**	1.4	2.1	2.1	1.3
Sector specific administrative burdens	**1.4**	1.3	2.1	1.9	0.5
Legal barriers	**0.0**	1.6	1.5	1.7	1.0
Antitrust exemptions	**0.0**	0.9	1.1	0.6	1.3
Ownership barriers	**2.0**	2.7	2.6	0.3	2.2
Discriminatory procedures	**1.2**	2.6	2.0	0.6	0.3
Regulatory barriers	**0.7**	2.5	1.7	0.2	0.0
Tariffs	**5.0**	4.0	3.7	2.0	1.0
Product market regulation	**2.4**	2.6	2.5	1.6	1.0
Factor 1 (Inward-oriented policies)	**2.6**	2.4	2.5	2.1	1.1
Factor 2 (Outward-oriented policies)	**2.2**	2.9	2.5	0.8	0.9
State control	**3.9**	3.5	3.0	2.4	0.9
Factor 1 (Public ownership)	**4.6**	4.3	3.4	2.3	0.8
Factor 2 (Involvement in business operation)	**3.1**	2.5	2.4	2.4	0.9
Barriers to entrepreneurship	**1.3**	1.3	2.0	1.8	1.3
Factor 1 (Administrative burdens on startups)	**1.3**	1.5	2.2	2.1	0.8
Factor 2 (Regulatory and administrative opacity)	**2.1**	1.1	2.2	1.9	2.1
Factor 3 (Barriers to competition)	**0.1**	1.1	1.3	0.9	1.2
Barriers to trade and investment	**2.1**	2.9	2.5	0.7	0.9
Factor 1 (Explicit barriers)	**2.7**	3.1	2.8	0.9	1.4
Factor 2 (Other barriers)	**1.3**	2.7	2.0	0.4	0.3
Administrative regulation	**1.7**	1.3	2.2	2.0	1.2
Factor 1 (Administrative burdens of startups)	**1.4**	1.5	2.3	2.1	0.7
Factor 2 (Regulatory and administrative opacity)	**2.1**	1.1	2.2	1.9	2.0
Economic regulation	**2.8**	2.9	2.5	2.0	1.0
Factor 1 (Regulation of economic structure)	**3.0**	3.2	2.7	2.1	1.0
Factor 2 (Regulation of economic behaviour)	**3.5**	3.7	3.1	2.7	1.2
Factor 3 (Regulation of competition)	**1.4**	1.2	1.4	1.0	0.8

N.B.: Data for Romania are for the year 2002 and for the other countries, 1997.
1. Eastern Europe: Czech Republic, Hungary, Poland.
2. Emerging markets: Eastern Europe, Mexico, Korea, Turkey.
Source: OECD.

Box 11. The administrative burden to the enterprise sector

The list below refers to problems that are faced generally by all private economic agents. In addition to the latter, some sector specific issues could also arise.

Excessive number of monthly declarations: The declarations are to be submitted either to the Financial Administration or to the bodies administrating each respective state fund, or both, as is the case for Social Contribution, Unemployment fund, Fund for handicapped persons, etc. Declarations to funds can be submitted at the institution's premises (but this is usually quite time consuming) or can be sent by mail. In the latter case, the probability that the declaration does not reach the destination is high, and the taxpayer would not necessarily be aware of it. However, penalties are applied directly. The actual communication between Treasury offices and tax payers takes place through hand-written notes. A related problem is the frequent changes (few times a year in some cases) in the forms and procedures of various declarations.

Redundancy of declarations: Beside overlapping declarations, discussed above, the most striking and widespread case of redundancy regards the employment/wages related information. All the data on employees are registered in the wage registration summary submitted monthly at the Professional Chambers. Still, they need to be registered again in the declarations for Social Contribution, Unemployment fund, Fund for the handicapped persons, etc.

Tax payers need own paperwork to compensate for the lack of communication between public institutions:. Each of the institutions, administrating various state Funds, has its own database in different formats that cannot be merged and no communication is actually taking place between them. In addition, such co-ordination is missing between the Treasury office and the rest of the institutions collecting or administrating funds and declarations. This explains the redundancy of the declarations. Economic agents have to compensate and correct the effects of poor database administration. For instance, when some of the special off-budget funds were cancelled (see Chapter II, *e.g.* Fund for financial support for education, etc.), all economic agents had to resubmit data on taxes paid during the previous year, although monthly declarations have been submitted already during the previous period. This would suggest that the previously existing information got lost.

Although the law on electronic signature exists, submission of declarations via e-mail is not allowed: The only institution that accepts submission via e-mail is the Institute for Management that administers the inter-agents compensation procedure. The main reason is that the Ministry of Finance is not, as yet, in the network of e-administration.

Electronic submission of various documents: (as balance sheets) is encouraged or even requested, but it should always by accompanied by a printout of the information. In addition, some time-consuming registrations as: the list of daily operations, a register of synthetic accounts (monthly registrations) and an inventory of accounts' balances (annually) have to be submitted in hand-written form by the accountant, although, in most cases, all these registrations already exist in electronic form.

Box 11. **The administrative burden to the enterprise sector** (*cont.*)

Asymmetric position of state institutions *vis-à-vis* economic agents: This arises mainly in two different types of situations. One originates in the impossibility for a private person or agent to penalise a wrong or incorrect behaviour on part of a state representative – it is basically impossible to sue directly a state official and a formal complaint has no effect. This obviously gives an almost discretionary power to state agents over private persons. The second is related to situations where economic agents are entitled to reimbursements of various kinds: *e.g.* VAT refunds, taxation errors, etc. The procedures in this regard are rather long and costly. For example, following a court's decision to refund an economic agent, according to the Romanian legislation, the Financial Administration has to carry a "basic control on the firm's activity" before making the reimbursement. But there is no restriction regarding the time lapse in which this control has to be done. Besides the delay in itself, this practice has an additional negative effect under high inflation. While for the sums due to the state, the courts established a compensation for inflation (and even market interest rates), no compensation exists for the interval between the court decision and the actual moment of reimbursement, thus leading to potentially significant losses for the economic agent. The economic agent could sue again the Financial Administration, but this would require another court procedure.

The sometimes uncertain legal environment and lack of legal assistance on part of official bodies creates room for corruption: in Romania, after issuing of a law, its effective application is regulated by an additional piece of legislation called an "application rule" or "methodological norm". When there is an ambiguity in the legislation that is not resolved by these application rules, the economic agent can ask for clarification (in written form) either directly to the Ministry of Finance or to the Service for Assisting the Taxpayer (SAT, existing each Financial Administration). The Ministry of Finance has the formal obligation to answer within 60 days, but this deadline is not always respected. Moreover, the information received cannot really protect the agent against a potentially different view of an audit control, for instance. Indeed, the information is usually released under the clause that "the clarifications are only meant to orient the taxpayer, and do not have regulatory power". Unclear regulations are often the source of micro-corruption. Evidence published by the Accountants Association signals the case where the Ministry of Finance issues clarifications as official (regulatory) documents. Until the end-2000, such documents were frequently issued, sometimes changing radically the content of the previously existing pieces of legislation. An example is the Ministry of Finance Ordinance 1223/1998 regarding the deduction of losses. The ordinance gives the right to economic agents to deduct certain losses from net profit, while the law states that the deduction should be made, more obviously, from gross profits. Although this practice ceased, not all imperfect pieces of regulatory ordinances were abolished.

Excessive intervention of the state in work relations: The firing procedure is viewed as long and cumbersome, hindering the employee's mobility, without really protecting him/her from illegal dismissal.

Box 11. **The administrative burden to the enterprise sector** (*cont.*)

The "harassment" related to frequent and often exaggerated controls: These controls mainly focus on how the economic agent calculates and reports taxes. There is no regulation regarding the minimum interval between two successive controls, and each time, additional paperwork is required. Noteworthy, each state fund and different tax payments have their own controlling body. Based on enterprise interviews, the regulations imposed by bodies such as fire inspection or sanitary control are sometimes enforced in an excessive manner, increasing the potential for micro-corruption.

Excessive time to obtain licenses: especially for building work. Obtaining licenses and approvals for construction of a building might last up to a year.

Hindering exit mechanisms: Most of such exit barriers were removed in Romania. Still, when a firm ceases to function and is cancelled from the Register of Commerce, it must, nonetheless, submit empty declarations to the Financial Administration until the latter makes a final control of activity, which may take several months.

"heavy" administrative duties are counterproductive, insofar as they are a source of true inefficiencies (with comparatively higher transaction costs) and widespread micro-corruption.

Along these lines, a streamlining of the tax system – without necessarily reducing the overall level of fiscal pressure – would simplify administrative obligations and improve business conditions; it would also create disincentives to tax evasion and informal business activity. An overview of the number of taxes to be paid to central and local budgets and the connected paperwork, as well as occasional paperwork to be carried out for administrative reasons is provided in Table 27. The results are staggering. There are 30 taxes and contributions that have to be paid on a regular basis (on a monthly basis) and another 28 different types of documents associated with other taxes, contributions and duties.

The legal environment is uncertain and a more stable framework is needed

Among the most important demands from the business community (*e.g.* IBD, 2001) is continuity and stability of legislation, with an increased attention to technical details and carefulness in preparing new legislation. In other words, more judicial expertise, co-ordination of related legislation and its overall impact, and consultation of affected parties would be needed. As already noted in the previous *Survey*, Romania has traditionally had a rather legalistic approach to policies. Laws tend to be detailed and also need complicated "methodological

Table 27. **An overview of the administrative tax burden in Romania**

Ordered by the frequency of declaration/payment

	Frequency of declaration	Body where the declaration is made	Body where the taxes are paid	Separate documents	Paperwork (No. of pages)
Monthly cumulative declaration concerning the payments towards the state					
Wage tax	M	Financial administration	Treasury office		3
Profit tax	Q	Financial administration	Treasury office		2
Excise	M	Financial administration	Treasury office		6
Tax on oil and natural gas from domestic production	M	Financial administration	Treasury office		1
Tax on wage fund	M	Financial administration	Treasury office		1
Contribution for civil aviation	M	Financial administration	Treasury office		1
Contribution for tourism	M	Financial administration	Treasury office		1
Social stamp for gambling activities	M	Financial administration	Treasury office		1
Social stamp for new autovehicles imported (with a motor of at least 2000 cm^2)	M	Financial administration	Treasury office		1
Tax of micro-enterprises revenue	Q	Financial administration	Treasury office		1
Dividend tax	when distributed to the shareholders	Financial administration	Treasury office		1
Tax on revenues from mandate, agency activities	M	Financial administration	Treasury office		1
Tax on revenue of non-resident physical and juridical persons withhold by the paying person	M	Financial administration	Treasury office		1
Tax on revenues from valuing of intellectual property	M	Financial administration	Treasury office		1
Tax on banking interests	M	Financial administration	Treasury office		1
Tax on pensions	M	Financial administration	Treasury office		1
Tax on gains from gambling activities	M	Financial administration	Treasury office		1
Tax on revenues from transfer of property rights on equities and capital shares	M	Financial administration	Treasury office		1
Tax on other revenues of physical persons	M	Financial administration	Treasury office		1
Payments from net profits	M	Financial administration	Treasury office		1
Tax on gambling activities	M	Financial administration	Treasury office		2
Other taxes on the state budget	M	Financial administration	Treasury office		3
Special fund for the solidarity with the persons with special needs	M	Financial administration	Treasury office		1

Table 27. **An overview of the administrative tax burden in Romania** (*cont.*)

Ordered by the frequency of declaration/payment

	Frequency of declaration	Body where the declaration is made	Body where the taxes are paid	Separate documents	Paperwork (No. of pages)
Other monthly declarations for payments					
VAT	M	Financial administration	Treasury office	Y	1
Social insurance contribution	M	National House for Pensions	Treasury office	Y	2
Unemployment fund	M	National Agency for Employment	Treasury office	Y	(No. of pages vary according to the number of employees)
Health insurance fund	M	Health Insurance House	Treasury office	Y	
Other payments declarations of a higher frequency					
Custom duties	Q	Custom authority			
Tax on land	Y	Local administration			
Tax on buildings	Y	Local administration			
Tax on transportation vehicles	Y	Local administration			
Tax for fito-sanitary license	2 years	Territorial unit of the authority			
Tax on mining activities and oil due	Y; Q for the due				
Other declarations with fixed frequency					
Balance sheet	6 months	Financial administration		Y	23
Wage registrations summary	M	Work Chambers		Y	(No. of pages vary according to the number of employees)
Declaration on global revenue (of the employees)	Y	Financial administration		Y	
Declaration for dividends distributed annually	Y	Financial administration			1

Table 27. **An overview of the administrative tax burden in Romania** (*cont.*)
Ordered by the frequency of declaration/payment

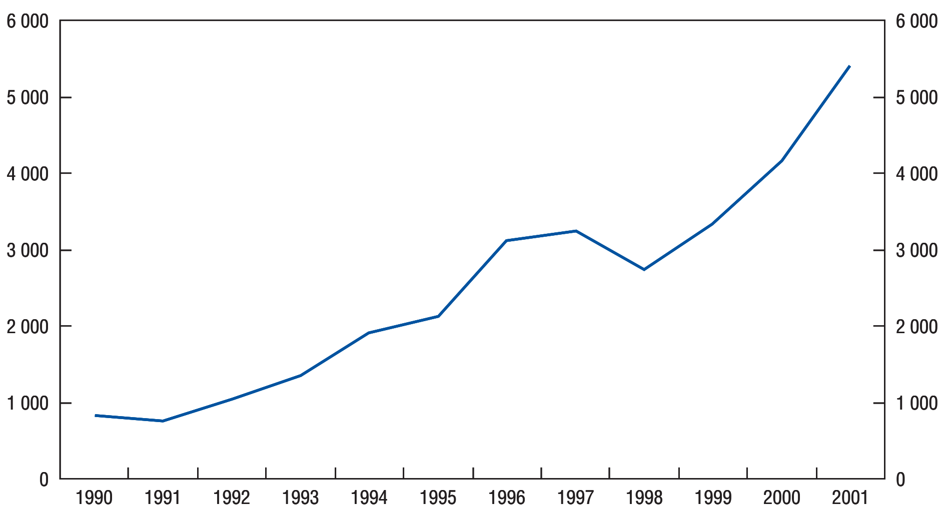
	Frequency of declaration	Body where the declaration is made	Body where the taxes are paid	Separate documents	Paperwork (No. of pages)
Occasionally paperwork					
Special tax for customs forms for international transports	When it is the case			Y	
Judicial stamp duty	When it is the case			N	
Metrology taxes	On request			Y	
Consular taxes	On request			Y	
Taxes for services rendered by the Competition Office	When it is the case			Y	
Duty stamp for the petitions and appeal regarding the amounts decided by the control authorities of the MFP	When it is the case			N	
Tariffs for license for activities that are state monopolies	Regularly for each field			Y	
Tax for the authorisation of activities in the nuclear field	On a determined period			Y	
Tariffs for the services rendered by the National Bureau of Cadastre	When is the case			N	
Duty stamps for the notarial activity	When it is the case			N	
Allowance for the services rendered by the general directions for labour and social protection	When it is the case			N	
Tax for issuing the energy certificate of the building	When it is the case			Y	
Tariffs for the services rendered by the Ministry of Labour and Social Solidarity	When it is the case			Y	
Tax for licensing the warehouse activity	When is the case			Y	
Tariffs for the services rendered by the National Bureau for Marking of Goods	When is the case			N	
Taxes for the services rendered by the Romanian Railway Authority	Every time			Y	
Special fund for the development and modernisation of the customs offices	All papers			Y	
Tax for issuing certificates and authorisations in constructions	Every construction			Y	
Tax for using the publicity facilities	Every			Y	
Duty stamp for the petitions and appeal regarding the amounts decided by the control authorities of the local fiscal authorities	When it is the case			N	
Tax for licensing the activity of collecting, recycling of residues	Once			Y	
Tax for licensing the activity of food processing	Once			Y	
Taxes in the field of protecting industrial property	Once			Y	
Taxes for licensing the activities in the electric and thermic power sector	Once			Y	
Tax for the license in the stock exchange field	Once			Y	
Tax for evaluation activities	Once			Y	
Tax for licensing the activities in the field of natural gas	Once			Y	
Tariffs for the fire protection certificate	Once			Y	
Tariffs for the services rendered by the National Commission for Equities	Once			Y	
Taxes for licensing transportation activities	Once			Y	

Source: OECD.

norms" to assure implementation. This "frenetic' legislative process makes it difficult for economic agents to understand the actual legal environment. The accumulation of several changes in the laws and the many different types of laws (including the so-called Emergency Ordinances that enable the government to accelerate the reform programme) tend to create a potentially confusing legal environment. As a broad and rough illustration of the increasing legislative complexity, the total number of laws and other pieces of legislation passed each year in Romania are displayed in Figure 20.

Another area that needs streamlining is the judicial process. The bankruptcy proceedings appear to be difficult and expensive to introduce, and are rarely applied. Courts tend to be over-burdened. More generally, reinforcing creditor protection would be important to develop and reduce the cost of credit. It is not only the legal system as such that creates problems, but also the constant changes in the business environment. An example was the removal in 2002 of the tax exemptions on VAT and custom duties for technology investments that had been decided in the government programme of 2001. Despite the fact that this move might be desirable insofar as it increases the uniformity of the tax system and insures equal treatment of economic activities, it also created a disruptive climate for investment. Many companies complained that it would be impossible to draw up sound investment plans in the absence of legal stability.

Figure 20. **Total number of legal acts passed each year**



Source: OECD.

Administrative inefficiencies, including micro-corruption, entail operational costs

While in the past there was a discussion about the overall effect of corruption (being "grease" or "sand" in the wheels of the economy), in recent years there has been growing consensus on the negative effects of corruption on economic activity. In cross-country studies, corruption has been found to lead to lower investment, and thus indirectly to lower economic growth.[21] Moreover, corruption has been shown to reduce foreign direct investment and to bias foreign capital inflows towards short-term money, which increases the likelihood of a country suffering from financial crises.[22] In countries that suffer from higher levels of corruption, government spending on education is lower,[23] while the performance of government projects has been proven to be by far superior in countries with more developed civil liberties (that are highly correlated with lower corruption levels).[24] On the national level, a study of the economic performance of Italian regions found corruption to have led to a decrease in growth, both directly, and by decreasing the productivity of public investment expenditures.[25] Finally, it has been shown that the size of the underground sector is larger in countries with higher levels of corruption and red tape, thus restricting the possibility of governments to obtain tax revenues.[26]

Corruption is perceived as especially important in Romania – both by the international community as well as by inhabitants (see Table 28). Its negative impact on business, however, is somewhat compensated by its predictability. Based on enterprise interviews, foreign investors see corruption in Romania as disturbing for good business environment, but somewhat less problematic than in

Table 28. **Comparison: Internal and external perception of corruption in transition countries**

	Local perception of corruption[1]	International perception of corruption[2]
Slovenia	42	4.8
Hungary	54	4.7
Estonia	63	4.4
Czech Republic	66	6.1
Poland	69	5.9
Bulgaria	74	6.1
Russia	75	7.7
Slovakia	80	6.3
Romania	**89**	**7.2**
Latvia	92	6.6
Lithuania	95	5.2

1. Per cent of surveyed local population thinking almost all public official take bribes, are corrupt.
2. Recalculated from Transparency International Corruption Perception Index, higher levels mean more corruption.

Source: Centre for the Study of Public Policy New Europe Barometer, 2001; New Russia Barometer, 2001, Transparency International 2001.

Table 29. **Comparison: trust in political institutions in transition countries**
Per cent of surveyed local population trusting

	Parliament	Parties	Courts	Police
Bulgaria	26	25	24	31
Czech Republic	20	21	34	40
Estonia	10	8	26	30
Hungry	16	14	36	29
Latvia	8	7	24	27
Lithuania	9	8	16	19
Poland	20	8	15	21
Romania	**13**	**9**	**19**	**36**
Russia	7	7	23	13
Slovakia	8	9	15	26
Slovenia	10	8	26	24

Source: Centre for Study of Public Policy New Europe Barometer (2001) and New Russia Barometer (2001).

other countries with comparable corruption levels. It is apparently common knowledge in the business community how much to pay to whom, and it seems that following payment, the desired results are usually obtained. In some sense, corruption is a response to the heavy administrative burden and uncertainties in the legal environment, noted above.

An area where corruption seems to be especially harmful is with regard to the judicial system. Following a survey of foreign investors in Romania,[27] the uncertainty of legal rights (caused to a large degree by corruption in the judicial system), is among the most important points that need to be improved. This is confirmed by the perceptions of the population. While the low trust of the Romanian population in their political elite is roughly in line with the perception in other transition countries, their distrust of the justice system is far above average (Table 29). This distrust is, moreover, very specific to the courts and not generalised to other institutions representing the law, as manifested by the relatively high level of trust of the Romanian population in the police. Dealing with judicial corruption is therefore an urgent task which could greatly enhance entry of new firms and economic development.

Notes

1. For a similar framework applied in the case of the Slovak Republic see Oliveira Martins and Price (2000).
2. See Boeri and Oliveira Martins (2002) for a discussion of this point.
3. Some of the macroeconomic targets were changed afterwards.
4. Given the large share of external debt in total public debt, monetary policy also contributed in recent years to this outcome by allowing for a trend appreciation of the real exchange rate.
5. OECD (2000) recommended that the short-term priorities should be: *i)* Improving the financial stability of the pension system. The government planned to extend coverage of the self-employed. The retirement age should also be increased more rapidly than the government planned. The value of previously awarded pensions have fluctuated too much and need to be stabilised. They should be linked to average wages rather than prices. But such a policy objective may be unrealistic until the number of contributors increases substantially; and *ii)* Contribution rates are already too high and should not be raised further, priority should be given to cutting them. As a more long-term reform, OECD (2000) noted that Parliament was considering proposals for a 4-pillar pension system, though decisions had been delayed. In OECD (2000) it was argued that if such a reform were adopted, the timing and content of its various elements should be carefully adapted to the just-mentioned short-term needs.
6. The Romanian Armed Forces have to undergo an extensive restructuring process to meet NATO's accession requirements. It will involve both moving towards a professional armed corps and catching-up with technological investments, geared towards more mobility and rapid development (IMF, 2001).
7. The statutory social contribution rates were increased from 35 per cent in 1997 to 43 per cent in 1998, then 60 per cent in 2000.
8. These include the introduction of primary dealer system, access of securities companies, a two-tier registration system, the obligation of primary dealers to quote at least the last four issuances (of above one year) and secondary dealers to quote at least four issuances (including the last two); and the formation of professional associations.
9. The central bank is only considering moving to inflation targeting by 2004.
10. See Barisitz (2001).
11. In Romanian: Autoritatea pentru Valorificarea Activelor Bancare.
12. The securities issues amounted to 4.4 per cent of GDP in 1999 (NBR, 1999, page 65). In addition to this, the NBR injected over 10 000 billion Lei (1.8 per cent of GDP) of direct credits to the troubled banks.

13. Typically under "isolation programmes" all overdue debt was frozen until agreements with all debtors were concluded. Wage arrears could only be paid once a company had generated internally sufficient cash to cover them. Most programmes offered severance packages for workers that were made redundant that could also be used for retraining. Enterprises under isolation were monitored by a special monitoring unit on a monthly basis. The programmes were limited in time, and those enterprises that after the end of the "isolation period" had not been turned around were supposed to be liquidated through bankruptcy procedures initiated by their creditors. For a general discussion of enterprise restructuring in transition countries see Djankov and Murrell (2002).
14. In 1997, energy prices were substantially increased but as subsequently they were not adjusted for inflation the effect of the price rise dissipated rapidly.
15. Of each Regie Autonome company considered.
16. It has been estimated that upgrading heating generation would cost EUR 4.6 bn, out of which EUR 1.7 bn will be needed for Termoelectrica's former heat generation units.
17. Following Neven (1995), the revealed comparative advantages are computed as follows:

$$RCA_i = \left(\frac{X_i}{\Sigma X_k} - \frac{M_i}{\Sigma M_k}\right) \cdot 100$$

Where Xi and Mi are, respectively, the exports and imports of product *i*. This indicator is bounded between 100 and (–100). The lower and upper limits of the index can be attained only in the (theoretical) case when there is a complete trade specialisation and there are only two goods. Under real world circumstances, the value of the index rarely exceed 10 (in modules). The higher the value of the index, the stronger trade specialisation. The RCA index can be interpreted as a "normalised" trade balance (*i.e.* given that the sum of the RCA indicator across sectors is equal to zero, the comparative advantages are in this way measured under the theoretical condition of a balanced trade). The value of this indicator is also related to the intensity of intra-industry trade. The stronger two-way trade, the lower specialisation, the closer to zero the index.

18. In co-operation with Romanian Ministry for SMEs and Co-operatives, the OECD and EBRD have recently produced a policy review of the entrepreneurship and small enterprise development situation in Romania, which examines the SME sector and makes a series of recommendations as to how the general business environment for SMEs could be improved, based on international good practices.
19. The answers were reviewed (see Annex Annex), and the qualitative information was then transformed into quantitative indicators according to the methodology developed in Nicoletti *et al.* (2000). The basic set of indicators derived from the questionnaire are aggregated following a factor analysis into several dimensions and finally into an indicator that summarises the level of product market regulation in the country. Romania is the first non-member country to have answered this questionnaire.
20. See Mauro (1995).
21. See Wei (2000) and Wei (1997).
22. See Mauro (1998).
23. See Isham, Kaufman and Pritchett (1997).
24. See Del Monte and Papagni (2001).
25. See Friedman *et al.* (2000).
26. See IBD (2001).

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Annex

Data used to construct the indicators of economic regulation

Questions	Answers
Is the "silence is consent" rule (*i.e.* that licenses are issued automatically if the competent licensing office has not acted by the end of the statutory response period) used at all?	The rule "silence is a favourable answer" is not used in any of the administrative procedures as regulated at present.
Are there single contact points for getting information on licenses and notifications?	All information regarding the incorporation and operating licences for tradesmen are supplied, within the CCIRB, by the Assistance Office of the Single Access Point and Bucharest Business Development Department. At the Bucharest Business Development Department one can get various information on advices, authorisations, licences, agreements, special arrangements.
Are there single contact points for issuing or accepting on licenses and notifications (One-stop shops)?	Taking into consideration the need to improve the business environment by reducing the bureaucracy and facilitating the investment process, the Romanian Government adopted the Emergency Ordinance No. 76/2001 on the simplification of the administrative framework for trader registration and licensing. The provisions of this normative act were aimed at the establishment of "One-stop-shop" for trader registration and licensing, providing a solution to all problems related to performing the necessary procedures for trader registration and licensing, simplifying the registration and licensing procedures, reducing the registration time limit, as well as taxes and fees related to registration and obtaining notices, licenses, authorisation and/or agreements necessary for trader presentation: – License issued by Fire Fighting Squad; – sanitary license; – veterinarian Sanitation license; – license issued by the Territorial state office for labour accident prevention; – environmental license. Regarding the functioning licenses, GEO No. 76/2001, as well as GD No. 625/2001 that aim at simplifying the procedures for issuing licenses, in the following respects: – To reduce the necessary number of licenses to five; – unifying the legal provisions on issuing licenses; At the same time the following is envisaged: – to provide full transparency of the related procedures and taxes by publicising the relevant regulations in Romanian Official Gazette, – to reduce the volume of the related taxes and fees and reduce the time limit of issuing licenses; – to remove the arbitrary practices of some public authorities in this field;

Questions	Answers
	– to harmonise the legislation and practices with EU standards, by reducing the number of activities that require previous licensing; – to introduce the written statement on own responsibility for licensing certain activities and strengthening the role of control activities carried out subsequently to trader registration and licensing. Persons who deliver licenses: according to law No. 188/1999 regarding the Statute of Civil Servants: Article 56 al. 2 stipulates: A civil servants cannot hold functions in R*egies* A*utonomes* companies or in other productive units; Article 57 stipulates: A civil servant cannot work in companies with private capital that have links with their duties in their public function and cannot represent any person regarding acts that have links with their functions.
Is there a complete count of the number of permits and licenses required by the national government (all ministries and agencies)?	According to the Action Plan for removing administrative barriers to business, approved by GD No. 1189/2001 and modified by GD No. 209/2002 regarding the "Improvement of the relation authority/entrepreneur", one of the measures consists in publishing an updated list of activities that require special licenses. For this activity, a consulting company will be selected and the Terms of Reference will be elaborated (due July 2002).
Is there an explicit programme to reduce the administrative burdens imposed by government on enterprises and/or citizens?	According to GD No. 1189/2001, the Action Plan for removing administrative barriers to business environment was elaborated and later modified and supplemented by GD No. 209/2002.
Is there a programme underway to review and reduce the number of licenses and permits required by the national government?	A first step in this regard was the issuance of the GEO No. 76/2001 (see the answer to the first question). According to Article 15, all Ministries in charge with the issuance of licenses and permits must proceed to the simplification of their own licensing procedures, reduce the number of permits, authorisations, settlements, reduce fees and taxes, as well as reduce the time limit for obtaining these documents. At the same time, the Action Plan sets out the following measures: – Publishing an updated list of activities which require special permits. – Observing a 30 day maximum time limit for issuing any authorisation. The public authorities in charge of issuing permits and licenses are to establish deadlines and elaborate standard forms to replace the non-standardised ones; In order to renew licenses, documents will be required only in the case changes have taken place; in the case where there are no changes, the statement of own responsibility will be enough. The simplification of the required licenses means that a sanitary license, veterinary license, license issued by the Territorial state office for labour accident prevention, environmental license, license issued by the Fire Fighting Squad will be required in addition to the statement on own responsibility only for specific fields of activity. Improving the procedure of acceptance and approval of registration documents by increasing the role of the statement on own responsibility. Publishing the inventory of authorisations, approvals, duplicates required by the administration and removal of about 50% of them by Government Decision or respective Minister's Order.
Are there systematic procedures for making regulations known and accessible to affected parties?	Yes. By publishing in the Official Journal of Romania, the issues raised by the Employers' Associations and other special issues, as well as on Ministry Internet sites.

Questions	Answers
	The legal framework is offered by Law No. 544 of 12 October 2001 on free access to public information (published in the Official Gazette, Part I, No. 663 of 23 October 2001).
Is there a general policy requiring plain language- drafting of regulation?	Law No. 24/2000 regarding the rules for elaborating normative acts (Article 33). Style of normative acts: (1) Normative acts have to be drafted in a concise, precise, sober, clear style that should exclude any ambiguous situations strictly observing the grammatical and orthographic rules. (2) The use of neologisms is forbidden if there is a well-known synonym in Romanian the language. If there are situations that require the use of words and expressions borrowed from foreign languages, the corresponding translation in the Romanian language will be attached. (3) Specialised terms may be used only if they are generally known in the field of activity related to the respective regulation. (4) Text drafting will be made by using words according to the current meaning in modern Romanian language, avoiding regionalisms. The drafting is to comply with the principle of easily understanding the text by its readers/listeners.
Do affected parties have the right to appeal against adverse enforcement decisions in individual cases?	Yes.
Is there communication at international level?	Yes.
Are there any inquiry points where affected or interested foreign parties can get information on the operation and enforcement of regulations?	Yes, through specialised departments of each institution of the central and public administration. At MDP there is a specialised department providing detailed information for foreign investors.
Does government policy impose specific requirements in relation to transparency and access to freedom of information?	Law No. 544/2001 regarding free access to public interest information establishes the free and unlimited access of any person to public interest information, as a fundamental principle of the relationships between citizens and public authorities in accordance with Romanian Constitution and international regulations ratified by the Romanian Parliament. Public interest information means any information, which regards activities or is the result of activities of public authorities or public institutions, irrespective of their form or expression modality. GD No. 123/2002 has approved Methodological norms of Law No. 544/2001. The law 544/2001 is in force in Romania.
Is registration in any transport register required in order to establish a new business in the road freight sector?	In order to set up a new road freight business it is necessary to register in the Road Freight Operator Register available in each local agency of the Romanian Road Authority. A new contract of an existing operator does not need supplementary registering. The cost is about EUR 20 for transport firm license and EUR 50 for single autovehicle licence.
In order to operate a national road freight business do you need to obtain a license (other than a driving license) or permit from the government or a regulatory agency?	In order to develop a new business in the road freight sector, it is necessary to obtain in advance a licence from the Romanian Road Authority.
In order to operate a national road freight business do you need to notify any level of government or a regulatory agency and wait for approval before you can start operation?	Before starting a new road freight business it is necessary to obtain a licence from the Romanian Road Authority.

Questions	Answers
In order to operate a national road freight business (other than for transporting dangerous goods or goods for which sanitary assurances are required) do you need to notify any level of government or a regulatory agency?	In order to develop a road freight business, after obtaining a licence from the Romanian Road, there is no need to notify another authority.
Road freight: Are criteria other than technical and financial fitness and compliance with public safety requirements considered in decisions on entry of new operators?	For road freight the honour and professional ability condition must be fulfilled.
Road freight: Do these entry regulations apply if a firm wants to transport only for its own account?	For road freight firms transporting for their own account, the current regulations for public transportation are partially applied.
Retail distribution: Procedures needed to start up a commercial activity: registration in commercial register: food and clothing.	Traders, including economic agents running retail distribution for foodstuffs and clothing must follow the procedure of the Emergency Ordinance 76/2001, (Article 1 point 1) regarding simplified procedures for registration and authorisation of the function of commercial agents. Agents must also register with fiscal bodies. The document for third parties is the registration certificate. The legal steps for registration procedures for a commercial company are obligatory for all traders including trade of foodstuffs and clothing. In case of particular goods, it is necessary to obtain a different licences.
Retail distribution: Procedures needed to start up a commercial activity: registration in commercial register: clothing.	–
Retail distribution: Procedures needed to start up a commercial activity: notification to authorities: food and clothing.	There are no specific regulations.
Retail distribution: Procedures needed to start up a commercial activity: notification to authorities: clothing.	–
Retail distribution: Procedures needed to start up a commercial activity: licenses or permits to engage in commercial activity: food and clothing	Procedures needed to start up a commercial activity with retail distribution for foodstuffs and clothing are those from Emergency Ordinance 76/2001, Article 1 point 4 regarding simplified procedures for registration and authorisation of the function of commercial agents. Authorisation is made under legislation in force according procedures from HG 625/2001.
Retail distribution: Procedures needed to start up a commercial activity: licenses or permits to engage in commercial activity: clothing	–
Retail distribution: Procedures needed to start up a commercial activity: licences or permits for outlet siting (in addition to compliance with general urban planning provisions): food and clothing	Authorisation of construction is necessary for new buildings and modification of existing ones.
Retail distribution: Procedures needed to start up a commercial activity: licences or permits for outlet siting (in addition to compliance with general urban planning provisions): clothing	–
Retail distribution: Procedures needed to start up a commercial activity: compliance with regulation especially designed for large outlets: food and: clothing	There are no specific regulations
Retail distribution: Procedures needed to start up a commercial activity: compliance with regulation especially designed for large outlets: clothing	–

Questions	Answers
Enterprise creation: Maximum number of procedures (*pre* and *post* creation) needed for sole proprietor firms	Authorisation procedure regarding natural persons carrying out economic activities is regulated by the Law-Decree No. 54/1990. The authorisation will be requested from City Hall depending on the locality of the person's residence. Subsequently, the trader-licensed natural person, needs to obtain a unique code of registration from the One-stop-shop established within the Territorial Chamber of Industry (which includes registration with the Trade Register and with fiscal authorities) as well as with respect to the specific field of activity, the issuance of certain functioning licenses from the public authorities/institutions in charge. To set up a new transportation firm in the road freight sector, approximately seven documents are necessary regardless of the number of owners.
Enterprise creation: Maximum number of government services to be contacted for sole proprietor firms	Contacting the government offices is not required, the application for the incorporation and the operating licence are handed in to the Single Access Point organised by each Chamber of Commerce and Industry. The incorporation is written in the trade registry (organised by the Chambers of Commerce and Industry) and the authorisations are provided by a maximum of five special bodies of the public administration. To set up a new transportation firm, only the Romanian Road Authority needs to be contacted.
Enterprise creation: delays (maximum weeks) before response by administration: for sole proprietor firms	*According to the law, the incorporation application and operating licence are settled within 20 days from the registration date.* For the issuance of functioning licenses regarding natural persons and family associations, city halls levy taxes that range between approximately EUR 2 (minimum amount) and EUR 16 (maximum amount), taking into account the type of activity. In addition to these taxes, the traders have to pay an amount EUR 17 for registration with the trade register and the fiscal authorities, as well as for the fees related to licensing certain specific activities. The taxes are levied in accordance with GD No. 601/2001 on the level of taxes and tariff levied for registration and authorisation of commercial activities , as well as GO No. 36/2002 regarding the taxation and local taxes.
Enterprise creation: Maximum number of procedures (pre and post creation): for corporations	According to GEO No. 76/2001 on the simplification of the administrative framework for trader registration and licensing, a unique registration and licensing procedure for traders was established. With a view to accomplishing all the formalities involved by the trader registration and licensing, the One-stop-shop has been set up, within the territorial Chambers of Commerce and Industry. In order to begin the licensing and registration procedure, the applicant is to submit to the One-stop-shop an enrolment request, together with the necessary documents and to pay all related fees and taxes. Within 20 days from the registration date of the request, the registration certificate (including the unique code) will be issued. In the annex to this certificate the following documents will be included: – Sanitary license. – Veterinary license. – License issued by the territorial state office for labour accident prevention. – Environmental license.

Questions	Answers
	The assigned unique code will be used by all information systems that process data on traders as well as by the trader in relation with third parties, including authorities and public institutions during the period of activity. Thus, on the basis of application form and the respective unique code, the company will be registered at: – Trade Register. – Fiscal Authority in charge. – Territorial state office for Labour and Social Solidarity. – Territorial health insurance office. – Territorial retirement office. – Territorial Employment agency. Issuance of the registration certificate and its annex entitle the trader to start his activities and the company becomes a legal person.
Enterprise creation: Maximum number of government services to be contacted: for corporations	In order to establish an enterprise, the One stop-shop is the only institution that has to be contacted. This is the interface between the future traders and the other institutions and authorities of public administration involved in the process of registration and licensing of a company (Trade Register, Fiscal Authority, all five licensing institutions, Territorial state Office for Labour and Social Solidarity, Territorial Health Insurance Office, Territorial Retirement Office, Territorial Employment Agency). In order to develop certain specific activities, there are notices or licenses that have to be issued beforehand. These documents are: – License issued beforehand by the Insurance Supervisory Commission. – Transient license issued beforehand by Romanian National Bank. – License issued beforehand by National Commission of transferable securities.
Enterprise creation: delays (maximum weeks) before response by administration: for corporations	According to the law, the incorporation application and the operating licence are settled within 20 days since the registration date. If the dossier is not complete/incoherent a written answer is sent to the applicant.
Enterprise creation: direct and indirect cost (minimum ECU) of administrative procedures: for corporations	The fees and taxes related to the establishment of one medium-size enterprise (limited liability company, with two shareholders) amount to approximately EUR 170, consisting of: – Taxes related to the services provided by the One-stop-shop. – Taxes related to the legal operations with Trade Register. – Notary public fees. – Publishing fee in the Official Gazette of the simplified abstract of the mandatory judge's decision. In addition to the above mentioned fees, the 5 licensing Public Authorities levy taxes that vary according to the specific activity developed, number of employees, etc. It is necessary to mention that these taxes and fees have to be paid only for those activities (stipulated by Governmental Decision, in keeping with the Classification of Activities from National Economy) which must be evaluated by the competent authorities for conformity with the specific licensing conditions. For the other cases, the trader must provide only the written statement on own responsibility stating the compliance with the functioning conditions stipulated by the specific legislation in the respective field of activity.

Questions	Answers
Other questions	
Are there any legal or constitutional constraints to the sale of the stakes held by the State in publicly-controlled firms?	No.
Are there any statutory or other legal limits to the number or proportion of shares that can be acquired by foreign investors in these firms?	There is no statutory or legal limit for the number or volume of shares that can be purchased by foreign investors in the companies holding state participation. Since according to the Romanian law, the joint stock companies must have at least five shareholders, it is not possible for one single person to acquire all shares of a joint stock company).
Do national, state or provincial governments have special voting rights (*e.g.* golden shares) in any firms within the business sector?	As regards the state's rights in the private firms, there are a number of firms in which the state detains "the nominative control share". Romania will analyse these firms by the end of 2002 one-by-one. In the case it does not conform to the rules of Communication by the EU Commission, these shares will be transformed into common ones by the end of the first semester 2003.
Road freight: Are there any regulations setting conditions for driving periods and rests?	*There is the European Agreement AETR to which Romania adhered. Beginning with the second half of year 2002 Romania will apply it for road freights and also for national traffic.* *In international transportation the AETR regulations are applied since 1968, 1970.*
Road freight: Do regulations prevent or constrain: Backhauling?	The regulations regarding road freight are elaborated according to the EU regulations of the sector and allow for the loading for return journey.
Road freight: Do regulations prevent or constrain: Private carriage?	*The regulation regarding road freight are elaborated according to the EU regulation in the sector and no discrimination exists between the private and state sector.*
Road freight: Do regulations prevent or constrain: Contract carriage?	According to the current national and European regulation, the public road freight is growing apace based on the general regulations of the transport contract.
Road freight: Do regulations prevent or constrain: Intermodal operations?	The Intermodal transportation is allowed. It benefits from some incentives.
Road freight: Within the last five years, have laws or regulations removed restrictions on: Own-account shipments?	Own-account shipment represents a distinctive transport category. It is correlated with the regulations of the *acquis communautaire*.
Retail distribution: Are shop opening hours regulated?	*Generally, yes. There are no regulations for foodstuffs and clothing units.* The shops must display their timetable. The opening hours are not regulated by the state.
Retail distribution: At which level of government regulations are applied: National/state/local	The regulations are elaborated at national level and territorial-administrative units as well.
Retail distribution: Did the regulation of opening hours become more flexible in the last 5 years?	Yes.
Air travel: Are carriers operating on domestic routes subject to universal service requirements (*e.g.* obligation to serve specified customers or areas)?	Air services operating on domestic and international routes must respect the standards and practices regarding the safety, quality and security recommended by the international organisations of airlines to which Romania adhered (OACI, EUROCONTROL, ECAC, JAA).
Railways: Are companies operating the infrastructure or providing railway services subject to universal service requirements (*e.g.* obligation to serve specified customers or areas)?	Yes.

Questions	Answers
Air Travel: Information about regulation of air travel fares: Air transport routes: Domestic	There are 17 airports opened to the international and domestic traffic. Now one airport operates a scheduled air services to 13 airports. The tariffs of each air operator on the domestic routes are stipulated by the competition law No. 21/1996 and must be registered at the aeronautical authority.
Air Travel: Information about regulation of air travel fares: Air transport routes: International: All routes	Romania has bilateral agreements regarding the international air services with 90 states. The tariffs on the international routes are established according to the specific provisions of these agreements, based on OACI Document No. 9587. There are three Romanian air operators which provide international scheduled air services. The most important is TAROM which operates to more than 35 destinations.
Air Travel: Information about regulation of air travel fares: Air transport routes: International (busiest route): Connecting countries included in regional agreements	Romania has bilateral agreements regarding the international air services with 90 states. The tariffs on the international routes are established according to the specific provisions of these agreements, based on OACI Document No. 9587. There are three Romanian air operators which provide international scheduled air services. The most important is TAROM which operates to more than 35 destinations.
Air Travel: Information about regulation of air travel fares Air transport routes: International (busiest route): Connecting other countries	Romania has bilateral agreements regarding the international air services with 90 states. The tariffs on the international routes are established according to the specific provisions of these agreements, based on OACI Document No. 9587. There are Three Romanian air operators which provide international scheduled air services. The most important is TAROM which operates to more than 35 destinations.
Road freight: Are retail prices of road freight service in any way regulated by the government?	*In the road freight sector, the transportation tariffs are established by the law of supply and demand.*
Road freight: Does the government provide pricing guidelines to road freight companies?	The tariffs of the transportation operators are established by the law of supply and demand.
Road freight: Are professional bodies or representatives of trade and commercial interests involved in specifying or enforcing pricing guidelines or regulations?	For the elaboration of the specific regulations in the sector, the professional associations of transport operations are consulted beforehand. These don't intervene in establishing the transport tariffs.
Retail distribution: Are the retail prices of certain products subject to price controls?	The Annex of the Emergency Ordinance No. 36/2001 and Emergency Ordinance No. 178/2001.
Retail distribution: Are the retail prices of Certain staples (*e.g.* milk and bread) subject to price controls?	No.
Retail distribution: Are the retail prices of Gasoline subject to price controls?	The retailed prices of gasoline are not subject to price controls or price regulation by any authority. The retailed prices are set as follows: refinery price (or distributor price) + taxes + excises. *The price can vary as a function of the distributors' margin or the retail trade stations. The gasoline retail prices fluctuate according to market demand.*
Retail distribution: Are the retail prices of Tobacco subject to price controls?	No. The retail price is a maximum price, established by each economic agent which produces or imports Tobacco and is notified by the Ministry of Public Finance. The price list with the maximum retail prices have a registered number given to them by the MPF which is published by the economic agent in two important newspapers.
Retail distribution: Are the retail prices of Alcohol subject to price controls?	No.

Questions	Answers
Retail distribution: Are the retail prices of Pharmaceuticals subject to price controls?	Yes, according to the provisions of the Government Emergency Ordinance No. 36/2001 (position 12 of the attached list).
Retail distribution: Are the retail prices of Other (please specify) subject to price controls?	Beside the regulated prices as provided in the Government Emergency Ordinance No. 36/2001, there are no other products subject to price control by the Competition Office. As regards the thermal and electric power and natural gas, the prices are established and adjusted by Sectoral Independent Regulatory Bodies.
Basic voice telephony/Trunk: Retail prices: Basis for regulation	Government Emergency Ordinance No. 36/ 2001/ 26 February 2001 regarding the regime of prices and tariffs regulated by the Consent of the Competition Office. Adjustment parameters take into account the consumer price index (position 5 of the attached list). For the basis voice telephony, the Government Emergency Ordinance No. 36/2001 stipulates in Article 2(1) that the prices and tariffs may be adjusted, in general, every three months, with the advice of the Competition Office, if the adjusting parameter changes by at least 5% compared to the existing level from the previous adjustment date. According to the annex, the adjustment parameter for the internal basis telephony services is the Consumer Price Index – CPI and for the international ones is the exchange rate. Moreover, according to the Government Decree No. 669/2001 in Article 3(2), the adjustment of the prices and tariffs upon the advice of the Competition Office based on a correction coefficient of 0.9 to the consumer advantage when the adjustment parameter increases, and of 1.1 when the adjustment parameter decreases. As a consequence, if the two conditions (3 months period and the parameter – modification over 5%) are not fulfilled simultaneously, an adjustment cannot be made. Thus, an exaggerated adjustment is being used, the "price cap" formula, to which a correction coefficient to the consumer advantage is added. Beginning 1 January 2003, the fix telephony market will be open to competition.
Basic voice telephony/International: Retail prices: Basis for regulation	*Government Emergency Ordinance No. 36/ 2001/ 26 February 2001 regarding the regime of prices and tariffs regulated by the Consent of the Competition Office. Adjustment parameters take into account the exchange rate (position 5 of the attached list). Idem.*
Mobile cellular telephony/Analogue: Retail prices: Basis for regulation	It does not require the approval of any regulation authority nor that of the Competition Office. As regards the mobile telephony, the market is open to competition, and several national operators already exist. However, until the telecommunication market is able to function under normal competition conditions, the National Agency for Regulating Communications, ANRC, will take measures (*ante factum*) to prevent abuses from a company with a dominant position through price control for access and inter-connection. The definition of market in the context of dominant position will be made according to the instructions for the telecommunications sector that are under way to be approved by the Competition Council. Acknowledging and sanctioning abuses (*post factum*) in every case will be made in accordance with the Competition Law No. 21/1996, by the competition authorities (Competition Office and Competition Council).
Mobile cellular telephony/Digital: Retail prices: Basis for regulation	It does not require the approval of any regulation authority nor that of the Competition Office

Questions	Answers
Is there an explicit recognition of national treatment principle?	The national treatment principle is recognised by Law No. 21/1996 on competition, by the provision that it is applicable to the Romanian and foreign undertakings without discrimination.
When business practices are perceived to restrict competition and hence prevent effective access of foreign firms (foreign owned or controlled) to such markets, can the latter have redress: through competition agencies?	Yes, they may have redress through the Competition Council which is the only authority to assess the compatibility of business practices with a normal competition environment.
When business practices are perceived to restrict competition and hence prevent effective access of foreign firms (foreign owned or controlled) to such markets, can the latter have redress: through trade policy bodies?	No, they may not. These aspects can be solved only by the Competition Council.
When business practices are perceived to restrict competition and hence prevent effective access of foreign firms (foreign owned or controlled) to such markets, can the latter have redress: through regulatory authorities involved?	No, they may not. These aspects can be solved only by the Competition Council.
When business practices are perceived to restrict competition and hence prevent effective access of foreign firms (foreign owned or controlled) to such markets, can the latter have redress: through private rights of action?	As regards this issue, Article 64 of the Competition Law stipulates: "*Apart from the sanctions enforced in keeping with the provisions of the present law, natural and/or legal persons reserve the right to sue for the complete remedy of the damage caused by the anti-competitive practices banned according to the present law*".
Are appeal procedures available to foreign parties?	Yes, the appeal procedures are also available to foreign parties at the same conditions as for the Romanian parties.
Are there any specific provisions which require that regulations, prior to entry into force, be published or otherwise communicated to the public in a manner accessible at the international level?	There are no such provisions in the Romanian legislation.
Has your country engaged in Mutual Recognition Agreements (MRAs) in any sector(s) with any other country (countries)?	Romania participates at present at the exchange experience within CEFTA. At the same time, the bases for starting the negotiations with the EU for concluding such a Protocol through the adoption in the national legislation of the EC Directives have been set.
Are there any specific provisions which require or encourage regulators to consider recognising the equivalence of regulatory measures or the result of conformity assessment performed in other countries, wherever possible and appropriate?	*Yes, by assuming the "acquis communautaire"*. Concerning the horizontal measures adopted by Romania, in order to develop a favourable and transparent environment in the field of product conformity assessment, the Law of product conformity assessment No. 608/2001 was adopted. Based on the New Approach principles, this law establishes the legal framework for the working out of technical regulation, conformity assessment and market surveillance. The Law 608/201 stipulates the recognition of the European marks for conformity, in terms of the technical regulation applicable to each single product.
Are there any specific provisions which require or encourage regulators to use internationally harmonised standards and certification procedures wherever possible and appropriate?	The law 608/2001 foresees that the technical regulation will refer to the European harmonised standards, adopted at a national level, which give the presumption that the products of the regulated domains stipulated in Annex 1 of the above law will conform to the main requirements. *The list of the regulated domains* 1. Low voltage 2. Simple pressure vessels 3. Toys 4. Construction products 5. Electromagnetic compatibility 6. Machinery 7. Personal protective equipments 8. Non-automatic weighing instruments 9. Implantable medical devices 10. Appliances burning gas fuels

Questions	Answers
	11. Boilers for hot water 12. Explosive for civil purpose 13. Medical devices 14. Explosive atmosphere 15. Recreational crafts 16. Lifts 17. Refrigeration equipment 18. Pressure equipment 19. Terminal equipment for communications 20. In vitro diagnostic medical devices 21. Terminal equipment for radio and communications 22. Packing and packing waste This list will be completed in each case by governmental decision. The Government Decision No. 71/2002 on the methodological norms (concerning the establishment of the procedures used for the products conformity assessment in Law 601/2001 concerning conformity assessment and of the rules for applying the national marking conformity CS), incorporates the provisions of the Directive 93/465/CEE concerning the modules for different stages of the conformity assessment procedures and rules for applying and using the conformity. According to regulations and practices, the European procedures for certification are adopted allowing for equal assessment of the products from the regulated domains bearing the CS marking and CE marking. On the horizontal level, the adoption of the conformity assessment law (which establishes the Ministry of Industry and Resources as co-ordinator for the quality infrastructure field and conformity assessment in Romania, and the accreditation as mandatory for the laboratories and bodies which request the designation) has imposed the completion and amendment of the actual regulations for standardisation (GD 39/1998) for accreditation (GD 38/1998) and for legal metrology (GD 104/2000). Reflecting the harmonisation of the New Approach European directives in Romania, so far, 15 have been transposed. At present the percentage of European harmonised standards adopted as national standards is 41%. In 2002 a further 27% of standards and in 2003 the process will be completed.
Are there any inquiry points where affected or interested foreign parties can get information on the operation and enforcement of regulations?	Yes, through specialised departments of each institution of the central and public administration. At MDP there is a specialised department providing detailed information for foreign investors.
Is there a requirement that unnecessary trade restrictiveness be avoided?	No.
Are there any statutory or other legal limits to the number or proportion of shares that can be acquired by foreign investors in state-participated firms?	There is no statutory or legal limit for the number or volume of the shares that can be purchased by foreign investors in the state participation holding companies. Since according to the Romanian law, joint stock companies must have at least five shareholders, it is not possible for one single person to acquire all shares of a joint stock company).
Special government rights can be exercised in the case of acquisition of equity by foreign investors	Yes.

Questions	Answers
Does the general competition law apply to publicly-controlled firms?	The Competition Law No. 21/1996 stipulates that its provisions apply to all undertakings, Romanian or foreign, irrespective of their proprietorship, as well as to the public administrative bodies when they intervene in market operations. Also see Article 2, par. (1) of the Competition Law: "(1) *The provisions of this law apply to acts and deeds that have or may have as an effect the restriction, prevention or distortion of competition, and were committed by:* *a) undertakings or groups of undertakings, natural or legal persons – Romanian or foreign, irrespective of nationality or citizenship – hereinafter "undertakings";* *b) central or local public administration authorities, to the extent that they, by the decisions issued or regulations adopted, intervene in market operations, directly or indirectly influencing competition, except for situations when such laws protect a major public interest."*
Is there rule or principle providing for exclusion or exemption from liability under the general competition law for conduct that is required or authorised by other government authority (in addition to exclusions that might apply to complete sectors)?	There are no such kinds of provisions in the Romanian competition legislation.
Publicly-controlled firms: Exclusion or exemption from competition law: Cartel and other horizontal	There are no such kinds of provisions in the Romanian competition legislation.
Publicly-controlled firms: Exclusion or exemption from competition law: Vertical and abuse of dominance – monopolisation	There are not such kinds of provisions in the Romanian competition legislation.
Publicly-controlled firms: Exclusion or exemption from competition law: Merger	There are no such kinds of provisions in the Romanian competition legislation.
On which of the following grounds may an otherwise illegal merger be permitted? Employment	There are no such kinds of provisions in the Romanian competition legislation.
On which of the following grounds may an otherwise illegal merger be permitted? Regional development	There are no such kinds of provisions in the Romanian competition legislation.
On which of the following grounds may an otherwise illegal merger be permitted? Industrial policy	There are no such kinds of provisions in the Romanian competition legislation.
On which of the following grounds may an otherwise illegal merger be permitted? National security	There are no such kinds of provisions in the Romanian competition legislation.
On which of the following grounds may an otherwise illegal merger be permitted? Public interest	This is an exception to the provisions of the Competition Law that allows for illegal mergers.
Application and interpretation of the general competition law – May the conduct be found lawful, despite harm to competition, on the grounds of other policy considerations? Horizontal agreements: price fixing	No.
Application and interpretation of the general competition law – May the conduct be found lawful, despite harm to competition, on the grounds of other policy considerations? Horizontal agreements: market division	No.
Application and interpretation of the general competition law – May the conduct be found lawful, despite harm to competition, on the grounds of other policy considerations? Horizontal agreements: boycott	No.
Application and interpretation of the general competition law – May the conduct be found lawful, despite harm to competition, on the grounds of other policy considerations? Horizontal agreements: other	No.

ISIC Rev. (2) classification		National, state or provincial government holds equity stakes in business companies	National state or provincial laws or other regulations restrict in at least some markets the number of competitors allowed to operate a business
		ANSWER	ANSWER
314	Tobacco manufactures	Yes	No
353	Petroleum refineries	Yes	No
37	Basic metal industries	Yes	No
38	Manufacture of fabricated metal products, machinery and equipment	Yes	No
4101	Electricity	Yes	No
4102	Gas manufacture and distribution	Yes	No
42	Water works and supply	Yes	No
61	Wholesale trade	Yes	No
63	Restaurant and hotels	Yes	No
7111	Railways	Yes	Yes, for infrastructure
7112	Urban, suburban and interurban highway passenger transport	Yes	No
7113	Other passenger land transport	Yes	No
7114	Road freight	No	No
7116	Supporting services to land transport	Yes	No
712	Water transport	Yes, for infrastructure (ports)	No
7116	Supporting services to water transport	No	No
7131	Air transport carriers	Yes	No
7132	Supporting services to air transport	No	No
72	Communication	Yes	Yes, for basic voice telephony up to 31 December 2002
81	Financial institutions	Yes	No
82	Insurance	No	No
832	Business services	No	No
9331	Medical, dental and other health services	Yes	No
9412	Motion picture distribution and projection	Yes	No

	ANSWER
Share of state-controlled enterprises in GDP (2001 or last recent year)	32.9%
Privatisation proceeds (million US $, 1997-2001)	1.3 billion US$ (OECD estimate)
average tariff (%)	34% for Agriculture and 16% Other goods

***Annex of the Governmental Emergency Ordinance* (GEO) No. 36/2001**

The List of the products and services whose prices and tariffs are established with the endorsement of the Competition Office:

1. The oil and oil products transport through principal main;
2. Railway transport for passengers;
3. River transport in the Danube Delta for the inhabitants in the area, subsidised from the state budget;
4. Underground passengers transport (metro);
5. Basic telephonic services: domestic and international;
6. Basic postal services: domestic and international;
7. Radio – communication and tele-communication services;
8. Raw water;
9. Drinking water and sewerage;
10. Heavy water;
11. Services provided by Domestic Affairs Ministry;
12. Human drugs from internal production and from import;
13. Sand and gravel;
14. Unfilled wood mass (starting price for tenders);
15. Natural mineral water at the spring (GEO No. 178/2001).

STATISTICAL ANNEX

Table A1. **GDP by expenditure**

Billion lei

	ESA 79									ESA 95			
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1998	1999	2000	2001
Current prices													
Gross domestic product	857.9	2 203.9	6 029.2	20 035.7	49 773.2	72 135.5	108 919.6	252 925.7	371 193.8	373 798.2	545 730.2	800 308.1	1 154 126.4
Final consumption	679.5	1 672.5	4 642.5	15 235.8	38 452.4	58 662.4	89 939.4	218 619.8	334 672.4	337 468.6	484 361.4	687 878.7	995 017.9
Final consumption of households	557.7	1 323.7	3 750.8	12 670.3	31 442.0	48 545.1	75 288.8	186 238.2	278 626.2	279 903.2	399 285.2	553 389.8	810 880.2
Final consumption of general government	114.3	333.9	861.1	2 473.2	6 851.8	9 877.0	14 273.9	30 999.8	52 740.9	54 326.7	79 039.7	125 000.0	171 989.3
Final consumption of private non-profit institutions serving households	7.5	14.9	30.6	92.3	158.6	240.3	376.7	1 381.8	3 305.3	3 238.7	6 036.5	9 488.9	12 148.4
Gross capital formation	259.5	618.1	1 893.5	5 795.9	12 348.3	17 510.0	28 159.9	52 171.4	66 525.2	66 333.5	87 740.6	157 680.3	252 650.3
Gross fixed capital formation	169.8	317.0	1 156.8	3 583.7	10 095.7	15 424.9	24 998.5	53 540.1	68 111.6	67 919.9	96 630.4	151 486.2	219 289.3
Change in stocks	89.7	301.1	736.7	2 212.2	2 252.6	2 085.1	3 161.4	–1 368.7	–1 586.4	–1 586.4	–8 889.8	6 194.1	33 361.0
Net exports	–81.1	–86.7	–506.8	–996.0	–1 027.5	–4 036.9	–9 179.7	–17 865.5	–30 003.8	–30 003.9	–26 371.8	–45 250.9	–93 541.8
Export	143.5	387.9	1 675.6	4 611.5	12 394.2	19 921.3	30 651.1	73 795.7	87 104.5	84 559.3	152 902.7	264 186.6	386 831.6
Import	224.6	474.6	2 182.4	5 607.5	13 421.7	23 958.2	39 830.8	91 661.2	117 108.3	114 563.2	179 274.5	309 437.5	480 373.4
Total domestic demand	939.0	2 290.6	6 536.0	21 031.7	50 800.7	76 172.4	118 099.3	270 791.2	401 197.6	403 802.1	572 102.0	845 559.0	1 247 668.2
At prices of previous period													
Gross domestic product		747.0	2 010.7	6 121.3	20 823.5	53 326.1	74 983.5	102 326.6	240 741.0		369 499.5	555 404.8	842 354.6
Final consumption		599.4	1 579.1	4 700.2	15 813.2	42 602.3	62 754.9	86 079.1	221 113.6		328 963.7	489 702.4	727 019.5
Final consumption of households		467.4	1 223.9	3 783.8	13 003.9	35 518.0	52 440.9	72 522.0	187 276.2		272 863.1	395 751.4	590 674.2
Final consumption of general government		126.4	341.2	884.3	2 744.6	6 921.0	10 024.9	13 066.8	31 556.3		51 867.3	86 906.4	127 311.8
Final consumption of private non-profit institutions serving households		5.6	14.0	32.1	64.7	163.3	289.1	490.3	2 281.1		4 233.3	7 044.6	9 033.5
Gross capital formation		187.9	542.7	1 837.3	5 286.0	11 835.5	17 945.1	24 916.5	49 164.5		59 957.2	105 690.3	186 807.9
Gross fixed capital formation		116.1	351.8	1 252.9	4 326.1	10 793.4	16 299.5	25 431.2	50 475.0		64 646.0	101 104.9	161 442.0
Change in stocks		71.8	190.9	584.4	959.9	1 042.1	1 645.6	–514.7	–1 310.5		–4 688.8	4 585.4	25 365.9
Net exports		–40.3	–111.1	–416.2	–275.7	–1 111.7	–5 716.5	–8 669.0	–29 537.1		–19 421.4	–39 987.9	–71 472.8
Export		117.8	399.2	1 862.0	5 489.4	14 503.6	20 325.4	34 144.7	72 523.2		93 408.2	189 808.0	292 141.3
Import		158.1	510.3	2 278.2	5 765.1	15 615.3	26 041.9	42 813.7	102 060.3		112 829.6	229 795.9	363 614.1
Total domestic demand		787.3	2 121.8	6 537.5	21 099.2	54 437.8	80 700.0	110 995.6	270 278.1		388 920.9	595 392.7	913 827.4

Table A1. **GDP by expenditure** (*cont.*)

Billion lei

	ESA 79									ESA 95			
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1998	1999	2000	2001
At 1995 prices[1]													
Gross domestic product	80 321.6	69 938.5	63 807.5	64 782.2	67 329.4	72 135.5	74 983.5	70 444.7	67 051.0		66 279.9	67 454.9	70 998.9
Final consumption	60 500.7	53 368.8	50 388.5	51 014.7	52 948.1	58 662.4	62 754.9	60 061.4	60 746.5		59 215.6	59 868.5	63 275.1
Final consumption of households	53 563.8	44 891.0	41 506.5	41 871.7	42 974.1	48 545.1	52 440.9	50 513.7	50 795.3		49 517.7	49 304.4	52 626.2
Final consumption of general government	7 592.8	8 396.6	8 580.2	8 811.3	9 778.2	9 877.0	10 024.9	9 177.1	9 341.9		8 919.0	10 101.5	10 288.3
Final consumption of private non-profit institutions serving households	452.4	337.8	317.4	332.9	233.4	240.3	289.1	376.3	621.2		811.9	928.4	883.9
Gross capital formation	32 471.0	23 511.7	20 643.6	20 030.9	18 268.7	17 510.0	17 945.1	15 878.2	14 963.1		13 524.8	16 291.6	19 301.1
Gross fixed capital formation	14 542.7	9 943.5	11 035.1	11 951.9	14 427.8	15 424.9	16 299.5	16 581.6	15 632.4		14 878.8	15 567.8	16 590.9
Change in stocks[2]	17 928.2	13 568.2	9 608.5	8 079.0	3 840.8	2 085.1	1 645.6	–703.4	–669.3		–1 354.1	723.8	2 710.2
Net exports	–10 117.4	–5 339.7	–6 317.7	–5 728.3	–3 568.7	–4 036.9	–5 716.5	–5 350.1	–8 916.3		–6 116.0	–8 833.8	–12 493.9
Export	15 233.7	12 505.4	12 869.7	14 301.4	17 024.0	19 921.3	20 325.4	22 642.1	22 251.7		24 580.2	30 513.0	33 741.7
Import	25 351.1	17 845.1	19 187.4	20 029.7	20 592.6	23 958.2	26 041.9	27 992.2	31 167.9		30 696.3	39 346.8	46 235.7
Total domestic demand	91 210.7	76 475.1	70 839.5	70 855.8	71 083.2	76 172.4	80 700.0	75 845.9	75 702.2		72 912.3	75 880.6	82 007.1
Statistical adjustment	–2 532.7	–1 602.4	–906.9	–535.2	–318.7	0.0	0.0	–144.8	257.7		–344.4	128.5	916.6

1. Computed by re-basing the price indices in the year 1995.
2. Stocks = Gross capital formation – Gross fixed capital formation.

Source: INSSE.

Table A2. **Balance of payments**

Millions US$

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Current account	–3 337	–1 012	–1 564	–1 174	–428	–1 774	–2 612	–2 137	–2 968	–1 469	–1 363	–2 349
Goods and services, net	–3 604	–1 245	–1 588	–1 243	–582	–1 902	–2 855	–2 394	–3 279	–1 684	–1 938	–3 189
Goods balance	–3 427	–1 106	–1 420	–1 128	–411	–1 577	–2 470	–1 980	–2 625	–1 257	–1 684	–2 969
Export fob	5 775	4 266	4 364	4 892	6 151	7 910	8 085	8 431	8 302	8 487	10 366	11 385
Import fob	9 202	5 372	5 784	6 020	6 562	9 487	10 555	10 411	10 927	9 744	12 050	14 354
Services	–177	–139	–168	–115	–171	–325	–385	–414	–654	–427	–254	–220
Credit	610	680	631	799	1 044	1 494	1 563	1 524	1 217	1 367	1 767	1 948
Debit	787	819	799	914	1 215	1 819	1 948	1 938	1 871	1 794	2 021	2 168
Income	161	15	–87	–145	–129	–241	–309	–322	–442	–411	–285	–335
Credit	175	104	53	63	116	81	79	204	263	152	325	369
Debit	14	89	140	208	245	322	388	526	705	563	610	704
Current transfers	106	218	111	214	283	369	552	579	753	626	860	1 175
Credit	138	277	136	231	344	479	634	730	886	804	1 079	1 449
Debit	32	59	25	17	61	110	82	151	133	178	219	274
Capital and financial account	3 449	872	1 167	1 022	334	1 104	1 721	1 040	2 723	502	1 233	1 304
Capital account	0	0	0	8	12	242	100	43	39	45	36	103
Financial account	3 449	872	1 167	1 014	322	862	1 621	997	2 684	457	1 197	1 201
Direct investment	–18	37	73	87	341	417	221	1 224	2040	1 025	1 051	1 154
Credit	0	42	80	94	342	420	223	1 229	2 063	1 102	1 122	1 281
Debit	18	5	7	7	1	3	2	5	23	77	71	127
Portfolio investment	0	0	–11	–73	75	–21	0	883	130	–715	101	583
Credit	0	0	0	11	112	13	0	1 067	510	213	472	1 149
Debit	0	0	11	84	37	34	0	184	380	928	371	566
Other investment	1 095	1 526	1 314	1 036	636	765	1 825	557	–298	341	976	934
Credit	1 331	2 147	2 346	2 393	3 034	3 830	4 027	4 433	4 047	3 523	3 693	3 213
Debit	236	621	1 032	1 357	2 398	3 065	2 202	3 876	4 345	3 182	2 717	2 279
Transit account	0	0	–54	38	3	–51	42	–10	–28	–17	7	8
Credit	0	0	11	40	36	27	42	75	11	4	50	8
Debit	0	0	65	2	33	78	0	85	39	21	43	0
Barter and clearing accounts	529	–504	–268	–128	–115	–505	–53	8	–3	–4	–10	6
Credit	529	45	91	12	20	17	4	44	5	8	25	7
Debit	0	549	359	140	135	522	57	36	8	12	35	1
Reserve assets (NBR)	1 843	–187	113	54	–618	257	–414	–1 665	843	–173	–928	–1 484
Credit	1 843	141	366	71	48	327	24	67	1 011	738	14	0
Debit	0	328	253	17	666	70	438	1 732	168	911	942	1 484
Net errors and omissions	–112	140	397	152	94	670	891	1 097	245	967	130	1 045

Source: National Bank of Romania.

Table A3. **Monetary survey**

End-of-period, billion of lei

	1996	1997	1998	1999	2000	2001 Mar.	2001 Jun.	2001 Sep.	2001 Dec.	2002 Mar.
Net Foreign Assets	–683	15 935	16 162	41 381	92 912	105 945	129 295	150 393	168 511	172 353
Domestic Credit	31 450	47 432	79 919	101 340	112 886	116 885	115 204	129 349	143 245	155 234
Credit to Government, net	4 609	11 531	20 833	43 621	37 878	32 458	22 319	26 119	24 990	24 997
Credit to non-government	26 841	35 901	59 087	57 719	75 007	84 428	92 885	103 230	118 254	130 237
In Lei	16 943	16 232	24 273	24 445	30 411	33 399	37 236	41 898	47 533	51 610
In foreign exchange	9 898	19 668	34 814	33 275	44 596	51 029	55 649	61 332	70 721	78 627
Other Assets, net	–432	–1 217	–3 552	–8 599	–20 737	–31 279	–36 001	–44 597	–41 244	–52 261
Broad Money (M2)	30 335	62 150	92 530	134 122	185 060	191 551	208 498	235 145	270 512	275 326
M1	11 173	18 731	22 110	29 669	46 331	39 108	46 001	51 073	64 309	55 881
Currency outside banks	5 383	9 200	11 525	17 372	25 742	23 774	29 645	32 645	35 635	33 416
Demand deposits	5 791	9 531	10 585	12 297	20 589	15 334	16 355	18 428	28 673	22 466
Quasi Money	19 161	43 419	70 420	104 454	138 729	152 443	162 497	184 072	206 203	219 445
Households deposits	8 808	20 166	30 967	39 238	44 549	48 382	52 348	55 327	63 706	70 378
Lei deposits (legal persons)	3 268	5 567	9 252	14 734	19 324	20 803	20 218	21 948	26 713	31 487
Forex deposits of residents	7 086	17 686	30 201	50 482	74 856	83 259	89 931	106 797	115 784	117 580
Memorandum items:										
Reference exchange rate (L/$)	4 035	8 023	10 951	18 255	25 926	27 566	29 160	30 465	31 597	32 887
Gross foreign assets	12 206	40 152	42 512	68 334	128 008					
Forex deposits in % of M2	23.4	28.5	32.6	37.6	40.4	43.5	43.1	45.4	42.8	42.7

1. Since December 1996, operations with the General Account of State Treasury a re recognised in the NBR's balance sheet only.

Source: National Bank of Romania.

Table A4. **Detailed structure of trade, 2001**

Top 50 products, in per cent

Code SITC		Quality ranking[1]	Export share [1]	Import share [2]	RCA [1]-[2]	Cumulative share of experts
842	Women's clothing, of textile fabrics	140	9.21	0.13	9.08	9.21
841	Men's clothing of textile fabrics, not knitted	146	7.86	0.17	7.70	17.07
851	Footwear	57	8.53	1.59	6.94	25.60
845	Articles of apparel, of textile fabrics, n.e.s.	159	4.33	0.35	3.98	29.93
821	Furniture and parts; bedding and similar stuffed furni.	140	4.39	0.51	3.88	34.33
334	Petroleum oils or bituminous minerals > 70 % oil	n.a.	5.34	2.30	3.05	39.67
248	Wood simply worked, and railway sleepers of wood	n.a.	2.82	0.02	2.80	42.49
673	Flat-rolled prod., iron, non-alloy steel, not coated	117	2.82	0.39	2.43	45.31
793	Ships, boats and floating structures	96	1.97	0.04	1.93	47.28
684	Aluminium	154	2.29	0.45	1.85	49.57
562	Fertilisers (other than those of group 272)	32	1.48	0.05	1.42	51.05
679	Tubes, pipes and hollow profiles, fittings, iron, steel	57	1.86	0.63	1.23	52.91
282	Ferrous waste, scrape; remelting ingots, iron, steel	n.a.	1.16	0.00	1.16	54.07
844	Women's clothing, of textile, knitted or crocheted	163	1.27	0.11	1.16	55.34
635	Wood manufacture, n.e.s.	57	0.95	0.08	0.87	56.29
746	Ball or roller bearings	87	0.98	0.14	0.84	57.27
773	Equipment for distributing electricity, n.e.s.	146	2.45	1.67	0.78	59.72
001	Live animals other than animals of division 03	n.a.	0.63	0.07	0.57	60.36
843	Men's or boy's clothing, of textile, knitted, crochet	159	0.65	0.08	0.56	61.00
658	Made-up articles, of textile materials, n.e.s.	159	0.66	0.12	0.53	61.66
716	Rotating electric plants and parts thereof, n.e.s.	72	0.79	0.29	0.50	62.45
784	Parts and accessories of vehicles of 722, 781, 782, 783	1	1.24	0.78	0.47	63.69
894	Baby carriages, toys, games and sporting goods	108	0.71	0.29	0.42	64.40
791	Railway vehicles and associated equipment	96	0.65	0.24	0.41	65.05
666	Pottery	166	0.40	0.02	0.38	65.45
573	Polymers of vinyl chloride or halogenated olefins	96	0.46	0.08	0.38	65.92
665	Glassware	154	0.52	0.19	0.33	66.44
723	Civil engineering and contractors' plant and equipment	24	0.58	0.26	0.32	67.02
675	Flat-rolled products of alloy steel	32	0.75	0.44	0.30	67.77
792	Aircraft and associated equipment; spacecraft, etc.	24	0.42	0.12	0.30	68.19
686	Zinc	96	0.37	0.08	0.28	68.55
522	Inorganic chemical elements, oxides and halogen salts	41	0.45	0.19	0.26	69.00
514	Nitrogen-function compounds	72	0.39	0.14	0.25	69.39
661	Lime, cement, fabrica. constr. mat.(excl.glass, clay)	126	0.40	0.18	0.22	69.79
222	Oil seeds and oleaginous fruits (excl. flour)	n.a.	0.40	0.18	0.21	70.18
676	Iron and steel bars, rods, angles, shapes and sections	117	0.53	0.32	0.21	70.71
848	Articles of apparel, clothing access., excl. textile	163	0.39	0.20	0.19	71.10
344	Petroleum gases, other gaseous hydrocarbons, n.e.s.	n.a.	0.18	0.01	0.18	71.28
288	Non-ferrous base metal waste and scrap, n.e.s.	n.a.	0.18	0.01	0.17	71.46
112	Alcoholic beverages	n.a.	0.17	0.01	0.16	71.64
512	Alcohols, phenols, halogenat., sulfonat., nitrat. der.	126	0.27	0.12	0.15	71.91
775	Household type equipment, electrical or not, n.e.s.	82	0.80	0.66	0.13	72.71
697	Household equipment of base metal, n.e.s.	126	0.29	0.16	0.13	73.00
043	Barley, unmilled	n.a.	0.19	0.07	0.13	73.19
523	Metallic salts and peroxysalts, of inorganic acids	126	0.34	0.22	0.12	73.53
247	Wood in the rough or roughly squared	n.a.	0.14	0.01	0.12	73.67
283	Copper ores and concentrates; copper mattes	n.a.	0.11	0.00	0.11	73.78
041	Wheat (including spelt) and meslin, unmilled	n.a.	0.35	0.24	0.11	74.13
811	Prefabricated buildings	24	0.21	0.10	0.11	74.34
524	Other inorganic chemicals; comp. of precious metals	126	0.12	0.02	0.10	74.46

1. Ranking of the SITC 3-digit manufacturing industries according to price *versus* quality competition. The highest quality competition (or the lowest price competition) is one. The lowest quality competition (or highest price competition) is 166. See K. Aiginger "The use of unit values for evaluating the competitiveness of nations", WIFO Institute, Vienna, 1995.

Source: INSSE and OECD calculations.

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