Romania
Functional Review

MINISTRY OF ECONOMY, ENERGY SECTOR AND BUSINESS ENVIRONMENT

Final Report

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The World Bank
Europe and Central Asia Region
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<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>ANRE</td>
<td>Romanian Energy Regulatory Authority</td>
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<td>EC</td>
<td>European Commission</td>
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<td>EU</td>
<td>European Union</td>
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<td>GSG</td>
<td>General Secretariat of the Government</td>
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<td>ICT</td>
<td>Information and Communications Technology</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>MEC</td>
<td>Ministry of Economy, Commerce and Business Environment</td>
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<tr>
<td>MPF</td>
<td>Ministry of Public Finance</td>
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<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>OPCOM</td>
<td>Romanian electricity market operator</td>
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<td>OPSPI</td>
<td>Office for State Ownership and Participation in Industry</td>
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<td>RIA</td>
<td>Regulatory Impact Analysis</td>
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<td>SOE</td>
<td>State Owned Enterprise</td>
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<td>SOP</td>
<td>Sector Operational Program</td>
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<tr>
<td>Transelectrica</td>
<td>Romanian Transmission System Operator (TSO)</td>
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EXECUTIVE SUMMARY AND ACTION PLAN

1. This Functional Review of the Ministry of Economy, Commerce and Business Environment (MEC), energy sector and business environment was undertaken by the World Bank as a part of the broad functional review of Romania’s public administration, as requested by the Government of Romania and the European Commission (EC) as per the June 2009 Memorandum of Understanding.

2. After several years of stable economic performance, the financial crisis put enormous pressure to Romania. The GDP fell by 7.1% in 2009 and another 1.3% in 2010. Economic forecasts envisage that the country might grow at 1.5% in 2011. The Ministry is under increased pressure to enhance the delivery of key Government priorities so that the economy returns to a sustainable growth and convergence with the European Union (EU). The Ministry faces substantial challenges but also unique opportunities to undertake bold actions in areas insufficiently tackled before or where previously-started reforms have stalled.

3. The Ministry has changed its structure, role and responsibilities substantially and frequently in the past six years. On top of several reorganizations (mergers, divisions, reshaping responsibilities) in recent years, there have been five ministers of Economy. Yet again, the Ministry is currently undergoing another reorganization including a systematic adaptation of functions and elimination of overlaps, and layoffs of staff - a different approach from previous mergers and divisions which were primarily additions and splits of departments. Frequent restructuring has affected staff morale and “reorganization fatigue” is visible.

4. The Review identifies the following key areas for attention and action by the Ministry and the Government:

- Resume the implementation of energy reforms to ensure investment and security of supply to support economic growth and quality of life;
- Streamline the functions of MEC departments, to reduce work overload of remaining MEC staff after the sizeable layoffs and to enhance SOE performance;
- Improve governance of energy SOEs in accordance with OECD best practice for transparency and accountability;
- Rebuild energy regulator ANRE’s capacity, autonomy and accountability;
- Improve inter-ministerial coordination of energy functions across the Government; and
- Improve institutional set-up and governance arrangements for business environment functions in accordance with good international practices for regulatory management systems.

5. The likelihood of successful implementation of the recommendations of the review will increase if certain preconditions are met:

- High level and broad support: Reforms would need high level (Prime Minister, MEC Minister, state secretaries) as well as broad middle management support across the organization (Director Generals and Directors of departments).
- Public support: the need to reform the governance in the energy sector is recognized by a broad range of external stakeholders, including private companies, minority shareholders in SOEs, civil
society and experts in and outside the public sector. Effective dissemination of the functional review would help mobilize such public support.

- **The IMF/EC/WB programs** provide an external stimulus to improve governance. Most importantly in the energy sector, Romania is in breach of EU’s 2003 Energy Package and missed the March 3, 2011 deadline for the Third Energy Package. Accurate transposition and implementation of the Third Package is needed, particularly in the liberalization of electricity and gas markets and independence and accountability in regulation.

- **Concrete steps and priorities for quick wins and benefits:** Proposed actions would (1) reduce staff overload and pressures on other limited public resources and (2) start the process to restore investor confidence.

6. **The proposed action plan of reforms is ambitious and challenging to implement.** Technical assistance requirements to support implementation have been identified. Funding requirements are substantial and it is recommended that the use of EU funds be considered.

7. **The functional review report is organized into two main parts, MEC/energy sector and Business Environment:**

   - **Part I of the report deals with MEC and the energy sector.** They are combined as energy is the main business of MEC and MEC’s energy SOEs account for over 80% of its SOEs. This combined MEC/energy sector approach allows for a report structure for Part I that substantially resembles final reports of other functional reviews. This executive summary highlights the top 10 reform actions – three for immediate implementation, another three for within the next six months, and four additional priority actions for “as soon as possible”; and

   - **Part II of the report deals with the business environment.** Business environment is a very small part of MEC. Responsibilities are scattered across the Romanian administration and the recommendation is to consolidate the functions and to move business environment to a higher political level, close to the Center of Government.

   - **The commerce functions of MEC were not covered in this Review.**

**Part I – the top 10 Recommended Reform Actions**

8. **Romania entered the EU in January 2007 implementing an energy strategy which the EC called exemplary.** In 2003, Romania had formalized its policy direction in the “Road Map for the Energy Field” and submitted it to the EU as the official strategy Romania would follow to achieve compliance with the EU’s electricity and gas directives and other energy sector parts of the EU acquis. In late 2007, reform implementation stalled as debate started on a succession of plans to merge coal/lignite mining and power and companies into 1-2 integrated companies, national champions. **The Review recommends that Romania resume the implementation of the Road Map and highlights a package of six interlinked reform actions to ensure investment and security of supply to support economic growth and quality of life.**
A Package of Six Inter-linked Reform Actions

9. The six priority actions recommended by the Review and summarized below are inter-linked. They form an integrated package of actions – all six should be implemented to restore the credibility of Romania’s commitment to sound commercial practices, competitive energy markets and implementation of EU-compatible energy laws and regulations. Private investment and professional management is required to ensure security of supply to support economic growth and quality of life. The first set of three reforms is designed start the process of restoring credibility and attracting investors’ attention. They are recommended for immediate implementation. They are actions that can be taken and should be taken without further delay. Romania has lost several years since reform implementation stalled in 2007 and cannot afford more delays and postponements. The second set of three reforms is required: (a) for significant investment commitments by private investors and their financiers; and (b) by most lenders to Romania’s public sector energy companies with the possible exception of some loans with sovereign guarantees.

10. Investment requirements in the energy sector are very large; conservatively estimated at about euro 30-35 billion in the next 10 years\(^1\), more than half in power generation. Sovereign guaranteed loans can at best cover a small fraction of the financing needs. Even if multiplied by a factor of three or five, EU funding for energy (well below euro 1 billion in the 2007-2013 period) can provide only a small part of the total needs. Therefore, the vast majority of the euro 30-35 billion has to come on commercial basis. The national champion strategy will discourage the private sector and fail to achieve such financing, with significant damaging effects on investment, security of supply, economic growth and quality of life. The implementation of the entire package of the six inter-linked reforms is needed.

(a) Top Three Immediate Reform Actions

11. The Review recommends that three reform actions be taken immediately to start the process of restoring the credibility of Romania’s commitment to sound commercial practices, competitive energy markets and implementation of EU-compatible energy laws and regulations:

- **Reform 1** - Government announces the cancellation of the plan to create the two national champions and the restart of the implementation of the 2003 Road Map: a balanced strategy of attracting private sector investment and developing viable public sector energy companies, including the listing of Hidroelectrica, Nuclearelectrica, Electrica and Romgaz;
- **Reform 2** - Government requires public sector electricity generators and Romgaz to award bilateral contracts transparently and competitively through the OPCOM Power Exchange (electricity) or other similar transparent and competitive procedures (Romgaz) and instructs Hidroelectrica and Romgaz to renegotiate their existing bilateral contracts and raise below-market prices to market levels or to terminate the contracts;
- **Reform 3** - Government and ANRE address other major commercial issues in the energy sector: Government causes its railways infrastructure company CFR to pay its electricity bills (or allows the distribution companies to disconnect electricity service to CFR); Government lifts legal,

\(^1\) This estimate is slightly below the World Bank’s regional investment requirement estimate of 3% of GDP/annum for Eastern Europe and Central Asia in the regional study Lights Out?
regulatory and physical (Transgaz) barriers on gas exports by domestic gas producers; and ANRE restarts the implementation of the wholesale gas pricing formula in its gas sector regulations.

12. Cancellation of the plan to create the two national champions and the endorsement, enforcement and implementation of sound commercial practices by the Government, energy regulator ANRE and public sector energy companies are prerequisites and basic building blocks for a business environment conducive for stock market listings and private investments in the energy sector. The evidence in support of these recommendations is strikingly visible in Romania. After having successfully attracted leading European energy companies (including CEZ, Enel, E.ON, GDF and OMV) to invest in the energy sector during the years when Romania was implementing a progressive energy strategy, new investments by the private sector - and it must be emphasized also by the public sector - stalled in 2007 as the debate started on a succession of plans to merge coal/lignite mining and power and companies into 1-2 integrated companies, national champions. The most recent setback – the departure in late 2010/early 2011 of four of the six private partners from the public-private partnership (PPP) company EnergoNuclear, from what would have been Romania’s largest private investment ever at about euro 4 billion - clearly signals the urgent need to change course.

13. Urgent measures are needed to restore the credibility of Romania’s commitment to sound commercial practices. A conservative estimate is that Hidroelectrica lost almost RON 1 billion through below-market priced bilateral contracts in 2009 (the only year for which sufficient details about the contracts were available). Assuming 2009 was a typical bilateral contracting year for Hidroelectrica, it will have lost about RON 4-5 billion during the period it was formally required by the Ministry to use the OPCOM platform. Renegotiations of the five biggest contracts in 2010 reduced annual losses from 2011 but losses will continue through 2018 as the contracts were also extended. Domestic gas producers Petrom and Romgaz are required to sell their gas production at a fraction of the economic price of gas, providing a (theoretical) discount of RON 7 billion/annum. Prospective oil and gas producers are affected by insufficient data and lengthy and non-transparent concession procedures by the National Agency for Mineral Resources and reviews by several ministries. ANRE’s non-implementation of its gas regulations has so far cost gas distributors E.ON and GDF over RON 1 billion since 2009. ANRE’s implementation of its electricity regulations is not transparent to market participants. Non-payment of electricity bills by the railways infrastructure company CFR has so far cost private electricity suppliers CEZ, Enel and E.ON and the public sector Electra RON 1.7 billion. While energy consumers in the short-term benefit from some of these practices, they undermine Romania’s energy security and economic growth in the medium-to-long term and already contribute to tax arrears and foregone dividends to the state budget. Subsidized energy prices weaken incentives for energy efficiency, which is the most effective measure for energy security and climate change mitigation and a contributor to industrial competitiveness. Subsidies should be targeted to vulnerable households. Romania can afford and should provide such targeted subsidies to ensure access of low-income households to basic energy services.

14. These top three reform actions should be taken immediately – Romania cannot afford more delays and postponements. Successive governments have tried, unsuccessfully, to set up national champions since late 2007. The March and April 2011 decisions of the Bucharest Appellate Court, striking down the plans to establish Hidroenergetica and Electra, are clear signals for the Government to change course instead of continuing the pursuit until 2012. Time for alternative solutions has come. The Review discusses and makes recommendations about an alternative solution.
Three Further 2011 Reform Actions - by the End of 2011 at the latest

15. The Review recommends that the following three reform actions be taken within the next few months, by the end of 2011 at the latest, to continue the process of restoring the credibility of Romania’s commitment to sound commercial practices, competitive energy markets and implementation of EU-compatible energy laws and regulations. These actions build upon the momentum that would be created with the implementation of the immediate reform actions:

- Reform 4 - Romania transposes EU’s Third Package of energy reforms into national legislation and energy regulation and implements the regulatory independence and transmission system operator requirements for ANRE and Transelectrica/Transgaz, respectively;
- Reform 5 - Energy regulator ANRE resumes energy market liberalization and removes regulated prices for electric and gas supply for non-residential consumers;
- Reform 6 - Government prepares a comprehensive program of SOE reform and starts its implementation with governance reforms at major viable energy SOEs including Hidroelectrica, Nuclearelectrica and Romgaz and liquidations of unviable SOEs.

16. The Review recommends that Romania resume the implementation of energy reforms in accordance with EU energy acquis as a positive response to the ongoing and possible/likely future infringements proceedings. The implementation of Road Map - Romania’s 2003 energy strategy – stalled in 2007. In 2009, the Commission launched infringement proceedings against Romania for not complying with the EU acquis on the internal market for electricity and gas, most notably the Electricity Directive 2003/54/EC, the Gas Directive 2003/55/EC, the Electricity Regulation 1228/2003 and the Gas Regulation 1775/2005. Romania continues to supply electricity and gas at regulated prices for all consumer groups. In addition, Romania has not implemented EU’s network transparency and capacity allocation requirements. These practices are direct violations of the EU energy acquis and infringement proceedings are underway. The Commission issued reasoned opinions on regulated prices on April 5, 2011 and may refer the cases to the Court of Justice to open litigation procedures, if Romania does not take actions. Moreover, after having developed energy regulator ANRE into a regional best practice model by 2005, successive governments have brought ANRE close to non-functionality and disrepute. Unless corrective actions are taken, Romania faces the specter of further infringement proceedings on ANRE, environmental non-compliance of coal and lignite plants, and non-compliance with EU’s Third package (as Romania missed the March 3, 2011 deadline for its transposition).

17. The EU adopted the Third Energy Package 2 in July 2009, to make the EU energy market fully effective and to create a single EU gas and electricity market, with the aim to help keep prices as low as possible and increase standards of service and security of supply. The package provides for (a) effective unbundling of energy production and supply interests from the networks; (b) increased transparency rules including retail markets and strengthening of consumer protection; (c) more effective

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2 The Third Energy Package consists of two Directives (concerning common rules for the internal market in electricity (2009/72/EC) and gas (2009/73/EC) and three Regulations (on conditions for access to the natural gas transmission networks (EC No 715/2009), conditions for access to the network for cross-border exchange of electricity (EC No 714/2009) and the establishment of the Agency for the Cooperation of Energy Regulators ACER (EC No 713/2009). They were adopted by the EU in July 2009. Member States had 18 months, till March 3, 2011, to transpose the two Directives into national law. The Regulations became applicable as of March 3, 2011.
regulatory oversight by independent market watchdogs, the national regulatory authorities; (d) establishment of the Agency for the cooperation of Energy Regulators (ACER) to ensure effective cooperation between national regulatory authorities and to take decisions that harmonize and integrate the operation of national and cross-border infrastructure; and (e) better cross-border collaboration and investment and a new European Network for Transmission System Operators (ENTSO) to bring together EU electricity and gas grid operators to cooperate and develop common commercial and technical codes and security standards. The Review recommends that Romania resume the implementation of energy reforms in accordance with the Third Energy package - implementing the now-superseded 2003 directives and regulations in response to the infringements is no longer sufficient.

18. The Review welcomes the Government’s commitment (expressed in its Letter of Intent to the IMF) to “deep-rooted reform of state-owned enterprises (SOEs), especially in critical growth generating sectors such as energy and transport”. Many SOEs have become a substantial fiscal burden. In addition to requiring subsidies to cover considerable losses, they have accumulated arrears of more than 4 percent of GDP. The quality of service in many sectors is in need of significant improvements and weighs on growth by hindering further private sector development. The Review makes a series of recommendations, summarized below, on the reform on SOEs currently administered by the Ministry of Economy. Other ministries also administer SOEs, including the Ministry of Transport, the Ministry of Agriculture and the Ministry of Communication. Arrears are concentrated in the SOEs administered by the Ministry of Economy (57%) and the Ministry of Transport (42%).

19. The Review recommends that the SOE reform program in the Ministry of Economy starts with Hidroelectrica, Nuclearelectrica and Romgaz. MEC administers 64 SOEs. It is not practical to prepare and implement a reform program that covers all 64 simultaneously. Energy SOEs account for 80% of the value of the Ministry’s SOEs. The Review recommends that the SOE reform is launched with action on three viable major SOEs, Hidroelectrica, Nuclearelectrica and Romgaz:

- Government transfers the financial control of Hidroelectrica, Nuclearelectrica and Romgaz to the Ministry of Public Finance (MPF);
- Government reconstitutes the boards of administration, by significantly reducing the number of government officials and removing political appointees, and replacing them with qualified non-government directors following transparent selections processes and qualification criteria;
- The reconstituted boards of the companies appoint professional executive management, following transparent selections processes and qualification criteria;
- Internal auditors of the companies report to the boards instead of executive management;
- Establish and publish corporate objectives and performance monitoring indicators for Hidroelectrica, Nuclearelectrica and Romgaz;
- Establish and publish disclosure policy for Hidroelectrica, Nuclearelectrica and Romgaz for information flow to the State, Parliament, media and the public; and
- List the shares of Hidroelectrica and Nuclearelectrica with IPOs of about 15-20% of the shares, along with the already planned IPO of Romgaz, in the Bucharest Stock Exchange.

20. The Review recommends that the SOE reform program also cover the Ministry’s other 61 SOEs, with appropriate phasing. In addition to Hidroelectrica, Nuclearelectrica and Romgaz as detailed above, early action on listing, privatization and restructuring is recommended/projected on
other major SOEs. They include Electrica and its three electricity distribution subsidiaries; Termoelectrica, Deva and Elcen; the three energy complexes; and mining companies CNH and SNLO. Listing, privatization or liquidation is recommended/projected as follows:

- Listing and an IPO of 15-20% of the shares is a realistic option for Electrica;
- The sale of the majority shares to strategic investors is recommended for Electrica’s subsidiaries, Elcen (together with Radet), and the three energy complexes. Elcen is effectively bankrupt but survives by defaulting to its fuel suppliers and the Government. If Elcen is offered for sale together with its main client, Bucharest City heat supplier Radet, it may have a sustainable future; otherwise, defaults will continue;
- The three energy complexes are unlikely to survive in public ownership. If they fall, also the future of mining company SNLO will be bleak;
- Deva and most if not all of Termoelectrica will have to be liquidated – the longer the Government delays the inevitable liquidation actions, the higher the cost through debts and defaults; and
- Mining company CNH would require a deeper and faster downsizing than currently planned if continued major state aid is to be avoided.

21. Instead of offering the three energy complexes for sale to strategic investors as envisioned in the Road Map and recommended in this Review, the Ministry is considering a merger of the three energy complexes and SNLO into a lignite complex Oltenia. A similar merger plan of Deva, Paroseni and CNH into a hard coal complex Hunedoara is also being considered. If the Government proceeds with these mergers, the Review recommends that the lignite complex Oltenia: (a) be added to the priority list of companies for SOE reform and measures summarized in para. 19 including a reconstituted board and professional executive management; and (b) be offered for sale to strategic investors in a privatization process parallel to the SOE reform process. Listing would not be expected to be successful as the financial performance of the Oltenia complex, if retained in the public sector, is likely to be marginal at best even if mining and power generation costs are reduced by 20% as envisioned. The hard coal complex is likely to incur major losses unless its scope is quickly limited to Paroseni and 1-2 mines needed to supply it. If the Oltenia complex is not privatized, joint ventures for new power generation projects might still be possible but they would likely to be based on imported fuels - private investors would most likely not be willing to rely on public sector lignite/coal complexes for their fuel supply.

22. In parallel with the professionalization of management at the key energy companies, a broader SOE reform framework should be developed that allows the SOE reform program to be extended over time across to the ministry and ultimately all SOEs in Romania with significant commercial operations:

- **Ownership policy** to define how the Government, primarily OPSPI in the case of MEC, carries out key shareholder functions;
- **Corporate governance code** for SOEs that is based on good practice in the private sector and with supporting documents including model articles of association for companies; and
- **Law on the corporate governance of state owned enterprises** that addresses gaps and outstanding issues in other laws and provides a legal foundation for the ownership policy and corporate governance code.
Other Priority Reforms – to be implemented as soon as possible

23. The Review highlights the following four actions, which would effectively complement the recommended six highest priority reform actions:

- **Reform 7** – the Ministry streamlines the functions of MEC departments, to reduce work overload after the sizeable layoffs (and to enhance SOE accountability and performance management) and focus on energy security, strategy and continued access to energy services;

- **Reform 8** - as part of Government’s review of the use of EU funds, the Government allocates additional funds for renewable energy, energy efficiency and energy infrastructure;

- **Reform 9** – the Government improves inter-ministerial coordination of energy functions; and

- **Reform 10** - the Government prepares a national climate change strategy.

24. The Review recommends the restructuring of the Ministry’s relationship with the subordinated companies – State Owned Enterprises (SOEs) administered by the Ministry. In spite of the major reduction in personnel (32% of positions, of which about half actual layoffs), the functions of the Ministry remain the same as before and lead to overload for the remaining staff. The implementation of the SOE reform program would reduce the significant involvement of the Ministry staff in the day-to-day management of the SOEs and would reduce the work overload of Ministry staff while at the same time enhancing SOE accountability and performance management. This would allow the Ministry to focus its energy activities on energy security; energy, energy efficiency and climate action strategies; and the continued access to energy services by low-income households (the social dimension of energy). The Review also recommends that the merger of the two Directorates that deal mainly with energy (Energy and Mineral Resources) and/or the transfer of gas to Energy (from Mineral Resources) be considered. Finally, the Review recommends that the Ministry reduces its exclusive reliance on ISPE as its reform advisor and also engages other firms with experience on energy and climate reforms in other countries.

25. The accelerated absorption of EU funds remains a focal objective of the Government. The Review recommends that as part of Government’s review and reallocation of the use of EU funds, additional funds be allocated for renewable energy (other than wind which benefits from a generous support mechanism), energy efficiency and energy infrastructure. One of the most challenging areas for energy efficiency improvement is the district heating (DH) sector. Even after considerable consolidation - from almost 200 DH systems reported at the turn of the century to about 80 systems operating today - many of the remaining systems are under great stress, operationally and financially. The deteriorating quality and increasing cost of service has made district heating a major national issue. DH tariffs have been adjusted, but they have generally not kept up with the increasing costs in inefficient systems. The Government, at central and local levels, provides subsidies, both to heat producers and to heat consumers. Annual subsidy from the central Government amounts to around euro 250 million. Municipal governments provide additional subsides of similar magnitude. Additional subsidies are effectively provided by SOEs when not paid for their fuel and heat supplies to the municipal companies – Bucharest City heating company Radet alone owes central Government-owned bulk heat supplier Elcen about RON 2 billion. This area is the prime candidate for receiving Government attention and EU funding, preferably for public private partnerships with qualified private companies. Consumer metering, heat controls and thermal rehabilitation of buildings would significantly reduce consumption.
and heat bills and a comprehensive program would also create jobs for workers laid out from the construction sector due to the financial crises.

26. **The Review recommends that the Government improves inter-ministerial coordination of energy functions across the Government.** The energy sector consists of many energy-related government functions which are spread across a wide range of ministries and agencies. The main government energy-related functions are:

1. **strategy/policy function** (MEC) with goals such as energy security, promotion of competition among producers and suppliers and consumer choice, energy affordability (in cooperation with Ministry of Labor), energy efficiency and municipal energy (in cooperation with Ministry of Environment, Ministry of Regional Development and Ministry of Administration);
2. **legislation initiation in energy** (MEC and energy regulator ANRE);
3. **representation to EC** (MEC in cooperation with the Department for European Affairs);
4. **ownership function of energy SOEs** (MEC and MPF); and
5. **energy regulation**, by a regulator (ANRE) that is meant to be independent of the Government.

27. Beyond governmental agencies and ministries, other actors with roles in the energy sector include: the Parliament commissions in the Chamber of Deputies and the Senate in charge of processing legislation on energy-related matters; SOEs under the local administrations, such as companies which produce electricity and heat; private companies in energy (electricity and gas distribution, oil and gas production); and other stakeholders, such as minority shareholders in MEC’s SOEs.

28. **The implementation of the Review’s recommendations would widen the ownership of state-owned energy companies.** The most important minority shareholder in energy SOEs is the Property Fund, a vehicle for the compensation of owners expropriated during communism. As the Fund’s portfolio is heavily dominated by its minority shareholdings in Petrom and MEC’s energy SOEs including Romgaz, Hidroelectrica, Nuclearelectrica and the energy complexes, the Fund is essentially an energy investment fund. The market capitalization of the Bucharest Stock Exchange is low and participation of the Romanian population is limited. The proposed program of privatizations and IPOs, in addition to subjecting the companies to market discipline, would widen the ownership of state-owned energy companies and provide a significant boost to capital market development in Romania.

29. **The Review recommends that the Government prepares a national climate change strategy.** Romania does not have a climate change strategy. Romania does not have an energy efficiency strategy, which is the key to successful climate action. There is no clear coordination of MEC’s energy strategies and actions with Ministry of Environment’s climate change actions. The Ministry of Environment has a department for Climate Change and Sustainable Development, whose functions are closely linked to the energy sector. The department is involved in matters concerning the allocation of emission permits among polluters, of which many are thermal power plants under MEC, and in ensuring that Romania makes best use of emission allocations and trading on international markets. However, the lack of cooperation of MEC and the Ministry of Environment contributed to Romania not being able to exploit the possibility to trade internationally the AAUs (assigned amount units under the Kyoto Protocol) which in spite of years of discussion since about 2004 has not be accomplished. (It had been estimated that a sale of AAUs could bring Romania about euro 2 billion.)
30. Ministries of Economy and Environment would need institutional capacity building in climate action. The department responsible with the environment in MEC has been dissolved. MEC has limited capacity to deal with complex issues on energy efficiency, planning for AAUs and emission allocations, and Romania’s position in EU-level and international climate action negotiations. The counterpart department in the Ministry of Environment has suffered similar loss of key competencies, because of personnel turnover and staff layoffs – only seven staff remain.

Part II – Business Environment Recommendations

31. In terms of the business environment, Romania is falling behind international comparators, even when compared with other countries in South East Europe or Central Asia. According to the Global Competitiveness Index, the country obtained the 67th position in 2010-2011, compared to the rank 64 in 2009-2010. In some of the pillars considered drivers for competitiveness and productivity, such as institutions, infrastructure, financial market development, business sophistication and innovation, the position of Romania falls to position 93. The 2011 Doing Business (DB) Indicators ranked Romania in place 56, falling two positions compared to the previous year (54 in 2010). Compared to neighboring countries, Romania has made progress in some of the DB indicators, such as starting a business or getting a credit, but it maintains the complexity of a regulatory environment that needs to be improved for doing business in areas such as registering property or paying taxes.

32. There are many ongoing initiatives in Romania that are related to the improvement of the business environment, but none of them is comprehensive or intends to align the whole administration in coordinated efforts. The Program of Government 2009-2012, main document of government action in Romania, acknowledges that “creating a business environment that fosters the competitiveness of firms and develops entrepreneurial skills” is essential to compete both in the EU single market and outside the EU. The National Reform Program 2007-2010, a key document setting out a comprehensive three-year strategy to implement policies in EU countries, includes a set of measures dealing with better regulation. In addition, the National Agenda for Better Regulation with the current Action Plan for the Strategy for Better Regulation of the Central Public Administration 2008-2013 contains measures tending to improve regulatory quality and the business environment.

33. The lack of a single strategy is a reflection of the various institutions responsible for the business environment in Romania. In addition to the Department for the Business Environment, there is a multiplicity of bodies dealing with business environment issues, such as the Public Policy Directorate, the Unit for Post-Accession at the Department of EU Affairs, several ministries and the Legislative Council. There is no formal mechanism for coordination and communication among these institutions and they intervene on an ad-hoc manner.

34. The Department for the Business Environment is a small unit in the Ministry, staffed with only nine officials, lacking its own budget and entrusted with a series of overambitious and uncoordinated responsibilities. Its role as driver for reform is challenged by the limited political leverage and capacities to implement broad reforms. The work of the Unit lacks of prioritization as some key functions to improve the business environment are missing and some others seem less relevant for promoting a better business environment in Romania.
35. A new strategy for the business environment, under responsibility of the Department for the Business Environment of the Ministry of Economy, Commerce and the Business Environment, is under discussion at Government level. The strategy seeks a medium and long term vision to deal with the business environment. It contains a package of 62 government actions, articulated around 18 measures for its future work.

36. The use of regulatory and policy tools to improve the quality of the regulation and the business environment in Romania is limited, ad-hoc and does not apply to the whole administration. The Government has introduced some of these tools, such as Regulatory Impact Analysis (RIA), consultation techniques or some projects to reduce administrative burdens, but the lack of a systematic approach and the political support needed to implement them has reduced its potential to improving the business environment. Results are therefore limited. Regulations continue to be produced without clear quality criteria and the stock has not undergone deep revisions to streamline and simplify it.

37. Three areas are essential for a redefinition of how to improve the business environment in Romania and to strengthen the regulatory management functions of the Romanian government. (1) New governance structures are needed within the Government, in particular high level political commitment and a permanent dialogue and coordination between government and the private sector. This will include clear prioritization and the definition of a single strategy for regulatory reform. (2) It is essential to revise the functions and responsibilities of the Department for the Business Environment, proposed to be located at the Center of Government. That new unit can take advantage of existing expertise there and in other bodies, which would make it a stronger body for coordination, oversight and enforcement. (3) The Government has to make better use of regulatory and policy tools to improve the business environment. The use of impact assessments, consultation techniques and administrative simplification should be deepened and strengthened.

38. This review recommends the following concrete actions to improve the business environment and consolidate a sound basis for regulatory management and reform in Romania:

(a) In terms of the improvement of governance structures for regulatory reform and the business environment:

- Provide strong political support at the highest level of government to the business environment issues and better regulation policy, acknowledging the cross-cutting character of this issue and the need to introduce measures all across the Romanian administration.

- Establishment of a formal and permanent advisory body composed by key government institutions and the private sector, chaired by the Prime Minister, to define priorities and content for regulatory reform and to improve the business environment

- Establish a single strategy for regulatory policy for the whole of the Romanian administration with clear objectives, targets and implementation of actions, with a focus to improve the business environment.
(b) In terms of the redesign of the institutional set up for regulatory reform and a Unit in charge of regulatory reform and the business environment:

- Streamline the institutional architecture to ensure coordination, oversight and enforcement for better regulation and improvement of the business environment.

- Establish a single unit with the responsibility to lead regulatory reform and the improvement of the business environment at the Center of Government, supported at the highest political level and by the permanent advisory body.

- Review and redesign responsibilities for the unit responsible for regulatory reform and the business environment.

- Allocate resources to the unit responsible for regulatory reform and business environment issues.

(c) In relation to key areas to strengthen administrative capacities and to make use of regulatory tools for better management and improvement of the business environment:

- Strengthen the use for modern regulatory tools and establish clear objectives and targets for their use.

- Concentrate the agenda for regulatory reform and improvement of the business environment in five key areas:
  
  - Strengthen and build capacities for regulatory reform (resources and human).
  
  - Increase the use of ICT in the area of regulatory reform and improvement of the business environment.
  
  - Design a comprehensive strategy for administrative simplification and burden reduction.
  
  - Deepen consultation techniques to ensure stakeholder’s views are taken into consideration and consultation serves the purpose of getting better quality information for policy and decision-making.
  
  - Revise the design for Regulatory Impact Analysis (RIA) implementation and start small in the efforts with impact assessments.
## Ministry of Economy, Commerce and Business Environment (MEC)

### Action Plan of the MEC Functional Review

<table>
<thead>
<tr>
<th>Objective/Issue</th>
<th>Sequenced Actions</th>
<th>Impact / Priority</th>
<th>Implementation Period</th>
<th>Responsibility</th>
<th>Progress/Output</th>
<th>Target/Outcome</th>
<th>Estimated Resource requirements</th>
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<tbody>
<tr>
<td><strong>Part I - MEC/Energy Sector: (1) Actions to complete the ongoing Restructuring Process</strong></td>
<td></td>
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<tr>
<td><strong>Expertise structure</strong></td>
<td>Set up teams of consultants to help develop coherent energy strategy and comprehensive legislative framework</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>MEC</td>
<td>Consultancy and advisory groups established.</td>
<td>Attract investment and increase competition in the energy market.</td>
<td>€€</td>
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<tr>
<td></td>
<td>Strengthen energy efficiency function to improve coordination of energy efficiency action plan with staff from ex-agency ARCE</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>MEC / Government</td>
<td>Transfer accomplished.</td>
<td>Compliance with EU energy efficiency directive.</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Establish an energy – related climate change unit within energy department</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>MEC</td>
<td>MEC’s climate change unit established.</td>
<td>Compliance with EU’s Third energy package.</td>
<td>€€</td>
</tr>
<tr>
<td><strong>Facilitate coordination</strong></td>
<td>MEC staff participating on inter – ministry / agency groups on energy</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>Government (with proposals</td>
<td>Amendments to legal acts.</td>
<td>Full compliance with EU energy regulation.</td>
<td>0</td>
</tr>
</tbody>
</table>

3 Technical Assistance Requirements: 0 = none; € = low (less than € 100k); €€ = moderate (between € 100k and 500K); €€€ = high (above € 500k)
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<tr>
<td>and eliminate overlaps</td>
<td>security, municipal energy and energy efficiency, climate change and social energy assistance</td>
<td></td>
<td></td>
<td>from MEC, MPF, ML, MAI, ME, MRD)</td>
<td>Inter – ministry / agency groups established.</td>
<td>Protection of vulnerable energy consumers.</td>
<td></td>
</tr>
<tr>
<td>Merger of Minerals and Energy departments or transfer of gas to the Energy department.</td>
<td>High &lt; 6 months MEC</td>
<td></td>
<td></td>
<td>Merger or transfer completed.</td>
<td>Improved gas – electricity coordination help comply with EU energy policy and cooperation with EC.</td>
<td></td>
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</tr>
<tr>
<td>Merger of the Financial – Accounting General Directorate and the Budget and Planning General Directorate.</td>
<td>High &lt; 6 months MEC</td>
<td></td>
<td></td>
<td>The new directorate is established.</td>
<td>Improved cooperation between the budget and planning with financial – accounting areas.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Improve utilization of EU funds and Raise financing for priority investments in the energy sector</td>
<td>As part of the review and reallocation of the use of EU funds, allocate additional funds for renewable energy, energy efficiency and energy infrastructure.</td>
<td>High &lt;6 months Prime Minister’s Office/ MPF/MEC</td>
<td></td>
<td>Reallocation of funds.</td>
<td>Improved absorption of EU funds. Financing of priority energy investments including EU energy corridors.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Use of EU Structural Funds for district heating and thermal rehabilitation of buildings (housing part as a capital cost component of social energy assistance).</td>
<td>High &lt;18 months MEC / MRD / ML / Government</td>
<td></td>
<td></td>
<td>Reallocation of funds.</td>
<td>Improved absorption of EU funds. Financing of priority energy investments. Protection of vulnerable consumers.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Budget Execution</td>
<td>Financial Accounting General Directorate to finalize and approve all internal control procedures.</td>
<td>High &lt; 6 months MEC</td>
<td></td>
<td>Finalization of internal control procedures and approval by Minister.</td>
<td>Improved control effectiveness. Facilitate learning for new staff. Increased transparency.</td>
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</tr>
<tr>
<td>Increase internal audit capacity (staff and equipment).</td>
<td>Enabling &lt; 6 months MEC</td>
<td></td>
<td></td>
<td>Reorganize internal audit as a directorate. Hire additional staff and</td>
<td>Improved MEC internal audit capacity. Increased MEC management awareness on</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Objective/Issue</td>
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<tr>
<td></td>
<td>Implement a fully Integrated Financial Management Information System.</td>
<td>High</td>
<td>&lt;18 months</td>
<td>MEC</td>
<td>Develop a project fiche for EU funding. Obtain funding and implement the system.</td>
<td>Improved effectiveness of planning, budgeting, reporting and strategic decision making.</td>
<td>€€€</td>
</tr>
</tbody>
</table>

**Part I - MEC/Energy Sector: (2) MEC SOE Reform**  
(similar recommendations made earlier for the Ministry of Transport SOEs; same approach could be applied to SOEs of other ministries)

<table>
<thead>
<tr>
<th>Boards of Administration</th>
<th>Reconstitute the boards of administration of SOEs. Create smaller, independent and professional boards and require a majority of board members to be independent of the Ministries.</th>
<th>Critical</th>
<th>&lt; 6 months</th>
<th>MPF and SOEs. MEC and Transelectrica and Transgaz</th>
<th>New boards appointed. Board members selection based on relevant professional skills and experience and through an open selection process. Board members’ remuneration at rates necessary to attract suitable candidates.</th>
<th>Companies with vision, goals and values. Companies with adequate strategy and high-level structure. Companies with management of the necessary caliber. Monitoring management performance.</th>
<th>€€€</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief Executive Officers and Chief Finance Officers</td>
<td>Separate the roles of CEO and Chairperson of the Board.</td>
<td>Enabling</td>
<td>&lt; 6 months</td>
<td>MPF/MEC</td>
<td>CEO and Chairperson roles separated.</td>
<td>Increased accountability of the management toward the board.</td>
<td>€</td>
</tr>
<tr>
<td></td>
<td>Reconstituted boards select CEOs and CFOs by transparent and merit-based processes.</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>Boards of administration</td>
<td>Merit-based open selection process applied. CEOs and CFOs appointed by the Board</td>
<td>Higher professionalism and performance of Management. Limited political patronage.</td>
<td>€</td>
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</table>

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<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>Corporate Governance Policy – for MEC and the Government</strong></td>
<td>Introduce minimum fixed-term contracts for CEOs and CFOs with performance targets.</td>
<td>Enabling</td>
<td>&lt; 6 months</td>
<td>MPF/MEC</td>
<td>New contracts established and implemented.</td>
<td>Stability in company management.</td>
<td>€</td>
</tr>
<tr>
<td>Draft and enact SOE law</td>
<td>Enabling</td>
<td>&lt; 6 months</td>
<td>Ministry of Justice/MPF</td>
<td>Law to lay groundwork for better SOE governance, including steps below.</td>
<td>Legal framework that restricts shareholder interventions, promotes board responsibility, and ensures hard budget constraints and SOE transparency</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Pilot Ownership Policy</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>MEC/MPF</td>
<td>Policy drafted that clarifies role of ministry/owner in key decisions,</td>
<td>Reduction of MEC intervention in SOEs, clear guidance on actions requiring shareholder input</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Pilot Corporate Governance Code</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>MEC/MPF/Ministry of Justice</td>
<td>Private sector based guidance for SOE boards</td>
<td>Boards exercise key responsibilities, leave management to manager</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Pilot Performance Management and Public Service Obligations</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>MEC/MPF</td>
<td>Performance management extended to board and company, regime for disclosing, managing public service obligations</td>
<td>More accurate measure of SOE commercial and non-commercial performance to facilitate accountability and transparency</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Mainstreaming corporate governance policy</td>
<td>Critical</td>
<td>&lt; 18 months (MEC) and &gt;18 months All ministries</td>
<td>MEC/MPF/Ministry of Justice/ Cabinet</td>
<td>Go from pilot policy, code and systems to all SOEs</td>
<td>Better corporate governance and performance of all SOEs with significant commercial operations.</td>
<td>€€€</td>
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<tr>
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<tbody>
<tr>
<td><strong>Corporate / Business Plans</strong></td>
<td>Require the Companies to present annually to the State the company’s medium-term Corporate/ Business Plan, prepared by Management and adopted by the Board.</td>
<td>High</td>
<td>&lt; 6 months</td>
<td>SOEs</td>
<td>Company’s medium-term Corporate or Business Plan presented to the shareholding ministries</td>
<td>Clarity in business planning, and accountability for results.</td>
<td>€€</td>
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</table>

**Part I - MEC/Energy Sector: (3) Energy Strategy, Regulation & Privatization**

<table>
<thead>
<tr>
<th>Energy Legislation</th>
<th>Sequenced Actions</th>
<th>Impact / Priority</th>
<th>Implementation Period</th>
<th>Responsibility</th>
<th>Progress/Output</th>
<th>Target/Outcome</th>
<th>Estimated Resource requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Implement Third Package for ANRE.</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>MEC/ANRE/ Government/ Parliament</td>
<td>Energy regulator ANRE’s capacity, credibility and accountability restored</td>
<td>Energy security, competition and investment. Romania has missed EU’s March 3, 2011 deadline</td>
<td>€€</td>
<td></td>
</tr>
<tr>
<td>Objective/Issue</td>
<td>Sequenced Actions</td>
<td>Impact / Priority</td>
<td>Implementation Period</td>
<td>Responsibility</td>
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<tr>
<td>Energy Strategy</td>
<td>Review petroleum legislation for streamlining concession ratification process and data access.</td>
<td>High</td>
<td>&lt;6 months</td>
<td>MEC, National Agency for Mineral Resources (NAMR)</td>
<td>Legislation and procedures amended</td>
<td>Enhanced exploration and production, energy security, royalties to the budget</td>
<td>€</td>
</tr>
<tr>
<td>and Climate Action</td>
<td>Cancel the proposal to merge mining and power generation companies into two national energy champions.</td>
<td>Critical</td>
<td>&lt; 6 months [immediate]</td>
<td>MEC / Government</td>
<td>Remove uncertainty created by the national champion debate since September 2007.</td>
<td>Start the process of restoring business environment/investor confidence in the energy sector.</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Prepare a strategy for complementary actions in energy efficiency and renewable energy.</td>
<td>High</td>
<td>&lt;18 months</td>
<td>MEC</td>
<td>Strategy published.</td>
<td>Energy security and climate change mitigation.</td>
<td>€€€</td>
</tr>
<tr>
<td></td>
<td>Prepare energy sector inputs for Romania’s national climate change mitigation and adaptation strategy.</td>
<td>High</td>
<td>&lt;18 months</td>
<td>MEC input to Ministry of Environment</td>
<td>National Climate Change Strategy published.</td>
<td>Climate change mitigation and adaptation.</td>
<td>€€€</td>
</tr>
<tr>
<td>Electricity and Gas Market Liberalization and</td>
<td>Prepare a roadmap for phasing out regulated prices in electricity and gas.</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>MEC / ANRE/ Government</td>
<td>Roadmap published.</td>
<td>First step in addressing ongoing infringement by the European Commission</td>
<td>€</td>
</tr>
<tr>
<td>and</td>
<td>Liberalize electricity and gas prices to non-residential consumers.</td>
<td>High</td>
<td>&lt;18 months</td>
<td>ANRE</td>
<td>Regulated tariff supply discontinued.</td>
<td>Attract investment and increase competition in the energy</td>
<td>0</td>
</tr>
<tr>
<td>Objective/Issue</td>
<td>Sequenced Actions</td>
<td>Impact/Priority</td>
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<tr>
<td>Protection of Vulnerable Consumers</td>
<td>Liberalize electricity and gas prices to residential consumers.</td>
<td>Enabling</td>
<td>&gt;18 months</td>
<td>ANRE</td>
<td>Regulated tariff supply discontinued.</td>
<td>Full compliance with EU energy directives.</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Define vulnerable consumers according to EU legislation.</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>MEC/MPF/Labor</td>
<td>Plan for consumer protection published.</td>
<td>First step in addressing ongoing infringement by the European Commission</td>
<td>€</td>
</tr>
<tr>
<td></td>
<td>Implement mechanisms to protect vulnerable consumers – social safety net to low-income households and auction mechanism for competitive market-priced energy to non-poor households and small commercial consumers.</td>
<td>Critical</td>
<td>&lt;18 months</td>
<td>Ministry of Labor (safety net) and ANRE (auction mechanism).</td>
<td>Mechanisms published.</td>
<td>Vulnerable consumers’ access to basic energy services protected.</td>
<td>€</td>
</tr>
<tr>
<td>Facilitate cross-border trade in electricity and gas</td>
<td>Improve coordinated transmission capacity auctions at the borders with Hungary and Bulgaria.</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>Transelectrica</td>
<td>Allocation mechanism announced and put into operation.</td>
<td>Transparent capacity allocation &amp; improved cross-border trade. Compliance with EU electricity directive.</td>
<td>€</td>
</tr>
<tr>
<td></td>
<td>Establish an intraday market in electricity.</td>
<td>High</td>
<td>&lt;6 months</td>
<td>OPCOM/ANRE</td>
<td>Intra-day market launched.</td>
<td>Improved electricity trading.</td>
<td>€€</td>
</tr>
<tr>
<td></td>
<td>Remove legal and regulatory barriers to the export of gas.</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>MEC, NAMR</td>
<td>Removal of barriers announced.</td>
<td>Compliance with the EU Treaty and the EU gas directive.</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Integrate transit gas lines into the transmission by providing homogeneous rules on all gas pipelines in terms of transparency, capacity allocation and tariffs.</td>
<td>Critical</td>
<td>&lt;18 month</td>
<td>MEC/Government</td>
<td>Renegotiation of old intergovernmental agreements</td>
<td>Compliance with the EU gas directive and regulation.</td>
<td>0</td>
</tr>
<tr>
<td>Objective/Issue</td>
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</tr>
<tr>
<td>Enable bi-directional flow of gas at the border with Hungary.</td>
<td></td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>Transgaz</td>
<td>Facilities installed.</td>
<td>Compliance with EU gas directive.</td>
<td>€€€</td>
</tr>
<tr>
<td>Energy regulator ANRE’s capacity, credibility and accountability</td>
<td>Restore ANRE’s funding autonomy through license fees.</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>MEC/Government</td>
<td>Publish ANRE’s funding arrangement.</td>
<td>First step in addressing ongoing infringement by the European Commission</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Remove ANRE from the unitary wage law.</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>MEC/Government</td>
<td>Publish ANRE’s staffing arrangement.</td>
<td>First step in addressing ongoing infringement by the European Commission</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Introduce measures for accountability.</td>
<td>High</td>
<td>&lt;6 months</td>
<td>ANRE/MEC/Government</td>
<td>Publish ANRE’s accountability measures.</td>
<td>Access to information to the public; step in restoring credibility.</td>
<td>€</td>
</tr>
<tr>
<td></td>
<td>Recruit experienced senior staff.</td>
<td>High</td>
<td>&lt;6 months</td>
<td>ANRE</td>
<td>Publish ANRE’s staffing arrangement.</td>
<td>Restore operational capability after 2010 large-scale staff departures.</td>
<td>€€€</td>
</tr>
<tr>
<td>Corporate Governance Measures in selective SOEs (in addition to overall SOE reforms)</td>
<td>Electricity generators to award bilateral contracts through the OPCOM Power Exchange.</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>MPF/MEC/generators</td>
<td>Publish contract awards.</td>
<td>Improve commercial functioning of public sector generators, restore credibility and attract investors.</td>
<td>€</td>
</tr>
<tr>
<td></td>
<td>OPCOM to continue to develop standardized products for more competitive and transparent trading of bilateral contracts.</td>
<td>Enabling</td>
<td>&lt;18 months</td>
<td>OPCOM/ANRE</td>
<td>OPCOM announcements</td>
<td>Improve commercial functioning of public sector generators and attract investors.</td>
<td>€</td>
</tr>
<tr>
<td></td>
<td>Romgaz to award bilateral contracts through transparent competitive processes.</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>MPF/MEC/Romgaz</td>
<td>Publish contract awards.</td>
<td>Improve commercial functioning of public sector gas producer, restore credibility and attract investors.</td>
<td>€</td>
</tr>
<tr>
<td>Objective/Issue</td>
<td>Sequenced Actions</td>
<td>Impact / Priority</td>
<td>Implementation Period</td>
<td>Responsibility</td>
<td>Progress/Output</td>
<td>Target/Outcome</td>
<td>Estimated Resource requirements</td>
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<tr>
<td>Hidroelectrica and Romgaz to raise below-market prices to market levels or terminate the contracts.</td>
<td>Critical as soon as legally possible for each contract</td>
<td>Critical</td>
<td>As soon as legally possible for each contract</td>
<td>MPF/ Hidroelectrica/ Romgaz</td>
<td>Publish results of renegotiations/ terminations.</td>
<td>Improve commercial functioning of public sector energy companies, restore credibility and attract investors.</td>
<td>€€€</td>
</tr>
<tr>
<td>Unbundling of transmission networks in electricity and gas in accordance with EU’s 3rd package of energy reforms.</td>
<td>Critical</td>
<td>Critical</td>
<td>&lt;18 months</td>
<td>MEC/MPF/ Transselectrica/ Transgaz</td>
<td>Certification by the European Commission.</td>
<td>Network access and operation in a transparent and non-discriminatory manner. Compliance with EU energy directives.</td>
<td>€</td>
</tr>
<tr>
<td>Payment of CFR’s current electricity bills and agreement on CFR’s arrears put into implementation.</td>
<td>Critical</td>
<td>Critical</td>
<td>&lt;6 months</td>
<td>Government/ CFR/electricity discoms</td>
<td>Announce payments and agreement.</td>
<td>Improve commercial functioning of railways and electric power sector.</td>
<td>€</td>
</tr>
<tr>
<td>Privatization and Private Sector Participation (only the most critical companies included here)</td>
<td>Initial public offering (25%) of Hidroelectrica, Romgaz and Electrica.</td>
<td>High</td>
<td>&lt;18 months</td>
<td>MPF/ Hidroelectrica/ Romgaz/ Electrica</td>
<td>Advisors selected, prospectus, actual listings.</td>
<td>Improve commercial functioning of public sector energy companies, restore credibility and attract investors</td>
<td>€€€</td>
</tr>
<tr>
<td>Sell majority ownership in Craiova, Rovinari and Turceni energy complexes – or in the Oltenia lignite complex.</td>
<td>Critical</td>
<td>Critical</td>
<td>&lt;18 months</td>
<td>MPF/energy complexes</td>
<td>Advisors, RFQ, RFP, financial closure of transactions.</td>
<td>Energy security, environmental improvements in accordance with Romania’s EU obligations.</td>
<td>€€€</td>
</tr>
<tr>
<td>Sell majority ownership in the three Electrica electricity distribution companies.</td>
<td>Critical</td>
<td>Critical</td>
<td>&lt;18 months</td>
<td>MPF/ Hidroelectrica/ Romgaz/ Electrica</td>
<td>Advisors, RFQ, RFP, financial closure of transactions.</td>
<td>Improve commercial functioning of public sector energy companies, restore credibility and attract investors</td>
<td>€€€</td>
</tr>
<tr>
<td>Sell majority ownership of Elcen and Radet.</td>
<td>High</td>
<td>High</td>
<td>&gt;18 months</td>
<td>MEC/City of Bucharest/ Termoelectrica</td>
<td>Advisors, RFQ, RFP, financial closure of transaction.</td>
<td>Secure efficient heating supply for Bucharest and eliminate arrears to the Government.</td>
<td>€€€</td>
</tr>
<tr>
<td>Objective/Issue</td>
<td>Sequenced Actions</td>
<td>Impact / Priority</td>
<td>Implementation Period</td>
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<td>Estimated Resource requirements</td>
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<tr>
<td><strong>Part II - Business Environment Reform</strong></td>
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<tr>
<td>Governance design for business environment</td>
<td>Provide strong political support at the highest level of government to the business environment issues and better regulation policy.</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>Government/Prime Ministry</td>
<td>Public commitment for improving the business environment and better regulation policy</td>
<td>Continued support to improvement of business environment and better regulation policy</td>
<td>0</td>
</tr>
<tr>
<td>Acknowledgement of business environment as a cross-cutting issue.</td>
<td></td>
<td>High</td>
<td>&lt; 6 months</td>
<td>Government/Prime Ministry</td>
<td>Integration of business environment issues and regulatory policy in cross-cutting strategies of government action Reorganization of internal structure of the approach to the improvement of business environment</td>
<td>Increased awareness of business environment as a cross-cutting issue in the administration</td>
<td>0</td>
</tr>
<tr>
<td>Establishment of a formal and permanent advisory body composed by key government institutions and the private sector, chaired by the Prime Minister, to define priorities and content for regulatory reform and to improve the business environment</td>
<td></td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>Centre of Government</td>
<td>Identification of five key priorities to shape the strategy for regulatory reform and improvement of the business environment Set up of a formal and permanent advisory body between key government institutions and the private sector, chaired by the Prime</td>
<td>Definition of priorities and key issues after regular meetings in the framework of the dialogue mechanism Businesses participation actively in the identification of priorities and content for strategic actions Businesses monitor monthly the improvements made and report directly to the Prime</td>
<td>€€</td>
</tr>
<tr>
<td>Objective/Issue</td>
<td>Sequenced Actions</td>
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<td>Implementation Period</td>
<td>Responsibility</td>
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<tr>
<td>Establish a single strategy for regulatory policy for the whole of the Romanian administration with clear objectives, targets and implementation of actions, with a focus to improve the business environment.</td>
<td>Critical</td>
<td>&lt; 18 months</td>
<td>Centre of Government</td>
<td>Publish a strategy for regulatory reform with objectives, targets and implementation of actions approved by government</td>
<td>Increased implementation of the strategy to reach objectives and targets</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Streamline the institutional architecture to ensure coordination, oversight and enforcement for better regulation and improvement of the business environment.</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>Government/Prime Ministry</td>
<td>New institutional architecture with identification of actors developed</td>
<td>Improved coordination, oversight and enforcement in terms of implementation of measures to improve the business environment</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Establish a single unit with the responsibility to lead regulatory reform and the improvement of the business environment at the Center of Government and supported at the highest political level.</td>
<td>Critical</td>
<td>&lt; 6 months</td>
<td>Government/Prime Ministry</td>
<td>Legal changes to entrust coordination, oversight and enforcement for better regulation to selected institution</td>
<td>Unit leads regulatory reform efforts avoiding duplication, overlapping and inconsistencies</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Review and redesign responsibilities for the unit responsible for regulatory reform and the business environment.</td>
<td>High</td>
<td>&lt; 18 months</td>
<td>Centre of Government/Department for the Business Environment</td>
<td>Review of current responsibilities: elimination of most administrative tasks and prioritization on content Responsibilities defined and clearly established in key public document</td>
<td>Responsibilities are clear for all institutions in government</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Revise the current strategy for the business environment under</td>
<td>High</td>
<td>&lt; 6 months</td>
<td>New unit for regulatory</td>
<td>New strategy is revised and focused in five key</td>
<td>Strategy is aligned with</td>
<td>€</td>
<td></td>
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<tr>
<td>Objective/Issue</td>
<td>Sequenced Actions</td>
<td>Impact / Priority</td>
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<tr>
<td>discussion to concentrate in five key areas: capacity building, the diffusion of the use of ICT to improve the regulatory management and business environment, the improvement of consultation techniques, the introduction of a targeted administrative simplification strategy and the review and improvement of the Regulatory Impact Analysis (RIA) system.</td>
<td>reform</td>
<td>&lt; 6 months</td>
<td>Government</td>
<td>Resources are made available for the unit</td>
<td>Increased financial capacities to undertake actions to comply with strategy</td>
<td>€€€</td>
<td></td>
</tr>
<tr>
<td>Allocate resources to the unit responsible for regulatory reform and business environment issues.</td>
<td>High</td>
<td>&lt; 6 months</td>
<td>Government</td>
<td>Increased financial capacities to undertake actions to comply with strategy</td>
<td>€€€</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administrative capacities and regulatory tools for better regulation and promotion of the business environment</td>
<td>Strengthen and build capacities for regulatory reform (resources and human).</td>
<td>High</td>
<td>&lt; 6 months</td>
<td>New unit for regulatory reform</td>
<td>Resources and people are allocated to the unit for regulatory policy and the business environment</td>
<td>Increased capacities to deal with regulatory policy issues and the use of regulatory tools</td>
<td>€€€</td>
</tr>
<tr>
<td>Clearly identify and strengthen the use of regulatory tools.</td>
<td>High</td>
<td>&lt; 6 months</td>
<td>New unit for regulatory reform</td>
<td>Identification of regulatory tools that can help implement the strategy</td>
<td>Increased use of regulatory tools to improve the business environment</td>
<td>€</td>
<td></td>
</tr>
<tr>
<td>Set objectives and targets for each regulatory policy tool to be used.</td>
<td>High</td>
<td>&lt; 6 months</td>
<td>New unit for regulatory reform</td>
<td>Objectives and targets identified and set for the use of each regulatory tool</td>
<td>€</td>
<td></td>
<td></td>
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<tr>
<td>Objective/Issue</td>
<td>Sequenced Actions</td>
<td>Impact / Priority</td>
<td>Implementation Period</td>
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</tbody>
</table>
|                | Increase the use of ICT in the area of regulatory reform and improvement of the business environment | High              | < 18 months           | New unit for regulatory reform / Cross-cutting issue | All laws and regulations inventoried  
Process mapping done for key regulatory instruments affecting the business environment  
Identification of processes to be streamlined, simplified or eliminated | Operational database for all laws and regulations  
One-stop-shop for businesses fully operational  
Simplification, streamlining and elimination of various regulatory instruments affecting the operation of businesses | €€€                                           |
|                | Design a comprehensive strategy for administrative simplification and burden reduction. | High              | < 18 months           | New unit for regulatory reform / Cross-cutting issue | Strategy for administrative simplification and burden reduction introduced  
Target for business reduction set  
Baseline for burden reduction completed | % of procedures that have been simplified  
% of costs savings for businesses  
% of time saved for businesses to comply with regulation | €€€                                           |
<p>|                | Deepen consultation techniques to ensure stakeholder’s views are taken into consideration and consultation serves the purpose of getting better quality information for policy and decision-making. | High              | &lt; 18 months           | New unit for regulatory reform / Cross-cutting issue | Consultation techniques tested in the policy and decision-making process | Number of consultations undertaken and reported under clear criteria for stakeholder’s participation | €€€                                           |
|                | Revise the design for RIA implementation and start small in | High              | &gt; 18 months           | New unit for | Design of RIA system | Number of proposals | €€€                                           |</p>
<table>
<thead>
<tr>
<th>Objective/Issue</th>
<th>Sequenced Actions</th>
<th>Impact / Priority</th>
<th>Implementation Period</th>
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<th>Estimated Resource requirements</th>
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<tbody>
<tr>
<td>the efforts with impact assessments.</td>
<td></td>
<td></td>
<td>regulatory reform / Cross-cutting issue</td>
<td>revised Legal changes introduced to new RIA system New criteria for impact assessment set</td>
<td>accompanied with RIAs.</td>
<td></td>
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</tr>
</tbody>
</table>


MEC Comments and World Bank Response

This attachment presents the Ministry of Economy, Commerce and Business Environment (MEC) official May 27, 2011 final comments on the April 7, 2011 draft final report of the MEC functional review. The World Bank’s brief responses are shown in italics. The addition of this attachment was agreed between MEC staff and the functional review team as it became evident in discussions during the team’s visits in April and May 2011 that an agreement on some of the key recommendations of the Review could not be reached.

Part I. Key 10 reforms proposed

WB: The analysis recommends that the following three reform actions be undertaken immediately to begin the process of restoration of the credibility of Romania’s commitment

Reform 1: The Government announces the cancellation of the plan to set up the two national champions… including the listing of Hidroelectrica, Nuclearelectrica and Romgaz.

In performing the study, the World Bank presents recommendations for the energy sector that do not take into account, entirely, the economic realities in Romania, such as:

- A substantial percentage of the electricity consumption estimated at around 50 MWh/year (without own technological consumption) is represented by industries which are mainly export-oriented, aluminium, steel, aluminium and steel finished products, chemical fertilizers, vehicles etc.;
- The Romanian companies compete on international markets with companies from countries where there are no environment restrictions (CO2, SO2, renewables) that generate additional costs for the electricity production;
- The electricity and natural gas represent an essential component of the price of the finished product; the efficiency and performance, the existence or non-existence of these companies (consumers) on the market depends mainly on the price of electricity and natural gas;
- Moreover, from 01.04.2011 the price of electricity at the final consumer increased with around EUR 7/MWh (a fact not mentioned by the experts of the World Bank in the report), because of the green certificates and cogeneration tax;
- By applying the recommended privatization measure for Hidroelectrica, Nuclearelectrica and the energy complexes, as well as the alignment of the hydro- and nuclear electricity prices to the OPCOM – PCCB price given by the marginal prices of the energy complexes (around RON 180/MWh until 01.01.2013 and RON 210/MWh after 01.01.2013), the average price of electricity will increase from RON 175/MWh to RON 211/MWh compared to the estimated growth from RON 160/MWh to RON 173/MWh, if a mix of energy would be obtained by setting up of the energy companies (champions). Thus:
A. Proposal of the World Bank:

B. Energy mix proposal in the case the energy companies (champions) are set up
Taking into account these realities, but also the estimated evolution of the electricity price presented above, in the proposal of the World Bank, there is a potential risk that important consumers ALRO, ARCELOR MITTAL, Oltchim, Feral, ALUMINA, TMK, Dacia, etc in Romania will relocate their activities in other countries or will close their business. In parallel to these, the small horizontal industry that supplies these large companies will reduce its activity and its consumption of electricity and natural gas.

The scenario proposed by the World Bank may lead to the following consequences:

- Closure of coal-based electricity producers, but also SNLO and CNH producers
- Reduction of the economic activity or even closure of business of some companies in the horizontal industry that supplies the coal-based production;
- Increase of the electricity price for household consumers and the remaining industrial area because of the significant percentage of wind energy and of the increase in the green certificates /MWh quota by the reduction of the final consumption.
- Negative impact on the Units 3 and 4 project because of lower power demand;
- Negative impact on the necessity of the project Tarnita 1000 MW;
- Negative impact on the investment performed by OMV Petrom (Brazi) with reduction of production at the level of internal consumption;
- Negative impact on the commercial deficit of Romania by drastically reducing the export;
- Negative impact on the macroeconomic development indicators and on the revenue to the state budget caused by the reduction of the industrial activity;
- Increase of the unemployment rate and of the inactive population with incalculable effects at national level;

In the alternative of setting up energy complexes, although there will be an increase of the electricity price, this increase will be in the economic affordability range for the final consumers, especially when certain economic efficiencies obtained through the corporate effect of the new companies will reduce to a great extent the internal pressure on the price increase.

We would like to mention that the European states, except for Romania, Latvia and Estonia, set up energy companies that mix at least 2 fuels (see chart below); this type of companies represent a Best Practice; to ensure the national energy security and cover the load curve, Romania needs this type of companies. The national energy system has been designed to operate as an integrated system, economic efficiency being ensured by the functioning on merit orders. The current production structure ensures two basic conditions for any energy system, that is, security in operation and continuous supply.

Starting from these requirements and considering that the energy import is limited both for technical reasons (interconnection capacity) and for commercial reasons, the possible short term gain is cancelled by these limitations and risks.

Currently, the separation of producers has clearly highlighted the real production costs. A mixed production structure, which would ensure an optimal use from a technical point of view, based on a clear operation mechanism based on merit orders to avoid cross-subsidies is the optimal solution in MECMA’s opinion.
- This is supported by the fact that, at different time and in different circumstances (see hydrological risk, the price evolution for fuels on the international market), certain generators, even Hidroelectrica and Nuclearelectrica, by being distinct commercial companies, may face financial losses or even problems in ensuring cash flow, thus risking closure because they are unable to pay, withdrawal of potential financing etc.

- The energy complexes are currently undergoing their environment and re-technologization investment program, not facing any financial losses that would raise questions on their viability. The energy complexes and SNLO Tg. Jiu are in an approved program for the reduction of production costs by 22% by 2013 to smoothen the influence of the introduction in the costs after the mentioned date of the expenses with the purchase of CO2 certificates. The investments that were started or are close to starting needed loans of over EUR 1000 million, which currently questions the success of their privatization at the moment.

- The full inclusion of the CO2 in the production costs as of 01.01.2013 (100%) leads to the energy complexes obtaining a minimum price between EUR 50 and 56 / MWh, which will lead to locating the production outside the electricity market and, consequently, the privatization will be difficult to undertake. Analyzing the load curve coverage, as stipulated in the current Energy Strategy, the lignite-based electricity generation will maintain in the following period a share of 30%.

- Mixing the electricity generation within certain commercial companies, by internalizing profits to regenerate the production capacities, has the purpose of ensuring Romania’s energy security, on the one hand, and obtaining a competitive level of the electricity price, on the other hand. Not mixing these types of energy and observing the recommendations of the World Bank will lead to an artificial increase of the electricity price, with drastic consequences for the final consumers, as follows:
- The privatization of Hidroelectrica and SNN will give the investors the possibility to artificially increase prices at the level of marginal prices, so that they obtain very high profits and benefits for them.

- The privatization of the energy complexes will have to bring the anticipated profits to the investors who, apart from the income needed to amortize the environment investments and to pay the existing loans (which are already internalized in the marketing strategy of the energy complexes), will have to also recover the investment for the acquisition of the plants.

- The solution chosen by the Government of Romania to set up two energy companies solves “indirectly” the requirements expressed by the World Bank regarding the privatization of the complexes and the listing of Hidroelectrica and Nuclearelectrica — this is done by stock exchange listing of the newly-created companies without externalizing the HE and SNN profit, maintaining an affordable electricity price for the consumers, ensuring the sources needed to regenerate the production capacities, benefiting the corporate advantages given by the dimension of the two companies.

- By presenting the above, we merely wished to underline that the recommendations forwarded by the World Bank were not based on an analysis that would entirely start from the economic realities of Romania in an international context, from the specific of the Romanian industrial sector, a large energy consumer, as well as from social aspects.

- From HidroE’s data, for example, the figures underlying WB’s conclusions are not relevant. We note the average day-ahead price in 2009 of about 170 RON/MWh considered by WB, while in reality the average day-ahead price, from official reports of OPCOM, was only 145 RON/MWh in 2009.

- The Letter of Intent on the precautionary Stand-By agreement between Romania and the International Monetary Fund stipulates the fact that, in case the strategy to set up two national energy companies is not implemented until the end of 2011, alternative solutions will be sought, including by the privatization of certain majority packages of some companies in the energy sector, specifying at the same time: “in order to bring investments in the sector, we will continue to prepare the sale of some minority or strategic packages in individual companies to be included in national companies (which could be further converted in shares in the mixed companies). In parallel, according to the provisions in the last Stand-by Agreement (LOI and Technical Memorandum of Understanding) actions are taken to set up the Hunedoara and Oltenia Complexes.

**Reorganization solution to continue the coal extraction activity in Valea Jiului (CNH)**

**Maintaining in operation 4 mines that have potential to become viable and state aids for 3 mines.**

This reorganization solution has been carefully analysed, to optimize it and to create implementation possibilities, being agreed by representative trade union organizations and authorized by the Ministry of Economy, Commerce and Business Environment through the protocol signed on February 10th, 2011.

**I. Setting up the HUNEDOARA complex**
The energy complex is set up at the level of Hunedoara county, by merging the energy coal generating units with S.C. Electrocentrale S.A. Deva and S.C. Paroșeni S.A.

The objective of the reorganization solution is:

Integration of the energy coal generating units within a new energy entity that will also include the SE Paroșeni and SC Electrocentrale - SA Deva thermal power plants.

The non-viable units will benefit of a state aid for closure, in phases until 2018, according to the Resolution 2010/787/EU.

According to the reorganization solution, the mining units were placed on a hierarchy, two unit groups being delimited as follows:

- **the first group, of the units with viability possibilities**, is formed of 4 mining units: Lonea, Livezeni, Vulcan, Lupeni, a part of the Coal preparation mine Valea Jiului, Mining Rescue Station Petroșani and the functional apparatus.

- **the second group, of the non-viable units**, is formed of 3 mining units: Petrila, Paroșeni, Uricani and a part of the Coal preparation mine Valea Jiului.

The staff restructuring program will be continued (reducing by 600 people in 2011) and the process to attract investors / privatization will be started.

### II. Setting up the OLTENIA complex

- In order to prepare for the attraction of investments in the sector, the company will be integrated within a structure which will be set up by merging the **Craiova, Turceni and Rovinari Energy Complexes and of the National Lignite Company Oltenia**; Furthermore, at Craiova and Rovinari investment attraction processes are initiated for the purpose of setting up IPP-type mix companies (new group of 500 MW).

- The phases for setting up the Company that will implement the capture and geological storage project for CO2 will be initiated, in close correlation with the transposition in the national legislation of the CCS Directive, the elaboration and harmonization of the legislative frame with the provisions.

- The energy complexes are currently under an investment program with environment improvements and upgrading, not registering any financial losses that would raise questions on their viability. CEN Turceni is the plant that has made the greatest effort to fulfil the environmental obligations. Between 2008 and 2013 we have planned environmental investments of EUR 350 million.

- Furthermore, the energy complexes, but also SNLO Tg. Jiu are within an approved program for the reduction of production costs by 22% by 2013, over 1000 people will be laid off out of the over 7000 that the company has now, in order to smoothen the influence of the introduction in the costs after the mentioned date of the expenses with the acquisition of the CO2 certificates.

- We are aware that a project of such a dimension needs re-examinations and reviews in various implementation stages. The more the global competition intensifies, the more the role of the merger and acquisition activity increases, as strategic instruments to obtain the needed access to resources and opportunities. Regarding the attraction of the investment capital, we think that the stock exchange listing of large structures will be far more attractive that listing its components. Furthermore, the aggregated formula is more attractive for the strategic investors.

- Romania will not abandon coal extraction and the energy production based on this resource. The coal based energy production represented last year around 34% of the total national electricity production,
the largest units being located in the Oltenia basin. Coal is the most abundant energy resource that Romania has, the hard coal reserves being available for around 200 years, and the lignite for another approximately 40 years. In comparison, the oil and gas reserves last for around 15 years, taking into account the certain reserves and Romania’s annual production. Despite these reserves, the mining companies are facing major problems related to costs and the ones supplying the electricity production must support major environment investments, otherwise facing the risk to be closed because of the European regulations.

- The acceleration of the privatization process is taken into account by stock exchange listing of certain minority share packages, IPO, as follows: in Petrom (9.85%, under way), Transelectrica (15%, by the end of 2011, a company already listed at BVB with 10%), Transgaz (15% by the end of 2011) and Romgaz (15%, by spring 2012), so that the control package remains in the hands of the state.
- Hidroelectrica and Nuclearelectrica will be listed afterwards, after an adequate preparation.
- We mention that a significant shareholder is Fondul Proprietatea, which holds 13.5% of Transelectrica’s shares, 15% of Romgaz and 14.98% of Transgaz. We notice that once the FP management was taken over by Franklin Templeton (in the summer of 2010), FP’s position has become more rigid in the relations with MECMA, regarding the restructuring of the energy sector but not only.

*WB Response:* WB views of the integrated energy champions are presented in detail in section H of the main text and in Annex 2 of the Functional Review. WB welcomes MEC’s alternative reform approach to list Hidroelectrica and Nuclearelectrica and establish and privatize Oltenia and Hunedoara lignite and coal complexes, line with the Letter of Intent agreed during the April/May IMF/EC/WB review of the joint program. The privatization of Hunedoara complex would require deeper restructuring than currently envisioned by MEC.

**Reform 2 – The Government requests state-owned power producers and Romgaz that bilateral contracts to be concluded in a transparent, competitive manner on OPCOM (electricity) or similarly competitive, transparent processes (Romgaz), and instructs HE and Romgaz to renegotiate existing bilateral contracts and raise prices to market levels.**

- We agree with the WB’s vision regarding the offer of the entire available quantities of energy on the OPCOM platforms, this approach being in agreement with the actions already initiated by MECMA. With regard to the renegotiation of the existing contracts, it is necessary to perform a legal analysis on the possibilities of renegotiation/termination of the respective contracts.
- With regard to the termination of the “unfavourable” contracts for Hidroelectrica, we agree that they should be improved by negotiation – an action already started by Hidroelectrica, especially having in mind the stock exchange listing of Hidroelectrica. The basis should be the comparison with electricity prices applied in case of European competitors for large electricity consumers and the possible facilities the respective companies get at a European level.
- Furthermore, we think that the estimated related to Hidroelectrica losses are exaggerated, taking into account the annual renegotiations performed by the company’s management in case of certain contracts. The fact that Hidroelectrica lost 4 billion RON is an unsupported statement.
- It is interesting for us that WB through its specialists has used economic information from unofficial sources. The results of the WB report were taken from a SAR report and not from official sources.
ANRE underlines that fact that Romgaz concludes bilateral contracts using a transparent procedure, the prices being the same for all partners. Romgaz offers discounts based on 6 criteria, known by all, the maximum being of 8 USD/1000 bcm. ANRE suggests a careful evaluation of the effects in the market of the actions taken for renegotiating the bilateral contracts, a gradual reduction of the quantities associated with an increase of the prices, an action that will be practically started in 2012, once some of the existing contracts expire.

WB Response: The data used for estimating Hidroelectrica's loss due to below-market priced bilateral contracts is based on: (a) quantities and prices sold in bilateral contracts - Hidroelectrica's Administrator's Report 2009, submitted to the World Bank in hard copy in January 2011; and (b) OPCOM prices. The review compared Hidroelectrica's prices in bilateral contracts with PCCB 1-year contracts concluded towards the end of 2008 for supply in 2009. The comparison with 1-year contracts is based on the assumption that, as per Hidroelectrica's public statements, prices can be negotiated annually on the bilateral contracts. The prices on OPCOM-PCCB were taken from OPCOM's website. PCCB contracts at end-2008 for 2009 supply varied around 190-200 RON/MWh. The review used lower prices and the assessment for 2009 is conservative. We have reflected in the Final Report Hidroelectrica’s information that in 2010 it renegotiated its major bilateral contracts. Price increases reduce the annual loss, contract extensions increase the total loss, compared to selling at market prices.

Reform 3 – the Government and ANRE deal with other major commercial issues in the energy sector: GOR instructs CFR to pay its electricity arrears (or allows suppliers to disconnect CFR); GOR eliminates legal, regulatory and physical barriers (Transgaz) on gas exports; ANRE returns to the application of the wholesale gas pricing formula

- On the payment of CFR arrears, we think that this requires both an involvement of the Government to identify a real solution for CFR’s arrears (amounts paid from the budget, offsetting measures with the state budget etc.), as well as a review of the existing regulations that, under the pretext of railway security, do not allow the disconnection of CFR units and lines, not even in cases where they have nothing to do with the railway traffic security. The respective regulations must be reviewed by ANRE, in order to avoid the perpetuation of the current situation that allows a preferential treatment of certain consumers, without any connection to railway safety.
- With regard to the “barriers” related to gas exports, we do not agree with this approach, because a healthy economic increase can be based on added value and not on export of resources. Romania cannot immediately continue the gas exports from the internal production because it does not currently have the technical capacity to supply gas to neighbouring countries. Transgaz is currently performing interconnection projects that will allow these operations.
- The only item under the responsibility of MECMA regarding natural gas is the natural gas price for the domestic production. ANRE (the institution that has the role to establish the energy and gas prices), has announced that it will contract a study regarding the impact of elimination of the regulated gas and electricity prices. As a result of joint MECMA-ANRE analyses, it was agreed upon elaboration by the regulation authority of an impact study regarding the increase of the natural gas exploitation price from the internal production. The affordability of the internal market does not allow the implementation of such a measure otherwise than gradually, in accordance with the results of the impact study. The liberalization implies that the regulation authority (ANRE) should not establish the gas and electricity prices except for vulnerable consumers, especially for the population. Thus, all
companies will negotiate new prices with the suppliers, under free market conditions. This will lead to the solving of the infringement procedure initiated by the European Commission against Romania.

- In what concerns the expertise and competence field of the specialized Directorate from the ministry regarding the gas price in the internal production, the principle of full cost recovery in the extraction of natural gas is considered to be met.

**WB Response:** Having signed the Accession Treaty and entered the EU, Romania does not have the right to prohibit exports, of resources or finished goods, in the EU. The Review recommends that the Government adopts domestic gas exploration, licensing and pricing policies that encourage companies to explore, produce and sell their gas in Romania.

The analysis recommends the following 3 reforms to be undertaken at the latest by the end of 2011

**Reform 4: Romania transposes EU’s third reform package for energy**

- The transposition of EU’s regulations (3rd energy package) has started, a proof in this sense is the draft Govt Emergency Ordinance amending Law 13/2007. The mentioned document includes provisions regarding the regulator’s independence; with regard to Transelectrica, in order to observe the European legislation stipulations, the transfer of the system operator is taken into account under the subordination of the Government.
- In order to ensure the independence, but also the transparency of ANRE’s functioning among the recently identified solutions within MECMA/Directorate energy and that can be included in the draft emergency ordinance are:
  - The creation of an independent body, that will monitor the function of the energy market and will transmit signals necessary for identifying certain slippages or abuses on the market; the respective body might directly report to the Parliament or the Competition Council. A model for this purpose may be the energy observatory from Brussels;
  - The nomination of ANRE’s president by a commission, based on specific, transparent criteria
  - The need to evaluate the impact of each new regulation in energy, before implementation, and to develop certain long-term plans, with clear deadlines for implementation.
- ANRE considers that the main requirement regarding the independence of the institution function has been ensured.

**WB Response:** Section B of the Review presents the comments on the version that was available at the time of the Review. (Section F.3 elaborates on the independence of energy regulator ANRE.) The Government committed to submitting a revised draft law transposing the Third Energy Package to the European Commission by the end of May. The Review recommends that the final draft be agreed with the Commission prior to its submission to the Parliament.

**Reform 5 - ANRE resumes the liberalization of the energy market and eliminates regulated tariffs for the non-residential gas and electricity consumers**

- The government will eliminate until 2015 the regulated energy prices, according to the scheduled agreed with the International Monetary Fund and the European Commission based on a calendar that will be established before September 2011, then vulnerable consumers needing protection will be defined. The electricity and gas tariffs will increase between 2011 and 2015; an accelerated schedule for the economy (by 2013 for companies) and in phases for the population (2013-2015). We mention
that as of 01.04.2011 the electricity price for the final consumer increased with about 7 EUR/MWh because of the green certificates and cogeneration tax. We note that the European legislation allows regulated prices in exceptional cases, for example in order to protect vulnerable consumers. Measures must however be targeted and limited in time (authorities will align to the European definition of residential consumers and categories for which subsidies are granted). The Ministry might appeal to an efficient regulation, granting subventions to poorer social categories, like in the USA.

- ANRE supports the above actions, in accordance with the terms and conditions from the agreements with IMF and EC. For the vulnerable consumers the prices will be established according to a well-defined methodology.

**WB Response:** The 2013 and 2015 deadlines were agreed with the IMF (not with the European Commission) and the LOI states that earlier deadlines may result from the infringement. The European Commission issued a reasoned opinion on Romania’s regulated prices in April and awaits Romania’s response.

### Reform 6 – GOR prepares a comprehensive program for SOE reform and starts implementation with the management reform of main viable SOEs, including HE, NE and Romgaz and closing non-viable ones

- 2011 is the year when the main objective is to optimize the functioning of state owned regies and local government regies or SOEs. The Ministry of Economy, Commerce and Business Environment will start, as of May this year, the procedures for management privatization.
- MECMA will publish the bidding notice for management privatization in some subordinated companies. Currently, the last evaluations to determine the companies that will enter the program are on-going.
- MECMA will introduce performance criteria for companies’ management, the main objectives being the focus on main activities, the efficient operational flow and value creation.
- Actions are taken to implement a management in accordance with the best practices in Europe, ensuring a transparent and consistent environment in making decisions.
- The government adopted, on April 29th this year, an emergency ordinance to “strengthen the discipline” in the autonomous regies and in state companies. Failure to meet the requirements in the law will lead to penalties and even dismissal of managers. “For each institution and state company a concrete restructuring plan will be established and there will be performance indicators for managers. A strong hand is needed”, said the Prime Minister Emil Boc.
- The state companies will not be allowed to increase their expenses and will have to report to the Ministry of Finance, some of them monthly, others quarterly, on the economic and financial indicators. If they fail to do so, the managers would be sanctioned and the fines are between 5000 RON and 10000 RON. The activity of the managers of profitable companies, but which get below-potential profits, would also be monitored.
- (point 18). The IMF Board approved the seventh and last evaluation of the stand-by agreement with Romania, based on the achievement of the targets for the last quarter of last year, as well as the terms of the future preventive agreement, that started on March 31st this year. The unanimous perception on what Romania has achieved in the past two years was positive. The MECMA solutions are correlated to the ones in the memorandum concluded with the international financial organizations, as follows:

**A. The economic operators will immediately elaborate multi-annual income and expenses budgets that will include:**
- the actual development stage of the company;
- the target to be met in 2014 with the phases for 2012 and 2013;
the strategy needs to lead to the restructuring of the companies and making them viable by increasing the economic efficiency, followed by capital attraction, privatization, as well as, case by case, the attraction of financial sources by sales of assets.

Updated information will be provided about the financial viability of each economic operator.

B. Programs with measures are currently being prepared for the restructuring, privatization or liquidation of non-viable companies. The programs will be agreed upon with the IMF representatives and approved by the Government and will also include the actions to be performed for closure, improvement of viability or privatization.

C. The economic operators from the MECMA portfolio will present investment programs comprising the major necessary projects for development, on investment sources.

D. The economic operators were required to develop programs that include concrete arrears reduction measures.

E. The reduction of any expenses that are not strictly economically justified. Also, measures are established to improve the governance of these operators.

The updated privatization/liquidation/restructuring plans of state companies.

The key companies under the authority of the Ministry of Economy, Commerce and Business Environment, which are mentioned in the draft Technical Memorandum of Understanding, are the following:

1. SC Termoelectrica SA
2. SC Electrocentrale București SA (Elen)
3. The national coal company S.A. Petroșani (CNH)
4. The national lignite company Oltenia.
5. SC Filiala Electrica Furnizare Transilvania Nord SA
6. SC Electrica Serv S.A.
7. SC Complexul Energetic Turceni SA SC Electrica Serv S.A.
8. SC Oltchim SA

1. Termoelectrica:

- The setting up of Paroseni subsidiary would be finalized
- The Braila subsidiary, Galati subsidiary and Deva subsidiary are set up. (At the moment Galati and Deva are branches)
- The Doicesti and Borzesti plants remain within Termoelectrica and are privatized. In this case we wait for the response from the European Commission (whose representative is present) with regard to the cancellation of the past debts or by case, declaring insolvency
- For this purpose the consultant to set up the privatization strategy is selected
- The staff number is reduced by 300 employees by June this year
2. Elen:  
- Elen has made profit in 2010 (214 million RON) and the first quarter of 2011 (78 million RON)  
- The transfer of the Iernut plant by ROMGAZ as payment for the 653 million RON debt is approved by the Board of the 3 companies and the general shareholders’ meeting has been called for the three companies.  
- There are discussions in the government to eliminate the heating subsidies from the state budget

3. CNH  
- Expediting the procedures to approve the notification to Brussels for state aid  
- Closure schedule: Petrila 2015, Uricani and Paroseni 2017  
- Until 2018 all sites will be environmentally rehabilitated and 3100 employees will be laid off  
- We are waiting for an answer from the EC representative regarding the possibility to provide the state aid from the state budget from the moment of notification to Brussels (not from the moment of approval)  
- The viable mines (Lonea, Livezeni, Lupeni and Vulcan), and Deva and Paroseni thermal power plants, will be merged into the Energy complex Hunedoara

4. SNLO  
- The company has a restructuring program to reduce the costs including by externalization of non-viable assets  
- The company has the capacity to pay, the receivables being higher than the payables  
- The improvement of the financial management by identifying the solutions to collect receivables  
- In order to pay amounts due to the state budget, SNLO will use the procedure in Govt Ordinance 29 for grading the payment obligations will be performed and the obligations will be paid including by cession of receivables to the Ministry of Finance – ANAF (fiscal authority)

5. Transilvania Nord  
- The company is undergoing a merger  
- A reorganization program was prepared, with concrete measures to increase the efficiency  
- At the evaluation in June, we will analyse the effects of this merger

6. Electrica Serv  
- The company is within a reorganization process by partial division, by separating the viable components from the non-viable ones within ElectricaServ  
- The privatization of the subsidiaries starting with the non-viable subsidiaries  
- The condition to finalize this process is an offset of debts with CFR Infrastructura, with the support of the Ministry of Public Finance
7. Turceni

- The economic results of the company are positive, therefore we think that the company does not meet the monitoring criteria to remain among the 18 companies (monitored by the IMF).
- We propose the inclusion in the next set of companies that are monitored.

8. Oltchim

- According to what was agreed at the previous meeting regarding the privatization, the selection procedure of the strategy consultant is ongoing.
- The privatization will take place at the latest in 2012

Point 19

- The WB analysis recommends that the reform program of state companies from MECMA should start with Hidroelectrica (HE), Nuclearelectrica (SNN) and Romgaz. In our opinion, since the three companies are among the most efficient, the economic reform must start with the healing of the sick economy, which means the reduction of arrears and not with its viable part. There is no point in selling companies and the money resulted to be injected again in the sick economy, blocking it as well. The problems, both in the economy and in the energy market, are not induced by the 3 mentioned companies.
- The program should ideally be implemented simultaneously in the 65 SOEs;
- Maintaining the reporting system of state regies and autonomous regies (which now report to line ministries) does not lead to a good control of their financial developments and financial health. Specialists consider this can be done by applying the provisions of the Government Ordinance no. 119/1999 regarding the internal public audit and preventive financial control. Thus, for companies where the state is the majority shareholder, and which are not under financial supervision, and for the ones listed at the stock exchange, the preventive financial control may be applied with quarterly reporting to the Ministry of Public Finance. For the economic operators under financial supervision, the delegated financial control may be applied on patrimony operations
- ANRE considers that the transfer of the “financial control” to the MPF should be understood as an approval of the state companies' budgets within MECMA.
- With regard to the reconstitution of the Boards, by a significant reduction of the number of government officials and their replacement with qualified non-government managers, we state that the incompetent ones must be replaced from the Boards, no matter what other positions they have.

- (Points 20 and 21) We agree that privatization is the key of the reform and investment attraction process in the energy sector. MECMA thinks that the privatization process will be more efficient by setting up mixed companies, whose purpose will be to develop new investments projects, by observing all the efficiency and environment requirements, rather than privatization with a strategic investor. In the newly established companies, in general the strategic investor will hold the majority package, whereas the state companies would contribute in kind (land, existing infrastructure, etc.). The foreign investors will ensure the management of the new units and will be able to transfer it to private managers, as they wish. We think that this approach may prove more efficient that privatization with strategic investors who, in a series of already privatized companies, delayed and still delay the development of the necessary investments, making pressures only for price increases. With regard to the ownership function of the state companies, we think that it belongs to the Romanian state, no matter how the coordinating ministry is called; we consider that the reduction of
the state property by attracting interested investors is one of the solutions to reduce the state participation in the benefit of the public. The data underlying the analysis is outdated and the economic information regarding the viability of the companies are no longer valid; for example, the data on the viability of Elcen or of the Energy complex Turceni, etc;

Point 21 Stock exchange listing, privatization or liquidation is recommended as follows:

- If the sale refers to the supply business, then this is an option to be considered after the merger of the supply subsidiaries of Electrica (EL).
- the sale of the majority stake in distribution or supply companies is to be analysed, because the previous sales did not reach their purpose, on the contrary – the service is poorer, the maintenance has reduced, investments also. Not even from a financial point of view EL did not gain, because dividends are not distributed and EL does not have decision-making powers in the boards of the privatized companies.
- ELCEN is not bankrupt. In our view, receivables are higher that the debts. If ELCEN would collect its receivables from RADET, the blockage would be solved and ELCEN would pay its debts.
- We agree with the analysis of the possibility to privatize together “ELCEN – RADET” after any option related to the reorganization of the power generators will have been abandoned. The privatization of RADET alone could be considered.
- The 3 energy complexes do not have any chances to survive not because they are in public ownership, but because they need investments, both for development and the environment. Alternative variants to the existing situation are analysed, according to the provisions of the LOI with the IMF.
- We do not agree with the liquidation of CET Deva. Deva is needed to burn Romanian coal that provides, despite the high price, Romania’s electricity independence.

WB Response: Section G presents the Review’s recommendations on SOE reform. The recommendation is to professionalize, not privatize, boards of administration and management of SOEs. SOE reform and listing are recommended for companies that have the prospect of a viable future as public companies. For the rest, the Review recommends privatization or liquidation. Investments by privatized companies are substantial – discussed in para. 108. Elcen is effectively bankrupt as it cannot collect its receivables. The Review promotes cost-effective options for power generation, including SOE reform and listing of public hydro and nuclear generators, restructuring of combined heat and power generation/district heating operations, and privatization of lignite complexes. The Review cautions about retaining unviable coal mines/generation, subsidizing inefficient combined heat and power generation/district heating and providing over-generous wind support schemes.

Other priority reforms – that need to be implemented as soon as possible

Reform 7 The ministry streamlines the functions of the departments within MEC, to reduce excessive workload resulting from significant layoffs and to increase the accountability of SOEs and performance management.
- We agree with the existing formulation, in the sense that the ministry will simplify the functions of the departments.
- The ministry analyses the situation of each company in its coordination: the arrears, profit and loss, competition, ability to implement the investment and to attract financing and cooperation, as well as the performance of the management. At the same time we take into account the protection of vulnerable consumers (according to the EU legislation) and of the situation of employees in these SOEs. The results of the analyses will materialize in the restructuring of the state-owned energy sector, taking administrative measures that will lead to increase of the efficiency of the companies’ activity.
- We fully agree with the proposals for the MECMA organization chart, and we will apply them in the future.

*WB Response: MEC’s and the Review’s views are similar. The one area to highlight is that subsidies should be carefully targeted to low-income households. Other consumer groups such as other non-poor households and small commercial consumers should be expected to pay market prices. ANRE could design mechanisms to help them to obtain competitive (market) prices through auctions as they may not be able to individually negotiate with suppliers.*

**Reform 8 – As part of the Government’s analysis regarding EU funds absorption, GOR allocates additional funds for projects on renewables, energy efficiency and energy infrastructure**

- The ministry has announced that companies interested to access funds totalling 243 million RON (almost 60 million EUR) for investment in energy efficiency can submit to the Ministry the proposals between May 13th and December 15th.
- MECMA, through the General Directorate for Energy, announces the call for projects related to investments in installations and equipment that would lead to energy savings, for the purpose of improving energy efficiency. The budget allocated to this call is about 243 million RON and the maximum value of the co-financing granted for a project is of 80 million RON”, is shown in a release of the institution. The program is financed from the state budget and co-financed through the European Regional Development Fund. The companies that can participate in the competition are large companies and small and medium industrial companies which undertake projects that would increase energy efficiency and energy savings.

*WB Response: Improving the efficiency of energy use is critical to Romania’s energy security, environmental improvements and climate change mitigation. Efforts need to be intensified across the board - raising awareness, providing technical assistance and finance/incentives, developing and enforcing regulations, to improve efficiency in industries, offices, homes, buildings - to accelerate the realization of Romania’s potential to improve energy efficiency.*

**Reform 9 – GOR improves the inter-ministerial coordination of energy-related functions**

- We agree with the recommendations regarding the improvement of inter-ministry coordination on the energy system at Government level.
Reform 10 – GOR prepares a national climate change mitigation strategy

- We agree with the proposals regarding the National Strategy regarding the mitigation of climate changes, noting that the ministry seeks solutions for its implementation.
- MECMA will seek financing from the European Union for a pilot-project for capture and storage of carbon dioxide from the combustion gases released by group 6 of the Turceni Thermo plant (GETICA CCS, presented on www.minind.ro). If the Romanian project wins, the EU would provide half of the needed financing, the rest being allocated from the state budget. The Romanian project implies investments of over 500 million EUR. The carbon dioxide capture and storage technology, known worldwide by the abbreviation CCS - Carbon Capture and Storage – is in the experimental stage. Its purpose if the drastic reduction of the carbon dioxide in the resulted gases, by burning the fossil fuels, considered to be the main cause of the greenhouse effect.

Part II - Recommendations for the business environment

Romania is ranked below most countries, initiatives related to improving the business environment, lack of a single strategy – reflection of the large number of institutions responsible for the business environment, the Business Environment Department is a small unit within the ministry with a staff made up of only nine officials, without its own budget and responsible with a series of tasks far too ambitious and uncoordinated, interventions are ad hoc and do not apply to the entire administration; improvement of government structures for the regulation and business environment reform, the key areas to streamline administrative capacities, the use of regulation instruments for a better administration and improvement of the business environment.

- The level of the relevant indicators to describe the business environment from a certain country must be appreciated as a result of multiple statistical and economic factors and parameters relevant for the actions and policies promoted by the entire public administration.
- In the Doing Business 2011 classification (WB Report that analyses 183 economies in the world), Romania is on place 56. Romania improved its ranking by 10 notches (from rank 102 to rank 92) with regard to the exit of the companies from the market (insolvency). The companies from Romania need three years and four months and 11% of the assets value to close down.
- Moreover, Romania climbed nine positions (from 93 to 84) with regard to construction permits.
- In what concerns the ease of starting up a business, Romania is on position 44; the process of setting up a business in Romania lasts 10 days, with a cost of 2.6% of the per capita income (8.5, in countries of Eastern Europe and 5.3 in the OECD countries) and a minimum capital of 0.9% of the per capita income.
- The companies in Romania get credits more easily than in other countries, from this point of view, Romania is on the 15th place.
- With regard to the easiness of the cross-border trade, Romania is on a relatively good position – the 47th place.
- With regard to the registration of properties and construction permits, two chapters in which Romania registers significant progresses in the last two years, the local business environment is located on positions 92, respectively 84 in the World Bank classification.
- Between 2009 and 2010, Romania implemented substantial changes of the legislation regarding bankruptcy, introducing, among others, an out-of-court procedure that facilitated the approach of insolvency cases.
Furthermore, Romania changed the regulations regarding the construction permits, by reducing the taxes and shortening the time needed to obtain them. The areas where most legal changes have been implemented are the closure of commercial activities, construction permits and tax payments.

Based on the draft Action plan for business environment development between 2011 and 2013 MECMA proposes: The creation of the National Competitiveness Council as a consultative body to Romania’s government for the coordination of the business environment development on competitive rules, one of the tasks of this body being the strategic and operational coordination of public policies to ensure the competitive development of the Romanian economy.

It is necessary to recognize MECMA’s position as a coordinator of GOR’s reforms with an impact on the business environment, which means also that MECMA is among other synthesis ministries and institutions (together with Min Public Finance, Ministry of Foreign Affairs, Min of Administration, Department for European Affairs) taking into account its roles and responsibilities in economic policies, resources, energy, trade and business environment, including SMEs.

We DO NOT support the transfer and the direct subordination to the General Secretary of the Government of the Business Environment Direction, because the expertise and focus on business environment is located in MEC. Optimal results can be achieved by coordinated actions between MEC and other line ministries.

The commitment to business environment can be seen in the number of projects under preparation, tendering or planning phase.

It is necessary to consolidate and diversify the structure regarding the SMEs and cooperation sector, by supplementing/redistributing the current staff at MECMA.

The OECD recommendation from 2002-2003 is that the business environment, the SME and foreign investment sector are permanently under the same coordination, a role that currently is performed fully by MECMA, which coordinates at the same time AIPPMIM and CRPCIS.

MECMA, through the Directorate for the Business Environment, prepares the implementation, starting this year, of the co-financed project from European Social Fund through the operational program Development of Administrative Capacity “Identifying/simplifying the administrative barriers that the business environment faces; elaborating and implementing quality and quantity monitoring indicators”.

A political adequate support can be insured by approving and implementing the proposals:

- There is a consulting body, presided by the minister of economy, commerce and business environment, approved by governmental resolution, The working group for the preparation and implementation of the Action plan regarding the improvement of the business environment.
- Furthermore, by the creation and operation of the National Competitiveness Council the dialogue mechanisms between the Government, the business environment and the civil society will be optimized.
- It is necessary to streamline the implementation of the Strategy for a better regulation at the level of the public administration.
- It is necessary and advisable to monitor the implementation of the already existing strategies for the business environment and to streamline regulations, and only afterwards, new strategies can be developed.

WB Response: The main disagreement is on the Review’s recommendation to transfer MEC’s business environment function to the Center of Government. WB made several recommendations in the 2010 Functional Review of the Center of Government about effective policy coordination and the recommendations here in the MEC Review are directly linked and internally consistent.
CONTEXT AND PURPOSE OF THE REVIEW

1. The Ministry of Economy, Commerce and Business Environment (MEC) is under increased pressure to enhance the delivery of key Government priorities so that the economy returns to a path of sustainable growth and convergence with the European Union (EU). After several reorganizations (mergers, divisions, layoffs of staff) in recent years, MEC is facing substantial challenges but also unique opportunities to undertake bold actions in areas insufficiently tackled before or where previously-started reforms have stalled.

2. The Ministry has changed its structure, role and responsibilities substantially and frequently in the past six years. Thus, the current Ministry is the successor of: the Ministry of Industry and Resources (until 2005); the Ministry of Economy and Commerce (2007); the Ministry of Economy and Finance (2007-2008); two separate ministries, Ministry of Economy and Ministry of SMEs (2008-2009), subsequently merged into the current Ministry of Economy, Commerce and Business Environment (2009). In the past five years there have been five ministers of Economy. On top of these changes, the Ministry is currently undergoing yet another reorganization including a systematic adaptation of functions, elimination of overlaps and significant layoffs, a different approach from previous mergers and divisions which were primarily additions and splits of departments. However, in spite of the new structure (Annex 1) and major reduction in personnel (32% of positions, of which about half actual layoffs), the functions of the Ministry remain the same as before and lead to overload for the remaining staff. Frequent restructuring has affected staff morale and “reorganization fatigue” is visible.

3. The Ministry faces additional challenges because of the economic crisis, hence increased pressures to deliver on its business environment functions. The improvement of business environment needed for Romania to resume its economic growth requires: (a) improved capacity in the Ministry and the enhancement of the business environment-related functions (such as harmonizing the legal framework for businesses, assess impact of regulations on businesses environment and reducing administrative burden); and (b) a streamlined, coordinated approach across the Romanian Government of units that have a role in facilitating business development and regulatory reform. Currently, the activity of the Ministry is focused on energy and mining-related issues (“80% of the day-to-day activity and resources”, as per the statements of Ministry staff), whereas the business environment work is relatively neglected and enjoys limited political attention and support at MEC and across the Government.

4. The Ministry and the Romanian government face unprecedented challenges in the energy sector which have broader implications in the Romanian economy and could impact on the country’s perspectives for growth:

- Romania experiences difficulties in implementing its energy strategy, particularly in setting up its planned two integrated energy companies and attracting private financing in the power generation sector;
- Key SOEs in the energy and mining sectors contribute to the country’s quasi-fiscal deficit or do not maximize profits, though these profits could cover a part of Romania’s budget deficit;
The withdrawal in late 2010/early 2011 of four of the six private partners from EnergoNuclear, the public-private partnership (PPP) company established to implement Romania’s largest investment project in two decades (Cernavoda 3&4, euro 4 billion), is the most concrete signal of the continued erosion of investor confidence;

As stated in Romania’s Letter of Intent (LOI) to the IMF of March 10, 2010, the Government is considering the possibility that its current energy strategy might not be implementable. “If the national champion strategy is not successful by end-2011, we will look for an alternative solution, including by privatizing majority stakes in some energy firms”;

Romania missed the transposition deadline and is unprepared for the implementation of EU’s Third Energy Package, which Member States were expected to have transposed into national legislation by March 3, 2011; and

Romania does not have a national climate change strategy.

5. The objective of the functional review of the Ministry of Economy, Commerce and Business Environment (MEC) is to analyze its current structure and operations, to provide recommendations so that the Ministry and the Government can improve the delivery of its key functions and respond effectively to the emerging challenges. The Ministry will have to address these challenges while undergoing a significant down-sizing in staff in response to the 25% budget cut. The downsizing and the hiring freeze affect almost every department of the Ministry except for the units managing EU funds. This makes strategic and efficient management of the Ministry’s resources critical to ensure that core parts of the Ministry have adequate resources to address growing functional needs and to respond adequately to Government priorities. The focus of the Review was on the Ministry’s energy and business environment functions. Commerce functions were not reviewed but could be covered in a possible future review.

6. The coverage of the energy sector review goes beyond the Ministry, into electricity and gas market issues, governance of energy SOEs under MEC, the institutional capacity of the energy regulator ANRE, and the coordination with energy-related functions in other ministries. MEC interact with several ministries including Administration – municipal energy; Regional Development – energy efficiency of buildings; Environment – environmental standards and compliance, climate change, energy efficiency; Labor – social protection for vulnerable consumers. The review examined SOE reform for the MEC-administered SOEs to support the implementation of the Government's commitment, stated in its LOI to the IMF, for “deep-rooted reform of state-owned enterprises (SOEs), especially in critical growth generating sectors such as energy and transport”. The review addressed energy strategy, regulatory and privatization issues and options, with recommendations which the Government could consider if the current policy of establishing two integrated power companies has to be abandoned (a possibility that has been recognized by the Government and is reflected in the LOI). The energy sections focus on electricity and gas, with less attention on oil and coal, as electricity and gas have a strong component of network industry / natural monopoly / service of general economic interest, where regulation and government action is critical.

7. The coverage of the business environment review similarly goes beyond the Ministry and assesses institutional capacities across the Government - as responsibilities are scattered across the Romanian administration, it was necessary to expand the analysis in order to provide sound policy
recommendations to improve the business environment as a key strategy for government action. The analysis of the business environment concentrated on the area related to governance structures and institutions needed to create appropriate conditions for business activity and thus promote a sound business environment. The review did not cover either macroeconomic aspects, such as taxation or the monetary policy, or infrastructure issues that are also needed for an environment conducive to business activity; these areas are out of the scope of this review.

8. **The review of the business environment was conducted in three stages:**
   - the review assessed the business environment of Romania in order to understand the current situation and main challenges the country is facing;
   - the review examined the current institutional setting established by the Government to promote and improve the business environment. The review covers a performance evaluation of the main institutions that deal with business environment issues in Romania, namely the Department for the Business Environment of the Ministry of Economy, Commerce and Business Environment, the Department of Public Policy at the General Secretariat of Government and the Unit of Post-Accession Monitoring of the Department of European Affairs, as well as a compilation of other institutions that have key responsibilities for improving business environment issues at the national and local level; and
   - The findings and conclusions were synthesized to propose the way forward for Romania in terms of increasing institutional capacities to promote the business environment through a comprehensive approach to regulatory management and reform.

9. **The draft final report is organized into two main parts, MEC/energy sector and Business Environment:**
   - **Part I of the report deals with MEC and the energy sector.** They could have been presented separately but are combined as energy is the main business of MEC (“80% of the day-to-day activity and resources”) and MEC’s energy SOEs account for over 80% of its SOEs. This combined MEC/energy sector approach allows for a report structure for Part I that substantially resembles final reports of other functional reviews; and
   - **Part II of the report deals with the business environment.** Business environment is a very small part of MEC. Responsibilities are scattered across the Romanian administration and the recommendation is to consolidate the functions and to move business environment to a higher political level, close to the Center of Government.
   - **The Ministry’s commerce functions were not covered in this review.**

10. **The MEC functional review was undertaken as a part of the broad functional review of Romania’s public administration,** as requested by the Government of Romania and the European Commission as per the June 2009 Memorandum of Understanding.
PART I: MINISTRY OF ECONOMY AND THE ENERGY SECTOR

A. Energy Sector Configuration, Roles and Relationships

11. The energy sector consists of many energy-related government functions which are spread across a wide range of ministries and agencies. The main government energy-related functions are:

6. strategy/policy function (MEC) with goals such as energy security, promotion of competition among producers and suppliers and consumer choice, energy affordability (in cooperation with Ministry of Labor), energy efficiency and municipal energy (in cooperation with Ministry of Environment, Ministry of Regional Development and Ministry of Administration);

7. legislation initiation in energy (MEC and energy regulator ANRE);

8. representation to EC (MEC in cooperation with the Department for European Affairs);

9. ownership function of energy SOEs (MEC and MPF); and

10. energy regulation, by a regulator (ANRE) that is meant to be independent of the Government.

12. Beyond governmental agencies and ministries, other actors with roles in the energy sector include: the Parliament commissions for industry and services (in the Chamber of Deputies and the Senate), which are in charge of processing legislation on energy-related matters; SOEs under the local administrations, such as companies which produce both electricity and heat; private companies in energy (electricity and gas distribution, oil and gas production); and other stakeholders, such as minority shareholders in MEC’s SOEs. The most important minority shareholder in energy SOEs is the Property Fund, a vehicle for the compensation of owners expropriated during communism.

13. Most of the companies in the Romanian energy sector remain in state ownership and are administered by MEC. In addition to the transmission grids for gas and electricity, the state owns all major electricity generators; half of the domestic gas production (one of the two big gas companies) and all gas storage; and three out of eight electricity distributors. The state is also a minority shareholder in the oil and gas company Petrom, privatized in 2004. MEC administers state shares in these companies. Even though the companies are state-owned, they are not managed in a fully coordinated manner the way a holding company would coordinate its subsidiaries, which has provided for some competition in the state-owned generation sector (mostly the three energy complexes Turceni, Rovinari and Craiova). Privatization of energy complexes would enhance the prospects for investment and competition in the generation sector (discussed in Section H and Annex 2). Transmission operators (Transelectrica, Transgaz) are relatively independent from generation and ensure non-discriminatory third party access. Both companies have relatively strong corporate governance, favored in part by the fact that they are also listed on the Bucharest Stock Exchange BVB, have international ratings and are subject to the stock exchange guidelines for corporate companies, issued in 2009.

14. Gas and electricity are traded on wholesale and retail markets. There are many private suppliers in both electricity (about 60) and gas (over 100). Romania is a net exporter of electricity (about
5% of production) and net importer of gas (from Gazprom/Russia, usually around 30% of consumption); it is thus relatively energy independent. While in principle fully liberalized in 2007, the actual effective market opening is around 50% in both electricity and gas, meaning that about 50% of the gas and electricity consumed in the country are sold to “captive” consumers. In electricity, there are several wholesale markets:

- **OPCOM Power Exchange.** OPCOM operates a well-functioning power exchange, currently ranking 8th in Europe, and has the prospect to provide market services also the regional market in south East Europe. OPCOM operates platforms for centralized auction and trading of bilateral contracts, daily trading (called a day-ahead market), and soon intra-day trading. Trading in OPCOM platforms has grown steadily since 2001 and accounts for about 20-25% of total electricity supply or about one half of the trading in the liberalized market. The use of the OPCOM platforms is voluntary to the market participants, except for five public sector generators which have been mandated to use the platform since 2006;

- **Directly negotiated bilateral contracts.** As OPCOM platforms account for about one half of the trading in the liberalized market, bilateral contracts negotiated directly between generators and their clients account for the other half. Such contracting is a regular feature in the European Union’s electricity markets. However, as virtually all generation in Romania is state-owned and as the biggest public generators have been mandated to use the OPCOM platforms since 2006, the fact that such a large share of electricity is still sold through direct negotiation between public sellers and private buyers instead of OPCOM platform or other transparent competitive processes is a major governance issue;

- **ANRE’s Portfolio Contracts.** In spite of full market liberalization, about half of electricity supply is still provided to captive consumers by the electricity distribution companies under retail tariffs regulated by ANRE. For such supply, ANRE requires generators to sell electricity to the supply companies affiliated with the eight distribution companies under regulated wholesale tariffs. These contracts are known as ANRE’s portfolio contracts. Such regulated prices are not in accordance with the EU electricity directives and regulations. An infringement process by the European Commission is underway;

- **Balancing and ancillary system services markets.** As electricity cannot be stored, supply must exactly meet demand. This balance is achieved by having enough generation or demand side participation at any moment. In the short-term, wholesale markets achieve an approximate balance in voluntary transactions between participants. Fine-tuning and outage compensation is done by the Transelectrica which ensures the security of supply on a real-time basis, by requiring dispatchable generators and balancing responsible parties to enter mandatory transactions. Transelectrica administrates balancing energy markets, participation in mandatory, with the buys and sells are structured in such a way as to simulate the trading on a competitive market, with Transelectrica as the “broker” between buyers and sellers. As Romania’s ancillary services market is largely dominated by the hydro producer Hidroelectrica, ANRE sets a price cap for ancillary services to mitigate the monopoly position; and
• **In addition, 5-7% of electricity is traded cross-border.** The allocation of cross-border interconnection capacity is done by Transelectrica and neighboring TSOs on a bilateral basis, by auction, but still not fully in accordance with the EU electricity directives and regulations and an infringement process is underway.

15. **The gas wholesale market functions in a similar manner as the electricity wholesale market, with the difference that gas can be stored, so there is no need for balancing or ancillary services, but there is a market for storage capacity.** However, so far the wholesale gas market lacks centralized trading platforms like day – ahead and “forwards” being exclusively based on bilateral deals, either regulated or negotiated. About 50% of the market is “captive” and consumers in the other 50%, including the largest industry, have the option to purchase at the regulated basket price. Two suppliers, affiliated with the companies that separately manage the main distribution networks, buy a regulated basket of domestic and import gas. Captive consumers pay the gas plus regulated tariffs of storage, transmission, and distribution. Domestic gas producers are required to sell to the domestic market and domestic gas producer prices are kept low to control the end-user gas price. These pricing and contracting practices are not in accordance with the EU gas directive and regulations. An infringement proceeding is underway.

16. **On retail markets, suppliers sell gas or electricity to end-users.** As explained above, retail markets comprise a competitive part (where users choose their supplier) and a “captive” part (where users remain with their existing supplier). ANRE’s tariff policy (subsidized prices for captive end-users, enabled through portfolio contracts and low domestic gas producer prices) is a barrier to effective market liberalization. Such regulated prices are not in accordance with the EU energy directives and regulations. Infringement processes by the European Commission are underway.

17. **ANRE is in charge with the regulation of gas and electricity.** Its regulatory focus is mainly on setting tariffs for networks and regulated consumers (captive or social), and little on ex-ante promotion of energy market competition. Currently (before the approval of the new laws to transpose Third Energy Package), ANRE is led by a President, three Vice-presidents, a regulatory committee with seven members (directors of different departments in ANRE) and a Consultative Council with seven members (Ministry of Economy, associations of businesses in energy, trade unions in energy, local administration etc.), which advises ANRE on major regulatory items. All are appointed by the Prime Minister. The current organization of ANRE, its leadership and financing, is under discussion in new proposed laws (March 2011), following an infringement process by the European Commission.

### B. Energy Sector Challenges

18. **Romania’s energy sector faces major challenges in meeting in the energy needs and implementing the common EU energy policy.** Romania’s energy challenges broadly mirror those of Europe: fast depleting domestic energy resources (oil, gas and coal); increased need for energy to support growth and hence higher dependence on imports; and increased concerns on energy security.
19. In the energy sector, Romania has commitments to the EU related to the acquis (Box 1), which consists of the development of the internal energy market and the implementation of Europe’s climate change strategy. While reforms in the past years have given Romania a relative advantage even compared to some older EU members in the liberalization of the energy sector, several key barriers to effective liberalization remain. Also, given its excessive development of the energy intensive industry before 1989, and the incomplete industrial restructuring, Romania faces substantial challenges in meeting EU’s climate change goals.

Box 1: Highlights of EU Energy and Environment Policy

EU energy policy, which Romania also must follow, has the objective to ensure the uninterrupted physical availability of energy products and services on the market in all EU members, at prices affordable for all consumers (residential and industrial), while meeting EU’s wider social and climate goals. Europe as a whole faces major challenges concerning energy security, climate change and a need to consolidate market competitiveness.

EU adopted in July 2009 the Third Package of energy reforms, to push forward the liberalization of gas and electricity markets and regulation of cross-border trade. The Third package consists of two Directives (concerning common rules for the internal market in electricity (2009/72/EC) and gas (2009/73/EC) and three Regulations (on conditions for access to the natural gas transmission networks (EC No 715/2009), conditions for access to the network for cross-border exchange of electricity (EC No 714/2009) and the establishment of the Agency for the Cooperation of Energy Regulators ACER (EC No 713/2009). Member States had 18 months, till March 3, 2011, to transpose the two Directives into national law. The Regulations became applicable as of March 3, 2011.

The Package resulted after an EC investigation on energy markets in 2006 which identified several barriers to effective liberalization: (a) internal energy market remains fragmented, with consumer choice across the EU being hampered by different national rules and practices; (b) limited interconnection capacity; (c) barriers to open and fair competition leading to sub-optimal consumer choice; and (d) obsolescence of capacities particularly in new member states. Also, the implementation of internal market legislation across the EU rated disappointing, with over 40 infringement procedures underway on the second internal energy market package from 2003. Some of these barriers are addressed by the Third Energy Package, particularly those concerning the lack of independence of the regulators, conflicts of interest between producers and transmission operators (and storage, in the case of gas); and the harmonization of national regulations to promote interconnections and the development of cross-border trade. The new Directives promote stronger measures to ensure financial and leadership independence of national regulators; effective unbundling of TSOs and storage facilities for gas; and the establishment of an Agency for the Coordination of Energy Regulators (ACER) to promote regulatory harmonization.

Another key direction of EU’s energy policy is related to the Europe 2020 strategy for sustainable development. The EU has set itself in 2007 ambitious energy and climate change objectives for 2020 (also referred to as “Europe’s 20-20-20 vision”):

- a unilateral and binding target to cut by 20% GHG emissions by year 2020 as compared to 1990;
- a binding target to increase share of renewable sources in the overall energy mix from under 7% in 2006 to 20% (further increased to 21%) of EU overall energy use by 2020; and
- Improve energy efficiency by 20% to save 20% of the EU’s total primary energy consumption by 2020 as compared to an acceptable baseline.
20. While both electricity and gas markets are legally fully liberalized since 2007, in practice effective liberalization has remained at around 50% (Figure 1). This means limited choice for the consumer and less competition among suppliers for better delivery. Full liberalization is hindered because prices in the competitive market are higher than the subsidized regulated prices. This removes incentives of residential and small non-household consumers to switch suppliers. ANRE’s basket for gas and portfolio contracts for electricity, and the production reserved for non-competitive bilateral contracts, contain the cheapest sources of energy and leave the more expensive sources to the competitive market. On the open market, there are also other distortions. In the gas market, eligible consumers are allowed to return to the “captive” status and be supplied at basket price, which means that the gas market opening is actually zero. In the electricity market, bilateral contracts especially Hidroelectrica’s negotiated directly with private partners limit the portion of the actually competitive and well-functioning market to about 25% (in 2009 Hidroelectrica sold about 12 TWh on non-competitive terms, its entire capacity available outside ANRE’s portfolio contracts).

Figure 1: Market Opening

21. While other countries in Europe also face delays in effectively opening the electricity and gas markets, Romania lags behind the implementation of energy markets liberalization compared to most EU members – only two countries, France and Romania, have been singled out having major issues in both electricity and gas (Figure 2). The current situation in terms of market opening has remained virtually unchanged since 2007, whereas most other countries have accelerated the pace of reforms. The delays in liberalization are visible in the prices for energy, which Romania manages to keep at the cost of maintaining soft budget constraints in SOEs, regulated prices and control of prices for domestic gas. As the EU is pushing forward for the liberalization in the Third Energy Package, Romania’s gap will increase, since the new legislation and measures taken in practice by the Romanian Government are not in compliance with the spirit of the new Directives and the direction in which EU is moving.
22. The deadline for transposition of the Third Energy Package in national legislation of Member States was March 3, 2011. Romania missed the deadline. Around the deadline, MEC has posted on its website two proposed laws for the transposition (Box 2). The two laws are not in compliance with the Directives and do not support the promotion of competition and liberalization of the energy markets, which is the spirit of EU’s package.

**Box 2: Review of MEC’s Recent Legislative Proposals for Third Package**

**Energy Market:**

All households are included in the vulnerable consumer category, and public service obligation is not properly defined.

Romania continues to have regulated prices, and the two laws do not propose a calendar for price liberalization (not even the calendar agreed upon with the IMF), including the deadlines and steps in which the gas and electricity “baskets” would be fully abandoned.

The two laws are meant to implement in Romanian legislation all the measures needed to promote free market competition. However, there are no provisions to address the major Romania-specific challenges for the
competition in the energy market caused by governance issues, including price distortions/subsidies and the non-competitive bilateral contracting practices of SOEs. The law could have been a good opportunity to introduce in primary legislation the obligation for SOEs to sell competitively, which is currently regulated by Ministerial Orders (currently 445/2009) and not followed consistently. Also, there is no requirement for ANRE to monitor risk areas such as SOE sales to preferred partners.

The electricity law introduces “tolling” contracts, which have been used in the past under a different name (“processing” contracts), meaning a form of PPP contract under which the private partner brings his own fuel and rents the power plant. Such contracts have been very contested in the past for suspicions of corruption.

**Energy Regulator:**

The regulator ANRE remains politicized and its activity will practically depend on the good cooperation between PM and ANRE’s president. Thus, the PM appoints the president and coordinates ANRE, and the clauses regarding the conditions for mid-term revocation are less clear than in the previous legislation. ANRE recovers its financial independence (by making own revenues from license fees and being exempted from the unitary pay law), but this is not matched by accountability measures to compensate for the increased financial independence (e.g., the only person that approves ANRE’s annual activity is the president, there is no obligation for ANRE to report to the PM or Parliament or audit its accounts). As a consequence, ANRE will remain attractive for politicization and will probably be involved again in media scandals, the very reason why it was transferred under budgetary control in the first place.

ANRE’s president controls salaries of staff, organization chart and functions (ROF). Regulatory committee and consultative council remain weak. In addition, the membership of the latter does not ensure representation of legitimate interests in the regulatory process. Thus, now the consultative council will be composed of "professionals from various fields", instead of representatives of consumers, local authorities, MEC, owners and trade unions from regulated industry etc., as it used to be in the previous law. The regulatory committee continues to be composed of ANRE staff, meaning informal ad hoc negotiations instead of consultation.

**Unbundling:**

The laws do not propose effective means to ensure unbundling. MEC is choosing not to go for ownership unbundling, but also does not provide an alternative in conformity with the Directives. MEC does not consider transferring either TSOs or producers to another ministry. The proposed approach, without ownership unbundling, does not include the safeguards included in the Directive (separation of all interests, including in the appointment of management and boards of TSOs and producers; establishment of a supervisory body to ensure the independence of the TSOs; the appointment of the compliance officer to ensure level play between producers etc.).

In terms of legislative process, the proposed laws have also not been debated transparently. Both laws have been under discussion in Parliament for several months, without open disclosure of discussions, and with the apparent intention to approve the existing draft laws on MEC website as final amendment in Parliament.

**Draft Laws and Consultation with the European Commission:**

Early involvement of the Commission on the content of the two proposed laws was missed. If the laws are enacted as currently drafted, Romania would most likely face another infringement process in the energy sector. It would seem to be useful to allow for sufficient time for screening of the current proposals before enactment.
Romania electricity prices are among the lowest in the EU and gas prices are the lowest in the EU. This is not surprising, in view of the continued supply of both electricity and gas at regulated prices and Government control of domestic gas producer prices. The average electricity price for households in the EU in 2010 was about euro cents 12.2/kWh while the Romanian price was about euro cents 8.6/kWh. For medium-sized industries, the EU average was about euro cents 9.2/kWh, while Romanian industries were charged about euro cents 8.5/kWh. The average gas price for households in the EU in 2010 was about euro 11.1/GJ while the Romanian price was about euro 4.2/GJ (=euro cents 1.5/kWh). For medium-sized industries, the EU average was about euro 7.8/GJ, while Romanian industries were charged about euro 4.1/GJ. A few comparator countries are included in Table 1. Romania’s regulated prices for both electricity and gas are almost equal for households and industries, in spite of the higher cost of supply to the households, showing the preferential treatment/cross-subsidization of households. Similar pricing practices can also be observed in other Eastern European countries. Unlike Romania, other gas producer countries included in Table 1 do not similarly control their domestic gas producer prices.

### Table 1: Electricity and Gas Prices for Households and Medium-sized Industries

<table>
<thead>
<tr>
<th></th>
<th>Electricity (euro cents/kWh)</th>
<th>Gas (euro/GJ)</th>
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<tbody>
<tr>
<td></td>
<td>Households</td>
<td>Industries</td>
</tr>
<tr>
<td>Romania *</td>
<td>8.6</td>
<td>8.5</td>
</tr>
<tr>
<td>EU</td>
<td>12.2</td>
<td>9.2</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>6.8</td>
<td>6.4</td>
</tr>
<tr>
<td>Croatia *</td>
<td>9.3</td>
<td>9.2</td>
</tr>
<tr>
<td>Germany</td>
<td>13.8</td>
<td>9.2</td>
</tr>
<tr>
<td>Hungary</td>
<td>12.3</td>
<td>12.2</td>
</tr>
<tr>
<td>Netherlands*</td>
<td>12.7</td>
<td>8.5</td>
</tr>
<tr>
<td>Poland</td>
<td>10.5</td>
<td>9.3</td>
</tr>
<tr>
<td>United Kingdom *</td>
<td>13.2</td>
<td>9.5</td>
</tr>
<tr>
<td>Turkey</td>
<td>10.7</td>
<td>8.6</td>
</tr>
</tbody>
</table>

Source: Eurostat (2010 data, except Hungary 2009; excluding taxes)
* = gas producer country

Despite the apparent (short-term) benefit for end-consumer from the low level of prices, this practice to keep prices at below market level, combined with lack of predictability on price adjustments, threatens Romania’s energy security in the medium to long term. Thus, low prices, non-EU compliant pricing practices and non-implementation of ANRE’s regulation (Box 3) affect investor confidence in the Romanian energy sector and threaten the country’s ability to attract much needed investments. The withdrawal in late 2010/early 2011 of four of the six private partners from EnergoNuclear, the public-private partnership (PPP) company established to implement Romania’s largest investment project in two decades (euro 4 billion Cernavoda 3&4), is the most concrete signal of the continued erosion of investor confidence. Since the sector, particularly electricity generation, needs major investments, failure to attract private capital in the sector could lead in the long run to supply risks. At the same time, low prices for domestic gas and facilities to energy intensive industries accelerates the depletion of gas reserves, expected to last for less than 15 years. In other words, Romania keep prices low at the expense of energy security.
Since the first quarter of 2009, ANRE has not been allowed to change the regulated end-user prices for gas. These prices consist of distribution, storage, transmission tariffs and the gas “basket” price. The basket price does not match the actual mix and prices of gas purchases of the two suppliers. The approved basket price is based on the following assumptions: the consumption consists of 80% domestic gas and 20% imports; 1 USD = 2.9 RON; the domestic gas price is 160 USD/m3 and import prices are 290 USD/m3. The shares of domestic and imported gas available to the gas basked fluctuated and reached as high as 40% import 60% domestic gas as domestic gas was diverted from the basket to preferred consumers. The exchange rate fluctuated between 1 USD = 3.1 – 3.5 RON; and the import gas prices rose up to 380 USD / m3. Since the two implicit suppliers GDF and EON import gas in real market price and are allowed to recover only the regulated basket price, they incurred losses on each unit of gas sold, in excess of RON 1 billion and increasing daily. This is a clear violation of the cost pass-through principle of regulated prices under which GDF and EON are allowed to recover in full from their regulated clients the gas acquisition price.

In 2009-2010, the Government approved legislation (to primarily support the fertilizer industry), according to which large, interruptible industrial consumers with a consumption of more than 1 million m3/day were allowed to use domestic gas instead of the basket. In reality, consumers in this category were never interrupted, but they received the benefit of low-price domestic gas. It must be noted that the consumption of the two largest fertilizer companies was as high as Romania’s total gas imports during 2009 & 2010, or as high as the total consumption of the households (20%). In other words, the regulator and the basket price practice forces Romania to (1) import expensive gas to give domestic gas to the two fertilizer companies; and (2) force not only the state-owned Romgaz, but also private distributors to subsidize out of their own revenues select companies.

25. In line with the rest of the EU, Romania’s energy strategy emphasizes renewable energy, energy efficiency and reduction of its carbon intensity. Romania has significant renewable energy resources (hydro, wind) as well as uranium deposits for electricity generation. Romania’s energy intensity is high and there is potential to reduce it significantly, including through cost reflective pricing. Romania has committed to ambitious targets to meet EU energy and climate change objectives. These include: (a) an increase in the share of electricity generation from renewable sources to 38% in 2020 (24% in total energy); (b) 20% increase of energy efficiency compared to 2005; and (c) the reduction of CO2 emissions by 20% - the most challenging of the three targets, the achievement of which might require Romania to raise the share of renewables in electricity generation to 50% (38% being insufficient even if Romania’s nuclear program continues). In late 2008, a World Bank report estimated the funding requirements for Romania’s energy efficiency and renewable energy program at over Euro 12.5 billion through 2020.

C. Energy Sector Linkages to Economic Growth

26. Instead of being an engine of economic growth, the energy sector threatens Romania’s macro and fiscal stability and long term development. The energy sector is a major fiscal burden on the Government budget and it severely affects Romania’s economic growth prospects in the medium-to-
long term if current energy market, pricing, subsidy and contracting policies continue and the proposed restructuring of the power generation and mining companies into two integrated energy companies is implemented. The major threats posed by the Government’s current energy policy for the macroeconomic stability and deficits include:

- **Threats for consolidated budget stability** - loss of potential revenue and increased expenditure burden on the consolidated budget;

- **Threats to energy security and economic growth** - risk of interruptions of supply, particularly in electricity, as critical generation facilities become obsolete and investments in generation do not keep the pace with economic growth; and

- **Threats to industrial development** - distortion of competition in the downstream markets, as some companies benefit from below-market priced energy, whereas others have to purchase electricity on market terms.

27. **Poorly targeted social support.** This is most striking in municipal energy (district heating), where annual subsidies from the central Government alone amounts to around euro 250 million. These consist of multiple forms of support, of which only about 14% is actually targeted at poor households, whereas the rest consists of price subsidies (fuel for generators, regulated “reference” price below market level etc.) and soft budget constraints. Municipal governments provide additional subsidies of similar magnitude. Additional subsidies are effectively provided by SOEs when not paid for their fuel and heat supplies to the municipal companies – Bucharest City heating company Radet alone owes central Government-owned bulk heat supplier Elcen about RON 2 billion. Subsidies are a disincentive to energy SOE performance, energy efficiency and due to poor targeting support the largest/richest consumers more than the vulnerable. Also, at national level, on gas and electricity markets, the fact that ANRE regulates electricity prices for captive consumers to below-market levels through its portfolio contracts and keeps domestic gas prices at low levels is a similar form of non-targeted social protection.

28. **Sales of energy at below market prices in non-competitive bilateral deals.** This is most striking in Hidroelectrica and Romgaz. Hidroelectrica’s bilateral contracts concluded outside OPCOM at prices that in some cases are as low as 50% of market price (Box 4). Romgaz sales of domestic gas at 40% of import prices to selected companies in the fertilizer industry. These practices reduce proportionally the potential profits of state-owned companies and consequently the dividends that the Government could earn as the majority shareholder. For example, it is conservatively estimated that Hidroelectrica’s profits could have been RON 0.9 billion higher in 2009. Hidroelectrica responded to the 2009 estimate by informing that the annual losses in 2011 and beyond will be smaller as Hidroelectrica renegotiated the biggest five of its bilateral contracts in 2010 and raised the rates. The duration of the contracts was extended to 2018. Therefore, although annual losses were reduced, the duration of losses was extended – the total loss may have been increased as a result of the 2010 renegotiations.

Box 4: Cost of Hidroelectrica’s below-market priced Bilateral Contracts

One of the major SOEs in the power sector, Hidroelectrica, sells most of its electricity outside the OPCOM power exchange OPCOM, through directly negotiated bilateral contracts with selected traders and industrial consumers, at prices well below prices at the OPCOM Power Exchange. Contract volumes frequently exceed its own electricity
generation, requiring Hidroelectrica to purchase the balance. Instead of purchasing at the OPCOM Power Exchange, Hidroelectrica buys more expensive power, through directly negotiated contracts with loss-making power companies Termoelectrica (including Deva and ELCEN) and selected private suppliers. Purchasers from Termoelectrica are part of the Government’s support mechanism for coal. In 2009, Hidroelectrica made a loss of about RON 900 million (euro 220 million) by selling electricity bilaterally at an average price of RON 100/MWh (according to Hidroelectrica’s 2009 Administrator’s Report) and purchasing power at RON 200/MWh while the OPCOM average price was about RON 170/MWh.

This is a conservative estimate of the cost of Hidroelectrica’s contracting practices. Instead of the OPCOM average price, Hidroelectrica could have achieved a higher selling price, being a producer of peaking power – prices at peak times are higher than off-peak and average prices. Hidroelectrica also loses as ANRE provides Hidroelectrica a very low price in its portfolio contracts, justifying this practice in part by Hidroelectrica’s own below-market bilateral contracting.

The World Bank has encouraged Hidroelectrica to use the OPCOM Power Exchange and limit the share of longer term sale contracts to the firm energy output of its hydro plants. Hidroelectrica’s contracting practices continue to lead, particularly at times of low hydro availability, to selling hydro power much below market rates and much below the rates at which it has to buy the power to compensate for the hydro shortfalls, having contracted much above the firm output of its plants. Effectively, due to these contracting and risk management practices, Hidroelectrica is carrying most if not all the hydro risk instead of sharing it/passing it on to the consumers who benefit from wet hydro years and therefore should also share the burden of dry hydro years.

29. Uneconomic pricing of domestic gas. A country such as Romania which has domestic gas production but has to import gas to meet the demand should in principle price its domestic gas at import parity. Romania controls the domestic producer price for the local market and prohibits exports. The (theoretical) cost of this uneconomic practice to domestic gas producers (foregone revenues) and the Government (through foregone dividend and tax revenue) is about US$ 2 billion/annum. (This amount is
theoretical as it is unlikely that the gas producers would actually seek to raise their domestic sale prices to full import parity, or would actually export gas.).

30. **Subsidies/State aid to loss-making state enterprises and profitable private companies.** Several companies (Termoelectrica, coal mines) do not operate under hard budget constraints. Arrears for Termoelectrica, Elcen and CNH totaled euro 1.88 billion in 2010. This practice of arrears accumulation will likely continue if the Government sets up the two integrated energy companies, although the relatively profitable Hidroelectrica and Nuclearelectrica would serve as vehicles to cross-subsidize the future losses in thermal generation and coal mining and might help slow down the growth of arrears. Below-market priced energy to some, while others have to purchase electricity on market terms, distorts competition in the downstream markets. Government policy to sell cheap domestic gas to some companies (Box 3) favored fertilizer plants but did not allow other companies to have access to similar conditions. Similarly, below-market price electricity sales by Hidroelectrica to large aluminum and steel companies are equivalent to state support to energy-intensive industries. The purpose of Hidroelectrica’s below-market price sales to selected traders is more difficult to determine and might involve objectives other than supporting energy-intensive industries. Romania faces the risk that if the European Commission reviews these practices some if not all of these distortions could be found to constitute state aid and the recipients could be required by to pay back such illegal aid from the date of Romania’s EU accession.

31. **Threats to energy security and economic growth are rising,** particularly from the electric power sector where critical generation facilities are facing obsolescence and investments to replace them have not materialized. Nominally, Romania’s power generation capacity of about 16.5 GW exceeds the peak demand of about 10 GW by a significant margin. However, about 8.5 GW of the 16.5 GW is thermal power capacity, most of it already obsolete according to the Ministry of Economy (Figure 3). All will most likely be obsolete and most probably will also have been closed as uncompetitive and/or environmentally non-compliant by the end of the decade. The Review’s base case assumption for Romania therefore has to be that none of this 8.5 GW can be relied to still generate electricity in 2020. If peak demand grows slowly by an average of 2%/annum, the peak will exceed 12 GW by 2020. If peak demand grows by 3%/annum, the peak will exceed 13 GW by 2020. Therefore Romania faces the challenge to replace thermal capacity to provide for the increasing demand, renovate at least one third of Hidroelectrica’s 6.5 GW capacity (its most important plants Irongates and Lotru have been rehabilitated), provide for the 2-3 GW load growth, and provide additional reserve capacity for wind power. The Ministry expects that about 5 GW would come from thermal power, mostly coal/lignite, and the rest from renewable energy, mostly wind. However, the future of coal/lignite power in Romania is an area of major uncertainty (paras. 128-133). The prospects of attract wind power investments are bright, due to the significant wind power potential and the generous support scheme (para. 123), but also wind investment face uncertainties as discussed below.
A long list of power generation projects have been/are being explored and talked about in Romania, but the prospects of many of the projects remain uncertain. Firm capacity additions (1,112 MW) and expected capacity additions (1,716 MW) amount to about 3 GW (Table 2). Other possible projects (excluding coal/lignite) could add about 7.5 GW, of which about 5 GW would be wind projects. While the prospects of most of the 7.5 GW of projects in the “possible” category are uncertain, even more capacity would be needed, to generate enough electrical energy and to reliably meet the peak due to the intermittent nature of wind power. Some of that electrical energy could come from new high-efficiency combined heat and power plants that would generate electricity and provide heat for cities.

Table 2: Generation Capacity Additions, Retirements and needed Rehabilitations/Replacements (MW)

<table>
<thead>
<tr>
<th></th>
<th>Firm</th>
<th>Expected</th>
<th>Possible</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hydro</td>
<td></td>
<td></td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Gas</td>
<td>860</td>
<td></td>
<td>1,260</td>
<td>400</td>
</tr>
<tr>
<td>Wind</td>
<td>252</td>
<td>1,716</td>
<td>7,000 *</td>
<td>5,000 *</td>
</tr>
<tr>
<td>Nuclear</td>
<td></td>
<td></td>
<td>1,400</td>
<td>1,400</td>
</tr>
<tr>
<td>Coal/lignite</td>
<td></td>
<td></td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Total</td>
<td>1,112</td>
<td>1,716</td>
<td>10,700 *</td>
<td>7,500 *</td>
</tr>
</tbody>
</table>

Source: Functional Review estimates, based on information from MEC, market participants and various project announcements, plans and reports. *rounded figures
Romania needs to secure investments in generation capacity, including reserve capacity, and grid strengthening. Reactivation of the EnergoNuclear’s 1,400 MW Cernavoda units 3&4 would be a major contributor. Most promising prospect among the various possible new generation projects is wind (Table 2) – due to the generous support scheme highlighted above. However, connecting much more wind capacity than the current 502 MW plus the firm 252 MW and the expected 1,716 MW – a total of 2,460 MW – will be a major challenge to Transelectrica. If all wind projects in the “possible” category were to materialize, another 5,000 MW wind would be added, for a total of almost 7,500 MW. It would be a major challenge for Transelectrica to connect and reliably operate a power system with 7,500 MW wind. Hydro projects such as the Tarnita 1,000 MW pumped storage hydro and/or gas turbine projects would be needed for reserve for periods of slow winds. Tarnita would also effectively support the operation of Cernavoda units 1-4 in their most economic and safest base load mode. The improved functioning and integration of the regional electricity market would also enable a higher share of wind power with less reserve capacity in Romania.

D. Current Functions and Organization of the Ministry of Economy

Over the past six years the Ministry of Economy, Commerce and Business Environment (MEC) has undergone significant organizational and structural changes, and the latest reorganization is still on-going. Thus, the current Ministry is the successor of: the Ministry of Industry and Resources (until 2005); the Ministry of Economy and Commerce (2007); the Ministry of Economy and Finance (2007-2008); two separate ministries, Ministry of Economy and Ministry of SMEs (2008-2009), subsequently merged into the current Ministry of Economy, Commerce and Business Environment (2009). The functions of the Ministry have changed accordingly. At present, according to its official mission statement, the Ministry “implements the strategy and Government program in industry, mineral resources, energy, trade, SMEs, business environment, in a manner consistent with the requirements of a market economy and to stimulate private initiative”.

However, in practice, the main focus, resources, and public visibility concerning the Ministry’s activity remain energy and mining policy and strategy; the drafting of energy legislation; and the management of SOEs, minority shareholdings and institutes in energy, mining, chemicals industry (Oltchim), defense etc. Other critical functions of the Ministry seem to be given less attention, particularly on business environment; SMEs; trade, economic cooperation; competitiveness policy; and industrial policy, and they are certainly less publicly visible. In the views of MEC staff, energy-related functions represent “80% of the day-to-day activity”, even though the staff allocation across the General Directorates on the broad activities of the Ministry seem to be relatively balanced, with roughly equal allocation of staff on energy & mining, industrial policy & business environment, and trade & foreign relations (Figure 4). However, the perception that energy and mining related functions should be given a higher importance by the Ministry is reinforced by the financial stakes of the Ministry in the two sectors. Thus, while the annual budget of the Ministry for its own activity is RON 2 billion, MEC’s shareholding in energy and mining companies reaches Ron 11.4 billion RON. Also, the energy and mining companies represent 86.4% of MEC’s total portfolio in SOEs.

4 MEC’s web-site http://www.minind.ro/soc_subord/6c.html lists a total of 64 SOEs, minority shareholdings and institutes (plus several subsidiaries in addition to the 64).
Figure 4: MEC Staff Allocation in General Directorates

<table>
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<tr>
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<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>40</td>
<td>67</td>
<td>35</td>
<td>100</td>
<td>66</td>
<td>131</td>
</tr>
</tbody>
</table>

Source: MEC, 2011

36. **Ministries of Economy in EU countries** (Box 5) have small departments dealing with energy-related issues, focusing on strategy for national and common EU-wide objectives (security of supply, competition and environment, and having arm’s length or no direct relationship with energy SOEs). In European countries where business and energy are concentrated in the same ministry, the main activity focus is on business environment functions. In contrast, in Romania successive reorganizations have downgraded SME-related functions from previously a separate Ministry to a small directorate in MEC, and business environment is dealt with by another small directorate in MEC, both in the DG Industrial Policy and Business Environment. Business environment functions in the MEC are given limited importance and they are poorly coordinated across the Government as discussed in the Business Environment section.

**Box 5: Ministry Structures in the European Union**

Review of the government structures in the EU shows that there is no single approach to organizing government structures. Multi-sectoral ministry of economy is the most typical approach. Romania is in line with this practice of several EU countries. A few countries have in recent years established ministries focusing on energy and climate action, reflecting the central role of energy production and consumption in climate change mitigation.

Ministries of economy (exact names vary), dealing with a number of topics including energy, are common in the European Union. Such ministries operate for example in Germany and France (among the larger EU Member States) and Finland and Sweden (examples of smaller Member States). The widest portfolio was probably in place in France up to 2007 where the Ministry of Economy, Finance and Industry used to prepare and implement the Government’s strategy regarding matters of economy, public finance, consumer protection, foreign trade, industry, energy (security of supply and competitiveness), raw materials, postal services and electronic communications, and tourism. Energy (and transport, ecology, and housing) now fall under a different ministry; however, the Ministry of Economy is still involved in the definition of the energy policy.

Ministries of energy and climate (names vary) have been recently established in the UK and Denmark. Unlike the typical EU practice of ministries dealing with a large range of topics, they have chosen to set up dedicated ministries focusing sharply on the close related energy and climate action challenges. Elsewhere in the EU, energy and climate change are typically dealt with by different ministries – climate change typically by the Ministries of environment (exact names vary). This is also the Romanian approach.
In addition, despite the bias towards energy, some key functions related to energy strategy and policy reportedly have significant gaps. Thus, functions related to municipal energy, climate change, energy efficiency are fragmented among other ministries and not well coordinated; whereas the focus of the energy function of the Ministry remains the proposed restructuring of the sector in two integrated companies.

D.1. MEC Restructuring

Following the latest restructuring in 2010 and early 2011, the new organization of the Ministry (Annex 1) is an improvement from the previous organization chart. The structure was streamlined significantly (with nine General Directorates from previously 13) and the selection of staff for the remaining positions after the downsizing was carried out through a competitive and transparent process of selection. The definition of departments and functions in the new organization chart followed the recommendations of a consultancy for MEC’s compliance with the ISO 9001 quality standard. The implementation of a difficult restructuring in a very short time - the most painful staff adjustment measures took place in 2010 and January 2011 - can be regarded as a considerable achievement. However, it will take time until the success of this restructuring can be properly assessed in practice, as the remaining staff needs to adapt to the new positions and increased work load and responsibilities. Given the necessary time for adaptation and the fact that the restructuring has been a painful process for all those involved, another major restructuring or further reductions of staff is not recommended.

In addition to the difficulties to be expected for another restructuring, unlike in the case of other sectors in the public administration, there is no universal recipe or model that one could recommend for yet another reorganization of the Ministry of Economy. Some major reorganizations in the past (notably the creation of one Ministry of Economy and Finance in 2007 by the merger of the two ministries) have been justified as following the French model (Box 5). In recent years there have been other proposals, such as from the technical academia, for the creation of a Ministry of Energy, which would have a steering role in energy policies and would concentrate functions related to energy and environment and climate change, currently separated in various institutions (Ministry of Environment, Administration and Interior, environmental agencies, energy efficiency matters in the Ministry for Regional Development etc.). International experience does not readily support that approach. The closest cases can be found in Denmark and the UK where the governments have set up ministries dealing with energy and climate change. Future major reorganizations of the existing MEC based on such justifications, with no detailed impact assessment, should be avoided. On the contrary, countries in the EU show a variety of institutional arrangements for Ministries of Economy. The challenge for Romania is to establish effective mechanisms for the coordination of functions across the Government to ensure correlation of business and/or energy functions with other government ministries and agencies; and on energy-specific functions they have a focus on broader, strategic issues related to policy formulation instead of dealing with the micro-management of SOEs.

The recent restructuring has been a painful process that involved significant layoffs and the downgrading of ministerial departments to smaller units. In the latest restructuring, the current number of staff was reduced to 598, after a cut of 32% of total positions (875 initial total positions; of the 277 reduction, 153 were vacancies and 124 were layoffs). The number of General Directorates was reduced from 13 to nine. The restructuring had several goals: a reduction by 25% of the wage bill of the
Ministry, maintaining all the functions of MEC, and ensuring the return to the initial level of salaries from January 1, 2011. The restructuring reduced several departments to levels which are inconsistent with their functions and almost dissolved the environment department. In contrast, MEC unit managing EU funds (the Managing Authority for the Competitiveness OP and the two Intermediate Bodies, for SMEs and for Energy) were protected against the layoffs. As a consequence, other departments have been reduced by more than a third so as to achieve an overall 25% budget cut.

41. The formal process in which the new functions of various departments were designed used the results of previous consultancies and focused on streamlining key processes and activities of the Ministry. The reorganization placed a significant emphasis on the reduction of high (General Directorates) and medium level management (Directorates) and organization of various units as either “services” or “compartments”. In these cases, the downgrading of departments to lower levels followed the reduction of numbers of staff in each of these units and the rules of the Romanian public administration that classifies departments by the minimum number of staff (e.g., a “service” has minimum five staff etc.). The latest rules of functioning (ROF) sought to eliminate some redundant small functions, but the overall goal of the restructuring was to keep the same functions for the Ministry with less people.

42. Maintaining all previous functions with 32% less positions (of which almost half actual staff layoffs) and the downgrading of high level units (General Directorates) to lower level poses significant challenges to the remaining staff, in terms of workload and staff motivation. In addition, the majority of units in the Ministry have been downgraded to lower levels (General Directorate to Directorate, Directorate to Service and Compartment etc.), following the layoffs and the general Civil Service rules that specify the number of staff needed for a unit to be General Directorate, Directorate, Service or Compartment. As a result, heads of these units have been demoted to lower positions in the civil service hierarchy, which affects prestige, power and motivation.

43. There seems to be significant scope for the reduction of work overload by restructuring MEC’s relationship with the subordinated companies and the separation of the ownership function of the Ministry and day-to-day management of the SOEs. The Ministry ROF indicates significant overlap of functions between departments of the Ministry (Planning, Budget, Human Resources, Energy, Mineral Resources, OPSPI) with departments of the subordinated companies, leading to day-to-day interference and unclear relationships with and accountability of the companies. Many MEC’s staff are actively involved in the management of MEC’s SOEs, through membership in general shareholders’ assembly or boards of administration. In addition, MEC also has a specialized department for state ownership and privatization functions (OPSPI). However, in all critical aspects concerning state ownership OPSPI needs the consensus of other departments in MEC. Since privatizations have been stopped, the main function of OPSPI is the legal drafting of mandates for members of the boards of administration and general shareholders’ assembly, for decisions that need approvals from departments that have related responsibilities in MEC. For all the decisions concerning SOEs, a number of departments have to sign the documents (e.g., for investments they have to be approved by the investment staff in Ministry, but also by budgets; for major SOE contracts the legal department in MEC also signs etc.). As each department is held accountable only for the part of the document on which it has responsibilities (e.g., legal for legal matters, accounting for financial matters etc.), the responsibility is dissipated among many departments or assumed by the Minister.
44. **As detailed in the SOE governance chapter below, the reduction of the responsibilities of MEC staff in relation to the subordinated SOEs could be achieved by the transfer of the SOEs (except TSOs Transelectrica and Transgaz, and the new company for gas storage) to the Ministry of Public Finance.** The proposed transfer would allow MEC to focus on policy and regulatory aspects not under ANRE’s responsibility (e.g., energy security). Arm’s length relationships with companies would mean clear MEC/Government statements of policy and objectives for SOEs against which the performance of SOEs management can be assessed, while SOE management should have the management autonomy to reach the stated objectives of SOEs. In addition to reducing the work overload, such simplification would also clarify the accountability of each department in MEC and the governance and management of SOEs.

45. **While the Review does not recommend yet another restructuring, the merger of the two Directorates that deal mainly with energy (Energy and Mineral Resources) could be considered.** In the latest reorganization, gas was moved from Energy to Mineral Resources; in the past, gas has been either in Energy or in Mineral Resources General Directorates. A possible merger of the two departments would put an end to the long discussion of whether gas is better integrated with Mineral Resources or with Energy. The arguments for transferring gas functions to Mineral Resources were that the Mineral Resources directorate is: (a) involved in the regulatory (concession) part of mining and extraction of natural resources; and (b) responsible with the regulation of the gas “basket” price, in charge with the implementation of a joint MEC/ANRE/ANRM Order that establishes the principles behind the “basket” (see energy challenges chapter). Supporters of inclusion of gas in the Energy Directorate see the need to facilitate better coordination of gas and electricity policies, matching the regulatory joint approach to gas and electricity by ANRE and also EC’s DG Energy structure. The gas market is important for the electricity market as gas is one of the key resources for the production of power. Both arguments have merits. This Review suggests that the two departments be merged in an attempt to achieve more effective integration and realize (modest) savings through eliminating overlaps in staffing and functions.

**D.2. Strategic Institutional Plan**

46. **In parallel with the actual restructuring, the Ministry finalized a Strategic Institutional Plan.** The purpose of such a document is to define the mission, vision and challenges from both the internal and external environment for the Ministry as an organization and for each department. The document has been prepared considering the partial results of the restructuring consultancy focused on processes in the Ministry for the ISO 9001 quality standard, and seeks to formalize a correlation between the activities of the Ministry with the Government Program. However, as per discussions with the MEC staff, the document would not be used in the future as a guide for the activity of the Ministry, and it is already outdated, being prepared before the end of the restructuring. The Plan would need updating and substantial enhancements to become a useful tool for the organization.

47. **A strategic institutional plan could be a relevant instrument for the finalization of the restructuring and orientation of the staff in their new organizational roles.** Such a document should detail the goals of the Ministry, the challenges from the internal and external environment and define the direction in which the Ministry should develop its activity and functions. As such, the strategic institutional plan would complement the ROF, and place the Ministry as an organization in a changing environment to which it must adapt (as opposed to the ROF which is a snapshot at a particular moment).
A strategic institutional plan could stabilize the structure of the Ministry. Future reorganizations need to be linked to the strategic institutional plan and justified by the changes in the environment, instead of ad hoc decisions. Special emphasis should be placed on how each department manages the internal and external environment and how it would react to foreseen changes, starting from the SWOT analysis included in the existing plan. It should also comprise an analysis of the human resources and training needs for each department, in order to prepare a coherent training program for the entire ministry; a budget analysis by department for benchmarking with resource use in other departments and seek ways to optimize resource use; the coordination of changes across departments.

E. Management of Resources

E.1. Human Resources

48. Following the reduction of staff during the latest restructuring, but also voluntary turnover and departures to the private sector, the Ministry has eliminated redundant positions and the view of MEC staff is that the current number of jobs leads to the maximum workload possible. Many staff in critical areas of the Ministry work long hours. In the workshop organized on January 27, 2011, the view of MEC staff was that the existing workload strains to the maximum the capacity of the personnel and if staff turnover continues because the private sector offers better perspectives, the Ministry might be unable to properly deliver its key functions.

49. The staff of the Ministry comprises a mix of skills and educational levels, with a high concentration (about 2/3 of total) of engineers and economists (Figure 5). Also, before the restructuring, more than half of the personnel were above 40 years of age. Engineers are concentrated in the energy and mining departments, and many of them were educated before 1989. This is both an asset (since technical education was highly valued and extremely competitive before 1989) and a burden (with many not being able to adapt to the principles of the market economy, a fact that affects the vision and preparation of strategies and understanding of the roles of the ministry).

Figure 5: MEC Staff Profile

![Distribution of skills / education, MEC, 2010](image1)

![Staff by contractual type, MEC, 2010](image2)

source: MEC, 2010

50. The system to reward staff performance, at the Ministry and subordinated companies, is commonly perceived as ineffective. Performance criteria for the general managers of SOEs do not focus

22
on one or two items (such as profitability), but include a combination of profitability, compliance with the investment plan, compliance with targets to reduce expenditures on certain items and execution compliance for the approved budgets etc. This complex definition of management performance can also be directly linked to the lack of a coherent state ownership policy for the SOEs under MEC. As a result, the replacement of managers is typically not linked to the failure to meet the (complex) performance criteria but with politicization (with managers receiving excellent results at appraisals being replaced with the change in Ministry leadership). In the Ministry, the rigid rules of civil service and the recent streamlining of bonuses following earlier excesses across the Romanian public administration also do not allow the financial reward for good performance. In addition, the Ministry does not have a well-budgeted training strategy for the development of human resources, which could have used the results of the staff appraisals to focus on the areas of needed improvements.

### E.2. Public Procurement

51. **Both the Ministry and SOEs are subject to the public procurement legislation (Ordinance 34/2006 with its subsequent amendments).** Accordingly, the Ministry and the subordinated SOEs are expected to contract competitively all supplies, works, or consultancy, exceeding the threshold amounts for public tendering in the procurement legislation. There is however evidence that the public procurement legislation is not followed consistently in some instances and this practice could have long standing negative effects on the performance of the Ministry or the financials of the subordinated SOEs, as illustrated by the examples below.

52. **The preparation of energy strategies is often contracted on a single source basis to a local institute (ISPE).** ISPE used to be subordinated to MEC before its privatization. The risk in this practice of single source contracting resides not in the amounts spent from the budget on the consultancy per se, but in the risk to the formulation of strategy options. ISPE used to be the monopoly designer of power plants before 1989 and there is a risk of bias towards proposing rehabilitations or upgrades to the existing power plants (which it initially designed) instead of replacements with modern technology. Given the high stakes involved - after several years of inconclusive debate about the national energy champions and the increasingly important climate change dimension - it would be advisable for MEC to also seek advice from companies directly exposed to international best practices on energy and climate change strategies and strategy formulation in other countries instead of continuing to rely exclusively on ISPE.

53. **For the SOEs, the main issues are related to single source contracting of maintenance, after wide-spread externalization monopoly companies which are owned by the beneficiary and have representatives of the beneficiary on the boards (e.g., Hidroserv for Hidroelectrica’s maintenance, SISE for Electrica’s maintenance, and similar companies in the mining sector); and the practice of purchase of electricity from expensive producers or suppliers.** Though maintenance companies in mining and Hidroserv and SISE have local branches and in theory these local branches could compete with each other and other service providers to provide maintenance services, in practice the contracting is not done competitively. There is a risk and in fact a common perception that the allocation of maintenance contracts follows political affiliation of the leadership of these branches and connections to the management of the purchaser of such services. Another situation in which SOEs do not follow the principles of competitive public procurement is seen in the purchase of very expensive power by
Hidroelectrica from inefficient, loss-making thermal capacities. Even though the cross-subsidy between energy producers is explicitly forbidden by the law, these purchases are in effect such cross subsidies. Table 3 shows Hidroelectrica’s purchases in 2009, averaging RON 200/MWh, through bilateral contracts, even though it could have bought electricity on the OPCOM power exchange at an average price of RON 170/MWh or much lower at off-peak prices (as it actually did, at RON 99.5/MWh for a portion of its purchases), to meet its supply obligations (Box 4). The opposite practice of selling electricity below market price is discussed elsewhere in this report – in Section C - as it does not seem to fall under the current public procurement legislation.

Table 3: Hidroelectrica’s purchases of electricity in 2009

<table>
<thead>
<tr>
<th>Supplier</th>
<th>Bilateral contracts</th>
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<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Volume</td>
<td>Value</td>
<td>Avg price</td>
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<tr>
<td>TERMOELECTRICA</td>
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<td>UT GIURGIU</td>
<td>20,850</td>
<td>3,544,500</td>
<td>170.0</td>
</tr>
<tr>
<td>NUCLEARELECTRICA</td>
<td>80,700</td>
<td>9,075,522</td>
<td>112.5</td>
</tr>
<tr>
<td>OPCOM</td>
<td>142,180</td>
<td>14,141,743</td>
<td>99.5</td>
</tr>
<tr>
<td>TOTAL</td>
<td>2,454,949</td>
<td>490,202,262</td>
<td>199.7</td>
</tr>
</tbody>
</table>

E.3. Budget Execution

54. Budget execution systems are aimed at ensuring efficient budget implementation, in accord with the policies stated in the budget and in compliance with budgetary authorizations. They should also be able to respond to possible changes in the macroeconomic environment without disturbing excessively budget management, in particular without generating arrears and creating inefficiencies. The functions of MEC departments involved in supervising budget execution were reviewed with respect of the capacity of the budget execution systems to achieve these objectives. In addition, the Review looked at a more narrow set of topics in budget execution at two MEC SOEs (Hidroelectrica and Transelectrica) and the role of internal auditors. The findings are presented in Annex 3. The recommendations are summarized below.
55. The budget execution Review recommends the following capacity building and organization measures for the Ministry:

- Financial Accounting General Directorate to finalize and approve all internal control procedures as planned by June 30, 2011;
- Increase internal audit capacity (staff and equipment);
- Consider the merger of the Financial – Accounting General Directorate and the Budget and Planning General Directorate, in part to be consistent with the similar Budget-Financial-Accounting General Directorates in other line Ministries in the Romanian Government. This merger should be done in parallel with increasing the role of the MEC’s Public Policies Unit in the overall MEC strategic planning and prioritization; and
- Implement a fully Integrated Financial Management Information System.

56. The following four recommendations from the budget execution review of the Ministry of Public Finance (MPF) are cross-sectoral and also relevant for MEC:

- MPF to eliminate credit openings;
- MPF to eliminate ex-ante delegated controllers to line ministries by December 31, 2012;
- MPF to enhance the implementation of the International Public Sector Accounting Standards; and
- The Government to adopt and implement the legislation on electronic signature.

F. Energy-related Functions outside of MEC

57. There are several energy sector functions outside of the MEC. As MEC is responsible for the overall energy policy, it must have a steering role and lead the energy-related actions across Government; at the same time, while the regulator needs to be independent of the Government, consultation on new legislation and policy measures is critical. Therefore, for the performance of the energy sector, two issues are of critical importance: the coordination of energy-related functions across the government and the independence, quality and accountability of the energy regulator. There is substantial scope for improved coordination of energy functions across the Government and cooperation with the Parliament. At present, as explained below, there is insufficient inter-ministerial coordination regarding energy functions, particularly in areas concerning environment, energy efficiency, municipal energy and energy services to vulnerable consumers.

F.1. Energy and Climate Change

58. Currently, Romania does not have a climate change strategy and there is no clear coordination of energy strategies (prepared by MEC) with climate change actions (where the main responsible institution is the Ministry of Environment). The MoENV has a department for Climate Change and Sustainable Development, whose functions are closely linked to the energy sector. The
MoENV department is involved in matters concerning the allocation of emission permits among polluters, of which many are thermal power plants under MEC, and in ensuring that Romania makes best use of emission allocations and trading on international markets. The cooperation of MEC and MoENV is critical in these matters, particularly given the high financial benefits at stake, such as the possibility to trade internationally the AAUs (assigned amount units under the Kyoto Protocol) which in spite of years of discussion since about 2004 has not been accomplished. It had been estimated that a sale of AAUs could bring Romania about euro 2 billion. The money collected from such sales would be invested in upgrading/replacing inefficient plants. The lack of effective coordination between MEC and MoENV departments on these matters reached a critical point in 2009. At that moment, Romania had finally decided to prepare the legislation for the sale of about 200-300 million AAUs. However, the drafting of the legislation, started in May 2009, is still on-going with no secondary legislation in place. The delay of more than two years was caused by the fact that Government coalitions could not agree on which Ministry should benefit from the funds: Environment or Economy (each having a Minister from a different party). Since a requirement in AAU trading is that the money obtained from the sale must be used for projects that reduce CO2 emissions, both ministries had prepared own lists of projects (Environment – for projects that would reduce CO2 emissions; Economy – rehabilitation of CHPs). Time is critical, since the value of these certificates depends on whether there would be a post-Kyoto agreement to carry forward the AAUs after 2012.

59. Romania prepared in August 2009 a memorandum containing an action plan with the measures needed for the energy and climate change legislative package (EU’s 20/20 by 2020 package), but none of the measures have actually been implemented. Thus, the first measure consisted of the establishment of the inter-ministerial committee (“task force”) to start the preparation of measures needed to bring Romania in compliance with EU requirements. Currently, the task force is not yet in place, even though the deadline was Q3 2009. The establishment in the future of such a committee, as well as the implementation of the subsequent measures, seems even less likely now, considering the reduced capacity in the environment and climate change departments in MEC and MoENV.

60. The department responsible with the environment in MEC has been dissolved and MEC has limited capacity to deal with complex issues on energy efficiency, planning for AAUs and emission allocations, and Romania’s position in EU-level and international climate action negotiations. The counterpart department in the Ministry of Environment has suffered similar loss of key competencies, because of staff layoffs during the crisis, personnel turnover, and the requirement that for every seven staff departures the ministry could hire only one replacement, which affected the entire Romanian administration. The Climate Change and Sustainable Development department in MoENV has currently only seven staff, of which one is on maternity leave. Even before the downsizing of the two departments, the coordination on a day-to-day basis was done more in an ad hoc manner, relying more on personal relationships that formalized procedures for coordination. Another direct consequence of the weak cooperation between MEC and MoENV is that there is no collaboration or informal consultation with the MoENV on the preparation of the current draft energy strategy updater of 2011, despite the importance of climate change measures in the Romanian energy sector to meet its commitments in the Europe 20-20-20 strategy.

61. Beyond Romanian borders, there is a global debate on the post-Kyoto arrangements to mitigate climate change, where the EU considers undertaking more commitments than the
unilateral obligation in the Europe 20-20-20 strategy. At national levels, this means that each state has to negotiate within the EU how much EU can commit, as a group; and how the total EU burden would be split among individual member states. Romania’s voice has not been heard in this debate. While a reasonable solution would be to follow Poland’s strategy (a country with high CO2 emissions from old coal power plants) to minimize rationally the costs borne by Romania, this approach would require collaboration between DEA, MEC and MoENV, to participate and react promptly to any new discussion in the international arena. DEA is disconnected from the two ministries, being involved only when specifically notified by line ministries that they have issued legislation on EU-related matters, and mostly checking the conformity of these laws with EU legislation instead of playing also a role as a negotiator jointly with the line ministry when Romania needs to negotiate, or perform a challenge function if the proposals from line ministries are not in line with EU’s Directives.

62. Irrespective of the EU’s 20/20 by 2020 energy and climate package and its renewable energy targets, it is in Romania’s self-interest to exploit its renewable energy and energy efficiency potential to improve its energy security and contain environmental emissions. Some would go even further and argue that sustainable development cannot be achieved if Romania does not significantly improve its energy efficiency and reduce its reliance on fossil fuels, especially coal. Romania has a considerable rich and diversified energy potential – in addition to coal, also oil and gas, hydro, uranium, biomass, favorable wind conditions. The 2007 Energy Strategy documents Romania’s large potential for renewable energy development. Wind power potential could be as high as 14,000 MW – applications amount to about 4,000 MW and the first large project of 600 MW is about to be commissioned. In a time horizon of 10 years, the new renewable energy sources, the wind and biomass particularly, could contribute as much as one fifth part of total generation (about 15 TWh/year).

63. There are coordination issues and inconsistencies even within MEC. For example, the protection of coal mines is inconsistent with the goal to reduce CO2 emissions and the measures to promote renewables or low-CO2 technologies (green certificates, ETS trading scheme). At the same time, the development of the existing green certificates scheme and the simultaneous introduction of ETS trading of non-free emission rights after 2013 might overlap and over-reward low emission technologies instead of using only the ETS to internalize CO2 costs. Regulatory inconsistencies such as the failure to finalize liberalization of prices also provide more support to those who consume more, by keeping energy prices below competitive levels for the “captive” consumers. Also, the regulation of bonuses for high efficiency cogeneration promoted by ANRE also contains favorable conditions for low-efficiency cogeneration facilities (in order to provide protection instead of promoting efficiency).

64. Romania’s 2007 Energy Strategy contains a comprehensive list of measures to improve efficiency across the Romanian economy, in industries, transport, residential sector, public sector, agriculture, and co-generation. Undoubtedly this is the right approach – there is potential to improve across-the-board and limiting attention to any one area or even a few areas would not give the required impact. However, achieving progress across the economy will require a tremendous effort and effective coordination. There is no energy efficiency strategy to help achieve that and realize Romania’s potential to improve its energy efficiency. The availability of EU (grant) financing gives Romania an opportunity to undertake a much larger program that might otherwise be affordable. But EU will not provide the skills to prepare, manage and implement the program – those have to be engaged and attracted by Romanian authorities, agencies, companies and individuals. Effective inter-ministerial/agency
cooperation does not yet exist: some institutions have more knowledge and skills than money; others have access to the funds. The fragmentation of responsibilities related to energy efficiency among ministries (incl. economy, finance, administration and interior, environment, transport) and agencies (incl. ANRE which was forced to take over the Romanian Agency for Energy Conservation (ARCE), the Romanian Fund for Energy Efficiency (FREE), the Environment Fund, Local Development Agencies) lead to poor results, delays on EU Structural Funds absorption, and possible waste of resources.

65. **One of the most challenging areas for energy efficiency improvement is the district heating sector.** Romania has an extensive district heating (DH) system. Based on international experience, DH is a least-cost option for heat supply in most densely-populated parts of urban areas. However, high rates of disconnection have been recorded in a number of Romanian cities even in apartment buildings as consumers resort to usually less economic but more effective individual heating systems. Even after considerable consolidation - from almost 200 DH systems reported at the turn of the century to about 80 systems operating today - many of the remaining systems are under great stress, operationally and financially. The continued provision of heating is an essential service. The deteriorating quality and increasing cost of service has made district heating a major national issue. DH tariffs have been adjusted, but they have generally not kept up with the increasing costs in inefficient systems. The Government, at central and local levels, provides subsidies, both to heat producers and to heat consumers, to an extent that the annual subsidy (direct and indirect) burden still amounts to around euro 250 million.

66. **The 2001-2004 Government approved a national strategy for the restructuring of the district heating sector in 2004, aimed at addressing the fundamental problems underpinning the chronic operational and financial issues.** The strategy covered pricing, subsidies, and restructuring and rehabilitation at heat production, heat distribution and heat consumption, including heat metering and heat control measures. Investments were estimated at euro 2 billion. The 2005-2008 Government reviewed the situation and came up with its own strategy – with investments estimated at euro 4 billion. Some (limited) progress has been made in the implementation of the strategy; however concern has been expressed that some of the investments made may have been poorly prepared and/or managed and are at risk of not delivering expected service improvements and benefits/savings. Difficult decisions, including further closures of CHP plants and DH systems, and politically sensitive pricing and subsidy issues, will have to be made (Annex 4). Investment requirements are very large and cannot be mobilized in the short-term - careful prioritization is essential. Consumer metering, heat control and the thermal rehabilitation of buildings would significantly reduce consumption and heat bills (Annex 5), and a comprehensive program would also create jobs for workers laid out from the construction sector to the financial crises. Large-scale EU funding should be pursued.

67. **The World Bank provided technical assistance in 2008 to MEC on the institutional vehicles and measures that would help Romania achieve its ambitious climate change targets.** A summary of the Romania Greening Fund study is attached as Annex 6. The recommendations remain valid even if the economic growth forecast proved too optimistic. Annex 6 also explains the role of ARCE as a Government instrument for energy efficiency measures. ARCE was merged into ANRE in late 2009 as a part of the Government’s streamlining of agencies. This decision should be reviewed. ARCE staff would be better placed at MEC’s Energy Department than in the energy regulator.
F.2. Energy and Social Matters

68. The main connection between energy and social protection concerns the treatment of residential users and particularly a category of vulnerable consumers. Currently, the social protection for residential consumers is not targeted towards providing the highest support to those who need it most. There are several mechanisms by which residential or poor consumers are supported. First, the Ministry of Labor has a department for social protection, which is in charge with identifying socially disadvantaged groups and households in order to provide directly targeted income subsidies, and support for energy. For example, relatively poor households receive a heating allowance (provided in Ordinance 5/2003), which is separated for district heating, gas, and wood. Wood support is the only benefit in cash, for the others the Ministry of Labor paying directly a part of the invoice. The Government has taken initial steps in 2010 to improve the targeting for the district heating support. However, in addition to the targeted subsidies, MEC and the PM’s Office/ANRE policies and regulations provide all residential consumers energy (heat, gas, electricity) at below-market prices. For example, the subsidies for the district heating consist of a mix of direct consumer subsidy and indirect support targeted at the providers, the latter being in effect state aid incompatible with the EU state aid policy.

69. Romania does not have a targeted definition of vulnerable consumers. A proper definition of the vulnerable consumers is required by the Third Energy Package and Romania needs to transpose the Directives in the national legislation. Vulnerable consumers are, according to the Directives, defined in terms of energy poverty and the right not to be disconnected in critical times (the latter category includes public institutions such as schools and hospitals). Social support needs to be targeted and it must not distort the market mechanisms and prices. Only low-income households should receive income support and have the right to receive energy from an implicit supplier. However, the Government has defined all households as vulnerable, which is contrary to the Directives, and has not set a calendar for the liberalization of prices coupled with social protection measures targeted at the low-income households.

70. To deal with infringements from the EC for the failure to liberalize energy markets, Romania will have to find solutions to subsidize only the low-income households (including a proper definition for vulnerable consumers in the primary legislation). Targeting subsidies to vulnerable energy consumers and liberalizing energy markets necessarily go hand in hand and require effective coordination of energy policies of MEC and regulations of energy regulator ANRE with social protection measures provided by Ministry of Labor. The planned comprehensive Social Safety Net, which the Ministry of Labor proposes to launch from 2013, would ideally be the only means for delivering energy subsidies and the energy prices should be market-based except for ANRE-regulated network tariffs. The parties in the coalition government support the implementation of the safety net. As 2012 and 2014 are both election years, a major restructuring of the social safety net could be a real challenge.

F.3. Independence and Competence of the Energy Regulator ANRE

71. One of the key functions in the energy sector is the regulatory function, which needs to be performed by a regulator that has the capacity, autonomy and competence to effectively promote increased competition in energy markets. To achieve market opening, more choice for the consumer, more competition to keep prices down, better service and improved security of supply, independent
national regulatory authorities have been established in each EU country. These must ensure that suppliers and network companies operate correctly and actually provide the services promised to their customers. Thus, the energy regulator is an ex ante regulator of competition, whereas the Competition Council is an ex post regulator.

72. **To effectively perform its functions, the energy regulator needs to meet several key criteria related to governance and regulatory substance.** These criteria are clearly specified in the EU Directives, and there are numerous reports (including from the World Bank and associations of regulators). In terms of governance, a regulator needs to be independent from both the Government and the regulated industry, accountable to the general public, consumers and companies, while the regulatory process needs to be transparent and regulations must be predictable. The quality of regulatory substance must be judged in terms of essence of regulations (in line with broad regulatory objectives, such as the promotion of competition in energy markets), and the capacity of the regulator to effectively enforce its own regulations on the sector, regardless of political or industry pressures. A recent assessment (Box 6) of ANRE shows deficiencies on most of these criteria.

**Box 6: Assessment of ANRE by the Romanian Academic Society (SAR)**

**Governance:**

ANRE is not independent from the Government, as can be seen in the frequent changes in leadership (5 presidents in 5 years) and, since 2010, the loss of budgetary independence. In the current conditions, ANRE is in breach of EU Directives and does not meet the requirements of the Third Energy Package, which will trigger an infringement in 2011 if corrective actions are not undertaken immediately. The EU has also sent very strong messages concerning the loss of independence of the regulator in a letter sent to the Romanian government in June 2010. Romania’s recent proposals for legal amendments of the Electricity and Gas laws for the transposition of EU’s Third Energy Package are also not in compliance with the European Directives 72/2009 and 73/2009 in terms of regulatory independence. While the regulator recovers its own financial revenues, in the proposal the regulator’s president remains under the control of the Prime Minister and obtains increased powers to the detriment of the regulatory committee and consultative council, whose roles are substantially reduced. As a consequence, the laws support the politicization of ANRE, whose functioning depends on the good relationship between the Prime Minister and ANRE’s president.

To reinstate the regulator’s credibility, ANRE must respond adequately to the recent media accusations of nepotism and relationships with the regulated industry, by firm actions. The loss of financial independence was a reaction of the Government to media and public pressure following such scandals. Restoring the regulator’s credibility requires the preparation and effective enforcement of ethics rules for its management and key staff, and the publication of ethics monitoring, to mitigate the agency’s negative public perception in recent years. The auditor’s accounts and internal processes subject to fiduciary risks must be externally audited and the audits must be part of the annual activity report, to be submitted preferably to Parliament (as in the case of CNVM). Additionally, the regulator should react timely, responsibly and by consultation with stakeholders to the market needs (new regulation or updates requested by OPCOM, Transelectrica etc) and EU regulations, including Romania’s commitments in the acquis.

A serious threat to both regulatory independence and quality is the loss of key, competent staff because of salary cuts and politicization of top positions. The loss of budgetary independence and the inclusion of ANRE’s staff in the Unitary Pay Law at low grade levels reduced the salaries of key personnel by up to 70%. While the recent law proposals would create the prerequisites for the restoration of salaries, it is also likely that it will render ANRE again
tempting for politicization in the absence of accountability measures, such as the approval or rejection of the annual activity report by Parliament and sanctions for those not acting in accordance with their job responsibilities.

The annual activity reports of the regulator do not show ANRE’s performance, details on the use of resources / powers, information that needs to be disclosed to consumers, regulated industry and citizens. ANRE must also implement adequate internal controls to mitigate fiduciary risks and have an effective external audit for both financials and internal processes, with published results. In addition, the legal framework needs to specify clearly that the management of the regulator can be replaced mid-term only for failure to perform.

Focus of Regulation:

ANRE focuses too much on tariffs instead of having a more proactive role in energy markets development and enhancement of competition. While such approach was acceptable in the early days of energy regulation (late ‘90s), EU regulators have evolved in the past decade, from tariff regulators to agencies that effectively promote competition in wholesale and retail markets, ensure unbiased access to networks, and implement Government policies on renewables, energy efficiency and environment. Several price / tariff regulations issued by ANRE, particularly in what concerns the regulated prices for residential and small non-residential consumers actually work against the objective of improved competition on the wholesale and retail markets.

The focus on tariffs instead of competition promotion is reinforced by the internal structure of ANRE, where the streamlining of departments in 2009 and 2010 has led to a merger of “markets” divisions with “tariffs”, in electricity and gas directorates. A better structure of ANRE would separate the functions related to “network access” (network tariffs, capacity allocation, cross-border issues) and markets and competition.

There are reasons for concerns about the capacity of ANRE to enforce some of its regulations, particularly in areas concerning consumer protection and monitoring and sanctioning the companies in breach of investment obligations according to regulatory periods. The recent scandal regarding ENEL (which had allegedly not performed its investments) highlighted that ANRE is not properly monitoring the post-privatization contracts that have a regulatory impact. In addition, there are increased political pressures to keep prices at below market levels, for both electricity and gas.

73. ANRE’s capacity started to slowly deteriorate in 2005 and more rapidly in 2009 when ANRE was subordinated to the Prime Minister’s Office and its budget autonomy was removed and salaries cut by over 60%. While in the early-to-mid- 2000s the Romanian regulator was a best practice model in the region, it is currently perceived as ineffective and exposed to political pressures (unable to implement own regulations, most notably in gas, and in the liberalization of energy markets, discussed below). ANRE highlights its 2009 subordination under the Prime Minister’s Office, loss of autonomy, salary cuts and staff departures as major issues - ANRE has lost about 60 regulatory staff and another 40 energy efficiency staff within the last year - and calls for corrective measures. An infringement process by the European Commission is likely if ANRE’s autonomy is not restored. EU’s Third energy package

5 A recent example was a press release on MEC’s website on March 2, just one day before the deadline for the transposition of the Third Energy Package that requires full independence of the regulator from governmental instructions on prices reads: “Regarding the media information about possible price increases, MEC’s opinion is that there is no reason why gas prices should increase for industrial and residential consumers. There is also no reason why prices should increase in the future. The only institution to issue decisions regarding gas prices is ANRE”.

6 Based on MEC functional review team’s, the joint IMF/EC/WB team’s and the World Bank’s Romania energy team’s discussions with market participants including all major private sector energy investors in Romania.
requires independence from the regulated industry and political bodies, with financial autonomy through earmarked revenues from own sources. The independence of the regulator should be matched by accountability, competence, predictability of regulations, and transparency. The Government has drafted legislation which does not adequately respond to the infringement and the Third package (Box 2).

74. **The rebuilding of energy regulator ANRE’s capacity, autonomy and accountability is critical – for restoring investor confidence and for implementing the regulatory part of the EU’s Third Energy Package.** ANRE should not be subordinated to the Prime Minister’s office. ANRE should report to the Parliament, not to the Government. The mid-term removal of ANRE’s leadership or member of its regulatory committee should be possible only if ANRE's Annual Activity Report is rejected by the Parliament. ANRE’s regulatory committee should be reconstituted into a body similar to the Board of Regulators of BNR (the Romanian National Bank, widely regarded to be the best functioning Romanian regulator). The members of the regulatory committee need would be reputable experts in energy and regulation, not ANRE’s own staff. They should be capable to assess ANRE’s staff proposals on regulations and ensure that the regulations are in line with ANRE's Regulatory Program, with EU Directives and international best practices in energy regulation. To be nominated, candidates should meet clear qualification criteria specified in law. Nominations could be made by a special commission or even by the President (as in the case of the Competition Council, another well functioning Romanian regulator), following the criteria in the law. The nominations must be transparent and debated with stakeholders and the general public, and the appointment must be confirmed by the Parliament. This process is crucial considering ANRE's loss of credibility. The Consultative Council, an advisory board to ANRE, should be reactivated. It should be composed of representatives of a broad range of stakeholders (regulated industry, employers, unions, local authorities; consumers etc.). The Consultative Council should be convened frequently and, although its resolutions would not be mandatory for ANRE, the regulator should take into consideration proposals resulting from the council meetings as they represent the legitimate interests of the stakeholders. The Government should consult stakeholders in the process of searching, screening and short-listing candidates for the President and Vice President positions. Instead of political appointments, making senior staff appointments that enjoy the confidence of the stakeholders is another key step towards the restoration of ANRE’s credibility.

**G. Reforming State-Owned Enterprises**

75. **The Government is committed to deep-rooted reform of state-owned enterprises (SOEs), especially in critical growth generating sectors such as energy and transport.** Many SOEs have become a substantial fiscal burden. In addition to requiring subsidies to cover considerable losses, they have accumulated arrears of more than 4 percent of GDP. The quality of service in many sectors is in need of significant improvements and weighs on growth by hindering further private sector development.

76. **Reforming corporate governance of energy SOEs in line could shed off tasks of various departments in MEC and ease their workload, while simultaneously increase the transparency and accountability of SOE management.** The OECD adapted in 2005 the OECD Guidelines on Corporate Governance on State-Owned Enterprises. These guidelines have been widely endorsed and now serve as a global benchmark for SOE governance reforms. In 2010, the OECD issued a Guide for State
Ownership to facilitate the practical implementation of the OECD Guidelines in the area of transparency and accountability. The 2005 Guidelines and the 2010 Guide provided the framework for the MEC functional review’s analysis and recommendations.

G.1. Government Ownership

77. The Government is committed to transferring the financial control of SOEs to the Ministry of Public Finance (MPF) by September 2011. Currently, the exercise of state ownership rights of SOEs is spread across state administration in several lines ministries including MEC which controls 64 SOEs. The centralization of the ownership function in MPF would facilitate the effective separation of ownership functions and the policy and regulatory functions of MEC (and other lines ministries). It would also facilitate reducing the involvement of MEC (and other lines ministries) in the day-to-day management of SOEs and allowing SOEs operational autonomy to achieve their defined objectives. Many MEC staff are involved in the management of MEC’s 64 SOEs through the general shareholders’ assembly and the boards of administration of these companies. In the case of energy, with the transfer of all SOEs to the Ministry of Public Finance, with the exception of transmission operators Transgaz and Transelectrica, Romania would meet the TSO unbundling requirement in the Third Energy Package.

78. Merely transferring the ownership functions from line ministries to MPF would not be sufficient. MPF would have to be ready to receive and execute the SOE ownership function. A separate directorate/ownership entity would probably have to be established. The OECD Guidelines recommend that such directorate/ownership entity should enjoy sufficient flexibility to organize itself and take decisions about its procedures and processes. The ownership entity should also enjoy sufficient budgetary autonomy to allow flexibility in recruiting, remunerating and retaining the necessary expertise, including from the private sector. If MEC’s SOEs are to be transferred to MPF, the transfer of OPSPI – MEC’s specialized department for State Ownership and Privatization - could also be considered.

79. Whether the financial control of MEC SOEs is transferred to MPF or initially retained at MEC, improved transparency and accountability of the SOEs requires a clear statement and implementation of state ownership policy and objectives of these companies. The OECD Guidelines call for the government to develop and issue its ownership policy that defines the overall objectives of state ownership, the state’s role in the corporate governance of its SOEs, and how it will implement its ownership policy. No such ownership policy exists at MEC for its SOEs.

80. The Government should exercise its ownership rights, according to the legal structure of each SOE, in five primary areas of responsibility. They are listed in Box 7.
Box 7: The Responsibilities of the State acting as an Owner - OECD Guidelines

1. Being represented at the general shareholders meeting and voting the state shares.

2. Establishing well-structures board nomination processes in fully or majority-owned SOEs, and actively participating in the nomination of all SOEs’ boards.


4. When permitted by the legal system and the state’s level of ownership, maintaining continuous dialogue with external auditors and specific state control organs.

5. Ensuring that remuneration schemes for SOE board members foster the long-term interest of the company and can attract and motivate qualified professionals.

81. **MEC carries out some of the recommended shareholders functions.** MEC, ultimately the minister, is represented in the meetings and chooses board members. Under the law, MEC’s role in monitoring SOE performance is limited and MEC does not report on the performance of energy or other SOEs. Explicit performance targets are contained in management contracts signed between the general managers and the boards. They tend to focus on short term operational performance. There is no equivalent of the performance management systems found in many other countries were the ownership entity and the company negotiate an agreement containing key performance indicators (KPI). Remuneration for board members is also severely limited by an emergency ordinance, and is basically nominal.

82. **Through the general shareholders’ assembly and other mechanisms, MEC carries out a number of functions that go well beyond good practice in SOE governance.** In most private companies and SOEs in other countries, the shareholders meets at least once a year, and may meet at most a few more times to approve certain extraordinary events. In SOEs under MEC, the general shareholders’ assembly can meet up to once a month, and the MEC employees that attend the meeting have a mandate from the minister on how to vote. This reflects in part various financial rules that SOEs have, including the need to approve even small changes to a detailed budget, as well as transactions and investment in excess of 5 million RON. However, it is not clear that these rules entirely justify such meetings, and the general shareholders’ assembly may be consulted on a range of other issues. This frequent consultation expands the scope for MEC intervention while diffusing the responsibility of both the general managers and the boards.

83. **Whether the financial control of MEC SOEs is transferred to MPF or initially retained at MEC, the Review recommends a major reconstitution of their boards, starting with the major energy SOEs.** It is not practical to reconstitute the boards of 64 companies simultaneously, hence the recommendation to start with MEC’s major SOEs. They are mostly in the energy sector. The Government is usually the sole owner and even where other shareholders are present, the Government is usually the controlling owner of MEC SOEs. This places the Government in a position to nominate and elect the boards without the consent of other shareholders. The boards of the energy SOEs are dominated with MEC staff. They are sometimes joined by a representative from MPF and/or staff from other line
ministries. This standard practice is inconsistent with the OECD Guidelines. The Guidelines call for the state to avoid electing an excessive number of board members from the state administration, particularly for partly owned SOEs and for SOEs in competitive industries – which is the case for many MEC SOEs, including the largest: Hidroelectrica, Nuclearelectrica and other state-owned power generators and Romgaz and petrochemical companies including Olchim. When carrying out their duties individual board members are expected to act independently and are not supposed to represent their constituencies. This principle is very difficult to adhere to for MEC and other government staff. Some countries have decided to avoid electing anyone from the state administration on the boards of their SOEs. A major reconstitution of the boards of MEC SOEs should be carried out in phases, starting as soon as possible with the major energy SOEs for which majority privatizations or minority IPOs are envisioned.

84. **Improved governance and more profitable functioning of SOEs would have benefits for the reduction of the budget deficit, creating space for EU funds absorption or other investment spending.** The profits of the SOEs (Hidroelectrica, Nuclearelectrica, Romgaz etc.) are distributed as dividends to MPF; normally 50% of the profits are distributed each fiscal year. During the crisis, Government required 90% to be distributed and also requested some SOEs to make additional “donations”. Romgaz was requested to “donate” RON 400 million to the state budget (ignoring and to the detriment of the minority shareholder, as discussed in the next paragraph), instead of Government calling for a special dividend distribution to help cover budget deficits. Bilateral contracting practices of some SOEs lead to significant foregone profits. For example, Hidroelectrica lost about RON 0.9 billion through below market bilateral electricity sales in 2009 alone, half of which could have been distributed to MPF in 2010 to cover the deficit. The Government cannot afford to continue to forego such potentially available revenues to the budget while attempting to reduce budget deficits and improve EU funds absorption.

85. **The Government and its SOEs should recognize the rights of all shareholders.** As a dominant shareholder, the Government is able to make decisions in general shareholders meetings without the agreement of other shareholders. Similarly, due to their dominance of MEC SOEs boards, MEC and other government staff are able to make decisions without the agreement of the non-government board members, if any. The OECD Guidelines highlight that while such decision making power is a legitimate right that comes with ownership, it is important that the state does not abuse its role as the dominant shareholder, for example by pursuing objectives that are not in the interest of the company and are therefore to the detriment of other shareholders. (a) The RON 400 million donation by Romgaz to the state budget in 2010 is perhaps the most visible recent case of such abuse of a minority shareholder. Having taken a Cabinet-level decision to “encourage” Romgaz to make such a donation, the Government went ahead in spite of the protests of the minority shareholder Fondul Proprietatea (the Property Fund). (b) A less publicized but in financial terms more damaging case of dominant owner acting against the interest of the company and its minority shareholder is Hidroelectrica’s bilateral

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7 The Fondul Proprietatea (the Property Fund) was established to compensate Romanians whose properties were confiscated by the former Communist regime. The Fund was launched in 2005 and listed in the Bucharest Stock Exchange on January 25, 2011. The executive chairman of the company that manages the Fund stated in a press release that the Romgaz donation set a “very negative precedent” that would damage foreign investors’ perception of the safety of doing business in Romania. “They have to understand what capital markets are all about. Capital markets are about treating all shareholders equally. If they want to make progress in privatizing state enterprises, this kind of behavior is going to make it very difficult.”
contracting practice (Box 4), which also hurts the Government as the owner through foregone dividends and tax revenues. (c) The Government tried to move ahead with the establishment of the national energy champions in spite of the explicit opposition of the Property Fund, forcing the Fund to resort to legal action in the Bucharest and Craiova Courts to block the mergers. (d) There is a similar case in Oltchim, where the state wants to purchase a loss-making refinery (Arpechim) from Petrom and create a vertically integrated chemical production chain. Though the creation of the integrated company would have been financed by the Government (euro 400 million for Oltchim’s takeover of Arpechim and euro 330 million as guarantees for another private refinery, RAFO), the move was opposed by Oltchim’s minority shareholder PCC who argues that the refinery would require significant investments, not justified in economic terms and which would reduce the future potential profits of Oltchim. The takeover received a no objection from Romania’s Competition Council but is pending at DG-Competition since 2009.

G.2. SOE Autonomy

86. **MEC should reduce its involvement in the SOE boards and let the reconstituted boards exercise their responsibilities and respect their independence.** Many MEC staff are involved in the management of MEC’s 64 SOEs through the General Shareholders’ Assembly and the boards of administration of these companies. There seems to be significant overlap of functions between departments of the Ministry (Planning, Budget, Human Resources, Energy, Mineral Resources, OPSPI) with departments of the subordinated companies, leading to day-to-day interference and unclear relationships with and accountability of the companies. It would take awhile for MEC to implement such a fundamental change, but change is needed, starting with the major energy SOEs for which majority privatizations or minority IPOs are envisioned.

87. **The reconstituted boards should appoint professional management to the SOEs, following transparent selections processes and qualification criteria.** In the current situation, where MEC is involved in the operations of its SOEs through the general shareholders meetings, boards and day-to-day management and places various responsibilities and obligations for social, public policy and other unspecified purposes, it is not possible to distinguish responsibilities and accountability between the SOE management and MEC management. Depolitization of SOE management is an essential and integral part of deep-rooted reform of SOEs. Just like the members of the boards of directors as discussed above, executive management of SOEs should not be political appointees. It would take awhile for MEC to introduce this approach across its 64 SOEs, but change is needed, starting with the major energy SOEs for which majority privatizations or minority IPOs are envisioned. As soon as each board is reconstituted, one of the first tasks of each board should be the appointment of professional management. In return for autonomy, the boards should hold SOE management accountable for results - for achieving the state’s objectives for the SOEs.

88. **Operational autonomy should be accompanied with clear statement of objectives and adequate monitoring of performance.** Under the current system, management contracts are signed between the general manager and board, using indicators that are essentially set by MEC. This limits the role of the board, while providing little guidance on the company as a whole. Setting the objectives and defining the monitoring indicators requires industry and financial knowledge and operational experience. Cooperation of the state as the owner and the SOE board and top management is needed. Once defined and set, is the responsibility of the SOE board to monitor management performance and report to the
state. The Government should not go straight to SOE management or staff for information, reports and feedback – which is what MEC does as a matter of routine with its SOEs, reflecting the unclear division of labor between MEC and its SOEs.

89. **Any obligations and responsibilities that SOEs are required to undertake in terms of public service should be clearly mandated by laws or regulations and preferably also incorporated in the companies’ articles of association.** Such obligations and responsibilities should also be disclosed to the public. Related costs should be covered in a transparent manner, preferably not from the SOE revenues but from the state budget - this would subject them to the normal budgetary mechanism and Parliamentary oversight. Accepting lower rates of return instead of funding special obligations from the budget takes the funding and the special obligations out of the budget process and therefore reduces accountability and transparency. It is not unusual for SOEs to be sometimes required to fulfill special responsibilities and obligations for social, public policy or other unspecified purposes. If they are not set in laws or regulations and if costs are not provided for in the state budget, the interest of the SOE and the performance of the SOE management is undermined. Sometimes even of the interest of the owner is undermined, through foregone profits, as in the case of Hidroelectrica’s bilateral contracting practices.

90. **SOE boards of administration meet frequently, but have limited influence.** Like the general shareholders’ assembly, the boards in these SOEs may meet frequently, at least once a month and often more, and seem to be involved in approving a wide range of company business. At the same time, boards play a very limited role in driving strategy or major decisions, which are taken by MEC. The boards nominally appoint the general manager, as per the Company Law, but this is very much a nominal decision, with the minister effectively deciding the appointment. To take another key area, internal and external audit, these are usually chosen by and effectively report to the management. Boards make little use of other good practice: some boards have specialized committees, but there role is limited at best, and boards do not undergo individual or collective evaluation. Very few board members have had director training.

91. **The responsibilities of SOE boards should be clearly defined vis-à-vis both the Government and management.** Consistent with the Companies Law and good practice, the board should play a leading role in choosing the general manager and the company’s performance management, and should oversee and influence strategy, major decisions, and choice of other senior executives. There should be significant delegation from MEC to the boards compared to current practice. At the same time, boards should also delegate more to management, and seek to focus their discussions on significant issues. To facilitate this, other good practices, including training, self-evaluation, and board committees, should also be implemented.

92. **Codes of conduct with clear procedures for doing business should be established for the energy SOEs.** The code would include requirements to: (a) to follow the rules of the power system and electricity market operators, including required responses to emergency conditions; (b) not manipulate the electricity market; (c) report the average price of transactions entered in the bilateral market, along with total volumes and number of counterparties, and not provide false or misleading information to the regulators, system operator or market operator; (d) retain records (at least) for three years; (e) maintain clear, written procedures for how the SOE procures and sells power to ensure that it follow competitive and transparent processes and how it manages risks.
G.3. SOE Transparency and Accountability

93. **OECD Guide for State Ownership** calls for the SOEs to be as transparent as publicly trade corporations, in the interest of the public (the ultimate shareholders of SOEs). Transgaz, Transelectrica and its subsidiary OPCOM are among the most transparent MEC SOEs. They report about their operations in a comprehensive and timely manner, comparable to reporting by Petrom, the biggest and majority privately-owned energy company in Romania. However, Transgaz, Transelectrica and OPCOM are still exceptions and their behavior is influenced by the listing of Transgaz and Transelectrica on the Bucharest Stock Exchange (Box 8). Hidroelectrica is among the companies in other end of the spectrum in terms of lack of transparency. As an example, its web-site is had been “under construction” since 2009. A major change will be required if the Government decides to list Hidroelectrica in the Bucharest Stock Exchange as recommended in this Review.

94. **The OECD Guide** recommends that the state, as the owner of the SOEs, establish an adequate framework to ensure that SOEs provide all necessary information for:

- The *State* itself – to be able to carry out its ownership function
- The *Parliament* – to play its role in reviewing the performance of the state as an owner of SOEs;
- The *media* – to monitor and raise awareness of relevant issues; and
- The *public* – to get a clear picture of SOE performance.

95. **It would take quite a long time for the Government to develop a coherent disclosure policy and introduce it across its SOEs.** It would take a while for MEC alone to introduce this approach across its 64 SOEs. However, a change is needed and a beginning should be made, starting with a clear disclosure policy for the major energy SOEs for which majority privatizations or minority IPOs are envisioned. They include Hidroelectrica and Nuclearelectrica. The Government does not yet intend to issue minority IPOs in the two companies, as they would be a part of the two national champions. However, if the two champions are abandoned by the end of the year, actions must start now to prepare the alternative plan, which should include IPOs in Hidroelectrica and Nuclearelectrica.

96. **Phased action starting with large energy SOEs is recommended for implementation as an integral pilot for a planned comprehensive Government strategy for SOE reform.** The gap between the OECD guidelines for state ownership, corporate governance, accountability and transparency of SOEs and the Romania practice by MEC and its major SOEs is wide. It is not realistic to expect rapid introduction of the OECD guidelines across all 64 MEC SOEs. **The Functional Review recommends that the Government and MEC select three large energy SOEs - Hidroelectrica, Nuclearelectrica and Romgaz - for immediate action as an integral pilot for a planned comprehensive Government strategy for SOE reform.** The Review highlights Hidroelectrica, Nuclearelectrica and Romgaz, in view

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8 The Government’s Letter of Intent to the IMF notes that implementing a comprehensive strategy addressing the viability of SOEs and reforming their governance will be vital and states that the Government will develop strategic action plans for key firms by end-April 2011 and all the rest by end-July 2011. The Functional Review’s recommendation to start MEC SOE reform with comprehensive action on state ownership, corporate governance,
of their importance for the energy market and to enhance their attractiveness ahead of their proposed IPOs. Improved governance and more profitable functioning of these three SOEs would have benefits for public finances, creating space for EU funds absorption or other investment spending. Their IPOs would be more successful and would raise more revenue to the state. Improved governance and more transparent functioning of these three SOEs would improve the perceptions of the media and the public about the Government as an owner of SOEs. Finally, improved governance and more transparent functioning of these three SOEs would improve the perceptions of the current and prospective private investors about Romania as an investment destination.

97. **Recommended reform of state ownership, corporate governance, accountability and transparency of Hidroelectrica, Nuclearelectrica and Romgaz consist of a series of inter-linked actions.** The rationale of the actions has been discussed in the preceding paragraphs. They would include the following:

- Transfer the financial control of Hidroelectrica, Nuclearelectrica and Romgaz to MPF as soon as the Government starts the implementation of the commitment to move the financial control of SOEs from line ministries across the Government to MPF;
- Reconstitute the boards of administration of Hidroelectrica, Nuclearelectrica and Romgaz, by significantly reducing the number of government officials and removing political appointees, and replacing them with qualified non-government directors following transparent selections processes and qualification criteria;
- Reconstituted boards to appoint professional executive management for Hidroelectrica, Nuclearelectrica and Romgaz, following transparent selections processes and qualification criteria;
- Internal auditors of the companies report to the boards instead of executive management;
- Establish and publish corporate objectives for Hidroelectrica, Nuclearelectrica and Romgaz;
- Establish and publish monitoring indicators for Hidroelectrica, Nuclearelectrica and Romgaz;
- Establish and publish disclosure policy for Hidroelectrica, Nuclearelectrica and Romgaz for information flow to the State, Parliament, media and the public.
- List the shares of Hidroelectrica and Nuclearelectrica with IPOs of about 15-20% of the shares, along with the already planned IPO of Romgaz, in the Bucharest Stock Exchange.
- In all of the above steps (except the first), consult the Property Fund, which is a minority shareholder in all three companies.

98. **The Review recommends that the SOE reform program also cover the Ministry’s other 61 SOEs, with appropriate phasing.** In addition to Hidroelectrica, Nuclearelectrica and Romgaz as detailed above, early action on listing, privatization and restructuring is recommended on other major SOEs. They are Electrica and its three electricity distribution subsidiaries; Termoelectrica, Deva

accountability and transparency of Hidroelectrica, Nuclearelectrica and Romgaz would be an integral pilot of this broad Government-wide strategy for SOE reform.
and Elcen; the three energy complexes; and mining companies CNH and SNLO. **Listing, privatization or liquidation is recommended/projected as follows:**

- Listing and an IPO of 15-20% of the shares is a realistic option for Electrica;
- The sale of the majority shares to strategic investors is recommended for Electrica’s subsidiaries, Elcen (together with Radet), and the three energy complexes:
  - Electrica could raise funds for priority investments, including participation in priorituy generation projects including EnergoNuclear and Tarnita, by selling its three discoms and its minority holdings in the already privatized discoms.
  - Elcen is effectively bankrupt but survives by defaulting to its fuel suppliers and the Government. If Elcen is offered for sale together with its main client, Bucharest City heat supplier Radet, it may have a sustainable future; otherwise, defaults will continue;
  - The three energy complexes are unlikely to survive in public ownership. If they fall, also the future of mining company SNLO will be bleak. Their merger - the recently-proposed lignite champion discussed in section H.3 – might help reduce costs if the merger facilitates the closure of high-cost mines;
- Deva and most if not all of Termoelectrica will have to be liquidated – the longer the Government delays the inevitable liquidation actions, the higher the cost through payment defaults; and
- Mining company CNH would require a deeper and faster downsizing than currently planned as part of the recently-proposed hard coal champion discussed in section H.3.

99. **In parallel with the professionalization of management at the key energy companies, a broader SOE reform framework should be developed that allows the SOE reform program to be extended over time across the ministry and ultimately all SOEs in Romania with significant commercial operations:**

- **Ownership policy** to define how the Government, primarily OPSPI in the case of MEC, carries out key shareholder functions;
- **Corporate governance code** for SOEs that is based on good practice in the private sector and with supporting documents including model articles of association for companies; and
- **Law on the corporate governance of state owned enterprises** that addresses gaps and outstanding issues in other laws and provides a legal foundation for the ownership policy and corporate governance code.

100. **The proposed major program of privatizations and IPOs would subject the companies to market discipline and at the same time also provide a significant boost to capital market development in Romania.** The Bucharest Stock Exchange has its own rules for corporate governance, to which all listed companies must abide. While Transelectrica and Transgaz – two MEC SOEs that are listed – would need further improvements to comply with the OECD guidelines, their experience is positive (Box 8). As the draft report of the Review was being finalized, the U.S. Ambassador to Romania Mark Gitenstein called for the expansion of equity markets and the reform of energy markets in a forceful
Based on the recent listing of the Property Fund at the Bucharest Stock Exchange, there is interest and demand for energy stocks also in the Romanian market. When the Fund was listed in January 2011 it immediately became one of the most actively traded stocks. As the Fund’s portfolio is heavily dominated by its minority shareholdings in Petrom and MEC’s energy SOEs including Romgaz, Hidroelectrica, Nuclearelectrica and the energy complexes, the Fund is essentially an energy investment fund. Accordingly, the Fund is actively trying to protect the value of its investments in MEC’s energy SOEs, as discussed above. The Property Fund’s stock represents 20% of the Stock Exchange’s general stock index and 30% of the financial stock index and the movements in its stock price impact these indices and affect investor confidence well beyond the energy sector. The market capitalization of the Bucharest Stock Exchange is low and participation of the Romanian population is limited. The proposed major program of privatizations and IPOs, in addition to subjecting the companies to market discipline, would therefore also provide a significant boost to capital market development in Romania.

### Box 8: Impact of Listing of Transgaz and Transelectrica

**1. Ownership:** Shareholders, MEC and private, are treated equally. The two companies have a duty to respond adequately to the inquiries of any shareholder, as well as potential investors in the stock exchange. There are clear mechanisms for the nomination of members of boards. The boards ensure a balance between executive and non-executive members, so that no single individual can dominate the decision-making process of the board; in addition, there is a more formal requirement that members of the board be competent and skilled. The nomination of board members is checked also by a consultative appointment committee, and the names of candidates, to be selected competitively, are publicly disclosed 15 days before the actual appointment. Salaries of board members are based on a wage policy issued by the wage committee. The total salaries of the board are publicly disclosed in the company’s annual report. While in practice the appointment of general directors is still politicized (as can be seen in the frequent changes of management by successive governments), the additional transparency and checks by other shareholders limit to a certain extent abuses such as the appointment of people without relevant experience.

**2. Autonomy:** Though Transgaz and Transelectrica have MEC as majority shareholders, the relationship with MEC is closer to an arms’ length relationship. Transelectrica and Transgaz have clear statements of objectives, and companies and their management are assessed based on the accomplishment of these objectives.

**3. Transparency and accountability:** Transgaz and Transelectrica publish a wide range of reports for investors and other stakeholders, respond to inquiries, and have extensive information on their website, on budgets, strategies, investment plans, assets, financials, activity reports, annual performances, public procurement etc. They organize periodic meetings with their investors to disseminate relevant information. They abide to the corporate governance principle “apply or explain”, introduced by the Stock Exchange in 2011 (either apply in full the Stock Exchange guidelines on corporate governance, or explain why a particular guideline is not applicable).

### H. Romania’s Energy Reforms

Romania has made good progress in the implementation of energy reforms and though its progress started to slow down in 2005 and stalled in 2007, Romania remains a regional leader in

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energy reform in South East Europe. In 2003, Romania formalized its policy direction in the “Road Map for the Energy Field” and submitted it to the EU as the official strategy Romania would follow to achieve compliance with the EU’s electricity and gas directives and other energy sector parts of the EU acquis. Romania’s energy market model was based on liberalization (gradual opening) as an integral part of Romania’s overall philosophy of liberalization of the national economy and free movement of goods and services. The stated aim was to create “such structures and a market environment so that to respond and cope with the increasingly integrated European energy market, where national markets are step by step losing their traditional borders and are becoming part of a common European market”. The European Commission characterized the Road Map as “exemplary”. Its successful implementation facilitated (for the energy sector) Romania’s entry into the EU in January 2007.

102. In 2007, Romania reviewed and updated its energy strategy. The resulting “Romania Energy Strategy for the Years 2007-2020” was approved in September 2007. The overall goal of the energy sector strategy is to “meet current and medium- and long-term energy needs at least cost, as required by a modern market economy and decent standard of living, providing for quality and security of supply in compliance with the principles of sustainable development”. While the European dimension is not explicit in the objective statement, the energy strategy is firmly set in Romania implementing the energy policy of the European Union and participating in its formulation as one of the EU Member States.

103. The current energy strategy 2007-2020 was developed through an exemplary iterative public consultation process, but was subsequently critically amended by the Cabinet which imposed a holding company concept during its review and approval of the strategy in September 2007. The initial draft of the strategy in 2007 presented a balanced approach for public and private investments in the energy sector (particularly generation) as the only solution to ensure adequate financing for major investments. However, the approved version introduced an integrated power holding company approach, consisting of the main electricity SOEs (generation and distribution) and thereby effectively excluding private sector participation, thus leaving the entire burden for investments to the existing SOEs. Upon the change of Government at end-2008, the one-company strategy was replaced by a new concept, consisting of the establishment of two holding companies. Later, the concept of two power holding companies was replaced by the creation of two integrated power generation/mining companies through mergers as there was no legal basis for the holding companies. Currently, in early 2011, the Ministry is updating the strategy and a new version is expected to be placed for public debate on the MEC’s website. The ongoing update of the strategy is an opportunity to consult and agree with stakeholders on the way forward.

104. Romania has restructured its power sector into several generation companies, transmission system operator Transelectrica (Romania’s TSO), electricity market operator OPCOM (Transelectrica’s subsidiary) and eight electricity distribution companies (five privatized, three public). The OPCOM Power Exchange was launched in 2005 and has developed quickly into the most successful exchange in Eastern Europe. Along similar lines, Romania has restructured its gas sector and now has two gas producers (public Romgaz and private Petrom), transmission system operator Transgaz, a gas market operator (at the Bucharest National Natural Gas Dispatcher Office), as part of Transgaz, and two large privatized gas distribution companies and several smaller distributors. Electricity regulator ANRE started its operations in 1999. Gas regulator ANRGN was merged into ANRE in 2007. Over the years ANRE (and ANRGN until its merger) has built up a solid track record as probably the most competent regulator in the region. Through a series of tariff adjustments by ANRE (and ANRGN) and
major improvements in bill collection by the distribution companies (from about 65% at the turn of the century to about 100% by 2005 in both electricity and gas, ahead of privatization), the sector reached cost-recovery level in about 2004. These remarkable accomplishments are at risk of stagnation, possibly even reversal, for four inter-related reasons: (a) the power holding company/merger proposal has put the generators and the electricity market and OPCOM as it operator at risk; (b) ANRE has stopped electricity market liberalization by freezing the share of Hidroelectrica electricity and increasing the share of Nuclearelectrica electricity in its portfolio contracts to the regulated market; (c) unlike Nuclearelectrica and the energy complexes, Hidroelectrica is not using the OPCOM Power Exchange for its bilateral contracting; and (d) deviations by ANRE of both electricity and gas tariff regulations it (and ANRGN) had approved and published affect the operations of the electricity and gas distribution companies as well as Transelectrica and Transgaz (the two TSOs).

105. The MEC Functional Review recommends 10 that instead of pursuing the mergers to create the two national champions, Romania return to the 2003 Road Map – the energy strategy that was used for Romania’s EU accession. The completion of the implementation of Romania’s EU accession energy strategy would include three major elements: (a) completion of electricity and gas market liberalization which has been on hold since 2007; (b) completion of the program to privatize most of the thermal generation (and close some high-cost units) and Electrica’s distribution companies; and (c) retention if majority public ownership and development of Hidroelectrica, Nuclearelectrica and Electrica. With this strategy, Romania would:

- retain in the public sector (through Hidroelectrica and Nuclearelectrica) about 50% of the generation, including the most competitive base load power (in nuclear and run-of-river hydro) and most competitive peaking power (in hydro). Keeping this half - a very competitive half - of total generation and a major electricity supplier (Electrica) would give the Romanian Government a strong presence in the power sector;

- open the other half of power generation to prospective private investors, in a liberalized competitive market. This would give the private sector a meaningful role, big enough to attract serious investors into the sector - investment requirements are very large and cannot be raised in the public sector alone; and

- contain public investment within affordable levels. Romania’s entry into the EU did not change or resolve the most important single issue in the energy sector: the need to raise significant volume of investment resources, particularly in the power sector, to ensure the electricity supply security supply for its citizens and for further economic development. The economic crisis has significantly worsened the situation. Government will have to be highly selective in supporting investments from public funds.

106. This recommended reform strategy is consistent with the findings and conclusions of the World Bank’s regional energy study of the Eastern Europe and Central Asia. As a part of the first workshop under the MEC Functional Review, the team presented the regional study Lights Out? and its

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10 The energy strategy chapter in the MEC Functional Review is the most recent in a series of formal documents and informal notes since September 2007 when the power holding concept was imposed into Romania’s energy strategy. In January 2010, the World Bank submitted a formal Energy Policy Note, to the incoming Government.
implications for Romania to MEC, GSG, energy companies, OPCOM and ANRE on December 14, 2010. The presentation was attached as an Annex to the Inception Report. Copies of the regional report were circulated at the December 2010 workshop. The report is available on the World Bank’s web-site. A brief summary is attached as Annex 8.

107. **Investment requirements in the energy sector are very large; estimated at about euro 30-35 billion in the next 10 years, more than half in power generation where Romania’s progress has stalled.** This estimate is regarded to be conservative. It is below the World Bank’s regional investment requirement estimate of 3% of GDP/annum for Eastern Europe and Central Asia in the regional study Lights Out?. Sovereign guaranteed loans can at best cover a small fraction of the financing needs. Even if multiplied by a factor of three or five, EU funding for energy (well below euro 1 billion in the 2007-2013 period) can provide only a small part of the total needs. Therefore, the vast majority of the euro 30-35 billion has to come on commercial basis. More than half of the investment needs are in power generation and that is the area where Romania’s progress has stalled as discussed in the next section. In contrast, investments are being made in areas where privatizations were carried out: (a) Petrom was privatized in 2004. It more than doubled its annual investments by 2006 and invested an average of over euro 1 billion/annum in the 2006-2010 period. Its contributions to the state budget in dividends and various taxes have been even higher; and (b) Table 4 shows the growth of annual investments in electricity distribution following privatizations in 2005. Banat, Dobrogea, Oltenia and Moldova were transferred to private owners in 2005. Muntenia Sud was transferred after a long delay in 2008 and major investments are now underway. The seller of these five discoms, Electrica, was also able to increase its investments in its three companies (Transylvania Nord and Sud and Muntenia Nord) using the privatization proceeds from 2005. The Government received half of Electrica’s privatization proceeds and an additional “donation” in 2010.

**Table 4: Distribution Investments, 2002-2010, (RON million)**

<table>
<thead>
<tr>
<th></th>
<th>Transylv Nord</th>
<th>Transylv Sud</th>
<th>Muntenia Nord</th>
<th>Muntenia Sud</th>
<th>Banat</th>
<th>Dobrogea</th>
<th>Oltenia</th>
<th>Moldova</th>
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Sources: Electrica; except CEZ (Oltenia 2005-2010); Enel (Muntenia Sud, Banat and Dobrogea 2010), and E.ON (Moldova 2005-2010).
H.1. Privatization and the Government’s proposed National Champions

108. The 2003 Road Map concluded that large-scale participation of the private sector will be needed and presented a comprehensive program of privatization as one of the means to attract investment and private management skills along with continued public sector investment and development of public sector companies in particular Hidroelectrica, Nuclearelectrica and Transelectrica in the power sector and Romgaz and Transgaz in the gas sector. The privatization program was launched successfully: national oil company Petrom, the two gas distribution companies and five of eight electricity distribution companies were sold through competitive bidding processes. However, progress slowed down from 2005 due to debates within the coalition governments and replacements of key persons (including the replacements, against the applicable laws, of the presidents of electricity and gas regulatory agencies soon after the change of government in 2005).

109. The Ministry of Economy attempted to restart the reform and privatization process through the preparation of a new energy strategy through an iterative consultative process (international best practice process) carried out in the course of 2007. The strategy proposed the continuation of the privatization program as well as continued development of Hidroelectrica and Nuclearelectrica – a balanced approach of public and private sector power development which was assessed to provide the best prospect for Romania to achieve the required financial and management resources to successfully complete the ongoing modernization of the power sector. The Cabinet endorsed the strategy in September 2007; however, the Prime Minister directed that the establishment of a national power holding company be considered. That direction launched a debate that still continues in 2011. Upon the change of government at end-2008, the one-company strategy was replaced by a new concept, consisting of the establishment of two power holding companies. Then, the concept of two holding companies had to be replaced by the creation of two integrated power generation/mining companies through mergers as there was no legal basis for the holding companies.

110. The prospects for implementation of the holding company/merger approach are not good. Several years have already been lost to this debate and there is a clear and present danger that another 1-2 years will be spent before it is finally concluded that the proposed approach is not implementable. No formalized assessment of the implementation of 2003 and 2007 energy strategies has been carried out. The Ministry and its consultants propose to organize power stations and mines into two groups which have similar average costs of generation – low cost hydro and nuclear compensating for the high cost thermal power and high-cost mines. No power system and market simulations have been carried out. No business plans justifying the proposed mergers, for example, showing how the proposed national champions could raise the financing of much-needed investments in the generation sector, have been prepared. The merger plan has been contested by various stakeholders in the past years and is currently blocked by 18 lawsuits, perhaps most notably by Fondul Proprietatea (a minority shareholder in several affected companies) and trade unions of Hidroelectrica. The March and April 2011 decisions of the Bucharest Appellate Court, striking down the plan to establish Hidroenergetica and Electra, are clear signals for the Government to change course instead of continuing the pursuit.

111. The prolonged debate about energy strategy, the holding companies and currently the mergers effectively stalled the implementation of the 2007 energy strategy. Romania has lost several years (and the debate is not over): (a) The privatization of the three energy complexes for which pre-
qualification applications were received in 2005 could have been completed in 2006 and investments would be close to completion by now. Instead, Romania has made little progress in addressing issues in the coal/lignite power generation and mining companies that feed them. Most of the deadlines for environmental upgrades which Romania committed to in its EU Accession Treaty will be missed; (b) Electrica’s three remaining distribution companies could have been privatized by 2008 and investments would be well underway; and (c) Furthermore, the debate and continuing uncertainty slowed down the preparation of major public sector projects as well, including both Hidroelectrica and Nuclearelectrica.

112. **Since September 2007, the Bank has expressed concern about the potential adverse impacts of the envisioned restructuring.** The holding company/merger approach poses risks on Romania’s electricity market and OPCOM; the pace of rehabilitation and environmental upgrade of thermal plants; and Hidroelectrica’s financial viability and its investment program. The Bank has emphasized that Romania does not need the holding company/merger approach in order to have a strong presence in the power sector and that alternative strategies are available for Electrica to remain a major force in electricity supply. Through Hidroelectrica and Nuclearelectrica, Romania will have in the public sector a very strong presence in the power generation sector, accounting for about 50% of the generation, including the most competitive base load power (in nuclear and Irongates hydro) and most competitive peaking power (in hydro). Keeping this half - a very competitive half - of total generation gives the Romanian government a strong presence. Opening the other half to prospective private investors would give the private sector a meaningful role, big enough to attract serious investors into the sector. Investment requirements are very large and having a major non-public segment would, along with the continued and increased use of OPCOM’s platform for centralized auction of Hidroelectrica’s and Nuclearelectrica’s bilateral contracts, help keep the public part under competitive control and also contain alleged corruption through transparency of public bidding. The Bank’s analysis is presented in more detail in Annex 2.

113. **The holding company/merger approach would lead to lower investment in the sector and a failure of the objective of creating two “energy champions” capable of competing in the South East Europe regional market.** For an economy like Romania’s, an inward investment strategy (supported by a liberalized electricity market) is a better growth strategy than outward investment. If the champions are supposed to divert investment to other countries’ markets, this would deprive Romania of scarce domestic investment funds. Even in case they were to compete successfully in the regional market, the productivity and economic impact of their investment would be lower than domestic investment for Romania’s energy security. If the champions are designed to defend the domestic market against incoming investment, that would be a costly mistake; attracting inward investment should be a clear part of Romania’s strategy to meet the energy sector’s investment requirements. The national champion strategy is likely to result in the continuation of current bilateral contracting practices and cross-subsidization of the unviable mines and thermal plants by viable hydro and nuclear generation and in the process undermining hydro and nuclear development including EnergoNuclear’s proposed Cernavoda units 3&4. From being one of the markets with average concentrations in Europe (Figure 6) and having the potential to join the least concentrated=most competitive national markets (marked in green on Figure 6), Romania would become one of the most concentrated national markets=potentially least competitive national markets (marked in red color on Figure 6) unless mitigated by regional competition.
The holding company/merger approach is a recipe for continued slow decline and eventual power shortages in the absence of private investment and available public funds. The duopoly would initially (but only temporarily) have enough electricity generation available capacity to cover demand on all markets including balance energy market, in both the winter and summer. They could (temporarily) manipulate supply to extract windfall profits by forming cartels, colluding tacitly, and reporting false capacity. However, as the demand is again growing after the crisis, electricity supply/demand balances will tighten in the absence of investments to replace aging and deteriorating plants (most now over 30 years old). More restrictive environmental standards and the increasing cost of CO2 emissions will further aggravate the situation. Increasing costs and shortages would threaten to constrain Romania’s economic recovery and growth. Cross-border trade (imports into Romania) will not provide protection to the possible (temporary) market manipulation or to the medium-to-long term electricity shortages as Romania’s neighbors in South East Europe continue to face their own supply/demand issues. While the debate continues, major private investments in the sector have stalled, notably PPPs in thermal electricity generation and the construction of Units 3 and 4 at Cernavoda, partly because of economic uncertainties and partly because of the two national champions concentrating about 92% of the electricity market and Romania’s non-compliance with EU Directives on gas and electricity market liberalization and its own laws and regulations.

H.2. Business Environment in the Energy Sector

Recent Government actions regarding the energy sector have seriously affected the confidence of some of the largest foreign investors in the Romanian economy, and this is likely to have spillover effects in other sectors of the economy. The largest foreign investors in Romania are
energy companies involved in distribution of electricity and gas and Petrom (oil, gas and power). Uncertainty regarding economic prospects, the direction of the Government’s energy policy and Nuclearelectrica’s ability to finance the majority of the project led to four of the six private partners to publicly withdraw from Romania’s largest project of the past two decades (the construction of nuclear Units 3 & 4 at Cernavoda, a project estimated at about euro 4 billion). Three years have been lost - Government changed its position in 2008 to insist on taking majority share instead of the original 20% minority position and the project stalled. Several other public-private partnerships (PPPs) announced for thermal generation have been put on hold or cancelled by private partners apparently for similar reasons. No public and only one significant private investment in new generation capacity has been committed in the last five years, by Petrom (860 MW gas-fired power plant). Wind power investments are attracted by Romania’s generous support scheme for wind and are not market-based investments.

116. Energy regulator ANRE’s capacity started to slowly deteriorate from 2005 and more rapidly from 2009 when ANRE was subordinated to the Prime Minister’s Office and its budget autonomy was removed and salaries cut by over 60%. While in the early-to-mid-2000s the Romanian regulator was a best practice model in the region, it is currently perceived as ineffective and exposed to political pressures (unable to implement own regulations, most notably in gas, and in the liberalization of energy markets, discussed below). ANRE highlights its 2009 subordination under the Prime Minister’s Office, loss of autonomy, salary cuts and staff departures as major issues and calls for corrective measures. ANRE has lost about 60 staff within the last year. EU’s Third Energy Package requires independence from the regulated industry and political bodies, with financial autonomy through earmarked revenues from own sources. The independence of the regulator should be matched by accountability, competence, predictability of regulations, and transparency.

117. Though no longer consistently implemented, ANRE’s tariff-setting objectives are in line with international best practice: full transparency, public consultations, incentive-based regulatory regime with efficiency incentives in investments and operations and maintenance and an increasingly program-focused rather than project-by-project focused ex-ante review of investments with an increased use of performance indicators. These are the commendable objectives. The current regulatory regime and the experience gained since ANRE’s establishment more than a decade ago provide a strong foundation to move towards those objectives. However, ANRE’s recent electricity and gas distribution tariff orders do not fully reflect these objectives. Market perception is that ANRE’s tariff orders are influenced by political considerations more than a few years ago. Restoration of ANRE’s standing would help in part restore private investor confidence about their participation in the power sector.

118. After having progressively opened the electricity market from 2001, the Government/ANRE stopped the effective opening process in 2007 by which time the share of Romania’s power supply at regulated prices had been reduced to 50%. Though not obligated to do so under Romania’s electricity law, public sector generators accepted this decision and have continued to supply electricity at rates set by ANRE for ANRE’s portfolio contracts for the regulated tariff supply. The biggest loser (financially) is Nuclearelectrica, which supplies about 75% of its output to the regulated market. Hidroelectrica also loses financially, having to supply at a very low rate, but a much smaller share of its

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11 Based on MEC functional review team’s, the joint IMF/EC/WB team’s and the World Bank’s Romania energy team’s discussions with market participants including all major private sector energy investors in Romania.
119. **Targeting subsidies to low-income energy consumers and liberalizing energy markets go hand in hand.** Elimination of regulated prices for electricity and gas is a commitment of Romania to the EU. Elimination of regulated prices and ANRE’s portfolio contracts which enable the use of regulated prices does not mean or prevent the provision of social support for low-income households to ensure their continued access to basic energy services. However, subsidies should be targeted to low-income households. Instead of regulated prices and regulated portfolio contracts, ANRE can use market-based mechanisms to arrange energy supplies to those consumer groups who – unlike low-income households – can afford and should pay market prices but may not have the power to negotiate contracts in the market. ANRE has recognized this and intends to replace regulated portfolio contracts with auctions; however the schedule has not been determined and the auction mechanism has not been developed. Clear separation of energy markets from the social goals will also help deal with the spectrum of EU infringements while creating additional support for poverty protection and social cohesion.

120. **The deterioration of the effectiveness of ANRE’s regulatory functions and the lack of political support for competitive energy markets have undermined the ability of Romania’s Competition Council to effectively enforce competition in the sector.** The Council has not reacted to the Government/ANRE putting the process of competition in the electricity market on hold. This is consistent with the Council’s weak position regarding the holding company/merger proposal. The Council has carried out consultations and sought feedback from market participants on the Government’s merger proposal. However, the Council has not issued its ruling but has instead decided to wait for the resolution of the court cases against the mergers.

121. **Government interventions at some of the generators, Romgaz and ANRE and the weakness of the Competition Council undermine a comprehensive system of monitoring and surveillance Romania’s energy markets.** Full-time staffs are engaged in market monitoring at the energy regulator ANRE, electricity market operator OPCOM, and the operator of the balancing and ancillary services markets Transelectrica. In addition, the Competition Council has responsibility for overseeing issues of market dominance and state aid. However, what on paper comes across as a comprehensive system of market monitoring and surveillance does not effectively protect the integrity of Romania’s energy markets. Sales of energy at below market prices in non-competitive bilateral deals are widespread in electricity as well as gas. A number of Hidroelectrica’s bilateral contracts were concluded outside OPCOM at prices much less than market price to the benefit of certain private suppliers or thermal generators, or as financial support to certain industries (steel, aluminum). In the gas sector, the policy to sell a mix of imported gas and domestic gas priced at less than 50% of its economic cost (import parity) to all consumers and in addition providing such below-market priced domestic gas to some companies without the obligation to also buy market priced imported gas subsidizes all consumers and especially favors large gas consumers such as fertilizer plants. The Government cannot afford to undermine liquidity and stability of OPCOM Power Exchange and continue to forego such potentially available revenues while attempting to reduce budget deficits and improve EU funds absorption.
122. **Romania has established a generous green certificates program to promote the development of renewable energy.** The program is based on: (a) a Green Certificates market; and (b) mandatory quotas of renewable energy acquisition for power suppliers. Electricity suppliers are required to purchase annually a number of certificates attesting that power was produced from renewable sources pro rata with the volumes of electricity sold to users. Certificates can be traded bilaterally or at OPCOM’s Green Certificates platform. The Law on Renewable Energy provides strong incentives for investors, to be strengthened further with an amendment that has been approved but not yet made effective pending review by the European Commission. Incentives are very generous, including euro 110/MWh for wind plus the revenue from the sale of electricity in the market, for a total of euro 150-160/MWh assuming market prices in the range of euro 40-50/MWh. This is over 50% above the average European support price of about euro 90/MWh (Figure 7), through feed-in tariffs where generators earn no additional revenue from sales to the market. Once the 2013-2020 phase of the European Emission Trading Scheme (ETS) is fully operational, the Government should review if the green certificates program is still needed and what level of support is justified. The expected acceleration of renewable energy, particularly wind (paras. 32-33), due to the significant wind power potential and generous incentives, will create new challenges for the stability of the power sector. OPCOM intends to develop an intra-day market to help deal with the commercial dimension of the inevitable changes in intermittent wind generation. The Government and ANRE also need to issue further regulations including the qualification of producers, guarantees of origin and statistical transfers.

![Figure 7: Comparison of European levels of wind support schemes (Feed-in tariffs)](image)

Source: Economic Consulting Associates

123. **One of the pressing issues in the electricity sector affecting investor confidence is non-payment by railways infrastructure company CFR to Electrica, CEZ, Enel and E.ON for the electricity supply to the train operators.** CFR’s total debt to the distribution companies amounted to
about RON 1,720 million or about euro 430 million as of end-2010, and continues to increase every month. Breakdown is provided in Table 5. One of the distribution companies, E.ON, was able to reach an offset agreement with the Government, explaining its favorable receivables position. As long as the distribution companies are not allowed to disconnect the railways, either the railways or the Government should pay for the electricity consumption. Alternatively, the Government should allow the distribution companies to disconnect the railways in case of non-payment. One of the distribution companies, E.ON, was able to reach an offset agreement with the Government, explaining its favorable receivables position. As long as the distribution companies are not allowed to disconnect the railways, either the railways or the Government should pay for the electricity consumption. Alternatively, the Government should allow the distribution companies to disconnect the railways in case of non-payment. Instead of disconnecting service to all operators, arrangements could be made to enable selective disconnections of trains of those operators that do not pay their bills to CFR. A solution to the settlement of the arrears (which will soon reach RON 2 billion) is also needed. Options include cash injections buy the Government to CFR and electricity companies offsetting their tax payments to the Government against CFR arrears. In the case of private electricity companies, options also include offsetting their dividend payments to Electrica and using CFR arrears to buy Electrica’s minority shareholdings – these measures would be a stop-gap measure, shifting the burden of CFR arrears to the Government-owned Electrica.

Table 5: Non-payment of electricity bills by CFR (RON million)

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Electrica</th>
<th>CEZ</th>
<th>Enel</th>
<th>E.ON</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unpaid Bills</td>
<td>950</td>
<td>391</td>
<td>173</td>
<td>375</td>
<td>11</td>
</tr>
<tr>
<td>Penalties for non-payment</td>
<td>770</td>
<td>321</td>
<td>101</td>
<td>322</td>
<td>26</td>
</tr>
<tr>
<td>Total Debt</td>
<td>1,720</td>
<td>712</td>
<td>274</td>
<td>697</td>
<td>37</td>
</tr>
</tbody>
</table>

Source: Electrica, CEZ, Enel and E.ON

124. The oil and gas sector suffers from several regulatory issues – most of which could be addressed by the Government and the concerned regulators. ANRE’s non-implementation of its own gas price regulation has put gas suppliers E.ON and GDF close to insolvency. Regulated gas prices are available in non-compliance with EU gas directive. MEC and the National Agency for Mineral Resources (NAMR) keep domestic gas prices at less than half of import parity and prohibit gas exports, in violation of the EU Treaty. Prospective oil and gas producers are subjected to lengthy and non-transparent concession procedures, in negotiations with NAMR and subsequent reviews by several ministries (MEC, MPF, Environment and Justice). Prospective bidders are concerned about the quantity and quality of data packages – better packages would encourage wider participation.

125. Private companies are increasingly concerned about the business environment and the overall direction of Romania’s energy sector. Their concerns include Romania’s unpredictable implementation and non-compliance with its own laws, regulations and privatization contract clauses; frequent changes of leadership in MEC and politicization of critical positions; the loss of independence of the energy regulator ANRE; uncertainties regarding the restructuring of the power generation and coal sector into two integrated energy companies (national champions); and doubtful receivables from other SOEs (most notably the railways infrastructure company CFR). The lack of confidence of large foreign energy investors is likely to spill over in the broader business environment and could affect Romania’s prospects for growth. The resumption of energy sector reforms, enhanced stability and predictability of regulations, coupled with a clear schedule for payments of arrears from SOEs like the railways company would be strong signals for strategic investors in the energy sector with benefits for the economy overall.
126. **Romania does not adhere well to the ten key principles of a competitive investment climate in the energy sector.** The World Bank’s regional energy study of the Eastern Europe and Central Asia (Annex 8) formulated ten key principles of a competitive investment climate. Romania adheres well to only one of the ten principles and poorly to six, as summarized in Figure 8. These were discussed in the first workshop under the MEC Functional Review where the team presented the regional study and its implications for Romania (para. 107).

**Figure 8: Romania’s adherence to the Ten Key Principles of a Competitive Investment Climate – one positive area, three areas of concern, and six major problems.**

<table>
<thead>
<tr>
<th><strong>DO’s</strong></th>
<th><strong>Don’ts</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Do introduce an acceptable legal framework.</td>
<td>1. Don’t impose a punitive or regressive tax regime.</td>
</tr>
<tr>
<td>2. Do provide supporting regulations administered by an independent and impartial regulator.</td>
<td>2. Don’t interfere with the functioning of the market place.</td>
</tr>
<tr>
<td>3. Do create an environment that facilitates assured nondiscriminatory access to markets.</td>
<td>3. Don’t discriminate among investors.</td>
</tr>
<tr>
<td>4. Do honor internationally accepted standards.</td>
<td></td>
</tr>
<tr>
<td>5. Do abide by contractual undertakings and preclude the use of an administrative bureaucracy to constrain investor activities</td>
<td></td>
</tr>
<tr>
<td>6. Do prevent monopoly abuses.</td>
<td></td>
</tr>
<tr>
<td>7. Do ensure that the sector is kept free of corruption</td>
<td></td>
</tr>
</tbody>
</table>

_**code:** Green color = positive contributor to Romania’s investment climate, Yellow color = area of concern and Red color = major problem area_

**H.3. Future of Coal & Lignite**

127. **Romania’s 2003 Road Map concluded and the 2007 Energy Strategy confirmed that determined measures were required to secure the future of lignite and coal fired power generation** which was assessed to be an integral element for Romania’s energy security. Some (high-cost and inefficient) plants of Termoelectrica were to be closed down to eliminate chronic losses and subsidies and private sector was to be attracted to rehabilitate some of the others in Termoelectrica and in particular three energy complexes Craiova, Rovinari and Turceni. Termoelectrica has entered into memoranda of understanding (MOUs) with reputable companies with an interest to develop generation capacity in Romania. These MOUs cover seven PPPs for a total of up to 4,000 MW. So far MOUs have not moved...
to actual investments. One major uncertainty affecting investors is the holding company/merger proposal which stopped the process to attract investors into three energy complexes. Termoelectrica has also attempted to involve the private sector in its Elcen subsidiary but in what appear to be relatively high cost production units, and they have not yielded significant results. Along with undermining energy security, Romania faces the risk of not meeting deadlines for environmental upgrades which Romania committed to in its EU Accession Treaty.

128. **High-cost coal and lignite burdens thermal generators.** Underground coal mining in Romania is expensive due to low productivity and high-cost outsourcing practices and is not able to compete with imported coal. Arrears to the state budget amount to euro 1 billion. Opencast lignite mining is potentially viable but has also become a loss-maker and a burden on government budget after years of low investment (salaries represent 60% of the total cost), questionable outsourcing practices (over-priced contracts with favored suppliers, section E.2), limited restructuring driven by the desire to keep as many mines open as possible instead of focusing on those that may have a viable future and closing the rest.

129. **Environmental requirements are increasing the cost of coal/lignite-fired power generation.** Romania faces the risk of major non-compliance with the commitments to upgrade its thermal power plants (complete listing is attached as Annex 7). These plants account for about 40% of electricity production and are about 80% obsolete according to MEC (para. 31). Some of the deadlines have already been missed. Romania faces the prospect of an infringement process; in the worst case power shortages should the European Commission require defaulting plants to be closed. Another risk to coal/lignite-fired generation comes from the implementation of the third phase of EU’s emission trading scheme (ETS). Initially, the power sector was required to purchase all their emission certificates starting from 2013. An amendment of the ETS directive in March 2011 provides some relief if an eligible country (which includes Romania) submits an application for Commission review and approval by September 2011. However, the number of free emission allowances that may be handed out to power plants is limited. The revised ETS Directive stipulates that even when a derogation is granted by the Commission, the level of free allocation in 2013 must not exceed 70% of the allowances needed to cover emissions for the supply of electricity to domestic consumers, and the share is to decline by 10% points/annum and reach zero by 2020.

130. **The rational for the Bank’s recommendation to privatize the potentially viable lignite-fired power generators and the mines that feed them (=the three energy complexes):** (1) Investment requirements in the power sector are very large. They cannot be raised in the public sector alone. The question is not whether to involve the private sector but in which parts of the power sector private sector they should be invited to invest; (2) The Bank’s recommendation has been that the Government retain Hidroelectrica and Nuclearelectrica and privatize most of the thermal generation (and close some high-cost units) and open the other half of the sector to prospective private investors; (3) The private sector would bring more than financial resources. They would also bring management skills, know-how and experience about lignite mining, power and environmental investments and efficient operation of the facilities. These skills are particularly critical to ensure sustainable lignite mining and lignite-fired power generation in Romania. The three energy complexes are unlikely to survive in public ownership. If they fall, also the future of mining company SNLO will be bleak; (4) Having a major non-public sector segment would help keep the public part under competitive control and also contain alleged corruption along with the transparency of public bidding through the continued and increased use of OPCOM’s
platform for centralized auction of Hidroelectrica’s and Nuclearelectrica’s bilateral contracts.

131. **Instead of offering the three energy complexes for sale to strategic investors as envisioned in the Road Map and recommended in this Review, the Ministry is considering a merger of the three energy complexes and SNLO into a lignite complex Oltenia.** If the Government proceeds with this merger, the Review recommends that the lignite complex: (a) be added to the priority list of companies for SOE reform and most of the measures summarized in para. 98 including a reconstituted Board and professional executive management; and (b) be offered for sale to strategic investors in a privatization process in parallel with the SOE reform process. Listing is not recommended. Listing would not be expected to be successful as the financial performance of the lignite complex is likely to be marginal at best even if mining and power generation costs are reduced by 20% as envisioned. The lignite complex might help reduce costs – if the merger process enables the closure of higher cost mines of SNLO and the three complexes – but not secure future investment. Joint ventures for new power generation projects (para. 127) might still be possible but they would likely to be based on imported fuels as private investors would most likely not be willing to rely on the Oltenia lignite complex for their fuel supply.

132. **A similar merger plan of Deva, Paroseni and CNH into a hard coal complex Hunedoara is also being considered.** The Government intends to close by 2018 (the new EU deadline for state aid) three of the seven CNH mines and retain the other four. However, only the Paroseni power station has a prospect for viable operation. It would need only 1-2 of CHN’s four mines for its coal supply. The Deva power station is not likely to become viable. The hard coal complex is likely to incur major losses unless its scope is quickly limited to Paroseni and 1-2 mines needed to supply it.

**H.4. Electricity and Gas Markets**

133. **Romania is a regional leader in the development of electricity markets; however, progress stalled in 2007 and EU directives are not being implemented.** Electricity market opening began in 2000, and by 2005, all non-residential consumers were eligible to choose their suppliers. Residential market was opened in July 2007. Actual market opening advanced progressively from 2001 through 2007 and by 2007 about one-half of Romania’s electricity supply was sold under regulated tariffs, the other half through bilateral contracts or through the OPCOM Power Exchange. (Along with the day-ahead market, OPCOM also operates a centralized auction of forward bilateral contracts and a green certificates market). Progress stalled in 2007 and EU directives are not being implemented. The Commission has launched infringement proceedings in 2009 against Romania concerning its system of regulated prices for electricity.

134. **Romania is also a regional leader in the development of gas markets; however, progress stalled in 2007 and EU directives and ANRE’s regulations are not being implemented.** Gas market opening began in 2001 and by July 2007 the market was fully open, in legal terms (consumers being eligible to choose their gas supplier). Progress stalled in 2007. Regulatory control remains high, due to the limited number of major suppliers - two major domestic producers and imports from one source, Russia. The National Natural Gas Dispatcher Office, as part of Transgaz, is not operating a centralized trading platform but, as its name indicates, a dispatch platform. The Government, ANRE and Transgaz should consider Transgaz establishing a trading platform, starting with the auction and continuous trading
of contracts similar to services available at the OPCOM Power Exchange. Reflecting increases in the price of imported gas and the pricing of domestic gas are the most pressing issues in the short-term – the Government has not allowed ANRE to implement its regulations since 2009. As a result, the gas distribution companies lose money on every unit of gas they sell to their customers. EU directives are not being implemented. The Commission has launched infringement proceedings against Romania in 2009 concerning its system of regulated prices for gas.

Prices for electricity and gas need to be liberalized, with a focus on liberalizing prices for industries and other businesses. The current system of regulated prices for electricity and for gas forms an obstacle to competition and acts as a barrier to new entrants in the market. As long as the current system remains in place Romania will not be able to attract the private investments it needs for its energy sector. Liberalization would be a positive response to address the Commission’s ongoing infringement against Romania – EU’s 2003 directives require full market liberalization. The first priority should be the abolition of regulated prices for non-household customers, in particular for large and medium sized industries and other businesses. Price liberalization for households, in particular those considered vulnerable, is not an immediate priority. The Government’s letter of intent to the IMF includes the complete removal of regulated prices for non-households in electricity and gas before the end 2013 and for households by the end of 2015. However, the proposed Laws for electricity and gas (Box 2), under preparation for the transposition of EU’s Third Energy Package, do not contain a time-table for liberalization of prices for non-households and households.

Romania’s electricity and gas transmission networks need to be more effectively unbundled. EU rules on unbundling of networks seek to achieve effective separation between transmission activities and production and supply interests in order to avoid that networks are operated in a discriminatory manner. Romania must ensure effectively unbundling of its transmission networks in conformity with the available models in EU’s Third Energy Package. Transmission networks need to be certified as complying with the unbundling rules. Certification is to be done by ANRE under the control of the Commission. One possible option for ownership unbundling would be for MEC to retain Transelectrica and Transgaz and thereby the ownership function for electricity and gas transmission networks while other energy SOEs are transferred to the Ministry of Public Finance as discussed in the chapter on the Governance of State-owned Enterprises.

Electricity and gas transmission networks need to be operated in a more transparent and non discriminatory manner. Transmission networks in electricity and gas need to be operated in a transparent manner, ensuring access of third parties on a non-discriminatory basis and on the basis of regulated tariffs. For gas, a number of pipelines transporting gas from Russia are not operated in a transparent manner. Specific intergovernmental agreements (IGA) concerning these pipelines, which have been concluded before Romania’s accession to the EU, establish a specific "gas transit" regime. This is not in compliance with EU internal market legislation. These IGAs need to be renegotiated and brought in line with the Internal Market rules, so that third party access on the basis of regulated tariffs can be ensured. The Commission is prepared to provide assistance to Romania in these negotiations, and can play a coordinating role with other Member States which are concerned by these pipelines, in particular Bulgaria and Greece.
Regional Energy Markets

138. **Romania has the resource base to support power development for the regional market in addition to meeting Romania’s own needs.** Studies sponsored by the EC and managed by the World Bank \(^{12}\) identified Cernavoda nuclear plant among the most competitive generating plants from a regional perspective. Hydro plants are particularly attractive under scenarios of high gas prices. Hidroelectrica has the potential to become a regional peaking power and ancillary system services provider (these services are necessary for the safe operation of the power system, such as frequency regulation, reactive power support, and fast reserves) with an increased potential after building Tarnita pumped storage plant. Hungary could be an excellent regional partner for Tarnita and/or other similar projects as it does not have pumped storage or conventional hydro capacity. The Czech, Slovak and Polish power systems all face the challenge of supplying electricity at peak times, without significant hydro capacity.

139. **Romania needs to improve practices and reinforce interconnections to improve cross-border trade.** The capacity limits of interconnectors and their impact on cross-border electricity transactions are very important for market players to optimize their market portfolio and manage their risks more effectively. Sell of massive wind electricity across the SEE region is critically dependent on short notice allocation interconnection capacity as well. The system of coordinated capacity allocation on the borders with Hungary and Bulgaria needs to be improved and well functioning intraday markets need to be established to improve cross-border trading. The Commission has issued infringement proceedings against Romania on this point, in relation to transparency of capacity allocation particularly. Transelectrica has identified priority interconnection projects, including Suceava-Balti (Moldova/Ukraine), Timisoara-Vrsac (Serbia) and a submarine cable interconnection to Turkey to facilitate higher power flows and support the functioning of a regional electricity market. Integration of revenues from increased transmission service with avoided cost of cross-border congestion, and with EU support for European priority corridors, could help overcome investment problems of interconnectors.

140. **OPCOM has developed a capability to offer electricity market services beyond Romania.** Such services would be needed across South East Europe for the improved functioning of the regional market, for which the Energy Community program is developing the required regulatory and market framework in accordance with EU directives. Based on recent discussions, Bulgaria and Serbia may be interested in developing their electricity markets in a market coupling with Romania. Hungary had expressed interest earlier but negotiations stalled in 2009. To succeed regionally, starting with negotiations with Bulgaria and Serbia, OPCOM would require the Government’s unequivocal support. The opposite is happening: Romania’s power sector restructuring proposals jeopardize Romania’s electricity market and as one of the several consequences, jeopardize OPCOM as the operator of transparent electricity trading.

141. **Legal, regulatory and physical barriers to gas exports need to be removed.** An obligation is in place for domestically produced gas to be put on the domestic gas market. There is also an obligation for suppliers to supply gas in accordance with a fixed mix of domestically produced and imported gas, the so called "gas basket". These measures act as a barrier to export. The Commission has pointed out to the Government that: (a) such measures and barriers are not compatible with the fundamental free movement

principle of the Lisbon Treaty; and (b) they need to be removed so that gas can be exported, de jure and de facto. Adequate physical interconnection between Romania and its neighbors is also required so that current physical barriers to the free movement of energy are removed. Action needs to be taken in order to ensure bi-directional flows of gas between Romania and Hungary. The basic infrastructure at the interconnection Szeged-Arad is already in place. Minor additional investments need to be made, to ensure that gas can physically flow also in the direction towards to Hungary.

142. **In the medium-to-long term, the diversification of gas supply sources will become an important issue.** This is an issue which Romania alone cannot address – a regional and possibly a Europe-wide approach is required. Romania’s Transgaz is a member in the consortium that is working to develop the Nabucco project, a gas pipeline from Turkey to Austria. Its progress has been slowed down for a variety of reasons, but one of the most fundamental is the issue of gas availability. Solutions are being explored by the European Commission, Member States and gas companies. One of the options for gas import diversification is the development of a coordinated approach to gas purchasing by Europe, which would enable the development of large-scale gas production projects in the Caspian and related transmission projects into Europe. The Commission’s Second Strategic Review of Energy Policy identified the need to provide a simplified interface between European buyers and Caspian and Central Asian producers of gas. Primarily, this would entail the creation of an entity tentatively titled the Caspian Development Corporation (CDC), to catalyze gas production and infrastructure development, by constructing a mechanism for coordinated gas purchasing by Europe. The CDC is envisioned as a vehicle that would present a credible single European client to Turkmenistan and others to whom they could conveniently and securely sell significant volumes of gas in case. Romania is among the potential beneficiaries of the coordinated/CDC approach. The Commission, the European Investment Bank and the Public-Private Infrastructure Advisory Facility (PPIAF) jointly financed and the Bank managed a study to design the CDC. The process to attract the initial founding group of companies to establish the CDC is expected to be launched in mid-2011.

**I. Utilization of EU Funds**

143. **The Review examined selective issues related to the Sector Operational Plan- Economic Competitiveness (SOP-C), based on interim evaluations** performed under EC financing (the evaluation of SOP-C, summary available on the Managing Authority’s website; and the evaluation of the National Strategic Reference Plan (NSRP), summary available on coordination authority ACIS’ website). A separate section discusses the allocation of EU funds to the energy sector.

**I.1. Sector Operational Program on Economic Competitiveness**

144. **The overall objective of SOP-C is to put Romania’s growth on fast forward, so that the country starts catching up with EU’s average productivity.** The program benefits of EU support through the European Regional Development Fund (euro 2.6 billion, or euro 3 billion including co-financing from the state budget). The program is oriented towards several priorities, such as increasing the companies’ productivity, with a focus on SMEs; setting-up of new enterprises and developing entrepreneurship; promoting research and innovation in enterprises and state-owned research institutions; development of ICT infrastructure; and increasing energy efficiency. The goal of the program is to bring Romania’s productivity at 55% of EU average by 2015.
SOP-C is the second-best performing OP in Romania, in terms of absorption (Table 6). Under SOP-C, by end-January 2011, 7,702 projects had been submitted, of which 2,333 approved, 3,462 rejected and 831 were under evaluation; plus 1,516 projects were under implementation (amounting to euro 1.5 billion, including state budget co-financing). While the absorption rate is relatively good compared to other SOPs, this result has to be viewed in the broader context. The overall absorption rate is still low at 8.6%, comparable to Bulgaria at about 10%.

Table 6: Absorption Rates of Romania’s Seven SOPs

<table>
<thead>
<tr>
<th>OPs</th>
<th>Total alloc 2007-13</th>
<th>Payment until Dec 2010</th>
<th>Total absorption rate, %</th>
<th>Absorption rate at n+3 (2007 alloc) %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environment</td>
<td>4,512</td>
<td>318</td>
<td>7</td>
<td>117&lt;sup&gt;2&lt;/sup&gt;</td>
</tr>
<tr>
<td>Transport</td>
<td>4,565</td>
<td>47</td>
<td>1</td>
<td>19</td>
</tr>
<tr>
<td>Regional OP</td>
<td>3,726</td>
<td>555</td>
<td>14.8</td>
<td>168</td>
</tr>
<tr>
<td>Economic Competitiveness</td>
<td>2,554</td>
<td>251</td>
<td>9.8</td>
<td>147</td>
</tr>
<tr>
<td>Human Resources Development</td>
<td>3,476</td>
<td>464</td>
<td>13</td>
<td>218</td>
</tr>
<tr>
<td>Administrative Capacity Development</td>
<td>208</td>
<td>10</td>
<td>4.9</td>
<td>50</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td>170</td>
<td>9</td>
<td>5.3</td>
<td>53</td>
</tr>
</tbody>
</table>

Source: Yearly allocations taken from the final OP's signed by the EU; the Authority of Structural Instruments Coordination, 2010

The overall progress of the SOP-C has been driven by the performance of some areas of intervention, while others are lagging behind. Consequently, the Managing Authority (MA) proposes reallocations for 2011-2013, notably from key areas of intervention oriented towards private sector to interventions having public sector entities as beneficiaries. Reallocations would be made first within each axis and, if amounts remain unspent, reallocations will be sought later (2012) between axes after agreement with the EC. Interestingly, projects targeted at public institutions have been more successful than those where beneficiaries are private entities. This is partly explained in SOP evaluations and the MA by the fact that the impact of the financial crisis has been more limited in the case of state budget financed entities, than for private beneficiaries. Private businesses have been hit harder by the crisis than public sector entities and had to postpone their investments, as they encountered difficulties in raising the necessary co-financing (credit crunch):

- **under Axis 1 (productive investments),** progress is particularly high in the case of tangible, production-oriented investments for SMEs and large companies, whereas progress in investments targeting intangible assets (standardization, internationalisation, and consultancy), competitiveness poles and entrepreneurship development remains slow. The MA proposes for 2011-2013 an increase of investments in SMEs (euro 195 million) and large companies (euro 98 million) by reducing the allocations for standardization (euro 21 million), competitiveness poles (euro 162 million), consultancy (euro 40 million) and supply chains / clusters (euro 69 million);
• **on research and development Axis 2**, progress is noted primarily in the high share of approved and contracted projects submitted by national, state-budget financed R&D institutions, whereas private companies had to postpone investments. The MA proposes reallocations from partnership research of public / private entities (euro 20 million) and enterprise R&D (euro 25 million) towards R&D infrastructure for public entities;

• the same reallocation trend from private to public beneficiaries can be seen on IT Axis 3, from IT connections (euro 23 million) to public services such as e-government (euro 23 million);

• the progress of **Energy Sector Axis 4** has been limited, because of the financial crisis, delays in the approval of State Aid schemes and final versions of the guides for applicants. Prospective beneficiaries (private companies) are interested in support for renewable energy, including wind notwithstanding the generous wind support scheme (para. 123). The MA proposes reallocations from energy efficiency (euro 50 million) and interconnections (euro 27 million) to renewable energy (euro 50 million) and distribution (euro 27 million). The major programs approved by the Intermediate Body and sent to the EC so far consist of desulphurization at Craiova (Units 7 & 8, RON 500 million). Two projects for desulphurization units for Rovinari (4&5) are under evaluation (euro 125 million). Several projects are under preparation for Transelectrica and Transgaz (euro 70 million).

147. **SOP-C is driven by the goal of full absorption and the reallocation from private to public beneficiaries is pro-cyclical.** The approach towards speeding up absorption is understandable considering that the absorption rates for all SOPs are low. The performance of managing authorities and intermediate bodies (MAAs and IBs) is assessed based mainly on how much of the available money has been spent, and less importance is given to the outputs and outcomes. This is a counter-incentive to developing a coherent strategy. However, SOP-C fares clearly better compared to other SOPs in terms of monitoring intermediate and final physical targets of output (e.g., Transport, where the target intermediate and final output indicators are not even determined yet). While the absorption rate is an important indicator of progress, this approach reduces the overall coherence of the National Strategic Reference Plan and correlation of national and EU policies. Also, since SOPs in general are “strategy substitutes” (programs consistently followed beyond one minister or electoral cycle), reallocations are not advisable before all other efforts have been made to push for the implementation of projects in the more difficult intervention areas.

**Key bottlenecks for SOP-C progress**

148. **There are several reasons for the delays or difficulties encountered in the SOP-C cycle, most of which are highlighted in previous evaluations (NSRF evaluation, 2009-2010) and continue to be relevant:**

• The most delayed key areas of intervention are those related to competitiveness poles, entrepreneurship development, clusters interventions or IT for private businesses. The delay is explained by the lack of coherent strategies, e.g. the National Strategy for Poles of Competitiveness or the National Strategy for Excellence Poles. Other strategic documents have been adopted late (the National Strategy for Broadband Communication). These led to delays in launching the calls for proposals for these areas. The main problem with competitiveness poles
and clusters / supply chains development is the lack of a definition of the concept in accordance with international models and good practice, adapted to local realities (e.g., industrial agglomerations lack cooperation relations), as well as the absence of a comprehensive strategy;

- The need to ensure compliance with applicable State Aid rules and the requirement to notify the State Aid schemes to the EC (e.g. certain interventions in the energy sector);

- Changes in government structure, including the location and subordination of intermediate bodies, which has seriously affected SOP-C. In 2004, the National Agency for SMEs and Cooperatives was designated as Intermediate Body for SMEs. In April 2007, the Ministry of SMEs and Trade was set up, and the National Agency for SMEs and Cooperatives and the National Tourism Authority were reorganized. The Directorate for Structural Funds Management within the newly established Ministry became the Intermediate Body for SMEs. In December 2009, following another Government re-organization, the Directorate for Structural Funds Management was relocated into the new Ministry of Economy, Trade and Business Environment, which replaced the Ministry of SMEs, Trade and Business Environment. All these cause delays because of approvals needed for the new structures;

- Lack of coherence of national strategies with EU programs, such as the Strategy for the Development of SMEs 2004-08 which was not adjusted in accordance with Romania’s accession to EU and the requirements for SME-targeted interventions under SOP-C. There is no national competitiveness mechanism to coordinate relevant sector strategies;

- Inability of to incorporate beneficiaries’ needs and expectations into the planning process. In some cases, this leads to low popularity of some potential key areas of intervention, such as support to SMEs for intangibles (standardization and consultancy services), for improving energy efficiency and environmental sustainability, as well as the development of business infrastructure and IT-investments for SMEs. In energy, this explains why the MA seeks reallocations from energy efficiency to investments in distribution and renewable energy; and

- Deficiencies in the legal framework, such as lack of implementing regulations for Law 220/2008 establishing the system to promote energy production from renewable energy sources.

The perception of key actors of the main problems in SOP-C differs. Box 9 presents the summary of the views of the MA, beneficiaries and banks.

**Box 9: Perceptions about the main problems in SOP-C**

<table>
<thead>
<tr>
<th>Managing Authority</th>
<th>Beneficiaries</th>
<th>Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beneficiaries do not understand procedures, over 90% of delays are because of beneficiaries not following properly public procurement rules (TORs eliminate competition among bidders, selection criteria too restrictive; errors in calculating scores)</td>
<td>Delays in approvals of pre-financing or reimbursements lead to liquidity issues, some companies are close to bankruptcy if they took bank loans for co-financing.</td>
<td>30% of private sector projects seeking loan for co-financing are non-bankable.</td>
</tr>
</tbody>
</table>
of bidders; attempts to bypass competitive procurement, e.g., by dividing activities so that each is below the competitive tender threshold; conditions in contracts are less restrictive than in tender).

Evaluation: beneficiaries have incomplete documents or not compliant with applicants’ guidelines.

Misunderstanding of eligibility criteria, poor economic justifications, unrealistic activity plans, lack of management experience; some beneficiaries do not comply with performance indicators during implementation.

Financing requests not correctly filled, guarantee letters do not meet criteria, bank documents not properly prepared, failures to follow reimbursement and contract schedules; expenses outside the eligibility period; accounting records not properly stamped and signed or marked as under SOP-C project.

Delays in VAT reimbursement.

Difficulties in accessing guarantees.

Worsening of credit climate during crisis led to withdrawals after projects approved.

Depreciation of the exchange rate during the crisis: delays during evaluation, combined with the fact that initial proposal budgets had been submitted in RON, led to substantially lower budgets of approved projects.

I.2. Allocation of EU Funds to the Energy Sector

150. Increasing the allocation of EU funds to energy projects could help the Government achieve its objective to accelerate the absorption of EU funds. Compared to the very large investment needs in the energy sector, the modest amount (euro 725 million) and accordingly the very low share of the energy sector in the allocation of EU funds (2%) is striking. Currently, the priority axes on energy of the sector operational program - Economic Competitiveness (SOP-C) address environment (Flue Gas Desulfurization for Craiova II, Isalmita and Rovinari thermal power plants), renewables (financing quotas of 40% to 70%) and energy efficiency including that of natural gas and electricity infrastructure. The small end-users are not eligible. According to a 2009 World Bank study (Annex 9), such a very low allocation is not unusual for the new Member States (Figure 9) – energy efficiency and renewable energy are not among the region’s investment priorities.
The Government intends to conduct a comprehensive review of the existing investment portfolio (including EU and non-EU funded projects). The review will prioritize and evaluate the existing portfolio of projects to focus on those where funding can be fully secured within a medium-term horizon (e.g., 3-5 years), examine the viability of old projects, with low priority and non-performing ones discontinued. This opportunity should be used by MEC to seek additional EU funds renewable energy, energy efficiency and environment, in cooperation with the Ministry of Administration, Ministry of Environment and Ministry of Regional Development. Annex 9 discusses related challenges.

Energy efficiency investments in thermal rehabilitation of buildings have the greatest potential to provide long-term benefit to a large number of low-income citizens in Romania, and a particular high importance for security of energy supply and protection of environment (Annex 5). Rehabilitation of heating systems and consumer end-use heat controls, insulation and heat metering significantly reduces the country’s energy consumption and CO2 emissions. It would reduce the need for future government support for energy use by vulnerable populations. It can be seen as a (social) service of general interest that promotes greater social cohesion. The investments addressed by this program contribute also to the development of SMEs that are active on the building services and materials markets.

The Law 260/2006 (republished) on thermal rehabilitation of Blocks of Flats - Condominiums stipulated the establishment of a SOP for thermal rehabilitation of apartment buildings since it meets at least four priorities of the National Development Plan (NDP): (P1) increase economic competitiveness and economy development based on knowledge; (P3) protection and improvement of environment quality; (P4) development of human resources, promotion of job creation and social inclusion and strengthening of administrative capacity; (P6) decrease of development disparities between country regions. It was a realistic solution for financing low – income beneficiaries of this program. A crucial aspect requested by the European Commission for the programs financed by the
Structural Funds has been fulfilled: a legal 50% to 80% co-financing from the national and local budgets was legally stipulated to that of owners’ associations.

154. **Despite the strong justification, the provision of the Law 260/2006 has not been included in a SOP.** There are several reasons that help explain this situation. Seven SOPs have already been assigned to various ministries and a new one would have required contributions from these existing programs. Moreover, it has resulted in disagreements among government officials on the assignment of this program because energy efficiency cuts across the missions of Ministry of Administration and Interior, the Ministry of Finances, the Ministry of Labor, the Ministry of Transportation, Constructions and Tourism (MTCT – the present Ministry of Regional Development and Tourism), the Ministry of Economy, and the Minister Delegate for Public Works and Territory Management at that time. Program’s results show that financing was the chief barrier because both family income and the financial resources of the state were limited. Additionally, the program seems to be compromised due to poor organization including corruption. Only about one percent of the 89,000 blocks of flats have so far been rehabilitated under the Thermal Rehabilitation program. At the current pace of about 25,000 apartments a year, the full implementation of the program would take over 100 years. The Government would have to address these issues to improve the prospects for obtaining EU support in the future.
PART II - BUSINESS ENVIRONMENT

A. Context and Purpose

155. **Business environment is a broad topic that covers a variety of policy interventions.** For the purpose of this review, the analysis of the business environment will concentrate on the area related to governance structures and institutions needed to create appropriate conditions for business activity and thus promote a sound business environment. It will not cover either macroeconomic aspects, such as taxation or the monetary policy, or infrastructure issues that are also needed for an environment conducive to business activity; these areas are out of the scope of this review.

156. **In order to grasp the current situation in Romania and come up with sound recommendations, it was necessary to expand the analysis beyond the attributions and responsibilities of the Department for the Business Environment at the Ministry of Economy, Commerce and Business Environment, which is the starting point of this review.** While this report attaches particular attention to this unit and the line Ministry, it is important to highlight that this functional report expands the initial scope of the task and it is intended to offer an assessment of institutional capacities across the GoR to improve the business environment as a key strategy for government action. Responsibilities are scattered across the Romanian administration, therefore it is necessary to expand the analysis to provide sound policy recommendations.

157. **The purpose of the review is therefore three fold.** First, the report will include an assessment of the business environment of Romania in order to understand the current situation and main challenges the country is facing. Second, the review will look into the current institutional setting established by the Government to promote and improve the business environment. This means that the review will cover a performance evaluation of the main institutions that deal with business environment issues in Romania, namely the Department for the Business Environment of the Ministry of Economy, Commerce and Business Environment, the Department of Public Policy at the General Secretariat of Government and the Unit of Post-Accession Monitoring of the Department of European Affairs, as well as a compilation of other institutions that have key responsibilities for improving business environment issues at the national and local level. Third, the review has the objective to discuss the way forward for Romania in terms of increasing institutional capacities to promote the business environment through a comprehensive approach to regulatory management and reform.

B. Business Environment in Romania

158. **Romania embarked on a complete transition to a market-based economy in the 1990s, which represented an impressive overhaul of its regulatory system.** The reform process that the Government undertook between 2000 and 2007 was important to sustain long-term growth and stability. The country was growing at an average rate of 7% between 2006 and 2008. However, the income gap between Romania and the EU remains large, which has urged the Government to put in place a second generation of reforms to help the country’s successful integration in EU and global markets. Important in this strategy is the implementation of less restrictive product market policies that enable firms to put resources, both capital and labor, to their most efficient use.
The financial crisis has shown the limitations of the approach followed by the Government and confirmed the need to deepen economic and administrative reforms. The fall of 7.7% in GDP in 2009 has reduced the domestic and external demand, lowered foreign investment and limited the flow of credit. Despite the improvements achieved in the previous years, as officially reported, the current situation does not seem so positive as the country might only grow at 1.5% in 2011. Compared to most EU countries, and in particular with the new 10 EU members, where economic activity is expanding and GDP is in an upward trend since mid-2010, Romania’s recovery has been delayed due to large macroeconomic disequilibria and the late implementation of key austerity measures.

In order to overcome the crisis, the European Commission has put in place Europe 2020, an agenda that intends to help Europe recover from the crisis through a coordinated, comprehensive program of reforms, covering fiscal consolidation, return to sound macro-economic conditions and front loading growth-enhancing measures. EU members are committed to introduce successful reforms consisting in improving the functioning of the labor and product markets, stimulating innovation and improving the framework conditions to do business in Europe. This will attract greater private-sector investment, which in turn will help enhance the quality of public finances. Romania should not isolate itself from these efforts; this requires understanding the importance of business environment issues and the best way government can efficiently and effectively contribute to its improvement.

In terms of the business environment, Romania is falling behind international comparators, even when compared with other countries in South East Europe or Central Asia. Much remains to be done in terms of implementation and enforcement of institutional changes, as well as to make tangible the reforms adopted, in a coordinated and strategic manner. Little has been achieved in the last two years, in particular after the crisis when all major transformations needed to facilitate business activity have been postponed.

According to the Global Competitiveness Index, Romania obtained the 67th position in 2010-2011, compared to the rank 64 in 2009-2010. Taking into account some of the pillars that are considered drivers for competitiveness and productivity of the Index, such as institutions, infrastructure, financial market development, business sophistication and innovation, the position of Romania falls up to position 93 in international comparison. These areas are fundamental elements of the business environment and play a key role for economic growth. Among the most problematic factors identified for

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13 National Commission for Economic Forecasting (2010). In addition to this official forecast, the European Bank for Reconstruction and Development report published on January 25, 2011 estimates an annual growth of GDP of 1.1% in 2011, while the World Bank, in a press conference in Bucharest on February 4, 2011, forecasts an economic growth of 1.5% in 2011.
15 European Commission (2011)
16 The definition of business environment is broad and covers a big number of aspects. For Stern (2002) the business environment can be defined as the “policy, institutional, and behavioral environment, both present and expected, that influences the returns, and risks, associated with investment” in a specific location. This general definition includes three broad categories. The first category covers macroeconomic aspects such as fiscal, monetary, and exchange rate policies, which clearly affects investors’ returns. The second category includes governance, institutions, and political stability. The final category includes infrastructure necessary for productive investment, such as transportation, electricity, and communications. This report makes reference mostly to the second category.
doing business in Romania, businesses reported access to financing, inadequate supply of infrastructure, inefficient government bureaucracy, tax rates and tax regulations.

163. **In 2007, Romania had been considered the second most active reformer on the case of doing business among 175 economies, being the first country in Eastern Europe. The positive track could not be maintained.** The 2011 Doing Business Indicators ranked Romania in place 56 (Figure 10), falling two positions compared to the previous year (54 in 2010). Compared to neighboring countries, Romania has made progress in some of the DB indicators, such as starting a business or getting a credit, but it maintains the complexity of a regulatory environment that needs to be improved for doing business in areas such as registering property or paying taxes.

**Figure 10. Doing Business – Global Rank in 2011 (Romania and selected countries)**

![Graph showing global rank in 2011 for selected countries](source: www.doingbusiness.org)

Other international comparisons reveal also the complexity of the Romanian business environment for doing business. Data from the Enterprise Survey of Romania conducted in 2009 also confirm that some regulatory instruments, such as licenses and permits, is an area of concern for businesses and seen as a major constraint for economic activity (Figure 11). Licenses and permits normally involve different layers of government, as lower levels of government play a decisive role in granting them and sometimes imposing additional burdens at their discretion. In the case of Romania, despite general rules at national level, municipalities and counties have the main role as implementers of these instruments, creating in most cases important delays to start-up and operate a business.
165. **An important element of the business environment is the perception that the private sector attaches to the way policy and regulatory decisions taken by government affect them.** The business community in Romania, both domestic and foreign, perceives deterioration in the conditions of the Romanian business environment in the last few years, in terms of inefficient policies and regulatory framework, and the lack of coordination, capacities and skills in the institutional set up that should be promoting and improving it. Some of the main areas that the business community identifies as serious concerns that should be tackled with urgency are presented in Box 10.

**Box 10. Main policy areas affecting the business environment in Romania, as perceived by the private sector**

According to various interviews conducted for this Functional Review, a number of areas are seen as potential hurdles for doing business in Romania and require particular attention from the government if Romania is to catch up with economic growth and a dynamic business activity. These priorities are:

- Access to finance and investment policy
- Taxation issues, in particular tax administration
- Administrative burdens to operate businesses
- Bottlenecks in infrastructure supply
- Education, research and innovation
- Energy and environment issues

All these issues pertain to the business environment of a country. This is why the strategy to improve it should establish clear priorities and tackle them in a coordinated manner with bodies responsible for these issues.

166. As expressed by a number of businesses representatives interviewed for this review, the regulatory system in Romania remains cumbersome and composed by non-transparent bureaucratic procedures, in which limited consultation with the business community is undertaken. Despite efforts made by the government to publish future laws and regulations, consultation takes place too late in the regulatory process without leaving time to the private sector to prepare and make contributions, and in most cases when decisions have already been made. In other cases, when contributions are made, the private sector feels they are not properly heard. The decision-making process appears as a black box where decisions are taken with much discretion.

167. An important element of the business environment is the perception that the private sector attaches to the way policy and regulatory decisions taken by government affect them. The business community in Romania, both domestic and foreigner, perceives deterioration in the conditions of the Romanian business environment in the last few years, in terms of inefficient policies and regulatory framework, and the lack of coordination, capacities and skills in the institutional set up that should be promoting and improving it. Some of the main areas that the business community identifies as serious concerns that should be tackled with urgency are presented in Box 8.

168. Investors, businesses and liberal professionals point to excessive time for different administrative procedures and compliance with regulations and information obligations, as well as to uncertainty due to frequent changes in regulation without prior notice. The lack of predictability is seen as a major concern, being the emergency ordinances a source of worry since things can easily be changed, as has happened with the fiscal code in the last few years.

169. Regulations are also vaguely worded and poorly explained besides the strong legalistic approach that characterizes them. In many cases, it is reported that secondary regulations do not match the primary law, adding a new possible layer of contradiction and dispute in administrative and judicial terms. This also impact the level of compliance with and enforcement of laws and regulations.

170. Different institutions are responsible for various regulatory instruments, which makes the regulatory process time consuming and burdensome for businesses. Even if some efforts have been done to streamline certain procedures, there is visible duplication and overlapping in the Romanian regulatory system, opening up the possibility for corruption and informality.
B.1. Initiatives to improve the business environment and recent achievements

171. There are many ongoing initiatives in Romania that are related to the improvement of the business environment. They cover some aspects of the business environment, but any of them is comprehensive and intends to align the whole administration in coordinated efforts. One of the most difficult tasks is to identify how they are coordinated among the different responsible institutions in terms of implementation and the results they have achieved as a whole for the country.

172. The Program of Government 2009-2012, main document of government action in Romania, acknowledges that “creating a business environment that fosters the competitiveness of firms and develops entrepreneurial skills” is essential to compete both in the EU single market and outside the EU. For that, the Government of Romania has set different lines of action that deal with the business environment (see Box 11).

Box 11. Main lines of action of the Program of Government 2009-2012 for the business environment, SMEs, competition and consumer protection

The Program of Government 2009-2012 has identified the following lines of action:

- Simplification and improvement of the legislative and administrative framework, reduction of bureaucracy and corruption, as well as administrative and fiscal burdens. The aim is to reduce the number of administrative procedures, the length of authorizations, permits, licenses and permits, the costs of these procedures and thus corruption;

- Acceleration of precompetitive reforms and promotion of a level playing field;

- Development and implementation of an integrated and transparent business environment, based on the assessment and recovery of factors affecting the competitiveness of enterprises and promoting measures to improve their legal and organizational framework;

- Development in the education system and specialized training systems; promotion of entrepreneurial culture; strengthening performance management and encouraging innovation. Efforts are needed to raise awareness in the business environment about the importance of intellectual and property rights, quality management, intangible assets, in particular patents and trade;

- Application of the new EU SME policy framework, the Small Business Act;

- Facilitation of access to EU structural funds and funding mechanisms in place through Eximbank, CEC, Romanian Guarantee Fund for SMEs, Agricultural Guarantee Fund, the Romanian Fund for SMEs Counter, etc.;

- Provision of high level consumer protection through effective enforcement; protection of consumers against unfair trade practices and the risks that may affect them; promoting cooperation with EU bodies, member states and civil society, fostering protection offered by state institutions.

The first set of actions that deal with the business environment in Romania are included in the National Reform Program 2007-2010, which is a key document establishing a comprehensive three-year strategy to implement policies in EU countries. According to this Program, the following areas are considered pillars of improving the business environment in Romania:

- Better regulations to encourage investments;
- Development of business infrastructure;
- Increasing companies competitiveness and promoting RDI;
- Consolidating competition and state aid policies; and
- Improving access to finance.

The Action Plan for the National Reform Program 2007-2010 contains the following general measures to comply with the first pillar, related to promote better regulation in Romania:

- Internalization of the latest and modern practices to promote the business environment reform;
- Assess the implementation of the declaration on oath and the tacit approval procedure;
- Strengthening the institutional mechanism for dialogue, decision making and the development of specific public policy.

One of the key implementers of these measures is the Department for the Business Environment of the Ministry of Economy, Commerce and Business Environment. An updated version of the National Reform Program 2011-2013 is currently under preparation and discussion, and as for other EU members, it is expected to be linked to targets set out for the strategy Europe 2020. This National Reform Program should be ready by April 2011. Its preparation is mainly coordinated by the Unit for Post-Accession Monitoring at the Department of European Affairs, but the definition about the content and areas of intervention is responsibility of the Department for the Business Environment of the Ministry of Economy, Commerce and Business Environment.

The second set of actions that deal with the business environment are established in the National Agenda for Better Regulation that is mainly in the hands of the Department of Public Policy of the General Secretariat of Government, even if some parts of the implementation of certain

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18 As agreed at the European Council in March 2005, Member States are committed to drawing up under their own responsibility, National Reform Programs (NRP) based on the Integrated Guidelines for Growth and Jobs which encompass the economic, social and environmental dimensions. The reform programs should be geared to their own needs and specific situation, allowing for the diversity of situations and policy priorities at national level. NRPs should be conceived as forward-looking political documents setting out their 3 year strategy to deliver growth and jobs. These programs, together with their implementation reports, allow the Commission to assess the policies and progress identified by Member States.
actions fall into responsibility of other institutions. The current Action Plan for the Strategy for Better Regulation of the Central Public Administration 2008-2013 contains the following measures:

- Improvement of regulatory impact assessment and consultation processes;
- Measuring costs and administrative burdens;
- Simplify administrative procedures;
- Improve the relationship between agencies, regulators and control mechanisms;
- Legal simplification; and
- Effective application of EU regulations.

177. **This strategy was prepared by the Secretary General of Government and the Department for European Affairs.** A working group in charge of better regulation was established in 2007, and included other institutions participating in the development of the strategy. The Action Plan is linked to the EU Better Regulation Agenda which attaches particular importance to improve the regulatory framework of the European Union.

178. **Other initiatives concerning the business environment can be found in Romania.** For instance, as part of the obligations acquired by the Government under the Memorandum of Understanding between the European Community, Romania and the International Monetary Fund, the Government committed to prepare an inventory of permits, licenses and approvals required to register property, business operation and activities related to construction. The result of this work led to identify 275 administrative procedures that have been incorporated in a simplification plan, coordinated by the Secretariat General of Government. The plan contains 49 measures undertaken by public institutions, including 13 procedures that have been eliminated and 9 additional procedures are in advance stage of being eliminated. Another 27 measures will be abolished.

179. **A relevant area to establish sound ground for the business environment is to increase transparency of government regulatory decisions and to improve the dialogue between the government and the business community.** Some of the actions that the Department for the Business Environment at the Ministry of Economy has undertaken are:

- Continuous consultation (online) business representatives on the regulatory barriers;
- Strengthen dialogue with the business community (organization of meetings, consultations, seminars, roundtables, discussions with business representatives);
- Launching of the website "business environment" dedicated to informing and consulting business, posted on the website of the Ministry of Economy, Trade and Business Environment at http://www.minind.ro/dma

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• Strengthening collaboration with representatives of professional associations and chambers of commerce at regional level, such as the Businessmen Association in Romania (AOAR), Foreign Investors Council (CIS), the Union of Liberal Professions of Romania (UPLR), etc.

180. **Despite recent achievements, in particular in terms of completing some of the actions contained in the various strategic documents outlined by the Government, results in terms of improving the business environment have been limited in scope and impact to the general economic situation of the country.** The multiplicity of interventions, without a single strategic line of action, makes it challenging to track results and measure their impact.

**B.2. Towards a strategy for the business environment and priorities for implementation**

181. **The Department for the Business Environment has prepared with the assistance of an international consulting firm a new strategy for its future work.** The strategy has been consulted with stakeholders through focus groups, workshops and peer review meetings, and it is currently under discussion at government level for approval.\(^2^0^9\) The approval is essential to further define its implementation and to develop an action plan with more concrete measures. The Department, however, has already started the implementation of some of the measures contained in the strategy.

182. **The strategy seeks a medium and long term vision to deal with the business environment. It contains a package of 62 government actions, articulated around 18 measures that can be grouped in four main objectives:**

- Promote economic growth through investment and improved investment climate;
- Increase transparency in decision-making, public policy through responsible behavior and integrity in business records;
- Develop business and professions by increasing access to public and private quality advisory services;
- Increase administrative capacities at the Department for the Business Environment to improve strategic planning processes, analysis, monitoring and evaluation.

183. **The strategy acknowledges the need to have a coherent and coordinated approach to deal with the business environment, highlighting the need to link this approach to other strategies, at EU and national level.** The strategy is planned to be implemented between 2010 and 2014, in two main stages:

- Phase I: 2010-2012 with urgent actions to be overcome the current economic crisis; and
- Phase II: 2012-2014 with more substantive actions to support the economic recovery.

\(^2^0^9\) A website was created to conduct this consultation process. Results can be found at www.proiect-dma.ro
184. **The Strategy also envisages three horizontal strategic priorities:**

- Simplification of the regulatory framework and institutional strengthening;
- Increasing administrative capacity at the Department for the Business Environment at the Ministry of Economy, Commerce and Business Environment, to improve strategic planning processes, analysis, monitoring and evaluation; and
- Develop mechanisms for e-government business environment.

185. **The implementation of the strategy does not envisage big regulatory changes in Romania, apart from some small changes in normative acts of government that could facilitate the application of some of the actions contained in the strategy.** The strategy contains some provisions for monitoring its implementation, which will be in hands of various institutions that will be responsible for implementing some of the actions to develop the business environment. In terms of budget, the strategy envisages a required budget for implementation estimated up to RON 173 million (approx. € 40 million). This should be covered mainly with EU structural funds.

186. **The strategy is an important step forward to develop a more comprehensive approach to deal with the business environment.** It acknowledges the current difficult environment in which it should be implemented, making use of actions proposed by businesses that, in principle, would not be so controversial to be implemented. It is intended to reduce resistance to change and to align the efforts to others at international level, in particular within the EU.

187. **However, this strategy lacks important elements that are needed to make it a more relevant policy document to be implemented in if the institutional context of Romania would be different. Some of the issues of concern refer to the following areas:**

- **First,** it is a strategy that covers many areas of intervention without a clear connecting thread not only among the various issues the Department will be dealing with, but also in relation to what the Government is doing at various levels and through different institutions. The strategy, therefore, does not bring the various pieces together, but encourages a disconnection between what the Department does from the rest of key functions that should be attributed to this Department. The dilemma of dealing with cross-cutting issues does not get resolved with this strategy;
- **Second,** this strategy does not scale up the work of the Department in terms of achievements over time. It seems that from now until 2014 the Department will have the same role, the same attributions, the same responsibilities. However, in order to implement some of the measures, the Department needs clear political support inside the Ministry and political leverage to coordinate most of the implementation of the measures. Keeping its position in the way it is now, is not a viable solution;
- **Third,** the strategy does not take into consideration the issue of sequencing, or what comes first, or second-best options. The strategy makes a series of suggestions, some of them logical, some others that not so clearly follow a well structured sequence, for a series of interventions. Since it
covers many aspects and it goes in various directions, it does not prioritize and this risks being once again an announced mistake in a couple of years; and

- Fourth, the strategy relies in excess on outputs, such as preparation of reports and diagnosis. The lack of information and comprehensive databases is certainly a serious issue in Romania, but relying in the preparation of reports and diagnosis could be a serious disadvantage to get to the implementation phase.

188. **The role of this strategy is important for the following years of dealing with the business environment in Romania.** It will be important to use the planned revision envisaged in 2012 to change the approach to the business environment issues and expand it to a broader strategy for regulatory management and reform.

C. **Institutional set-up for business environment – role and performance of various institutions**

189. **In many countries – unlike Romania - improving the business environment is a key priority at the highest political level.** The regulatory environment in which businesses operate influences their competitiveness and their ability to grow and create jobs. The EU Better Regulation agenda, for instance, is intended to create a better regulatory environment for business, one that is simple, understandable, effective and enforceable, and Europe 2020 relies in increasing competitiveness of its members. Many OECD countries attach great importance to promote regulatory reform as one of the main vehicle for improving the business environment.

190. **Several studies show that sound institutional capacities working in a coordinated manner to ease the regulatory framework for business activity and to promote a favorable investment and economic climate are fundamental pillars for the business environment.** International experiences show that a proper institutional arrangement, basically in charge of a clear and comprehensive policy applicable to the “whole-of-government” and in the hands of a single unit responsible for this issue, is essential for success. In countries that have been leading this process, many EU countries for instance, a single unit, located at the center of government, in charge of regulatory reform and improving the business environment can be identified.

191. **In Romania, managing and improving the business environment does not seem to have been a single and coordinated policy area task to a single unit in government.** Historically and based on the many recent changes at institutional level, dealing with the business environment has been attached to different institutions that have not acted as engines for reform because they usually lacked all the political support needed to introduce deep reforms and changes in the administration, as well as new tools to make the regulatory environment conducive to economic activity. Those units responsible for the business environment have worked in a fragmented institutional set up, which has made difficult their coordination.

192. **In the current institutional set-up, several institutions deal with business environment issues.** This section will review the most relevant ones, i.e. the Department for Business Environment at the Ministry of Economy, Commerce and Business Environment, the Public Policy Directorate at the
General Secretariat of Government and the Unit for Post-Accession Monitoring of the Department of European Affairs. Other institutions will be also mentioned as they have some key responsibilities and functions for business environment-related issues at national and local level.

**C.1. Department for the Business Environment**

193. In the current government structure, the main institution responsible for business environment issues in Romania is the Ministry of Economy, Commerce and Business Environment. Organization chart is attached as Annex 1. This responds to the Government Decision 720/2010 that approves the restructuring and reorganization of the Ministry of Economy, Commerce and Business Environment following the Government Decision No. 1.634/2009 about the organization and functioning of the Ministry. However, this unit has more than ten years of existence and it has been attached to various bodies, from a Vice-Prime Minister in charge of Business Environment or the General Secretariat of Government, to a Ministry dedicated to the Business Environment. If one day the unit was at the center of government, its current situation does not say much about the political relevance it has. The unit itself has been partially dismantled with the budgetary restrictions and administrative reshuffle.

194. The Directorate for the Business Environment is under the mandate of the General Directorate for Industrial Policy and Business Environment. It has a Head and a Deputy Head and it is composed of two units:

- The Department for the Business Environment, composed of nine government officials; and,
- The Department of SMEs composed of six government officials.

195. In the current structure of the Ministry, the Department does not receive the political attention it should get. Since the Ministry is mainly dealing with energy issues, the relevance of business environment issues is not high. The Ministry is not able to move forward this agenda, in particular in areas that clearly other ministries and government bodies are involved. As it stands today, the cross-cutting nature of business environment issues gets completely diluted.

196. However, the Institutional Strategic Plan 2010-2012 of the Ministry of Economy, Commerce and Business Environment includes several complex projects to strengthen the institutional capacity of the ministry. The following can be identified as priorities:

- Strengthening institutional capacity to improve management reform and the business environment in Romania, in partnership with the General Secretariat of Government;
- Development of a government strategy for improving and developing the business environment (Strategy DMA, presented in the previous section of this report);
- Assessment of administrative barriers and the legislative environment faced by the businesses, building a sustainable system for monitoring and evaluation; and
The Department for the Business Environment is responsible for the following issues in the field of business policy as a public priority of the government:

- Initiate measures to harmonize the legislative framework for businesses;
- Ensure predictability and enable businesses to plan activities by assessing impacts of legislation on the business environment;
- Propose actions to reduce bureaucracy;
- Develop, update and monitor action plans for businesses;
- Support the Executive Secretariat and Working Groups to develop an Action Plan for monitoring businesses;
- Initiate and implement concrete actions to comply with objectives set by government related to impact on businesses;
- Prepare reports and summaries to inform the Government and international organizations on the implementation of the Action Plan for the Business Environment;
- Ensure effective information flow and dialogue between all entities involved in this area;
- Elaborate and participate in the preparation of normative acts related to the business environment;
- Participate in seminars, conferences, roundtables and international symposia related to the business environment;
- Identify and test ways of improving the business environment (e.g. transparent administrative codes of practice, encouraging and supporting entrepreneurial initiatives, etc.);
- Update the information regarding the business environment in the official website of the Ministry of Economy, Trade and Business Environment;
- Respond in writing to complaints, no later than 30 days after receiving them;
- Collaborate on specific projects with the World Bank, European Commission, OECD, The American Chamber of Commerce, ensuring coordination with businesses;
- Collaborate in special topics and agenda related to the business environment as a result of obligations of Romania as EU member;
- Work in committees and ministerial councils to develop and implement actions, measures and projects related to the business environment;
- Work with business representative institutions to reduce administrative barriers and improve the legal framework;
- Participate in events organized by the CCIR territorial chambers of commerce and bilateral chambers of trade;

- Organize and participate in running the survey to assess the impact of administrative and procedural regulations on the business climate, using expertise, methodologies and tools applied by international organizations;

- Ensure that the thematic and methodological requirements are in place for the execution of specific projects;

- Ensure the management and resolution of documents that have been discussed and distributed;

- Coordinate and organize activities related to economic, fiscal policies and trade, internal market, competitiveness, and impact on businesses;

- Promote continuous dialogue with trade unions and employers’ confederations, as well as professional associations, to identify problems that face and ways to improve the business environment; and

- Ensure compliance with legal provisions on emergency situations

198. **The Department for the Business Environment is also responsible for the following issues, in order to meet Romania’s commitments with international organizations (EU, World Bank, OECD, etc) and their recommendations:**

- Proposing, implementing, coordinating and monitoring actions in reducing administrative barriers, in accordance with the objectives set by the EU Action Program for Reducing Administrative Burdens in the EU;

- Proposing and initiating actions for transposition into national law and implementing Directive 2006/123/EC on services in the internal market;

- Developing and proposing actions for adopting and implementing tools identifying and measuring the administrative costs imposed by regulations to businesses, in accordance with international practices and methodologies identified, particularly the Standard Cost Model (SCM);

- Ensuring, together with the Department for European Affairs and the General Secretariat of Government, coordination and implementation of business policies in order to meet the recommendations and commitments on the Better Regulation agenda;

- Coordinating, together with the Ministry of Foreign Affairs, and implementing the “Regional Investment Initiative in Southeast Europe – OECD” (part of the Stability Pact and Investment Reform Index Project);

- Seeking compliance with commitments of the annual ministerial Declaration of the Investment Compact Program;
• Meeting commitments under the Statute signed by Romania when joined the Declaration for International Investment and Multinational Companies of the OECD;

• Representing the Ministry of Economy, Trade and Business Environment in the quarterly meetings of the OECD Investment Committee;

• Ensuring, together with the Ministry of Foreign Affairs, the coordination as point of contact for the national guidelines to implement the OECD International Investment and Multinational Companies Declaration, as well as representing the Ministry at the OECD Investment Committee Working Group on Regulatory Reform in South East Europe;

• Participating in the coordination and performance of the Special Group of Transposition to adopt measures to speed up implementation of the Directive 2006/123/EC on services in the internal market.

199. The Department for the Business Environment is also responsible for the following issues, in order to increase accountability in the use of EU funds:

• Initiate specific business projects to absorb EU funds related to post-accession;

• Develop programs and projects with international funding, establishing units for project implementation (PIU);

• Monitor activities under grant projects financed by EU post-accession funds;

• Take corrective actions in ongoing projects financed by EU post-accession funds; and

• Report on implementation and internal control in accordance with guidelines established.

200. The number of responsibilities listed above reveals several issues that should be of concern in terms of developing a comprehensive approach to tackle business environment inefficiencies and getting expected results in terms of improving the Romanian business environment:

• The list shows the complexity of the areas and the broad scope of actions the Unit has to undertake to fulfill these obligations. The list is broad and covers too many aspects;

• The responsibilities listed here are overambitious, given the size of the unit, which is composed of only seven officials, and with limited resources. The risk of being too ambitious with these responsibilities can make difficult to get into the implementation phase and obtain results;

• The lack of prioritization is evident from this list, as it is the fact that some key functions are missing and some others seem to be irrelevant for promoting a better business environment in Romania; and

• Some of these responsibilities would require extensive political leverage that the Unit does not seem to have inside the Ministry or across the public administration.
C.2. Public Policy Directorate at the General Secretariat of Government

201. The Public Policy Directorate is responsible for improving the development, coordination and planning of public policies at the central level of government. Public Policy Units in each ministry mirror the one at the General Secretariat of Government. In the organization structure of the General Secretariat of Government, the Department appears in the following place and has around 72 posts (Figure 12). The Directorate is entrusted with the following responsibilities:

- Development of an integrated mechanism for coordinating the design and implementation of public policies;
- Strengthening institutional capacities in government for ex-ante analysis and policy design, strategic planning and monitoring and evaluation of public policies at central level;
- Strengthening inter-ministerial consultation in public policy issues; and
- Development of programs in partnership with international organizations for improving the development, coordination and planning for public policies at central level of government.

Figure 12: General Secretariat of the Government
202. The objectives of the work done by the Public Policy Directorate are:

- Effective public policies;
- More transparent decision-making;
- Introduce impact assessments to base public policies;
- Improving consultation among central government institutions;
- Create a link between public policy planning and budgeting; and
- Development of methodologies for evaluating and monitoring public policies.

203. The Directorate plays a prominent role in terms of the business environment as it is responsible for some actions contained in the Better Regulation Strategy and other key documents of Government that deal with implementation of actions to improve the business environment. Its particular location at the center of government makes it a potentially important Unit that can mobilize resources and capacities across the administration to implement and get results, in particular to strengthen policy process and stimulate changes in policy institutions.

204. Sound policy formulation is essential to improve and develop the business environment. Ensuring that policies are coherent, coordinated, effective and efficient can have a strong impact on the way legal provisions and regulations are prepared in Romania. Being the Directorate in charge of these issues, its role in terms of improving the business environment is relevant and essential to ensure that a predictable legal and policy framework is in place in the country.

C.3. Unit of Post-Accession Monitoring at the Department of European Affairs

205. The Department of European Affairs coordinates the formulation of policies and strategies concerning European affairs, according to Law No. 102/2007. It coordinates the development, adoption and implementation of national strategies, combining a post-accession strategy through the National Reform Program, the Lisbon Strategy and the Strategy for Romania’s domestic market.

206. The Post-Accession Monitoring Unit is mainly focused on establishing and maintaining mechanisms that ensure compliance with the obligations of the EU membership. The Unit monitors as well the priorities and objectives set by Romania as EU member state, analyzing failures that might arise in the implementation of EU policies and it proposes measures to eliminate them.

207. This Unit does not have an implementation role in terms of improving the business environment, but the coordination role in terms of preparing the National Reform Program is relevant for the purposes of this review. This Unit is the technical focal point to ensure that Romania responds to the commitments of the Lisbon Strategy. The Unit appears close to the Sub-Secretary of State, linked directly to the Minister in charge of this Department. The organizational chart is shown in Figure 13.
C.4. Ministry of Administration and Interior

208. The Ministry of Administration and Interior monitors the enforcement of provisions contained by the strategies and programs of reform and restructuring of the central and local public administration, elaborated on the basis of the Governing Program, in compliance with the EU standards and the domestic legislation. It also ensures achieving strategies and programs that deal with the public administration. It also guides and controls the prefects’ activity for the fulfillment of the Governing Program.

209. Within the Ministry, the Public Policy Unit is in charge of strengthening the managerial capacities of the ministry, helping to improve the process of developing, implementing and coordinating public policy documents, as well as controlling and monitoring their implementation in the ministry and the areas of responsibility. The unit is staffed with 13 people and coordinates as well with the Department of Public Policy of the General Secretariat of Government. Its responsibilities relate to the following activities:

- Coordination processes of public policies;
- Development and monitoring of institutional strategic planning;
- Development and monitoring of budgetary planning; and
- Promotion of public policies at local level.
210. **The Unit is currently implementing a project on “Effective decision-making processes at local government level in Romania”,** financed by the European Social Fund. This is an operational program to strengthen and develop administrative capacities at local level. The general goal is to improve existing procedures in local governments, using new tools, in order to generate an efficient management cycle and effective public policies. The program intends to expand the use of Regulatory Impact Analysis (RIA) to improve decision-making at local level.

**C.5. Legislative Council**

211. **According to Article 79 of the Constitution of Romania, the Legislative Council is “an advisory expert body of the Parliament that initials draft normative acts for the purpose of a systemic unification and coordination of the whole body of laws.”** It is also responsible for keeping the official record of legislation in Romania. The role of the Council is mainly to advise the Government on bills, draft statutory orders, draft codes and other legislative proposals, to ensure that legislation conforms to the provisions and principles of the Constitution.

212. **The Council is the main executing institution for one of the areas covered by the Better Regulation strategy, dealing with the simplification of national legislation.** It helps identifying obsolete laws and inconsistent regulations that can be repealed by ministries and different institutions responsible for the legal acts. The Legislative Council is invited to provide legal feedback on the pertinence of the legal instruments and help ministries and other institutions in the process of simplification.

**C.6. Ministry of Regional Development and Tourism**

213. **The Ministry of Regional Development and Tourism has two important regulatory functions that affect directly the possibility to do business in the country and the attraction of investments into big infrastructure projects.** One is the work done by the Directorate General of Territorial Development which is responsible, among many other issues, for regulating aspects related to land registration through the Government Decision on Urban Planning Regulation. The other unit is the Technical Directorate for Construction (TDC) whose mandate is to prepare and monitor the enforcement of legislation and regulations applied in the construction industry.  

214. **These two procedures are part of the licenses the Government committed to simplify and streamline under the MoU with the European Commission.** These two areas are of concern for the business community since they represent bottlenecks for big infrastructure projects, construction works and attraction of big investments. Some improvements have been made, in particular concerning the time required by local authorities to respond to businesses about their request to build in certain areas, but much has to be done as to complete a national cadastre and reducing all irregularities in property titles that remain in the country.

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21 See Functional Review of the Ministry of Territorial Development and Tourism.
D. Enhanced institutional capacities for regulatory management and reform

215. Having a sound business environment is an issue that is closely linked to the institutional set-up that promotes and improves it. Many researches and international benchmarking have proved the strong link between the quality of the regulatory framework, basis of any business environment, and coordinated and articulated institutions that are able to implement a coherent strategy and use tools to improve the business environment and monitor progress over time. It has been acknowledged that regulatory quality captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

216. The current situation in Romania shows that there is much to be done in terms of strengthening institutional capacities for managing and reforming the business environment. The institutional fragmentation and an uncoordinated approach have made Romania to lag behind other EU countries that are taking advantage of offering a more favorable regulatory framework that facilitates doing business, ensures business growth and attracts investments.

D.1. Setting up a clear policy for improving the business environment

217. Romania has a number of strategic documents that outline the main lines of action in terms of improving the business environment and to introduce better regulation policies. However, “there is no formal policy framework for improving the business environment, to provide a medium and long term vision and perspective on the general direction of government policies affecting the business environment”, as acknowledged by the Strategy for the Business Environment prepared by the Ministry of Economy, Commerce and Business Environment in 2010. This means that the country does not have a policy characterized by the adoption by governance institutions of certain policies (explicit policies to regulate better) and the systematic use of policy and regulatory tools (simplification, consultation and impact assessment).

218. In contrast to the tendency followed by most EU and OECD countries, which are moving towards the adoption of regulatory management and reform (Figure 14) through a single and explicit regulatory policy applied government wide, Romania lacks a single, comprehensive and coordinated strategy to deal with (1) the business environment and (2) regulatory reform issues, which is at the core of how government intervenes through regulatory instruments in the business activity. Regulatory reform is a much broader concept that includes managing, improving and promoting business environment issues, therefore an explicit regulatory reform program is a pre-condition to promote and improve the business environment.

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22 OECD Indicators of Product Market Regulations or Doing Business Indicators have encouraged this discussion at international level.
23 Kaufmann D., A. Kraay, and M. Mastruzzi (2010)
24 Ministerul Economiei, Comerțului și Mediului de Afaceri (2010), p. 10
The main reasons for regulatory reform are to improve competitiveness and growth, and to reduce the burden of regulations on businesses. The main motives for reform are primarily found in the domestic policy agenda, including the need to reduce burdens on business which is almost universally expressed. Government and business continue to be perceived as key drivers of the reforms, as the explicit goal of many countries is to improve the regulatory environment for business, often in response to criticism and to improve government processes.

Despite several efforts undertaken in the last few years, the Government has not been able to establish a single strategy that introduces general criteria to the whole administration to improve the quality of the regulation that directly affects businesses and citizens. The logical development of the implementation of Better Regulation policy at the level of the EU institutions is to develop similar policies in Member States. The Lisbon Agenda, therefore, recommended that each Member State develop an explicit regulatory management policy, analogous to the Better Regulation policy adopted for European Union institutions to improve regulatory quality. This shows a difficult task ahead for the Government: the need to bring together all the different components of various policy documents that are currently being discussed and used in Romania into a single, explicit policy that is applied nation-wide and follows principles and criteria applied in other EU member countries.
D.2. Importance of institutional drivers and administrative capacities

221. The explicit and single policy to improve regulatory management and reform and the business environment must be driven politically and needs to be supported by appropriately staffed structures. The promotion and improvement of the business environment depends heavily on the institutional drivers used for this purpose and the existing administrative capacities required to deal with these issues. In many OECD countries, business environment issues are responsibility of units that have a broader mandates: managing and promoting regulatory reform in a broader sense, which means, ensuring that the policy is focused on new legislation as well as on the stock of existing regulations, to bring about constant improvement in regulation making and the overall regulatory environment. The number of countries with regulatory oversight bodies has increased significantly, together with an increase in the powers and analytical responsibilities of these bodies: in 1998, only 17 countries out of the 27 surveyed had a dedicated body responsible for promoting regulatory policy; in 2008 almost all OECD member countries and the European Commission reported having one.\(^{25}\)

222. Managing regulatory reform and ensuring that regulations are prepared, implemented and enforced with quality, is essential to establish a legal framework that is conducive for business activity. Many examples at international level show that for that purpose, a single unit, at the center of government, and with high political support is essential (see Box 12). The concretization of that institutional set up depends on the administrative, social, political and economic conditions of each country, but reforms tend to be easier and more successful if such a body is entrusted with responsibilities that mobilize the whole administration through the use of quality control criteria and policy and regulatory tools.

Box 12. The role of oversight bodies for regulatory reform: international perspective

Oversight bodies have been key pieces in the process of regulatory reform, working as ‘engines of reform’, maintaining a whole strategic point of view, coordinating inside the administration. Oversight bodies’ general role, besides supervision, control and coordination, consists in forcing regulators to demonstrate and justify the relevance of their regulation (potential and existing), using accountability and assessment mechanisms, as well as offering them technical advice and promoting regulatory reform throughout government whilst guaranteeing regulatory quality. The main functions of oversight bodies for regulatory reform are: coordination and supervision, the challenge function, advocacy and advice.

A key role of oversight bodies is to coordinate and supervise, making sure that regulatory reform meets quality standards, complies with a general economic strategy and that Regulatory Impact Analysis (RIA) is undertaken appropriately. In that sense, channels of communication between regulators and bodies must be properly settled. Furthermore, the level of government from which the body coordinates is important, as well as the used tools. In Korea, for instance, a Regulatory Reform Committee was set up by law with a “general mandate to develop and coordinate regulatory policy and to review and approve regulations.” Its main functions are to give some strategic perspective in the regulatory reforms, to undertake research, to monitor improvement efforts of each agency and to make sure there is coherence between their actions. The Prime Minister, a significant group of experts and six Ministers participate in this body.

\(^{25}\) OECD (2009), p. 22
The **challenge function** empowers the oversight institution with the competence of questioning regulation and its reforms by assessing quality of regulatory policy through RIA and the gatekeeper function. In Australia, for instance, the Office of Regulatory Review (ORR) is located within the Productivity Commission, which was established in 1998 as the Government’s principal advisory body on all aspects of microeconomic reform. The ORR vets and reviews draft regulations to ensure that they are properly formulated and that they include assessments of, among others, administrative costs for government, business and other affected parties.

**Advocacy** means to take especial consideration to maintaining the right path for the long term strategy. Oversight bodies can be very useful in the promotion of regulatory reform and quality. Overlapping and duplication of functions can be avoided through information activities inside and outside government. Oversight bodies can help to raise public awareness of reform outcomes and benefits. Provide **advice** and support helps to create and maintain a cultural change in regulators. This generally under-prioritized task could be achieved through extensive guidelines, continuous training and providing specific expertise even with external consultants if necessary. In the United Kingdom, the Better Regulation Commission played for many years a continuous advocacy role of reform throughout the regulatory institutions. There has been an extensive effort in compiling information into reports and giving conferences to public staff of regulators.

Source: Rodrigo and Andres-Amo

223. **One of the current shortcomings of the Romanian institutional set up to deal with business environment issues is precisely the variety of institutions responsible for such issues and the general agreement that creating a better business environment is important, but no single body is in charge of its clear and coherent promotion.** The institutional fragmentation for managing regulatory capacities is hindering to develop and improve capacities inside the Romanian administration –not only at central level, but also at lower levels of government – to deal with the urgent challenges imposed by the business environment.

**D.3. Tools to improve the business environment**

224. **There are a number of policy and regulatory tools that can be used to improve the quality of regulation, and therefore focus on making it easier for businesses to start up and operate.** The use of these tools has increased in many countries over the recent decades, mainly driven by a demand from stakeholders to eliminate red tape, provide regulatory certainty and open the decision-making process to views and concerns from those affected by regulations.

225. **The Government is working in the application of some of these tools, but the lack of a single strategy and the political support needed to introduce them for all the administration makes also difficult to understand how they are having an impact on improving the business environment.** Results are, so far, limited and government interventions are ad hoc. There are many international good practices, in particular in EU countries that can provide insight to the Government on how to make them useful for the country and the way they should be integrated in a coherent manner as part of a strategy to improve the business environment.
D.4. Administrative simplification strategies

226. **Simplification of heavy regulatory environments is fundamental to promote the business environment.** Excessive regulation and problems in applying them impose unnecessary costs on the business sector, diverting resources to unproductive activities. Reducing the burden of government regulations on business and citizens is a large part of a strategy to improve economic performance and productivity.

227. **Many countries, in particular EU members, have embarked in broad programs of administrative simplification, aiming at reducing red tape and administrative costs imposed on businesses.** All OECD countries reported in 2008 to have an explicit government program dealing with administrative burdens imposed on citizens and businesses (Figure 15). One of the key pillars of the EU Better Regulation agenda is cutting red tape. National measurements and targets have been established at EU and national level, looking for 25% reduction in burdens by 2012 in most of these countries. Romania has acknowledged the importance of this strategy as part of the Better Regulation agenda.

![Figure 15. Reducing Administrative Burdens (1998, 2005 and 2008)](image)

Notes: Data for 1998 are not available for the European Union, Luxembourg, Poland and the Slovak Republic. This means that this figure is based on data for 27 countries in 1998 and for 30 countries and the EU in 2005-08.

(*) No data are available prior to 2008.

(**) No data are available prior to 2005.

Source: OECD

228. **Romania has a complex body of laws and regulations that calls for urgent action.** In the last few years there has been an inflation in producing regulatory instruments, in particular emergency ordinances, a common procedure used by Ministries by which, in certain clearly defined circumstances, they over ride the parliamentary process and enact measures that are not subject to the full legislative process. Sample data showed that emergency ordinances were used 228 and 111 times in 2008 and 2009.
respectively. In 2009, the Government accounted almost 210,000 normative acts adopted in the country (see Figure 16): 205,650 were adopted by local administrations and 4,201 by the central administration.

229. **Romania has made limited progress in cutting red tape and introducing a broad program of administrative simplification.** Even if this issue appears explicitly in the various policy documents dealing with the business environment, there is no clear strategy that embraces an effort to cut red tape at national level. The requirements explicitly made in the MoU in relation to the simplification of certain licenses and permits have not been fully met. Some ministries involved in that process referred to the difficulty of getting the right information so simplification can be implemented, as well as the lack of administrative culture to think about simplification measures, costs and time associated to processes, etc.

230. **As acknowledged by the Unit for Public Policy of the General Secretariat of Government, Romania still lacks an integrated assessment of administrative costs.** There have been however some very positive developments in the reduction of burdens on citizens or by eliminating certain licenses procedures, but still much remains to be done. The Unit for Public Policy is the institution responsible for proposing next steps in terms of identifying a methodological approach for Romania, conducting measurement and intensive dialogue with stakeholders and making proposals for simplification and streamlining.

**D.5. Use of Regulatory Impact Analysis (RIA)**

231. **Countries are using Regulatory Impact Analysis (RIA) as a tool to assess the possible impacts and measure costs and benefits of proposed policies and regulations.** The need to based
decisions on evidence has made compulsory in many countries the use of RIA. By 1996, around 15 OECD countries had adopted RIA, and this trend accelerated in 1997-1999. At EU level, impact assessment has become a crucial tool to improve the quality of new policy and regulatory proposals and it is widely accepted that major proposals should be accompanied by an impact assessment. The Better Regulation agenda of the EU has encouraged progress in the use of RIA in a number of EU countries since 2002.

232. **Romania has adopted RIA in theory, but the development, implementation and improvement has been slow or almost inexistent.** The Government Decision No. 775/2005 for the approval of the regulation regarding the procedures for elaborating, monitoring and evaluating public policy at central level requires ministries to develop public policy proposals in a specific format for all major acts prior to their drafting. In addition, a formal process of impact assessment of new legislation was introduced with the Rules of Operation of the Council of Ministers, adopted in 2005.28 Article 59 (4) provides that draft laws and by-laws submitted to the Council of Ministers must be accompanied by an assessment of the costs to the administration and the opinion of the Minister of Finance on these costs.

233. **Regulatory impact assessment must include expected quantitative and qualitative impacts resulting from implementation of the chosen option; at the same time an alternative policy option should be reviewed.** The sponsor of the proposed legislation should provide information on the financial proposal and set out the goals and objectives and risk factors that may be involved in the implementation of the proposal. Alternatives to the proposed legislation should be analysed and explained and proof submitted to the effect that the proposed option represents the best “value-for-money.” In practice, however, impact assessments are limited and not conducted on various options, but on a single decision that has already been taken.

234. **The impact of the proposed legislation on the existing legal framework must also be discussed and attached to the impact assessment, prior to its discussion in the Council of Ministers.** The Appendixes of the Rules of Operation of the Council of Ministers also requires preparation of a detailed table with a three-year forecast of the financial requirements for implementation of the proposed policy. The Council of ministers Rules of Operation set out a framework for a rational and evidence-based choice in the process of policy making.

235. **In the instructions for implementation of the Law on the Restriction of Administrative Regulation and Administrative Control over Economic Activity, a unified form for economic analysis and impact assessment has been established.**29 New standard forms for financial justification of draft laws have been introduced.

236. **Government adopted by government decision No. 1361 from 27th of September 2006 the introduction of RIA for normative acts.** A template was attached to the government decision, requiring all central agencies to prepare impact assessments for both bills proposed by the government for ordinances and emergency ordinances, as well as for draft government decisions that have an impact on social, economic and environmental terms.

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27 OECD (2010), p. 61
28 Governmental Decree 216 of 12 October
29 Council of Ministers Decree No 216/2005
The position of RIA in the policy cycle in Romania is presented in Figure 17.

Figure 17: Regulatory Impact Analysis in policy making process in Romania

Source: Government of Romania

The General Secretariat of Government was designated as the coordinating institution for impact assessment. The line ministries and the other institutions of the central public administration involved in the development of policies are, therefore, required to undertake an impact assessment prior of sending their proposals. However, the process is primarily a formality and the use of RIAs has not been systematic in the Romanian administration.

The criteria for measuring impacts are general in nature and are more descriptive and qualitative than quantitative. The Government prepared a new template for ex-ante evaluation of draft normative acts, called substantiation note. The main parts of the template are:

- Reference(s) to the relevant policy document, from what draft normative act is derived;
- Problem description based on socioeconomic indicators;
- The essence of draft normative act;
• The main findings on social, economic or environmental impacts (summary of impact assessment, that can be based on information from previously accepted policy documents);

• Fiscal impact on the budgets components of the consolidated general budget with forecast for next 3-5 years;

• Institutions involved in normative act implementation process;

• Conformity of normative act with acquis communitaire;

• Necessary legislative amendments, impact on legal system; and

• Description on consultation process; organizations involved and their opinions.

240. There are a number of guidelines and manuals that Public Policy Departments publish describing impact analyses methods, including cost-benefit analyses, but there is no official methodology for undertaking impact assessments and skills are limited in Ministries to use quantitative methodologies. The use of RIA in Romania remains at initial stages and it does not appear to be a widespread tool to systematically improve draft public policies, laws and regulations.

241. The use of RIA requires developing capacities in the institutions that undertake impact assessments. At present, those capacities have not been fully developed and that might explain one of the reasons why the tool is not used in practical terms. Apart from the National Commission of Prognosis, linked to the Ministry of Finance, which participates in the preparation of impact assessments related to issues dealt with by the Ministry, there are no clear capacities in the various Romanian institutions to undertake impact assessments on challenging topics. Training and strengthening links with academia, where analytical capacities might be more developed, should be reinforced for the tool to be used.

D.6. Consultation techniques

242. Transparency is a key feature of good public governance. Consultation is essential for ensuring that government responds to needs of businesses and citizens, bringing predictability and transparency to the process of preparing and enforcing regulations. Businesses need to be able to fully understand the regulatory environment in which they operate, and to have a voice in regulatory decision making.

243. It is a major challenge to governments to ensure that their regulatory processes take into consideration the views of all groups in society. Participation of stakeholder in the regulatory process ensures that feedback about the design and effects of regulation is taken into account when preparing new regulation. It increases the likelihood of compliance by building legitimacy in regulatory proposals and may therefore improve the effect of regulation and reduce the cost of enforcement. Hence, formalized consultation processes are an important feature of regulatory transparency and a key factor in strengthening regulatory management systems.

244. The Government has attached importance to increasing transparency through the use of consultation techniques when dealing with the business environment. Consultation with the public is undertaken in accordance mainly with two laws: one for policy initiatives and one for draft laws.
Romania is the only SEE economy to have adopted a law on consultation during the legislative drafting process. In 2002, the government decided to make consultation with employers’ organizations and non-governmental organizations mandatory for all proposed regulations that may have an impact on the business environment. In particular, this decision established a minimum period (30 days) for the authorities to withhold further actions, in order to give the consulted parties an opportunity to comment and provide suggestions.  

245. **In 2003, the government extended the consultation requirements to all aspects of government decision making by introducing the Law on Decisional Transparency in Public Administration, Law no. 52/2003.** The Law established a framework in which institutional dialogue and regular meetings between government officials and the private sector take place. Under the law, institutions and public authorities are required to make public all draft legislation 30 days before approval and adoption of the proceedings, in order to organize a debate if it is requested by an association or by a legally constituted public authority, to consider all recommendations received and take them into account to prepare the final draft bill. If public authorities are making decisions, they are obliged to announce in advance the agenda of public meetings so citizens can access them.

246. **Public institutions and authorities contribute with information to publish an Annual Report on Transparency as well.** The Directorate for Government Strategies, a body of the General Secretariat of Government is responsible for supporting ministries and government agencies in relation to make available public information and to strengthen institutional transparency, to communicate with the public, and to evaluate perceptions of government decisions on society in general.

247. **The consultation process is compulsory for all significant initiatives.** It is required by law that the public is informed of all policy proposals though, in practice, this requirement is satisfied by publishing a draft of proposed legislation on the web page of the public institutions. One of the results of the Annual Report of Transparency from 2009 reveals that central government agencies use their own web pages to make public their decisions, while local authorities display information at the institution. In 2009, 70% of draft laws were announced publicly at local government level. The central government recorded a decline from 51.1% in 2007 and 33.5% in 2008 to 31.2% in 2009 (Figure 18).  

248. **The main methods of consultations used in Romania are:**

- Working groups for formulating policy and drafting legislation;
- Official letters for requiring comments on a certain policy or normative Acts; and
- Public meetings.

249. **While there is a good legislative basis for holding consultations, there are problems with the implementation of the laws on public consultation.** The process is seen more of an information dissemination process rather than as an exchange of views and learning process to improve decision-making. Officially, the number of people participating in public meetings has been on average 7.3 individuals in 2009, but this includes a decrease of 9% of citizen participation in meetings at local level, compared to 2008.

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30 OECD (2010), p. 182
31 Secretariatul General al Guvernului (2010)
Despite all these improvements, much can still be done in order to ensure that stakeholder’s views are taken into account and they actively participate in the preparation of major regulations affecting them. Business consulted for this report showed dissatisfaction about the quality of consultation procedures, the lack of systematic information on draft proposals, short deadlines to prepare contributions and the limited space offered to discuss ex-ante the preparation and modification of significant pieces of legislation that might have direct impact on the business environment. At the same time, consultations should be linked to the way impact assessments are undertaken and ensure that information provided by stakeholders is included in the data processing of information for possible impacts.

E. Specific Policy Recommendations

Romania faces important challenges in terms of establishing a sound governance basis for an improved business environment. The current institutional set-up, characterized by several institutions responsible for various key issues related to the business environment and therefore a fragmentation in terms of coordination and coherence, does not provide the governance elements needed to implement a broad program tending to change the regulatory environment affecting businesses.

A number of policy documents outline in general terms what should be a strategic vision to deal with the business environment, but the Government has not been able to bring together all these efforts and materialize them in just one single, coordinated, efficient and effective regulatory policy, with clear principles, objectives, targets and monitoring indicators, that is in charge, among other things, of improving the business environment. Today several ad-hoc and short-term interventions can be found in Romania, dealing with some aspects of the business environment, such as promotion of SMEs, some strategies for administrative burden reduction, some “better regulation” programs, etc. This piecemeal approach does not bring certitude and transparency to do business in the country and it does not help eliminating the deep barriers and bottlenecks that remain to attract...
investments, to create jobs and to stimulate economic activity. In addition, results are scare and this does not translate into a visible improvement of the business environment in the country.

E.1. Improving the governance design to deal with the business environment

253. The current governance structure to respond to the needs and demands of the business environment does not meet the expectations of domestic and international stakeholders and it does not correspond to an articulated, functional institutional design, as it exists in other developed countries. The main issues that should be addressed in order to improve the governance structure for the business environment are:

- **Provide strong political support at the highest level of government to the business environment issues and better regulation policy.** In Romania there is a need for businesses to have predictable policies, competitive markets, and suitable public infrastructure. All these elements are key components of a sound business environment that has to be promoted at the highest political level. Despite the fact of key government documents mentioning it as a priority area for government action, the improvement of the business environment does not have strong political support at the highest level of government at this stage. This is reflected in the current fragmented institutional set-up, the limited resources assigned to the Department in charge of these issues, the diversity of projects that overlap and duplicate efforts and the lack of systematically embrace a change in the administrative culture of the Romanian administration in the way regulations affecting businesses are prepared and implemented. It is necessary the involvement of the Prime Minister, the Center of Government and a new structure around him to implement policies and introduce tools that have to be applied to the whole administration and be ruled by the same criteria.

- **Acknowledge that “improving the business environment” is a cross-cutting issue.** Many of the current governance gaps in terms of the business environment are related to the fact that this issue is not treated as a cross-cutting policy area that needs solutions, tools and changes across the whole Romanian administration. The current governance design makes it very difficult to introduce changes that should apply to the whole administration and this piecemeal approach has led to very limited results. Attaching to this issue political support and an explicit acknowledgment of the cross-cutting character of the actions needed will help to revitalize the discussion and could facilitate the implementation of a more strategic approach to deal with it.

- **Establish a formal and permanent advisory body, chaired by the Prime Minister and composed of members from key government bodies dealing with the business environment and representatives from the private sector, to define priorities and content of “improving the business environment” agenda.** A clear definition of priorities and content of what Romania considers “improvement of the business environment” is essential to start any strategy and implementation of actions. In the current context, priorities are diffuse and each government institution defines “dealing with business environment” in various ways. There is no common understanding of what is wanted, where the improvements should be made and how this can be achieved. The only way to create momentum and stress the political support at the highest level for these issues is to set-up an advisory body that ensures a continued mechanism between government institutions and the private sector to discuss concerns, content and strategic approach. This dialogue
mechanism, such as the already existing Inter-Ministerial Committee for the Business Environment, should express the high political support the Center of Government is attaching to this issue. The Prime Minister should chair the meetings and be informed regularly of discussions and progress made. The dialogue mechanism should also ensure that some initial coordination is introduced into the various government institutions responsible for business environment issues in order to let them know what they are doing and how inconsistencies and overlapping could be reduced.

- **Establish a single strategy for regulatory policy for the whole of the Romanian administration with clear objectives, targets and implementation of actions, with a focus to improve the business environment.** The only way the business environment can be improved is by linking this issue to a broader and single strategy for regulatory management and reform that focuses the efforts in improving the regulatory framework affecting businesses. That single policy and strategy has to find its own place in the policy making of Romania, in the same way other policies are unique, like fiscal policy or social policy. Regulatory policy needs to be applied with a “whole-of-government” perspective and as such, clear objectives, targets and actions should be defined. The different strategies currently in place should be integrated into a single, explicit regulatory policy and strategy.

**E.2. Redesign the mission and responsibilities of the Department for the Business Environment.**

254. The governance set-up to deal with the business environment is directly linked to the kind of institutions that should be in charge of this policy area. The current structure, with the Department for the Business Environment at the Ministry of Economy, Commerce and Business Environment, as the main actor, but many others with important responsibilities as well, is not the best option.

255. The Department for the Business Environment lacks political support, is understaffed, is in charge of a multiplicity of responsibilities without clear prioritization, does not have enough resources to implement and lacks political leverage to introduce deep changes in the administrative culture of the Romanian administration through the use of new policy and regulatory tools. The strategy that has been prepared for its future work, even if it is a more structured piece, has not been approved, goes in various directions and will be hardly implementable.

256. Under these circumstances, it would be better to think of a new profile for such a Department and move it to a higher political level in the government structure, close to the Center of Government. At the same time, this should be an opportunity to revise the current responsibilities assigned to this institution to concentrate responsibilities about regulatory reform and the business environment in the new single structure. This will allow prioritizing, revising current programs, streamlining actions and setting new goals and objectives. Much has been done already in Romania in this field. This could be an opportunity to bring together all existing efforts and revitalize the agenda for better regulation in the country, aligning it to the EU objectives and targets.

257. Some of the issues that should be revised in order to redefine the role and responsibilities of the Department for the Business Environment are the following:
Streamline the institutional architecture to ensure coordination, oversight and enforcement for better regulation and improvement of the business environment. Coordination, oversight and enforcement are essential actions that have to be clearly assigned to institutions responsible for the management of the business environment. In the current structure, this gets diluted in the multiplicity of actors and there is a clear problem to ensure that policies are coordinated, that one of the various units oversees compliance with clear criteria and the use of tools, and the whole administration enforces new procedures to deal with the business environment.

Entrust a single unit with the responsibility to lead regulatory reform and the improvement of the business environment at the highest political level. The current institutional set-up in Romania to deal with the business environment does not serve the purpose of objectives and goals that it should be accomplishing. A number of institutions are entrusted with a series of responsibilities that overlap and duplicate actions, without reaching much progress in their efforts to improve the business environment. Taking into consideration the particularities of the Romanian administration, it should be advisable to create a single unit in charge of regulatory management and reform, located at the highest political level, at the Center of Government. This could be done using the existing expertise of the Department for the Business Environment and moving it to a higher political level. There is also regulatory reform expertise in the Unit for Public Policy at the General Secretariat of Government. Both institutions play already a key role in moving forward the better regulation agenda in Romania and could act as a single institution dealing with these issues.

Redesign responsibilities for the unit responsible for regulatory reform and the business environment. The current responsibilities of the Department for the Business Environment are overestimated, not only in terms of the current number of staff in charge of this, but also in terms of the low political leverage the Unit has across the Romanian administration. They also lack of a clear prioritization and in some cases, they overlap with other efforts done at other levels and in the hands of other institutions. The business environment issues seem to be sometimes dissociated from the better regulation agenda, since several institutions are in charge of them and the way they communicate and coordinate is not so clear. If the Government decides to create a single unit for regulatory reform and the business environment, it will be necessary to discuss and assess its responsibilities with care.

Revise the current strategy for the business environment under discussion if the unit is given major political support and leverage. The unit at the Center of Government should be responsible for regulatory management and reform issues and develop a strategy with an action plan with short, medium and long-term goals. It should implement measures for the whole Romanian administration in order to get concrete results that can be translated into an improvement of the business environment. It cannot continue going in various directions. Prioritization and focus are essential elements for the strategy.

Allocate resources to the Unit responsible for regulatory reform and business environment issues. Any unit dealing with better regulation and business environment issues should be allocated with sufficient resources – human, technical and financial – to be able to accomplish its tasks. This is not the case today in Romania, as institutions have suffered important cut-backs and reshuffles. The possible use of EU structural funds to cover the implementation of a better regulation strategy is
relevant and a good opportunity to make use of resources and expertise that can boost the implementation of regulatory reform in the country. Resources allocated based on a single strategy for regulatory reform could bring the opportunity to focus the work on the business environment with a more strategic approach and prioritize on areas where potential gains are higher.

**E.3. Improve administrative capacities and the use of tools for better regulation and promotion of the business environment**

258. **Building capacities within the administration to learn how to implement better regulation is fundamental for success.** This is an area that remains a challenge for Romania, since much of the improvement of the business environment relates to the way the administration creates proper conditions for business activity and regulations that stimulate or impede that activity.

259. **Better regulation requires also the introduction of tools that tend to change the way regulators operate.** For them to make use of these tools, training and expertise are needed. Governments have to invest in capacity building activities, otherwise regulators will not be able to use these tools.

260. **In the Romanian legal context, there is a tendency to over-regulate.** On one hand, the production of normative acts is big and requires constant efforts to keep regulations up-to-date and embark on broad programs to simplify and streamline the regulatory stock. On the other, creating new regulations can only be improved if the proposals are assessed against certain quality control criteria and ensuring that decisions are based on evidence. A proper management of both the flow and the stock of regulations can only be achieved if regulators are trained and tools are systematically used over time.

261. Among the areas that need to be discussed and addressed in Romania to ensure proper capacity building and the use of regulatory tools for better regulation are:

- **Strengthen and build capacities (resources and human).** Many efforts have been made in Romania to introduce innovative tools for policy development and better management of public policies. Better regulation requires that those capacities are strengthened and efforts continued so the whole administration, in particular those that regulate and potentially affect the business environment, embarks in a new way of preparing and implementing regulations. This task is not easy and it requires sustained political support and allocation of resources. Up to now, some pilot projects and ad-hoc trainings have been the main way to disseminate better regulation. This trend is unsustainable over time, it does not bring results and it has limited impact. The approach should ensure that focused training is available for regulators on a constant basis, ensuring that they use in their daily work what they are learning. The Government should prioritize the training of regulators not only in the use of new tools, but also to encourage a gradual change in the administrative culture.

- **Clearly identify and strengthen the use of regulatory tools.** Romania needs to improve the use of regulatory and policy tools that can better the quality of the regulation and reduce discretionality and ad-hoc policy and regulatory making. The EU trend towards an evidence-based policy making, combined with high priorities in improving competitiveness and reducing barriers to entrepreneurship, should be a key driver to deepen efforts to systematically use regulatory and policy tools to improve the quality of the regulation. The regulatory process should also be transparent and ensure a fair participation of groups potentially affected by regulations. Businesses should be given an
opportunity to participate in the design of better regulatory policies and contribute to the use of regulatory tools. The use of these tools is fundamental to promote a business environment that is attractive and facilitates business activities.

- **Set objectives and targets for each regulatory policy tool to be used.** Results of the various ongoing initiatives to improve the business environment are difficult to track in the current Romanian system. It is essential that the unit responsible for regulatory reform and the business environment identifies clear objectives and targets for each one of the actions to be introduced, in order to track results and monitor implementation gains.

- **Increase the use of ICT in the area of regulatory reform and improvement of the business environment.** One common complain heard in Romania is the lack of trustworthy data and information to make better regulatory decisions. Many countries have moved forward in the use of ICT to support regulatory reform. But the use of ICT should not be seen as a goal in itself, it should be seen as a step to improve and streamline processes, eliminate duplications and redundancies, simplify formats and papers. The creation of a single website where inventories of regulations and other regulatory instruments can be shown to the public could help increasing transparency and predictability. The work done to get to that point is intensive and requires strong coordination to get all information needed to be posted. It also requires introducing legal changes necessary to post information that result from deep process reengineering.

- **Design a comprehensive strategy for administrative simplification and burden reduction.** Despite the various efforts to introduce some administrative simplification measures and some good results of pilot projects, very little has been achieved in order to reduce the time and money businesses and citizens spend in dealing with government regulations. The design of a comprehensive administrative simplification strategy is urgent, in which the Government establishes clear targets for burden reduction and conducts a national measurement of administrative costs. This requires extensive political support at highest level and coordination power since it is a cross-cutting issue that affects the entire Romanian administration.

- **Deepen consultation techniques to ensure stakeholder’s views are taken into consideration and consultation serves the purpose of getting better quality information for policy and decision-making.** Consultation is an area where the Government has made relevant progress, but still much can be improved in order to make this tool a real instrument for transparency and to achieve better results. Businesses complain of the.

- **Revise the design for RIA implementation and start small in the efforts with impact assessments.** There is a need in Romania to better understand the reasons and consequences of policy and regulatory decisions. Many countries have moved forward in the efforts to introduce impact assessment as a tool to improve the decision-making process. The implementation of RIA is not an easy task, and the design that has been proposed in Romania seems overambitious. The situation is such that almost no one uses impact assessments in a systematic way and the quality of those prepared is not high. Therefore, it will be good to revise the current design and introduce the use of RIA step by step, in a gradual way, developing analytical expertise and establishing basic criteria at an initial stage.
CONCLUSIONS AND ACTION PLAN

262. The MEC Functional Review identified the following key areas for attention and action by MEC and the Government:

- Resume the implementation of energy reforms to ensure investment and security of supply to support economic growth and quality of life;
- Streamline the functions of MEC departments, to reduce work overload of remaining MEC staff after the sizeable layoffs and to enhance SOE accountability and performance management;
- Improve governance of MEC SOEs in accordance with OECD best practice for transparency and accountability;
- Rebuild energy regulator ANRE’s capacity, autonomy and accountability;
- Improve inter-ministerial coordination of energy functions across the Government; and
- Improve institutional set-up and governance arrangements for business environment functions across the Government in accordance with good international practices for improved regulatory management systems.

263. A detailed action plan summarizes the recommendations. The action plan is ambitious and challenging to implement. Technical assistance requirements to support implementation have been identified. Funding requirements are substantial and it is recommended that the use of EU funds be considered.

264. The likelihood of successful implementation of the recommendations of the review will increase if certain preconditions are met:

- **High level and broad support**: the reform program would need high level (Prime Minister, MEC Minister, state secretaries) as well as broad middle management support across the organization (Director Generals and Directors of departments).
- **Public support**: the need to reform the governance in the energy sector is recognized by a broad range of external stakeholders, including private companies, minority shareholders in SOEs, civil society and experts in and outside the public sector. Effective dissemination of the functional review would help mobilize such public support.
- **The IMF/EC/WB programs** provide an external stimulus to improve governance. Most importantly in the energy sector, Romania is in breach of EU’s Second Energy Package and missed the March 3, 2011 deadline for the Third Energy Package. Accurate transposition and implementation of the Third Package is needed to deal with the ongoing and avoid further infringement procedures, particularly in the liberalization of electricity and gas markets and independence and accountability in regulation.
- **Concrete steps and priorities for quick wins and benefits**: Focus on the measures that could bring immediate improvements in 2011-2012, including proposed actions that would (1) reduce staff overload and pressures on other limited public resources and (2) start the process to restore investor confidence.
Annex 1 - MEC Organization Chart
Annex 2 - Power/Mining Merger Proposal

1. The Government confirmed during the January/February joint IMF/EC/WB mission its intent to proceed with the power generation and mining company mergers to create two integrated power generation/mining companies. The Government proposes to create two large companies:

   - **Electra** would hold the three energy complexes, the lignite mining company CNLO, two units of Hidroelectrica and Nuclearelectrica; and

   - **Hidroenergetica** would hold most of Hidroelectrica, most of the Termoelectrica subsidiaries and the hard coal mining company CNH.

2. The proposal would consolidate a large number of power and mining gas companies into two integrated power generation/mining companies. [Romgaz has been dropped for the scope.] Such consolidation intensifies concerns about lack of transparency at the time when increased transparency and improved governance in public corporations are called for.

3. **WB recommends that the Government, instead of pursuing the merger proposal, formulate its actions on the basis of the July 2003 Road Map** and the **August 2007 draft energy strategy**. The World Bank has major concerns as the proposal does not adequately respond to the management, corporate governance, and investment challenges faced by Romania’s energy sector. The implementation of the proposal would subject Romania to a major security of supply risk. In addition, the proposal raises several macroeconomic concerns. It would likely discourage private—domestic and foreign—investment at a time when more private investment is needed. By slowing the necessary restructuring of the energy sector, the implementation of the proposal would contribute to delay and weaken further the economic recovery process.

4. **WB is concerned about the feasibility and time requirements of implementing the merger proposal.** A lot of time has already passed and no implementation might follow. In the meantime, no investment and restructuring actions, no progress. More than five years has already been effectively lost. Feasibility and time requirements have to be highlighted because:

   - Romania does not have a holding company law. After pursuing a holding company approach for more than two years, the proponents concluded that setting up holding companies requires new legislation. Enacting a holding company law will take some time even under the best of circumstances. The proposal was converted from creating holding companies to creating two integrated power generation/mining companies through mergers. This proposal has made little progress but has attracted a lot of opposition;

   - The European Union will have to be consulted, either directly or through the Competition council. **WB is concerned about the impacts of cross-subsidization as discussed below.** The European

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32 Road Map for the Energy Field, Ministry of Industry and Resources. The implementation of the Road Map was supported by the WB under the Electricity Market Project (2003), the First Programmatic Adjustment Loan and the Partial Risk Guarantee for Banat and Dobrogea Privatization (2004), and the Energy Community – Romania/Lotru Project (2005). The European Commission characterized the Road Map as exemplary.

33 The Cabinet approved the draft in September 2007 but imposed the power holding company, which effectively put the implementation of the strategy on hold.
Commission may regard cross-subsidization as state aid. State aid and competition concerns may lead into a review process the duration and outcome of which are difficult to predict;

- Lenders will have to consent to the transfer of their loans. That process takes time even under normal circumstances. Now that the holding company structure has been dropped and replaced by mergers, lenders’ review process will take even longer. Some lenders may ask for immediate repayment of their loans - the financial crisis has forced most lenders to be much more risk averse.

5. WB has fundamental concerns about the management/corporate governance and investment approaches underpinning this proposal, and its macroeconomic consequences of the cross-subsidization of non-profitable segments of the energy sector by the profitable parts, in particular in the current economic context:

- Investment requirements in Romania’s energy sector are very large, due to growing demand for energy (after the temporary slowdown caused by the current crisis), an inefficient and aging energy system (particularly in the power sector), and increasing environmental requirements (including desulphurization and to contain greenhouse gas emissions). Significant private sector participation is required to meet the investment challenge. The proposal’s high reliance on the public-sector subjects Romania to a high risk of not being able to raise the required investments. WB endorses a more balanced public-private sector approach, along the lines of the July 2003 Road Map and the August 2007 draft strategy.

- The ability of new state-owned companies to raise financing is not clear. The two integrated power/mining would be new state-owned companies with no track record of their own and worse, both would contain parts (lignite and coal mines and lignite and coal power generation companies) with proven track record of loss-making. This is not going to provide comfort to lenders appraising projects in a difficult financial environment. WB’s assessment is that the prospects of Hidroelectrica and Nuclearelectrica to raise financing are better (in terms of amounts, timing and terms and conditions) than the prospects of proposed two new companies.

- Management/corporate governance requirements to effectively deal with the challenges facing Romania’s sector are highly demanding. Significant involvement of the private sector is required to meet the challenge. The proposal’s high reliance on the public-sector subjects Romania to a high risk of not being able to manage the development and operation of some of the energy companies. Corporate governance, management of the two envisioned large holding companies successfully in the public sector in Romania, is a major risk and therefore a major concern. WB endorses a more balanced public-private sector approach, along the lines of the July 2003 Road Map and the August 2007 draft strategy.

6. The 2003 Road Map proposed the privatization of lignite plans and the lignite mines that feed them. Accordingly, the Government created the three energy complexes, combining Termoelectrica power stations and lignite mines from Romania’s lignite mining company. The new plan would add all remaining mines of the lignite mining company to Electra and adds to the complexity of managing Electra. This is a major risk - government does not have a good record in managing mines in Romania. Adding the underground coal mining company to Energetica is the same as lignite to Electra, same issue, but an even greater risk due to the higher degree of unviability of underground coal mining in Romania.

7. Cross-subsidization would slow down the restructuring, reduce the competitiveness and undermine the sustainability of the energy sector and the security of electricity supply. WB is concerned about the risk that funds will flow from the more successful parts of the power sector (hydro, nuclear) to sustaining loss-making coal and lignite generation units and coal and lignite mining. Trying to rehabilitate old lignite and coal plants and mines in the public sector (even in the private sector) is a
major risk - a lot of money would be spent (drawn from hydro, nuclear and borrowed) and resulting plants might not be competitive nor meet EU environmental standards. WB would recommend privatization, to competent reputable strategic investors who know how to mine and use lignite and coal efficiently and within the most stringent environmental standards. Most likely they would replace, not renovate the old plants, but the sites are valuable and the old units could be operated while the replacement units are being built. Government could retain minority positions to share in the profits if they want to. Holding minority shares involves risks as well but much smaller risks than being a majority owner in charge.

8. **Hidroelectrica.** Transferring two units of Hidroelectrica should not materially weaken Hidroelectrica. Lotru is in one of the two units so the WB loan would be affected, going out from Hidroelectrica which is part of Energetica. WB has informed the Government and Hidroelectrica that in the absence of business plans for Electra and Energetica, WB is unable to process the request to transfer Lotru to Electra. The bigger issue is that funds from hydro will go to lignite and coal. There is a risk that hydro development will be undermined.

9. **Nuclear Development.** The proposal involves a major risk that the Romanian participation in future nuclear development will be undermined by moving money from Nuclearelectrica to lignite in Electra, instead funding Nuclearelectrica's share in EnergoNuclear (the new PPP company for Cernavoda 3&4). Nuclearelectrica is already struggling in funding its share in EnergoNuclear and a reduction of its 51% share looks inevitable. Reduction below 50% is advisable - EnergoNuclear’s prospects for funding and implementing the project will improve once Nuclearelectrica’s share is reduced to below 50% - but Romania should retain a meaningful participation instead of Nuclearelectrica having to become a marginal partner due to lack of funds (as funds are diverted to sustain lignite in the holding company).

10. **Thermal/Hydro/Nuclear Mix.** One of the arguments for the proposal is the mixing of thermal, hydro and nuclear to improve balance and competition. The proposal does not attempt to implement such mixing - it mixes lignite and nuclear in Electra and coal and hydro in another. Such mixing, or the mixing of thermal, hydro and nuclear, is not needed. Restructuring in public sector is not needed and is unlikely to be successful if attempted. It would be preferable (and certainly much less risky) to retain and develop companies that work and have a future (Hidroelectrica and Nuclearelectrica) and deal with lignite and coal through privatization and private management. Government can stay as a minority shareholder. Enel, CEZ, E.ON, and Petrom all intend to develop generation projects and if the Government does not quickly announce thermal power privatizations, some if not all may eventually go ahead. These private projects can be expected to utilize the most modern technology and retain management experienced in these technologies. The risk is great that they will wipe out government-sponsored even if rehabilitated energy complexes of Electra and the thermal units of Energetica other than Elcen.

11. **International References.** Proponents of the mergers often mention in their presentations that successful Western and Northern European power companies have thermal and hydro units, sometimes also nuclear units and use that as an argument in favor of the proposed mergers in Romania. It is useful to keep in mind that in South East Europe (SEE), power companies also have thermal and hydro (nuclear units are rare). These SEE companies typically suffer from issues very similar to those affecting the Romanian power and mining sector. The main difference is transparency – transparency issues (contracting, trading and other forms of corruption) are more visible in Romania due to the more advanced degree of restructuring and unbundling. **The merger proposal is not required to address the fundamental issues in Romanian power and mining companies and the mergers would not solve these issues.**
Rationale for Private Sector Participation

12. Summarizing the rational of WB’s recommendation to privatize most of the thermal power sector (starting with the energy complexes) and electricity distribution:

- Investment requirements in the power sector are very large. They cannot be raised in the public sector alone. The question should not be whether to involve the private sector but in which parts of the power sector private sector should be invited to invest;

- WB’s recommendation has been that the Government to retain Hidroelectrica and Nuclearelectrica and privatize most of the thermal generation (and close some high-cost units) and Electrica’s three electricity distribution companies. With this approach, Romania would: (a) retain in the public sector about 50% of the generation, including the most competitive base load power (in nuclear and Irongates hydro) and most competitive peaking power (in hydro). Keeping this half - a very competitive half - of total generation would give the Romanian government a strong presence in the power sector; and (b) open the other half of the sector to prospective private investors. This would give the private sector a meaningful role, big enough to attract serious investors into the sector - investment requirements are very large;

- The private sector would bring more than financing resources. They would also bring management skills, know-how and experience, about lignite mining and power investments and efficient operations of the facilities. These skills are particularly critical to ensure sustainable lignite mining and lignite-fired power generation in Romania. Lignite-fired power generation is at risk, some of it already exceeds and the rest of it is soon at risk of exceeding the market prices;

- Having a major non-public sector segment would help keep the public part under competitive control and also contain alleged corruption along with the transparency of public bidding through the continued and increased use of OPCOM’s platform for centralized auction of Hidroelectrica’s and Nuclearelectrica’s bilateral contracts;

- Abroad, if the Romanian government desires its companies to pursue business elsewhere, Electrica, Hidroelectrica and/or Nuclearelectrica, could join forces for joint projects, among themselves or together with other partners.

Related Issues in Electricity Market Development

13. Resume Market Opening. Romania liberalized its power sector in six years, starting with 10% opening in 2001 and reaching 100% in 2007. Progress in 2003-2005 was particularly noteworthy, first to 40% in 2003 and then to 83.5% (all but residential) in 2005. In the same 2003-2005 period, ANRE progressively reduced the size of its portfolio contracts and thereby made electricity available to the liberalized market. Suppliers and eligible consumers responded: the share of electricity sold in the liberalized market increased rapidly from about 10% to about 50%. Little further progress has been made since 2007. This is primarily because ANRE first stopped reducing its portfolio contracts and later increased the share of low-cost Nuclearelectrica in the portfolio contracts. This simultaneously limits the amount of electricity that suppliers can offer to the eligible consumers and reduces the interest of eligible consumers to exercise their freedom to choose their electricity supplier. The recommendation is to resume effective market opening and the transition away from regulated generation contracts, using the OPCOM Power Exchange (not negotiated deals) to ensure transparency and competitiveness. This would be important for Nuclearelectrica’s internal cash generation and ability to finance its participation in the new EnergoNuclear.
14. **Avoid politically-motivated tariff-setting and portfolio contract management by ANRE and electricity contracting by public generators.** Measures would include: (1) increasing use of the OPCOM Power Exchange, both the day-ahead market and the centralized auction of forward bilateral contracts by public sector generators including Hidroelectrica that has so far made little use of the OPCOM Exchange; (2) reviewing possibilities to terminate/reduce bilateral contracts (including Hidroelectrica’s) already awarded at below-market rates and resell available electricity through the OPCOM Power Exchange instead of new bilaterally negotiated deals; (3) setting of network tariffs for electricity and gas transmission and distribution companies strictly in accordance with approved and published methodologies; and (4) use of social safety nets and other targeted subsides to secure the continued access of low-income households to basic energy services (electricity, gas, and heating services).
Annex 3- Review of Budget Execution

Budget execution systems are aimed at ensuring efficient budget implementation, in accord with the policies stated in the budget and in compliance with budgetary authorizations. They should also be able to respond to possible changes in the macroeconomic environment without disturbing excessively budget management, in particular without generating arrears and creating inefficiencies. The functions of the Ministry of Economy and Commerce (MEC) departments involved in supervising budget execution have been reviewed with respect of the capacity of the budget execution systems to achieve these objectives.

A. Review of Budget Execution at MEC

Main organizational arrangements for budget execution within the MEC

The main activities of the MEC in budget execution area include: (i) in-year financial planning and release of funds; (ii) debt management; (iii) payment processing; (iv) accounting and reporting; (v) financial control; and (vi) internal audit.

MEC has in place a rather unique arrangement, with a Financial – Accounting General Directorate (FAGD) and a separate Budget and Planning General Directorate (BPGD). The Budget directorate has been established in 2009 with the aim to improve the links between budgeting, planning and the strategic objectives of the MEC. However, it is not clear whether this objective has been achieved and unless there is a clear advantage of such arrangement, it is recommended that the merger of the two general directorates is considered, to return to the pre-2009 structure and to be consistent with the similar Budget-Financial-Accounting General Directorates from the other line Ministries in the Romanian Government. This transition should be done in parallel with increasing the role of the MEC’s Public Policies Unit in the overall MEC strategic planning and prioritization, which should work closely with the Budget and Financial directorate.

In-year financial planning and release of funds

Allotment procedure

After the approval of the annual budget law, the main spending authorities (ordonatori) draft quarterly budget implementation plans which are reviewed by the FAGD and BPGD and approved by the MEC Minister. The main spending authorities include presidents of subordinated agencies, heads of other public authorities and specialized agencies and chiefs of autonomous public entities and state owned enterprises.

Once the quarterly budget implementation plans is approved, the main spending authorities distribute the approved budgetary credits for their own budget and for their subordinated public entities or units, whose managers are secondary or tertiary spending authorities. Then, the secondary spending authorities distribute the approved budgetary credits for their own budget and their subordinate tertiary spending authorities.

To ensure prudent budget execution, the main spending authorities are required to allocate in their budget implementation plan 10% of approved funding as a reserve, with the exception of personnel expenditures
and funds related to external liabilities, which are entirely distributed. This reserve is distributed during the second half of the year.

**Cash releases**

Cash is released through monthly “credit opening” (deschidere de credit). Main spending authorities present each month several requests to the FAGD and BPGD for cash releases, which should be in line with the quarterly spending limit. These requests are accompanied by a note presenting the operations that will be financed. After these requests are reviewed, the “credit openings” are authorized and thus cash availability is released to spending authorities. These “credit openings” are recorded in the Treasury payment system. Then, the authorized cash releases are distributed in cascade within the spending units.

The FAGD exercises a tight control over credit releases, through the combination of quarterly cash limits and monthly credit opening. Such controls may help keeping cash under control, when the budget is not based on realistic revenue estimates. However, this process is time-consuming and involves a large number of checks and verifications. The process affects negatively expenditure management at the lowest administrative level when the distribution of “credit openings” within MEC is approved with some delays. It also risks generating arrears if the cash releases do not take into due account the payment schedule related to the existing commitments, or if the cash releases are limited due to the overall limited funds availability.

**Payment processing**

An effective Treasury Single Account system is in place. All cash transactions are channeled through the Treasury account at the central bank, with the exceptions concerning transactions in foreign currency, for the foreign trade activities, which are processed by commercial banks. The MEC and subordinated entities’ accounts are kept with the Treasury. Payments are made to these accounts through the Treasury information system generally within one day. The subordinated entities lack an effective system to monitor that the funds have been made available to them and they rely heavily on frequent informal checks by telephone with MEC financial staff and the Treasury whether the funds are available.

Spending authorities have to bring payment orders (ordonantare) to the Treasury branch offices. This procedure, required by Law on Public Finance (500/2002), is cumbersome, time consuming and involves significant paperwork and signatures. Up to now, problems related to the legal authorization for electronic signature prevent the automation of the transmission of payment orders from spending authorities to Treasury branch offices. At the Treasury branch offices, the payment orders are generally scanned (a payment order includes a bar code) or manually processed to be registered in the Treasury data base.

**Accounting and Reporting**

Main, secondary and tertiary spending authorities of the State budget and other government entities keep their accounts using the accrual accounting method (e.g. they account for depreciation of fixed assets). There is a unified chart of account for the central and local government units. The government has already implemented, from 2003 to 2010, 18 International Public Sector Accounting Standards (IPSAS) accrual accounting standards (among a total of currently 31 standards). Consolidating the implementation of these standards and implementing further IPSAS standards will require further training and close supervision.
This is being followed up separately by the Bank, through a technical assistance with the Ministry of Public Finance (MPF).

FAGD’s staff structure includes about ten persons for each the accounting compartment and the financial reporting compartment. A few staff positions are not filled in and it is unclear when these will advertised, given the continuing hiring freeze, whereby only one position can be advertised for every seven positions that are closed (staff retiring or positions eliminated).

The budget expenditure classification system allows reporting according to the international standards. It includes an administrative (organizational), a functional and an economic classification.

MEC and the main spending authorities prepare quarterly and annual financial statements, which include:

- a report on budget execution which shows: (i) the commitment authorization; (ii) the initial payment budgetary credit; (iii) the revised budgetary credit; (iv) the budgetary commitments (reservation of the budgetary credit for a specific use); (v) the legal commitments; (vi) the payments; (vii) the verified expenditures including unpaid expenditures; (viii) monthly reports on salary expenses.
- a balance sheet that shows assets and liabilities.

MEC consolidates these financial statements and then, they are centralized by the Public Institutions Accounting Methodology General Directorate (PIAMGD) within MPF through dedicated software. Quarterly reports are transmitted to the PIAMGD within 45 days to 60 days from the end of the quarter under review. In parallel, the Treasury Information System is able to produce budget execution reports on a cash basis, nearly in real time.

The time needed to get data on commitments is significant. Commitments made the first month of a quarter are reported only 3.5 to 4 months after the end of that month. This poses the following problems:

- Sometimes, appropriations already committed have been sometimes cut during budget revisions, because these insufficiencies in commitment reporting. This may lead to arrears generation.
- Reporting commitments in a timely manner together with sanctions for over-committing and off-budget commitments will contribute to improved fiscal discipline.
- More effective cash planning would required a shorter reporting period for commitments and reporting the payment schedule associated to the commitments.
- MEC financial information software systems are focused mainly on the accounting and reporting, but even these processes rely heavily on manual interventions (for example, the accounting records for the foreign trade activities, which account to about half of MEC total budget, are kept manually). The data transfer from the MEC software into the format requested by MPF’s PIAMGD is done manually, based on the MEC trial balance, can take up to a week to consolidate all MEC subordinated entities and it is prone to errors.

In addition, for the moment, there is no systematic procedure to compare the expenditure payments disclosed in the budget execution reports of a secondary and tertiary spending authority with the payments transactions registered in the Treasury System.
Budget execution financial controls

The Law No 500 on Public Finance defines four stages of budget execution - commitment, verification, payment order and payment (ALOP norms in Romania) and stresses the principle of separation of duties. There are a few written procedures within MEC, mostly on financial preventive control and other activities such as salaries, cash advances for business trips, etc. The FAGD plans to update and finalize writing all the internal control procedures by June 30, 2011. The system of preventive (ex-ante) financial controls performed in MEC is as follows:

- internal financial controllers who perform ex-ante financial control of all expenditure transactions (commitments, cash opening and payment order-ordonantare); these are regulated by the own financial preventive control norms;

- MEC is subject to the “delegated” MPF financial controllers who belong to the staff of the MPF Central Harmonization Unit (CHU) for Financial Management and Control. They perform financial controls on transactions above a certain amount, which are generally in the range of 25 000 RON. These transactions are submitted to a “double visa” system, consisting of both the visa of the internal own “preventive” financial controller and the visa of the MPF “delegated” financial controller.

An acceptance note is issued at the verification stage (lichidare), but it is not submitted to the visa of the financial controllers.

The “double visa” system increases the paperwork and risks to make line ministries thinking that they are relieved of their accountability requirements, their transactions being verified ex-ante by a MPF controller. The MPF intends to phase out its delegate financial controls within line ministries by December 2012. After this date, only financial controllers reporting to line ministers will make preventive controls. This desirable measure may need further actions to strengthen internal control within line ministries. Line ministries are preparing a program of work for this purpose. The MPF CHU for Financial Management and Control will have to review and monitor these work programs. As of March 2011, MEC is still among the ministries that are subject to the visa of the MPF delegated financial controller.

Internal audit

The internal audit units within the MEC structure are established in accordance with the Law on Public Internal Audit (672/2002). These internal audit units are monitored by the MPF CHU for internal audit, that prepares the internal audit methodology, carries out training activities and participates in sectorial audits involving several ministries.

Each main spending authority and all public institutions with a budget of more than € 100 000 have set up an internal audit unit. The number of internal auditors per unit is on average low and many internal auditor positions are not filled in. This hampers the effectiveness of internal audit. The development of internal audit in Romania is fairly recent, and thus the support of the CHU for internal audit is crucial. The internal audit department in MEC is facing the generic issues for the whole country, ie reduced visibility of internal audit (organized as a compartment instead of a directorate); excessive ad-hoc internal audit missions, that impair the effectiveness of a risk based internal audit strategy and annual work plan; limited staff resources; reduced training budgets that impede the ability to ensure appropriate continuous professional development; relatively limited interest of the MEC management in the internal audit findings with a view to improve and streamline processes and procedures.
However, it is worth mentioning that despite the staff reductions, the MEC internal audit compartment includes a suitable skill mix of economists, engineers and a lawyer. Most of the internal audit findings revolve among the following: lack of managerial accountability; insufficient knowledge of applicable legislation; absence of written procedures, etc.

Financial control and internal audit functions within MEC are supported by the Central Harmonization Unit (CHU) for financial management and control, and the CHU for internal audit, both operating under MPF. Such an organization is similar to the Public Internal Financial Control (PIFC) model promoted by other EU countries.

**Directions for further improvements**

The budget execution system suits the basic requirements for sound public expenditure management. A robust Treasury single account (TSA) is in place, financial reports covering different steps of the expenditure cycle are produced and there are effective compliance controls, at least for the central government. However, improvements are needed in the following directions:

- The budget system presents inefficiencies, because some cumbersome, sometimes duplicate, procedures. Reducing, these inefficiencies will liberate time for other activities than paperwork.
- Responding effectively to the new requirements stated in the fiscal responsibility act requires timely and comprehensive budget execution monitoring.
- For more effective financial and management control, actions to strengthen internal control and internal audit need to be pursued.
- To increase both effectiveness and efficiency in budget execution management some organizational arrangements may need to be reviewed.

Some of the improvements suggested below will depend on the implementation of automated processes. However, subject to further review, most of them may be implemented within a short term horizon.

**Streamlining budget execution procedure**

Budget execution procedures should be streamlined to avoid inefficiencies and remaking the budget during budget execution. *A review in detail of the business processes and the paperwork at the different stages of the expenditure cycle would be desirable.* However, some measures can be already identified:

- The cumbersome credit opening procedure will no longer be needed if the budget is based on realistic revenue forecasts and commitments are monitored in a timely manner. *Therefore, it is suggested to phase out the credit opening procedure in coordination with the improvement of commitment monitoring.*

- For efficiency the payment orders issued by spending authorities should be sent electronically to the Treasury local offices. This will require resolving the issues related to the legal authorization for electronic signature or finding other solutions to ensure secure transactions. *It is recommended to undertake immediately actions, with the view to implementing the electronic signature for electronic transmission of payment orders (ordonantare) to Treasury offices, by the end of 2011.*
• Some special cases should be reviewed. For example, it is questionable to submit the debt service payments, which are obligatory expenditures to the visa of two financial controllers.

**Pursuing the implementation of internal control and internal audit**

Actions to pursue the implementation of a modern internal control and audit system within line ministries should be pursued.

- The delegated MPF financial control posted within line ministries should be phased out by the end of 2012, as planned, or even earlier.
- Written procedures for internal control to be completed as planned, by June 30, 2011.
- Actions to increase the capacity and effectiveness of the internal audit units should be taken.

**Reporting**

Effectiveness of fiscal reporting in supporting the management of budget execution is limited, particularly because the time needed to get data on commitments. *Commitments should be reported monthly within about two weeks from the end of the month.*

*Payment transactions recorded in the Treasury system should be systematically compared with the payments disclosed in the budget execution reports of each spending authority, including local governments.*

A full fledged integrated financial management information system will respond to these requirements, because it will manage expenditure transactions at the different stages of the expenditure cycle. However, implementing a fully fledged integrate financial management information system (IFMIS) is costly and needs time. MEC could use the experience of some of the existing systems implemented in other line ministries as well as the existing systems from some of the entities under its coordination, such as Transelectrica (please see below sections). At any rate, such steps should be taken in close coordination with the overall Government plans to implement an IFMIS for all its activities. In the immediate future, subject to further review, a cost-effective solution may consist of using the Treasury information system to report monthly commitments made by spending authorities and to ensure consistency between line ministries reports and reports from the Treasury information system.
B. Financial Management at Transelectrica and Hidroelectrica

Overview

Separate from the generic issues affecting MEC, there are a number of specific aspects related to the financial management functions of Transelectrica and Hidroelectrica companies. A number of good practices established within the companies could be easily disseminated throughout the MEC structure and the other entities within its coordination, making use of ‘in-house’ readily available good practices. There are also a number of areas where the companies could enhance their day to day financial management functions, as detailed below.

Budget approval

Even though the legal requirements mandate that the company’s annual budgets be approved within 30 days after the approval of the State Budget Law, in practice there are significant delays. For example, some of the recent years companies’ budgets have been approved with a couple of months after the State Budget Law approval. Such instances, even if considered as isolated incidents, undermine the yearly planning and budgeting functions.

Accounting and Reporting

Accounting and reporting systems in Transelectrica and Hidroelectrica are relatively well organized and have relatively little manual interventions. Transelectrica’s accounting systems are based on mostly Oracle financials, however, it has not kept the entire system fully up to date and a couple of areas, such as salaries and reporting modules, require manual interventions. The salaries’ module and HR areas are covered by separate software, provided by SIVECO, a large Romanian software company. Also, the projects management (“investments”) module is used separately, and it should be integrated in the main contracting module. In addition, the higher value inventories could be managed in an improved module, due to their longer useful lives, with all the additional benefits, to better plan their maintenance, warranties, incident history, etc., in a similar manner to the fixed assets module.

Hidroelectrica’s accounting and reporting system has been developed by a Romanian software company about ten years ago and despite several updates it has become clear that an upgrade would be beneficial to the company. The implementation of a fully fledged integrated financial management system would significantly enhance Hidroelectrica’s financial management functions’ effectiveness.

Both companies are affected by the relatively frequent changes in their management structure and their organigrams’ changes that led to modifications in the procedures. This has also had an impact on the financial and accounting staffing structures and internal subordination, while there are no visible benefits of such changes.

The companies are required to comply with the Romanian statutory reporting requirements as well as with IFRS, mostly for the IFIs and other foreign lenders. There is some capacity to ensure the preparation
of IFRS – compliant financial statements, but the companies sometimes use accounting firms that make the conversion of the Romanian statutory financial statements into IFRS – compliant financial statements. Despite having done this exercise for many years in a row, there is no full IFRS conversion capacity at Transelectrica and Hidroelectrica. In addition, the regular statutory reporting requirements to the various bodies, such as the MEC (which also requests various ad-hoc reports), the MPF, the National Securities Commission (CNVM) are perceived by the companies as burden-some and adding on significantly to the reporting requirements to the IFIs and the other financing commercial banks. These statutory reporting requirements should be revisited and wherever possible it is recommended to consider the simplification and mainstreaming of the reporting requirements.

Flow of funds

As commercial companies, Transelectrica and Hidroelectrica have opened several bank accounts in various commercial banks, which are used for their own revenues, for external and internal loans and for the day to day activities with clients and suppliers.

Internal control and internal audit

Transelectrica and Hidroelectrica have organized their internal control mechanism in accordance with the relevant legislation. The internal control written procedures are in place for almost all processes, as well as for accounting policies. The personnel is required to be fully knowledgeable of the procedures, although there is no systematic regular testing of the procedural knowledge. Sometimes, the personnel cannot keep up with the updated procedures and this undermines the effectiveness of these procedures. In general, internal controls related to financial management and accounting processes are well organized, and in Transelectrica’s case, the number of procedures established is so large that it has probably exceeded the optimal balance of benefits versus complexity. Overall, the control environment is considered appropriate, but the procedures should be revisited to ensure that there is no overlap of procedures and that the benefit versus complexity prevails.

In Hidroelectrica’s case, the contracting practices continue to lack transparence despite many recommendations from the World Bank team made during the implementation of the investment loan financing the Lotru project. Thus the company continues to engage into various bilateral large contracts buying expensive electricity from the coal-based producers and selling cheap electricity, thus effectively cross-subsidizing the coal-based electricity producers. While this issue is beyond the internal controls effectiveness and has much more to do with the Government policy that the company management has to follow at the expense of significantly affecting Hidroelectrica’s performance and long term financial sustainability.

Internal audit departments within Transelectrica and Hidroelectrica have been established in accordance with the legislation on internal audit. These departments have been gradually developed to cover all activities over the past years, until about 2008-2009. However, they are currently affected by significant staff reductions and instead of increasing their capacity over time to cover all activities, the structures remained the same or even diminished in size, being downgraded to compartment level. There are audit committees in the company’s structure, but their effectiveness is questionable and the companies’
management is not genuinely interested in the internal audit findings and as a consequence regards these
departments as something required by law, but does not use these departments to the full extent possible.
Internal audit training has been reduced and there is a risk that not all internal auditors would be able to
complete the minimum continuous professional development requirements. Despite the certain assistance
that the companies’ internal audit departments receive from MEC’s internal audit, the internal audit
capacity remains relatively weak.

Transelectrica’s internal audit compartment has recently been included in the “audit directorate” that is
also covering the quality and environment audits. Since the chief internal auditor has to first report to the
director of the audit directorate, even though it has to also audit the environmental and quality areas, it
creates a perceived blurred accountability reporting line and possibly conflict of interest. A change in the
organizational structure to ensure full independence of the internal audit function would help
mainstreaming the internal auditing requirements.

Overall, it is recommended to reconsider the set up, organization and capacity of the internal audit
departments for both Transelectrica and Hidroelectrica.

**External Auditing**

Transelectrica and Hidroelectrica are subject to annual statutory audits, in accordance with the Romanian
legislation requirements. In addition, the IFRS – compliant financial statements are audited in accordance
with International Standards on Auditing, as required by the legal agreements with the IFIs and other
foreign lenders. The auditors have consistently issued qualified opinions, on both companies’ financial
statements, mainly due to non compliance with certain financial covenants under the various financing
agreements (for Hidroelectrica there have also been mentioned some earlier years qualifications related to
the lack of provisioning for electricity that had to be provided for free to former employees). These are
various financial ratios covenants that are not met under the IBRD legal agreements and the other IFIs
and commercial banks’ financing agreements. The non compliance has worsened significantly for both
Transelectrica and Hidroelectrica for the year 2009 financial statements, as the companies’ performance
deteriorated, also influenced by the crisis that has hit hard the Romanian economy late in 2008. In
Hidroelectrica’s case, the non-compliance could have been avoided if the company wanted to improve its
contracting practices, and the non-compliance will persist in the current environment of contracting
arrangements. As of the date of this report, the financial statements for 2010 have not yet been finalized
and it is expected that these will be available in June 2011.
Annex 4 - Principles for Social Support for Vulnerable Consumers

A sustainable social support scheme for vulnerable consumers (defined in terms of energy poverty) could be attained by redirecting all government subsidies to fund a fully targeted energy assistance system for all low-income households, regardless of energy use. The planned comprehensive Social Safety Net (SSN), which the Ministry of Labor proposes to launch from 2013, would ideally be the only means for delivering energy social assistance, and the energy prices should be market-based except for ANRE-regulated network tariffs. The SSN energy component would eliminate all price distortions as heat reference prices and, consequently, the involvement of ANRE and ANRSC in social assistance measures. Elimination of these hidden subsidies in the form of low prices (ANRE’s portfolio contracts for electricity, the basket price for gas, and the combination of reference prices and producer subsidies for heating) would lead to significant increases in prices. In the case of heating, subsidies are estimated at approximately one half of the real price.

Energy service must be priced to promote full employment and economic viability of the energy sector. However, the energy supply must also promote social solidarity and not exclude vulnerable groups. To this aim, Ministry of Labor, Ministry of Finance and Ministry of Economy would develop an integrated energy assistance strategy and program based on transparent budgeting and eligibility rules (equalizing eligibility requirements across electricity, natural gas and DH), using regulatory information on binomial tariffs for all residential energy customers. All energy services will be priced using a fixed component associated with the true costs of service provision and a variable (volumetric) component associated with the true cost of service consumption. All energy consumer groups should have to pay these costs and no energy prices should be distorted by state subsidies. In the binomial energy payment system:

- Consumers pay for the variable costs of service
- Public service obligation is a share of fixed cost element of the service
- Suppliers receive a predictable payment stream.

In this way, a clear separation of regulatory and ministerial functions, of energy markets from the social goals of poverty protection and promoting social cohesion, would be reached. A new framework energy law with clear definitions of SGEI for the energy sector with specific reference to social funding of access to energy for vulnerable groups would be established. Pursuant to this law, the energy SSN would include the capital cost of energy efficiency investments in rehabilitation of heating systems and consumer end-use heat controls, insulation and heat metering. These investments are eligible for co-financing from the EU structural funds because the SGI principles of fixed cost funding and of high public interest are observed.

A case can be made for the continuation of regulated tariff supply to residential consumers, at least up to a reasonable level of monthly consumption above which consumers should pay full market price. High-end residential consumers and all non-residential consumers currently supplied at regulated prices should be required to source their electricity from the market. This would bring the share of regulated tariff supply from the current 50% (temporarily about 55%) to about 20% and the difference, about 30%, would become available for market-priced supply by the generators currently required to sell to the regulated market.
Annex 5- District Heating and Combined Heat and Power Generation & Energy Efficiency for Buildings

A. District Heating and Combined Heat and Power Generation

One of the most challenging areas for energy efficiency improvement is the district heating sector. Romania has an extensive District Heating (DH) system. Based on the international experience, DH remains a least-cost option for heat supply in most densely-populated parts of urban areas. However, high rates of disconnection have been recorded in a number of Romanian cities even in apartment buildings as consumers resort to usually less economic but more effective individual heating systems. The 2001-2004 Government approved a national strategy for the restructuring of the district heating sector in 2004, aimed at addressing the fundamental problems underpinning the chronic operational and financial issues. The total strategy cost 2 bn EUR. The 2005-2008 Government reviewed the situation and came up with its own strategy, amounting to 4 bn EUR. Both DH strategies highlighted consumer metering and heat control as the highest priority area for immediate action.

Rather limited progress has been made in the implementation of the strategy. Some progress has been made with heat controls and insulation, but most of the program remains to be put into implementation. The current strategy is the updated Thermal Rehabilitation 2006-2009, approved by a law, the program is simply not adequately funded and it rolls forward to future years. Thus, in the program, the total amounts invested reached only 200 million RON (100 million RON in 2008, 43 million RON in 2009 and 54 million RON in 2010), plus 400 million RON was the local cofinancing.

Even after considerable consolidation - from almost 200 DH systems reported in the early 2000s to about 80 systems operating today - many of the remaining systems are under great stress, operationally and financially. The deteriorating quality and increasing cost of service has made district heating a major national issue. With very few exceptions, none of the existing CHP plants comply with the EU definition of Combined Heat and Power (CHP) plants in terms of efficiencies and power/heat ratio. Rehabilitation of the plants will not change this situation.

DH tariffs have generally not kept up with the increasing costs in inefficient systems. The Government, at central and local levels, has responded by providing increasing amounts for subsidies, both to heat producers and to heat consumers. The complicated governmental support scheme for DH includes four forms of price subsidy, three forms of direct aid and different forms of support for energy efficiency. This system is cost-inefficient and distorts markets. In 2010, about EUR 250 million were spent on energy subsidies and aids, but only EUR 30 million – i.e. less than 12% of spending – was allocated to direct aid.

Prices paid by the users are thus not reflective of the real costs, efficiency of producers and market conditions. For illustration, in 2008, the price of a Gcal was RON 217.3, of which RON 123.7 was paid by the users only, Lei 47.8 by the central Government, and RON 45.8 by the municipalities. The producer subsidies (45% of the fuel cost provided by the state budget) were to have to be eliminated over three years starting in 2005, as they are state aid incompatible with the
EU acquis. The elimination of these subsidies was also part of the fiscal adjustment required by the IMF. Little progress has been made though this approach is a counterincentive to energy efficiency, and support is biased towards the largest / richest consumers. Currently, almost a half of the population living in cities receives consumer subsidies and all consumers benefit from producer subsidies. The government has no strategy to improve energy access and affordability and simplify the current system which is fragmented, with dispersed authority and multiple subsidies.

Thermal rehabilitation of buildings has the greatest potential to provide long-term benefit to a large number of low-income citizens in Romania. While providing improved living conditions and improved heat quality to 35% of Romania’s population, the improved insulation would also reduce heating allowances by reducing heat consumption with at least 40%. These investments could reduce the country’s energy consumption by over 600,000 toe/year, and CO2 emissions by over 4 million tons/year. Hence, the rehabilitation of consumer end-use heat insulation, heat controls and metering is of highest importance for security of energy supply, energy access, protection of environment and social cohesion.

**B. Energy Efficiency in Buildings - Inconsistent policies on energy efficiency for buildings: case study on thermal insulation and consumption metering (CRPE Paper)**

About 67% of the existing housing stock in Romania has been built after 1960 and consists of blocks of flats made of poor materials in most cases. The heat losses are notoriously high, representing roughly 30% of total heat consumption for buildings. As an illustration of the magnitude of losses, a 2-room apartment in Romania consumes as much heat as two 4-room apartments in Germany. However, there is hope: Germany has started from a similar situation (blocks of flats erected in the ‘60s-‘80s, no metering in East Germany). By implementing well-designed strategies for energy efficiency, it managed to reduce total energy consumption for buildings by 65% between 1978 and 2001. Most energy savings came from implementing coherent programs of insulation and metering for blocks of apartments.

Romanian blocks need thermal rehabilitation, consisting mainly of coating the buildings with insulating materials and changing windows, and an improved management of consumption, by metering and user capacity to regulate consumption. While individual owners of apartments have incentives to change their windows on their own expense, coating the exterior walls is most efficient for the entire building and needs coordination of all private owners of apartments. Also, metering and the capacity to regulate one’s own consumption would create incentives for less energy consumption, and allow the resizing of heat-producing plants and distribution networks. Thus, the government undertook two complementary measures for energy efficiency in buildings:

- Metering and heat control by thermostatic valves, so that users pay for what they use, having incentives to reduce consumption (Strategy for residential heating, approved by Government Decision 882/2004). Two thirds of blocks of flats are connected to centralized energy supply, so ensuring user payments and control is likely to contain consumption to what is affordable and stimulate households to save energy. The
installation of metering and valves is still ongoing, and has been finalized only for 50% of the blocks included in the plan. Further delays stimulate individual apartment owners to disconnect from centralized heating (even though this is generally more energy efficient) and buy individual boilers, in which consumption can be regulated by the user and is metered. This leads to a vicious circle: consumers disconnect; less consumers lead to lower energy efficiency and poorer utility providers; utility companies cannot afford investments to reduce heat losses in production and distribution. There have been also extreme cases, where whole towns got disconnected from centralized heating, sometimes after the CHP was rehabilitated with money from donors. This happened in the case of Fagaras, where inhabitants found centralized heating too costly in the absence of metering and the capacity to regulate the heat consumption.

In the first half of the 2000s, about 21% of apartments were disconnected (581,000 out of 2.7 million), disconnection rates generally varying from 3-18% among towns (indeed, in most of these cases, centralized heating would have been clearly inefficient under market conditions anyway).

- Thermal insulation programs, financed by the central government, local governments and users, in varying proportions. The first intention to prepare a strategy came as early as 2000, but the program became operational only in 2003, when the financing sources were defined. Emergency Ordinance 174/2002 specified that the financing would be 25% from the central government, 15% advance payment from the condominium association and 60% of loans to condominium associations. However, it was quite difficult to involve the banks in granting loans to condominium associations. Banks were reluctant to finance owners, as the latter did not feel they had responsibilities regarding the “shared space” (block facade), nor the money. Banks were willing to give loans that could be repaid by the reduction in heat bills, but since they did not trust owners to be truly accountable, they demanded partial guarantees from the state.

In late 2005 the legislation was changed to allow owners contribution of 34%, state budget financing of 33% and local budget subsidy of 33% (Emergency Ordinance 187/2005). The percentages were changed again in 2009 by a new Emergency Ordinance, to 50% central government, 30% local and 20% owners. Regardless of the sharing percentages, the completion of one block of flats required cooperation of local and central governments, plus the availability of funding from owners. This explains why the program is severely delayed (only a few dozens of blocks have been finalized).

The policy response to speed up the process was not adequate. Instead of proposing incentives for increased owner responsibility, the government eliminated the priority criteria for buildings to be included in the program, which existed in previous legislation (number of apartments, materials, heat losses).

By the end of 2009, only 35,000 apartments were expected to be finalized. The reasons are twofold: first, a poor coordination of institutions involved (central and local governments; and the collective action dilemma when 100 individual owners have to cooperate to finance the private part). Second, owners either do not have the financial capacity to put upfront the financing (an
average of 1300-1500 EUR) or do not feel accountable for the “shared space.” Most rehabilitation works could be finalized where local governments agreed to finance more or in full the contribution of owners. This is a bad practice, as it does not stimulate the owners’ responsibility on the blocks of flats. Most of the blocks under rehabilitation in Bucharest now are in Districts 1 and 2, where mayors agreed to finance owners’ contribution entirely from local budgets.

What can be learned from these experiences? First, a coherent policy should be put in place to reduce energy consumption in residential buildings. Users must pay based on consumption, to have the interest to reduce losses. Thus, metering and thermostatic valves are crucial for energy efficiency, as well as paying the full cost of energy (without subsidies to heat producers, for example). Only when the true cost is revealed would owners be willing to pay upfront for building rehabilitation, as the costs of insulation would be lower than the cost of heat. Secondly, policies should not diminish owner responsibility. The local governments’ initiative to pay in full the local and private counterpart of insulation costs would lead other condominium associations to expect state intervention in the future as well. Therefore, a coherent policy should:

- ensure copayment from apartment owners;
- adapt copayment proportions based on affordability (support less the blocks where the condominium association is better off in financial terms). This would allow the rehabilitation of more blocks with the same money; and
- prioritize investments (first priority should be the buildings where the insulation would be the most cost-effective, where 1 RON invested reduces the highest quantity of heat losses; do not invest in blocks that are so run down that they should be simply demolished etc).
Annex 6- What can Romania does to meet its Climate Change Objectives?
(Executive Summary from WB study: Design Options for Romania Greening Facility, December 2008)

Romania’s energy challenges mirror those of Europe – fast depleting domestic energy resources (oil, gas and coal), increased need for energy to support growth and hence higher dependence on imports, increased concerns on energy security. In order to sustain economic growth Romania has to implement an aggressive strategy to reduce its energy intensity and simultaneously increase renewable energy supply or face supply risks and exceeding its emission targets under international agreements. In line with the rest of the EU, Romania’s energy strategy emphasizes renewable energy, energy efficiency and reduction of its carbon intensity. Romania has significant renewable energy resources (hydro, wind) as well as uranium deposits for electricity generation. Romania’s energy intensity is high and there is potential to reduce it significantly, especially through cost reflective pricing and other measures. Based on a GDP growth rate of 5.8%, key indicators of energy use for Romania through 2020 would be as below.\(^34\)

**Romania’s Growth and Energy Outlook to 2020**

<table>
<thead>
<tr>
<th>Year</th>
<th>2005 Actual</th>
<th>2010 Est.</th>
<th>2015 Est.</th>
<th>2020 Est.</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (2005 Euro billion)</td>
<td>79.50</td>
<td>108.30</td>
<td>142.20</td>
<td>186.0</td>
</tr>
<tr>
<td>Final Energy Consumption (million toe)</td>
<td>25.1</td>
<td>27.7</td>
<td>30.6</td>
<td>33.8</td>
</tr>
<tr>
<td>Energy Intensity (toe/’000 Euro GDP)</td>
<td>0.32</td>
<td>0.26</td>
<td>0.22</td>
<td>0.18</td>
</tr>
<tr>
<td>Annual reduction from 2005 base (%)</td>
<td>5.7%</td>
<td>4.1%</td>
<td>3.7%</td>
<td>3.7%</td>
</tr>
<tr>
<td>Electricity Consumption (TWh) and [million toe]</td>
<td>56.5</td>
<td>66.1</td>
<td>74.6</td>
<td>85.0</td>
</tr>
<tr>
<td>Renewable energy production (Twh); % of total and [million toe]</td>
<td>20.21</td>
<td>21.70</td>
<td>26.0</td>
<td>32.5</td>
</tr>
<tr>
<td>Nuclear Energy production (TWh) and % of total and [million toe]</td>
<td>5.54</td>
<td>10.8</td>
<td>21.6</td>
<td>21.6</td>
</tr>
<tr>
<td>Electricity from fossil fuels [0.48]</td>
<td>54.5%</td>
<td>51.3%</td>
<td>36.2%</td>
<td>36.3%</td>
</tr>
<tr>
<td>Emissions (million tCO2) c/ KP cap=240 by 2012</td>
<td>160.08</td>
<td>205.41</td>
<td>221.3</td>
<td>232.6</td>
</tr>
<tr>
<td>Emissions Intensity (tCO2/ ’000 2005 Euro GDP)</td>
<td>2.01</td>
<td>1.90</td>
<td>1.80</td>
<td>1.63</td>
</tr>
</tbody>
</table>

\(b/:\) Based on 2005 actual (National Energy Data Services) and projected at 2% growth rate.
\(c/:\) Romania National Allocation Plan (2007-12) submitted to the EU; 2015 and 2020 estimated by authors.

\(^{34}\) Growth estimates before the crisis. As Romania is expected to resume growth in the future, the recommendations remain largely valid in the long run.
Key Drivers and premise behind Romania’s energy outlook are as follows:

- Romania would continue improving its energy intensity, as from 0.36 toe per thousand Euro of GDP in 2003 to 0.32 in 2005 (11.1% reduction), while GDP grew by 13% during the same period. Further reduction in energy intensity is to be targeted through aggressive energy efficiency as contemplated by the Energy Strategy. Even with these targets for energy intensity, Romania would be trailing many countries in the EU.

- Romania’s GDP and emission intensity showed decoupling since 2001, indicating a fundamental change in the productive sectors of the economy. Further reduction in emission intensity is contemplated through quadrupling of nuclear energy and increase of renewable energy by 50% by 2020. This means that out of about 30 TWh increase in electricity consumption by 2020, about 25 TWh would be produced from domestic and non-fossil sources.

- Electricity from fossil fuels will correspondingly reduce in the energy mix and remain at 2006 levels in absolute terms. Romania would modernize its coal and lignite power plants with latest technologies to improve efficiency; and

- In order to achieve the EU-goal of 20% CO₂ reduction from 1990 levels by 2020, Romania would need further aggressive actions on energy efficiency and renewable energy.

Renewable Energy

Romania already produces a large share of electricity from renewable sources, mostly large hydro, and it seems to be well placed with pipeline of projects to reach the targets it has set for itself for 2015 and potentially for 2020 also. Along with large projects such as Tarnita hydropower project (1,000 MW) and the several medium size plants Hydroelectrica is planning to develop, and the already large interest for developing wind energy projects (up to 2,000 MW) indicate good prospects.

Euro 2.1 billion financing for new capacity additions in hydro and wind energy through 2015 is expected to come almost entirely from private sector, including commercial banks. The pricing support mechanism through tradable Green Certificates (GC) is taking shape. Hydropower and wind energy are well supported by GC as evidenced from the other countries, and hence there is strong rationale to continue with a market based system such as the GC. In the context of EU legislative requirements, renewable energy supported by a tradable GC system can benefit from beneficial state aid treatment.

Project developers and commercial banks indicated that there are administrative barriers (e.g. permits, licenses, etc) which take a long time and should be streamlined as soon as possible; also the required revenue certainty should be facilitated by extending the GC system sufficiently over the long term period (i.e. beyond the 2012). The recent study (unpublished) by EBRD identified several barriers for renewable energy in Romania, which should be examined and addressed on a priority basis by the government.

In this context, electricity pricing policy needs to be developed with environment and climate considerations as advocated by the EU to give the right signals to the market for promoting renewable energy.

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Energy. ANRE should take the lead to finalize such a policy and ensure early discussion and dissemination to the public through a well supported awareness campaign.

**Energy Efficiency**

Romania should achieve reduction of energy intensity by an average 3.7% annually through 2020, which is aggressive, but compares with 3.3% for the rest of the EU over the same period. Even at this rate, Romania’s conformance with the EU target of 20% reduction in CO\textsubscript{2} emissions compared to 1990 level seems unattainable. Romania’s challenge is to achieve growth with the most feasible energy intensity and attempt to remain within its Kyoto cap. Romania would have to implement the EU’s 10-point action plan on energy efficiency and focus on those areas where large savings in energy consumption can be realized through technologies and policies that change behavior towards conservation and efficiency.

### End-use energy consumption, 2005 (ktoe) a/

<table>
<thead>
<tr>
<th>Sector</th>
<th>ktoe</th>
<th>% of total</th>
<th>Potential savings (%)</th>
<th>Potential Savings (ktoe)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
<td>10,505</td>
<td>41.85</td>
<td>13.0</td>
<td>1590</td>
</tr>
<tr>
<td>Population</td>
<td>8,055</td>
<td>32.09</td>
<td>41.5</td>
<td>3600</td>
</tr>
<tr>
<td>Services, etc</td>
<td>2,298</td>
<td>9.15</td>
<td>14.0</td>
<td>243</td>
</tr>
<tr>
<td>Transport</td>
<td>4,244</td>
<td>16.91</td>
<td>31.5</td>
<td>1390</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>25,102</td>
<td>100.00</td>
<td>100.0</td>
<td>6823</td>
</tr>
</tbody>
</table>


The indicative potential savings represent 27% from the 2005 level. Exploiting this potential by 2020 will allow Romania to meet the EU proposed target of 20% reduction in energy consumption from 2005 level and would result in 1.5% annual improvements in energy intensity. But this would not be sufficient to curtail overall energy consumption which would reach 44.6 Mtoe in 2020 and potentially exceed the Kyoto limit on emissions. In order to achieve 3.7% reduction in annual energy intensity, policies and measures aimed at energy conservation would be required to capture additional energy savings. Industry, residential and transport sectors all need to be targeted for energy efficiency gains.

The top 5 subsectors in industry consume 84%\textsuperscript{36} of the energy - metallurgy 33%, chemicals 24%, construction materials 12%, food processing 9% and fabrication 6% - and thus offer opportunities for targeted energy efficiency initiatives. Industry also offers most cost effective solutions based on experience of the Romanian Energy Efficiency Fund (FREE). Studies indicate that industrial energy efficiency gains could be achieved through re-design of the overall energy system with utilization of waste heat where available, use of efficient lighting, replacement of electric motors with more efficient ones, automatic controls to optimize performance and efficiency, new industrial furnaces, etc.

Residential energy consumption includes: electricity, space heating and hot water (either central heating provided or own system). The action plan contemplates energy efficiency improvements through heat insulation of walls and roofs, insulation of basement and heat piping, and replacement of windows, etc. Although residential sector offers the largest potential, it is also the most difficult due to the large number and the high transaction costs.

\textsuperscript{36} National Institute of Statistics, 2005
The investment requirement for undertaking energy efficiency in the key sectors through 2015 is estimated at about Euro 4 billion, and the expected benefits are significant.

Energy Efficiency Benefit Estimates by 2015

<table>
<thead>
<tr>
<th>Subsector</th>
<th>Investment (Euro M)</th>
<th>Energy Savings (ktoe/year) a/</th>
<th>Potential savings (Euro M/year) b/</th>
<th>CO2 avoided (ktons/year) c/</th>
<th>Investment cost effectiveness (Euro M/ktoe)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>1200</td>
<td>828</td>
<td>306</td>
<td>2,459</td>
<td>1.45</td>
</tr>
<tr>
<td>District heating</td>
<td>1600</td>
<td>864</td>
<td>320</td>
<td>2,022</td>
<td>1.85</td>
</tr>
<tr>
<td>Public buildings</td>
<td>1000</td>
<td>165</td>
<td>61</td>
<td>588</td>
<td>6.06</td>
</tr>
<tr>
<td>Industrial / Cogen</td>
<td>200</td>
<td>337</td>
<td>124</td>
<td>789</td>
<td>0.59</td>
</tr>
<tr>
<td>Total</td>
<td>4000</td>
<td>2,194</td>
<td>860</td>
<td>5,858</td>
<td>1.82</td>
</tr>
</tbody>
</table>

a/ Regional Environment Center, 2006, “Developing a GIS in Romania”, and authors’ estimates
b/ Estimated at Euro50 per barrel of oil equivalent
c/ Assuming oil or natural gas avoided

The benefits are compelling for Romania to undertake a national program on energy efficiency, but this would still be inadequate to achieve the needed reduction in energy intensity. Through efficient pricing signals and competitive provision of energy services, Romania could tackle the conservation and change of behavior for energy consumption and thereby achieve the targeted annual 3.7% energy intensity reduction through 2020. Romania’s end user prices for gas and electricity are still below those of Hungary and Poland and trail those in the EU-15. The government needs to develop and implement a long term pricing policy supporting the national goals and undertake a sustained awareness campaign to ensure stakeholder and popular support for such initiatives.

Romania’s experience with implementing energy efficiency projects has been improving, but is still inadequate to handle the scale up that is demanded by the aggressive approach warranted. Key recommendations are as follows:

- The government should provide adequate resources to ARCE, the Energy Conservation Agency, to enforce the regulations on energy audits by large consumers of energy and ensure conformance with agreed and monitorable targets for energy efficiency.

- Expectation of grant funds from the EU for energy efficiency projects (through Structural Funds) have also delayed investment decisions by project sponsors. The use of Structural Funds are governed by EU’s State Aid rules, which are intended to ensure that state support do not impede competition principles. Romania’s proposal for EU support of Euro 869 million for energy efficiency through 2013 represents a small part of the overall allocation, and shows the competing priorities in the program. Experience from other member states for the use of structural funds shows a number of challenges, especially with using them for energy efficiency and renewable energy. Romania’s challenge would be to maximize the use of structural funds for

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37 Operational Program (OP) Environment (Priority Axis 3, Euro 229.3 million), OP Increase of Competitiveness (Priority Axis 4, Euro 638.5 million).
energy efficiency (and renewable energy projects) and thereby leverage funds from financial sector and international finance institutions (IFIs) in an expedient way to help achieve the targets.

- Government should clarify the budget support for energy efficiency and renewable energy projects and whether and how the EU structural funds would help municipalities and other sectors in undertaking their projects. The funding gap is about Euro 2.4 billion through 2015 for energy efficiency projects alone.

- Lack of a pipeline of well prepared projects remains the most significant barrier and as of this time the efforts by donor agencies are continuing in this regard. Large scale projects which provide significant savings – district heating, residential improvements and industrial applications – should be undertaken on a priority basis. Based on the experience gained from the Global Environment Facility (GEF) Energy Efficiency Project, the transaction costs are still high and clients demand pre-investment technical assistance (TA) support (feasibility studies, structuring finance and finding attractive financing, etc).

- In addition to pre-financing TA support, mechanism for promoting energy service company (ESCO) industry, facilitating bridge financing and guarantees for EU financed projects are needed for scaling up investments in energy efficiency. Although currently available funding for energy efficiency projects is inadequate to meet country’s targets, banks, funds and private sector financing would become available for well defined project pipeline and well prepared feasibility studies. Institution that would be a focal point of provision of such TA therefore would help address this key barrier.

- Developing such an institution on an existing structure is the most pragmatic choice. Existing Romanian Energy Efficiency Fund (FREE) is well placed to play this role given its experience in successfully managing energy efficiency project cycle, ability to foster cooperation and coordination between the public and private sector, and, as a market oriented entity, ability to attract highly skilled specialists.

- Romania’s current institutional, policy and market incentive framework is reasonably well developed and aligned with the international best practice. However, this institutional framework does not translate in equally high outcomes compared to other countries with similar or weaker institutions and policies\(^\text{38}\). Government commitment and sustained efforts are required for enhancing institutional effectiveness.

Proposed Romania Greening Facility – as a public-private partnership framework

The Romanian Energy Conservation Agency (ARCE) and the Romanian Energy Efficiency Fund (FREE) both support energy efficiency projects, while the Environment Fund Administration (EFA) supports general environmental projects, including renewable energy. Building and strengthening partnership between public and private sector is essential for addressing scale-up challenges. After examining the various alternative options, we recommend that the Romania Greening Facility (RGF) to be promoted as a

\(^{38}\) EBRD. *Securing sustainable energy in transition economies*. May 2008. Outcomes measured in terms of energy and carbon intensity and share of electricity generated from renewable sources.
“partnership framework” rather than as an institution. Such a framework would aim to exploit the strengths of the existing institutions and leverage public funds to catalyze commercial financing.

The World Bank proposed that FREE be considered for forming the core of the RGF, with institutional reach to ARCE, EFA and financial sector. Such a transition can be gradual and in line with emerging demands from the clients. FREE as the core of the RGF (either in its current form or in a modified form) will collaborate with ARCE for technical assistance, with EFA for renewable energy and with banks for financing. FREE would need to increase its capital and suitably strengthen its managerial and technical cadre gradually to handle the scale up and new business lines in residential and municipal energy efficiency. FREE can continue the energy efficiency business line, but with emphasis on additional functions to support other agencies and financial sector. The organization of RGF can be structured either focusing on sectors (e.g., Polish ‘KAPE’, Finnish ‘Motiva’, German ‘DENA’) or scope of activities (Latvian Environmental Investment Fund, Croatian Environmental Protection and Energy Efficiency Fund).

Through a TA Window and a Financing Window, we propose that the RGF provide the following key services:

- **Technical Assistance:** The TA scope would include preparation of strategies and programs (especially for municipalities); pre- and bankable feasibility study, project planning; facilitating financing; awareness-raising; support for best practice demonstration projects, full service to commercial banks to enhance their growth in energy efficiency and renewable energy lending. The RGF would work closely with ARCE on the one hand and provide direct assistance to commercial banks and other clients on fee basis.

- **ESCOs:** Promote a robust ESCO industry to deliver bundled small scale as well as large projects with performance guarantee type incentive structure and financing. This is particularly suited for residential and public building energy efficiency projects.

- **Bridge-financing and Guarantees:** Facilitate bridge-financing for EU Structural Funds supported projects, including through guarantees for commercial banks financing such projects.

- **Financing:** Support to clients – mainly municipal and residential – complementing and not competing with commercial banks and other private sources of funding as applicable.

- **Monitoring:** ARCE would track and monitor overall progress towards Romania’s conformance with agreed targets and the EU 20-20-20 vision goals.

**Urgent actions are needed**

The key actions recommended concerning RGF are summarized below.

Immediate term (six months)

- Undertake a full business plan preparation for FREE’s scale up operations, including scope of activities with ARCE and EFA;

- Formalize coordination arrangements among FREE, ARCE and EFA;
- Amend FREE’s charter as required to support expanded TA activities and mobilization of new capital;
- Provide additional resources to ARCE for carrying out its mandate (enforcement) and FREE to undertake preparation for RGF;
- Publish EU Structural Funds guidelines for energy efficiency and renewable energy.

Short term (6 to 24 months)

- Adopt RGF business plan and mobilize financing;
- Review and decide on adopting the proposal from Greenmax (private sector firm) for residential energy efficiency financing
- Adopt bridge financing guidelines to support investments eligible for EU Structural Funds reimbursement;
- Begin awareness building campaigns and workshops;
- Develop project pipeline for financing;
- Develop and implement cost reflective pricing policy for energy.

To sell or not to sell AAUs

The report advocates aggressive actions in energy efficiency and renewable energy which not only reduce Romania’s emissions, but also contribute to its competitiveness and energy security. Romania has surplus emission credits (called Assigned Amount Units, AAUs) under the Kyoto Protocol, which can be used to accommodate increase in emissions arising from economic growth in the future. However, the magnitude and availability of surplus AAUs in future depends upon the post-2012 climate regime which is under international negotiations. It is possible that Romania’s emissions cap is reduced from current levels in the next climate regime, which would correspondingly reduce its surplus AAUs. Therefore, many experts and some officials in the Government believe that Romania should consider selling some of its surplus AAUs now and use the proceeds towards greening activities that reduce emissions (called “greening of AAUs”). Several EU countries and Japan have expressed interest in purchasing AAUs, including from Romania. In response to the request, the report contains a complete treatise on the legal and transactional aspects of a typical AAUs sale as guidance, should the Government elect this option in future.
Annex 7- Romania’s Environmental Clean-up Deadlines

A. Conformation to maximum levels of SO2

By December 31, 2008:
S.C. Electrocentrale Deva S.A. nr. 1, 4 power boilers x 264 MWt

By December 31, 2009:
S.C. Termoelectrica Doicești nr. 1, 1 steam boiler x 470 MWt

By Dec 31, 2010:
S.C. Complexul Energetic CRAIOVA CRAIOVA II 1, 2 boilers x 396,5 MWt
S.C. COMPLEXUL ENERGETIC TURCENI S.A. nr. 2, 2 power boilers x 789 MWt
S.C. COMPLEXUL ENERGETIC TURCENI S.A. nr. 3, 2 power boilers x 789 MWt
S.C. Termoelectrica PAROȘENI nr. 2, 1 steam boiler x 467 MWt + 1 hot water boiler x 120 MWt
R.A.A.N., Filiala Romag Termo nr. 2, 3 boilers x 330 MWt
S.C. COLTERM S.A. nr. 7, 1 hot water boiler x 116 MWt

By December 31, 2011:
C.E.T. ARAD nr. 2, 2 industrial steam boilers x 80 MWt
S.C. Complexul Energetic CRAIOVA S.E. CRAIOVA II - 2, 2 CAF x 116 MWt + 2 x CR 68 MWt
S.C. COMPLEXUL ENERGETIC ROVINARI S.A. nr. 2, 2 steam boilers x 879 MWt
TERMEOLECTRICA GIURGIU nr. 1, 3 power steam boiler x 285 MWt
S.C. Electrocentrale Deva S.A. nr. 2, 4 power boilers x 264 MWt
S.C. PETROTEL-LUKOIL S.A. nr. 1, 2 DAV3 + HPM 1 x 45 MWt + 14,7 MWt + 11,4 MWt
S.C. PETROTEL-LUKOIL S.A. nr. 2, 3 technological steam boilers x 105,5 MWt
S.C. C.E.T. GOVORA nr. 3, 1 boiler x 285 MWt

By December 31, 2012:
C.E.T. BACĂU nr. 1, 1 steam boiler x 343 MWt
S.C. ELCEN București Vest nr. 1, 2 steam boilers x 458 MWt
S.C. Complexul Energetic CRAIOVA S.E. IȘALNIȚA, 4 boilers x 473 MWt

By December 31, 2013:
C.E.T. ARAD nr. 1, 1 boiler cu abur x 403 MWt
S.C. ELECTROCENTRALE ORADEA S.A. nr. 2, 2 groups of steam boilers x 300 MWt + 269 MWt
S.C. TERMOELECTRICA S.A., Sucursala Electrocentrale Brăila, 6 steam boilers x 264 MWt
S.C. C.E.T. BRAȘOV S.A. nr. 1, 2 boilers x 337 MWt
S.C. ELCEN București Sud nr. 1, 4 steam boilers x 287 MWt
S.C. ELCEN București Sud nr. 2, 2 steam boilers x 458 MWt
S.C. ELCEN București Progresu nr. 1, 4 steam boilers x 287 MWt
S.C. COMPLEXUL ENERGETIC ROVINARI S.A. nr. 1, 2 steam boilers x 878 MWt
S.C. Electrocentrale Deva S.A. nr. 3, 4 power boilers x 264 MWt
S.C. C.E.T. IAȘI II, 2 steam boilers x 305 MWt
S.C. Uzina Electrică Zalău nr. 1, 4 industrial steam boilers x 85,4 MWt
S.C. TERMICA S.A. SUCEAVA nr. 1, 2 boilers x 296 MWt
S.C. COLTERM S.A. nr. 5, 1 hot water boiler x 116,3 MWt
S.C. COLTERM S.A. nr. 6, 3 steam boilers x 81,4 MWt
B. Conformation for NOx

By December 31 2008:
- ARPECHIM PITEŞTI nr. 2, 1 boiler BW x 81 MWt
- ARPECHIM PITEŞTI nr. 3, 4 boilers x 81 MWt
- PRODITERM BISTRITĂ, 2 hot water boilers x 116 MWt + 2 steam boilers x 69 MWt
- S.C. C.E.T. BRAŞOV S.A. nr. 1, 2 boilers x 337 MWt
- Regia Autonomă de Termoficare Cluj, 2 hot water boilers x 116 MWt
- TERMEOELECTRICA GIURGIU nr. 1, 3 power steam boilers x 285 MWt
- TERMEOELECTRICA GIURGIU nr. 2, 2 industrial steam boilers x 72 MWt
- S.C. Electrocentrale Deva S.A. nr. 1, 4 power boilers x 264 MWt
- S.C. COLTERM S.A. nr. 2, 1 hot water boiler x 58,1 MWt.

By December 31 2009:
- C.E.T. ARAD nr. 1, 1 CR steam boiler x 403 MWt
- C.E.T. ENERGOTERM S.A. REȘIȚA nr. 2, 1 hot water boiler x 58 MWt
- TERMICA Târgoviște, 1 hot water boiler x 58,15 MWt
- S.C. Complexul Energetic CRAIOVA S.E. CRAIOVA II - 1, 2 boilers x 396,5 MWt
- S.C. C.E.T. IAȘI I nr. 2, 2 steam boilers x 283 MWt
- S.C. Uzina Electrică Zalău nr. 3, 1 steam boiler x 72,3 MWt.

By December 31 2010:
- S.C. ELECTROCENTRALE ORADEA S.A nr. 1, 2 groups of steam boilers x 127 MWt + 1 x 269 MWt
- S.C. C.E.T. S.A. nr. 2 Brăila, 2 boilers x 110 MWt
- C.E.T. ENERGOTERM S.A. REȘIȚA nr. 1, 2 boilers x 45,94 MWt
- S.C. Uzina Termoelectrică Midia nr. 2, 1 boiler x 73 MWt
- S.C. Uzina Termoelectrică Midia nr. 3, 1 boiler x 73 MWt
- S.C. Uzina Termoelectrică Midia nr. 4, 1 boiler x 73 MWt
- S.C. Termoelectrica S.E. Doicești nr. 1, 1 steam boiler Benson x 470 MWt
- S.C. Electrocentrale Galați nr. 3, 3 power boilers x 293 MWt
- S.C. Termoelectrica S.E. PAROȘENI nr. 2, 1 boiler cu abur x 467 MWt + 1 hot water boiler x 120 MWt
- S.C. C.E.T. IAȘI I nr. 1, 3 steam boilers x 94 MWt
- S.C. TERMICA S.A. SUCEAVA nr. 1, 2 boilers x 296 MWt
- S.C. TURNU S.A. TURNU MĂGURELE nr. 1, 1 hot water boiler x 58 MWt
- S.C. TURNU S.A. TURNU MĂGURELE nr. 2, 1 hot water boiler x 58 MWt
- S.C. ENET S.A. nr. 1, 3 boilers x 18,5 MWt
- S.C. ENET S.A. nr. 2, 1 hot water boiler x 58 MWt.

By December 31 2011:
- C.E.T. ARAD nr. 2, 2 industrial steam boilers + 1 boiler x 80 MWt
- S.C. TERMON S.A. ONEȘTI, 3 boilers x 380 MWt
- S.C. C.E.T. S.A. nr. 1 Brăila, 2 boilers x 110 MWt
- S.C. TERMICA S.A. nr. 1 Botoșani, 3 hot water boilers x 116 MWt
- S.C. ELCEN București Sud nr. 12, 2 hot water boilers x 116 MWt
S.C. ELCEN Bucureşti Sud nr. 16, 1 hot water boiler x 116 MWt
C.E.T. ENERGOTERM S.A. REŞIŢA nr. 4, 1 hot water boiler x 58 MWt
S.C. ELCEN Bucureşti S.E. Palas nr. 1, 1 hot water boiler x 116 MWt
S.C. Complexul Energetic CRAIOVA S.E. IŞALNIŢA, 4 boilers x 473 MWt
S.C. Electrocentrale Deva S.A. nr. 2, 4 power boilers x 264 MWt
S.C. C.E.T. IAŞI I nr. 3, 4 hot water boilers x 116 MWt
R.A.A.N., Filiala Romag Termo nr. 1, 3 boilers x 330 MWt
R.A.A.N., Filiala Romag Termo nr. 2, 3 boilers x 330 MWt
S.C. Rompetrol S.A. Bucureşti Vega Ploieşti, 3 technological steam boilers x 24,75 MWt
S.C. PETROTEL-LUKOIL S.A. nr. 1, 2 DAV3 + HPM 1 x 45 MWt + 14,7 MWt + 11,4 MWt
S.C. PETROTEL-LUKOIL S.A. nr. 2, 3 technological steam boilers x 105,5 MWt
S.C. Uzina Electrică Zalău nr. 1, 4 industrial steam boilers x 85,4 MWt
S.C. COLTERM S.A. nr. 4, 1 hot water boiler x 116,1 MWt
S.C. C.E.T. GOVORA nr. 3, 1 boiler x 285 MWt.

By December 312012:
C.E.T. ENERGOTERM S.A. REŞIŢA nr. 3, 1 hot water boiler x 116 MWt
S.C. ELCEN Bucureşti S.E. Palas nr. 2, 1 hot water boiler x 116 MWt
S.C. ELCEN Bucureşti S.E. Mureş nr. 5, 4 steam boilers x 277 MWt
S.C. COLTERM S.A. nr. 6, 3 steam boilers x 81,4 MWt.

By December 312013:
S.C. TERMOELECTRICA S.A., Sucursala Electrocentrale Brăila, 6 steam boilers x 264 MWt
S.C. ELCEN Bucureşti Sud nr. 14, 1 hot water boiler x 116 MWt
S.C. ELCEN Bucureşti S.E. Palas nr. 3, 1 hot water boiler x 116 MWt
S.C. Electrocentrale Galaţi nr. 2, 2 power boilers x 293 MWt
S.C. Electrocentrale Deva S.A. nr. 3, 4 boilers x 264 MWt
S.C. ELCEN Bucureşti S.E. Mureş nr. 1, 1 steam boiler x 277 MWt
S.C. ELCEN Bucureşti S.E. Mureş nr. 4, 1 steam boiler x 277 MWt
S.C. COLTERM S.A. nr. 5, 1 hot water boiler x 116,3 MWt
S.C. COLTERM S.A. nr. 7, 2 hot water boilers x 116,3 MWt
S.C. C.E.T. GOVORA nr. 2, 2 boilers x 285 MWt
S.C. ENET S.A. Vrancea nr. 3, 1 hot water boiler x 116,3 MWt

C. Conformation with dust limits
By December 312008:
S.C. ELECTROCENTRALE DEVA S.A. nr. 1, 4 power boilers x 264 MWt
S.C. C.E.T. IAŞI II, 2 steam boilers x 305 MWt.

By December 31, 2009:
C.E.T. Bacău nr. 1, 1 steam boiler x 345 MWt
TERMOELECTRICA GIURGIU nr. 1, 3 steam boilers x 285 MWt
S.C. COLTERM S.A. nr. 6, 3 steam boilers x 81,4 MWt

By December 31, 2010:
C.E.T. ARAD nr. 1, 1 steam boiler x 403 MWt
S.C. C.E.T. Braşov S.A. nr. 1, 2 boilers x 337 MWt
S.C. TERMOELECTRICA DOICEŞTI nr. 1, 1 steam boiler Benson x 470 MWt
S.C. COMPLEX ENERGETIC TURCENI S.A. nr. 2, 2 power boilers x 789 MWt
S.C. TERMICA S.A. Suceava nr. 1, 2 boilers x 296 MWt
S.C. C.E.T. GOVORA S.A. nr. 3, 1 boiler x 285 MWt.

By December 31, 2011:
S.C. COMPLEX ENERGETIC CRAIOVA S.E. CRAIOVA II-2, 2 CAF x 116 + 2 CR x 68 MWt
S.C. COMPLEX ENERGETIC ROVINARI S.A. nr. 2, 2 steam boilers x 879 MWt
S.C. ELECTROCENTRALE DEVA S.A. nr. 2, 4 power boilers x MWt
S.C. PETROTEL LUKOIL S.A. nr. 1, DAV3 + HPM, 1 x 45 MWt + 14,7 MWt + 11,4 MWt
S.C. PETROTEL LUKOIL S.A. nr. 2, 3 technological steam boilers x 105,5 MWt
S.C. ALUM S.A. TULCEA, 3 boilers x 84,8 MWt + 1 x 72,6 MWt
S.C. C.E.T. GOVORA S.A. nr. 2, 2 boilers x 285 MWt

By December 31, 2013:
S.C. COMPLEX ENERGETIC Rovinari S.A. nr. 1, 2 steam boilers x 878 MWt
S.C. ELECTROCENTRALE DEVA S.A. nr. 3, 4 power boilers x 264 MWt
S.C. UZINA ELECTRICĂ ZALĂU nr. 1, 4 steam boilers x 85,4 MWt
S.C. ELECTROCENTRĂLE ORADEA S.A. nr. 2, 2 groups of steam boilers x 300 MWt + 1 x 269 MWt.

D. Conformation with Nox applicable from January 1, 2016 of large burners with nominal thermal capacity above 500 MW, using solid fuel
ELECTROCENTRALĂ ORADEA nr. 2, 2 groups of steam boilers x 300 MWt + 1 steam boiler x 269 MWt;
S.C. ELECTROCENTRALĂ DEVA S.A. nr. 2, 4 power boilers x 264 MWt;
S.C. COMPLEXUL ENERGETIC ROVINARI S.A. nr. 2, 2 steam boilers x 879 MWt;
S.C. COMPLEXUL ENERGETIC TURCENI S.A. nr. 3, 2 power boilers x 789 MWt;
S.C. ELECTROCENTRALĂ DEVA S.A. nr. 1, 4 power boilers x 264 MWt;
S.C. TERMICA S.A. SUCÈAVA, nr. 1, 2 boilers x 296 MWt.
Annex 8- Energy Outlook in Eastern Europe and the Former Soviet Union

The outlook for primary energy supplies, heat, and electricity is difficult for the Eastern Europe and Central Asia region, despite Russia and Central Asia’s current role as a major energy supplier to both Eastern and Western Europe. In spite of the underlying resource base, the region as a whole will face an energy crunch unless investments of more than $3 trillion are made over the next 20 years, according to the World Bank’s regional study, *Lights Out? The Energy Outlook in Eastern Europe and the Former Soviet Union*. The study and its implications for Romania were discussed in a workshop in December 2010 attended by representative MEC, GSG, energy companies and ANRE.

The demand for primary energy in the Europe and Central Asia region is expected to increase by 50 percent by 2030 while the demand for electricity is expected to increase by 90 percent. Before the current global financial crisis hit in 2008, several importing countries in the region had begun to experience difficulties with supplies. The financial crisis has slowed demand for energy and has created some breathing room to allow countries to take action to mitigate the impact of the anticipated energy crunch. But this window of opportunity will only exist for about five to six years. Mitigating actions are required on both the supply and the demand side, and without a change in behavior the region as a whole could face an energy crunch – moving from being a net energy exporter to a net energy importer by 2030.

**Energy trends reflect economic trends**

Following the break-up of the Soviet Union, the countries of Europe and Central Asia experienced six years of dramatic economic decline, followed by vigorous economic recovery, enabling the region to become one of the most economically dynamic in the world. This economic performance was reflected in the region’s energy sector – the initial economic decline was accompanied by a sharp reduction in the production and consumption of energy. But as the region’s economy recovered, both production and consumption increased. Investment, however, lagged, particularly in energy asset maintenance and upgrading, creating the prospect of an energy crunch.

The region was the hardest hit by the global financial crisis that began in 2008, dampening energy demand significantly. This created some breathing room, but this is only a temporary respite before energy availability again becomes a serious concern. Once growth picks back up, so, too, will energy consumption.

**Investment needed to stave off crunch**

**If energy production is to be maintained or increased to meet Europe’s energy requirements, significant investment will be required.** The projected needs for primary energy development from 2010 to 2030 are estimated to be on the order of almost $1.3 trillion in order to ensure the availability of oil, gas, and coal. In addition, the region’s power infrastructure is in desperate need of upgrading. Electricity capacity has hardly increased since the early 1990s and plants are getting old. Investment needed in power sector infrastructure over the next 20 to 25 years is on the order of $1.5 trillion, with a further $500 billion required for district heating.

The deteriorating capacity has not yet become a full-blown crisis because of the decline in demand during the 1990s and the current drop off in demand related to the financial crisis. But construction lead times of
several years mean that action is required now. This level of investment – more than $3 trillion – cannot be provided in this region by the public sector alone. Attracting private sector investors will require changing the investment climate to make it conducive to such investment.

**Energy Efficiency – untapped potential**

**Investing in energy efficiency achieves three goals, simultaneously and at least cost: lower greenhouse gas emissions, better energy security, and more sustainable economic growth.** An additional $1 invested in energy efficiency may avoid more than $2 in production investment. But much potential remains untapped because of the many obstacles to investments in energy efficiency, including inadequate energy prices and lack of payment discipline, a lack of information on the latest technologies, too few contractors and service companies, and financing constraints.

Governments have a major role to play in energy efficiency, not only in allowing energy tariffs to reflect costs, but by being proactive in setting and updating energy efficiency standards for homes, equipment, and vehicles, and in enforcing them. The report recommends that to set an example, governments should undertake energy efficiency programs in the public sector, inform the public on energy efficient technology options, and design cities with alternative means of transport.

**The outlook for addressing climate change**

The challenge for these countries going forward will be to secure additional energy supplies quickly and at minimum cost, while acting in an environmentally friendly fashion to limit the growth of greenhouse gases. Carbon emissions relative to GDP in the region are among the highest in the world. In 2005, Russia was the third-largest CO₂ emitter in the world, after the United States and China. The region’s EU members have already started tackling climate change, improving energy efficiency, developing renewable energy technologies, and tapping into carbon finance. Other countries in the region will face increasing pressure to catch up, and quickly.

There is a disconnect between the global efforts to reduce carbon emissions and the region’s national energy strategies for the next 20 years. The region’s policymakers and businesses will have to rethink these strategies and engage seriously in the global efforts. But transitioning to a low carbon economy can be costly. By tapping into carbon finance, countries in the region can reduce their carbon footprint and attract critical capital to rebuild their energy infrastructure and industrial base using efficient and cleaner technologies. Governments should ensure that national policies and legislation facilitate the use of carbon finance, foster rapid technological modernization, and spur a revolution toward energy efficiency.

**Time is of the essence**

The report emphasizes that given the enormous need for investment, and the long lead times required to implement projects in the energy sector, countries need to position themselves to secure funding support for such progress as quickly as they can. Failure to introduce an enabling environment to support investment in the sector will translate into a shortfall in investment that, in turn, could constrain economic activity. A 10 percent shortfall in energy availability could lead to a 1 percent reduction in economic growth, and a larger shortfall could have even more detrimental impacts.
Annex 9- Challenges in absorbing EU funds and Lessons for Romania
(from World Bank study: Design Options for Romania Greening Facility, December 2008)

The structural funds are distributed among the member states according to the population and need. The programs are drafted by the European Commission and national and regional authorities on the basis of the Commission’s guidelines and priorities of the member states. The member states are responsible for distributing the funds to eligible projects at the national and regional levels. Since national and regional authorities are responsible for the management of the funds and selection of the projects, the rules for participation, submission, reporting etc. vary according to the policies and practices of the respective member states. Therefore, the structural funds give the new member states the opportunity to ensure sustainable energy by improving energy efficiency, boosting the use of renewable energy, reducing green gas emissions and dependency on fossil fuel imports. However, only a tiny part of the structural funds allocated during the 2004-2006 period was used for sustainable energy projects.

The review of the use of structural funds for sustainable energy projects in select countries showed the following:

- In the **Czech Republic**, approx. Euro 6.6 million was approved for renewable energy projects from the total of Euro 454.333 million allocated to the operational programs (OP) in the country. The funds for sustainable energy projects were distributed through OP industry and enterprises and OP infrastructure aimed at supporting combined heat and power production, renewable energy sources and low emissions combustion technologies.

- In **Hungary**, the EU support for the Environmental Protection and Infrastructure OP during the 2004-2006 period was Euro 327.2 million. About Euro 23 million of this budget was allocated to energy projects for industry and municipalities (42% for public and industrial energy efficiency and 58% for renewable energy sources). The support scheme for private citizens consisted of Euro 7.7 million.

- In **Slovakia**, a significant amount of funds was allocated to fossil fuels projects (co-firing of coal and biomass, natural gas boilers etc) aimed at reducing carbon emissions. The project with the largest funding of Euro 14 million was oriented to co-firing of coal and biomass at Zvolenska teplareniska. About 31 sustainable energy projects received Euro 40.199 million from OP infrastructure. The funds were distributed as follows: biomass – 25.1%, geothermal – 2.3%, emission reduction – 21.4%, natural gas – 15.5%, energy efficiency – 1.2%, co-firing (coal + biomass) – 34.5%. About 42 projects were funded from OP industry and services and received Euro 22.309 million. Biomass projects received 50% of this amount.

- In **Lithuania**, the sustainable energy projects were funded through three operational programs: OP infrastructure, OP development of industrial sectors and services and OP rural development and fisheries. Eligible projects included intelligent utilization of energy in renovated buildings.

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energy auditing of buildings and infrastructure, regional co-operation, research and development, education, consulting and processing of agricultural products for energy utilization.

- Compared to the other Central and Eastern European countries, **Poland** submitted a significant number of projects for structural funds and received large amounts for these projects. The main program on sustainable energy was Integrated Regional OP – support for the modernization of district heating systems, reconstruction of heating boilers and their substitution with low emission technologies. End users were community authorities and public institutions[^42].

The structural funds are only a small part of a large financial package that includes market-based instruments, bank financing and private sector initiatives aimed at supporting energy efficiency improvements and renewable energy. In addition to the structural funds, the EU has launched the framework programmes (FP) for research and technological development and the Competitiveness and Innovation Program (CIP). CIP contains two important initiatives, the Intelligent Energy Europe (IEE) focused on energy efficiency and renewable energy and the Entrepreneurship and Innovation program devoted to "eco-innovation"[^43]. No project could receive co-financing from two different EU programs at the same time. For example it is not possible to get 50% co-financing for a project from structural funds and the remaining 50% from FP7. The “double financing” should be avoided.[^44]

**Key barriers and remedies for promoting energy efficiency and renewable energy**

**Strong emphasis on energy efficiency or renewable energy is needed** in the national programming documents. Although most countries in Central and Eastern Europe have officially supported energy efficiency and renewable energy sources, progress towards implementing their commitments in these areas has been slow and uneven. Energy efficiency and renewable energy sources require strong political commitment, favorable institutional and regulatory conditions in order to thrive. Since the development of energy efficiency and renewable energy sources is impeded by many barriers and market failures (e.g. higher costs, imperfect information, capital market failure, etc.), government intervention and support remains crucial.

**Awareness building on environmental citizenship is needed urgently.** Active involvement of stakeholders in the development of sustainable energy projects is important. Due to the economic cost of transition, people in Central and Eastern Europe attach relatively less importance to environmental improvements compared to the imperatives of economic and social progress. Broad and sustained support needs to be built up from grass roots to promote environmental goals and thus enable pricing and other reforms as well as energy conservation and efficiency programs across the economies.

**Private sector participation is essential.** The investment in energy efficiency projects in Eastern Europe with a payback period less than five years is estimated to be between US$ 5-10 billion. This large


investment requires the participation of the private sector. Therefore, the market should offer opportunities for large investments with low transaction costs and acceptable risks and returns\(^{45}\).

**Renewable energy development faces high cost and technical, administrative, financial and market barriers.** The annual cost of achieving a 20% share of renewable energy at the EU level is likely to reach Euro 24-31 billion per year in 2020. Although the cost of renewable energy sources is decreasing, most types of renewable energy still cost more than their conventional counterparts. Competition from conventional energy players (energy producers, suppliers, distributors), lack of transparency and technical problems prohibit the development of renewable energy sources and access to the grids\(^{46}\). In the Czech Republic for example, the Temelin nuclear power-plant, leading to as much as a 50% over-capacity of electricity for about a decade, diminishes the prospects for commercially viable renewable energy development\(^{47}\). In Poland where the share of coal in electricity generation higher than 90%, strong lobby groups for coal make the market penetration for new technologies quite difficult. The producer of renewable energy has to take over the costs for keeping the grid stable in Poland. The electricity act in Hungary gives access to the grid if the capacity is above 0.1 MW, while more than 20 administrative procedures are required to develop renewable energy business. Moreover, credit availability is an issue because Banks have limited experience funding renewable energy projects and local investors often have poor creditworthiness.

According to the EBRD analysis, the key issues that impede the development of renewable energy sources in Central and Eastern Europe include:

(a) Lack of high quality resource data for developers;
(b) Lack of local equipment and operations & management suppliers;
(c) Lack of mandatory buy-back policies with feed-in tariffs at a sufficiently high level;
(d) A general absence of awareness and information about renewables;
(e) The general perception among governments and local investors that renewable energy is “risky”;
(f) A relatively low level of economic development, leading to:
   (i) Pressure to keep energy prices low through governmental subsidies
   (ii) Lack of creditworthiness of local investors
   (iii) Lack of sponsor equity
   (iv) Lack of long-term financing
   (v) Underdevelopment of the private sector
   (vi) Inability of consumers to pay market rates for electricity and heating
(g) The socialist era legacy of inefficient and unresponsive bureaucracies;
(h) Strong fossil fuel and, in some cases, nuclear lobbies, and the associated overcapacity;
(i) Lack of public support and demand\(^{48}\).

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\(^{45}\) UNEP. *Financing Energy Efficiency and Renewable Energy for Climate Change Mitigation.*


\(^{48}\) Ibid
Challenges in using Structural Funds

There are tight policies and rules governing the use of structural funds. These rules have been adopted by the EU-15 since the late-80s. New member states have been under significant pressure to implement these rules and learn in a very short time. Therefore the experience of EU-10 with applying these rules would be important for Romania.

The absorption of structural funds

In the EU-10, 43% of structural funds and 78% of cohesion funds were not used according to the Commission’s EU Budget 2006 Financial Report. Of the EU’s Euro 106.6 billion budget, only Euro 11.5bn was spent in the EU-10, whereas the five largest member states accounted for Euro 97.4bn of EU spending in 2006. Poland (Euro 5.3bn), Hungary (Euro 1.8bn) and the Czech Republic (Euro 1.3bn) were the main beneficiaries of EU funds. In the EU-15, France (Euro 13.5bn), Spain (Euro 12.9bn) and Germany (Euro 12.2bn) received the largest share of EU spending. The co-financing capacity required by the cohesion policy represents a key issue for the financial absorption of structural funds. Since many sustainable energy projects are costly, this requirement significantly impacts the eligibility for EU funding. The co-financing capacity for EU-supported projects implies the ability to plan and guarantee national contributions in multi-annual budgets, and to collect contributions from different public and private partners. The financial absorption is also affected by administrative and technical constraints related to the capacity and programming procedures.

Building administrative absorption capacity

Developing effective central, regional and local structures to prepare acceptable plans, programs, and projects in due time, to select projects, to arrange coordination among partners, to deal with the vast amount of administrative and reporting work required by the Commission, and to finance and properly supervise the implementation process can be challenging. In some countries, these structures have become overly complex. Latvia, a small country, has eight implementation agencies covering different sectors. In some of the larger member states some operational programs can have as many as 30-40 implementing structures. For example, in Poland several implementing institutions dealt with a few operational programs that covered sustainable energy projects. Diffused responsibilities among these institutions and lack of transparency have been challenges in the implementation of the EU-funded programs. In addition, many implementing agencies have pursued only administrative activities or well-established areas of activity. Czechinvest is an example of implementing body that has taken a proactive role in promoting economic and social development.

Generating good projects

Project generation is a core element of the programming process. The number and quality of applications can differ significantly among countries, regions, programs, priorities, measures, and interest groups. The causes include the lack of resources and experience on the part of applicants and administrations. In addition, the calls for proposals have been delayed and the application forms have been not

understandable and manageable for all the potential recipients. Awareness raising and marketing of the funding opportunities available, distribution of information targeting potential project applicants, websites and media activities are important to increase the application rates and promote decentralized sustainable energy projects. Latvia has scheduled regular radio and television programs, covering the opportunities and implementation of EU funds in the country. The Hungarian Government has set up structures to assist partners and applicants, notably the Information Center and the Training Center (provides training for organizations involved in the structural funds management and implementation).\(^{52}\)

In Estonia, the developer of the Athme Biomass CHP Project acknowledged the lack of awareness with regard to funding opportunities for energy efficiency and renewable energy projects and capability to prepare competitive projects at local level. The project’s aim was to replace an oil-shale fired power plant commissioned in 1950s with a biomass CHP with an output of 50 MWth and 20 MWel. The cost of the project was Euro 48 billion out of which 35% was covered from structural funds. Based on his experience, the developer decided to offer assistance to the local authority on potential eligible projects, public awareness campaigns, technical guidelines for the preparation of projects and instruments aimed at monitoring the projects.\(^{53}\)

**Transparency**

Transparency in managing structural funds is a significant problem in most of the new EU member states. Evidence from 2004-2006 shows that beneficiary countries have not always been able to develop transparent mechanisms for the management of the funds and there have been cases of misuse and corruption. In many countries the development of online application procedures and databases of projects supported by structural funds has been very slow. The description of the projects that received assistance is still missing in many cases. There is also a lack of information in English on the national Structural Funds.

Partnership is necessary in the implementation of structural policy; programming should not be implemented just by the central administration. Social partners, NGOs and representatives of local groups of interest should play an important role in the preparation of projects and public awareness, especially at community level. Except the case of Poland, NGOs had no influence in the project selection process and the monitoring of the use of funds. Even if NGOs were invited into partnerships, they have often faced problems regarding the appointment of their representatives by countries’ authorities, difficult access to information, unclear and changing rules, non-transparent project selection process.\(^{54}\)

**Fraud**

The financial impact of irregularities and suspected fraud in the use of EU structural funds has been of particular concern for the European Commission. The total amount affected by irregularities in 2006 was Euro 703.3 million. This would not help streamlining and expedited processing and use of funds.

\(^{52}\) Irene McMaster and John Bachtler. *Implementing Structural Funds in the New Member States: Ten Policy Challenges*. European Policies Research Center, 2005


Monitoring and evaluating the EU programs

Monitoring and evaluating the EU programs have been challenging in all EU member states. The focus of the new member states has been on financial management issues, particularly to ensure adequate oversight of the absorption of funding. Monitoring should be focused not only on the financial part but also on the implementation process and outputs linked to impact. The programming authorities face a range of issues including delays in establishing effective monitoring systems, IT problems, lack of human resources, indicators with insufficiently clear definition and focus, poor coordination and data gathering systems and difficulties in dealing with the varying requirements of ERDF, ESF and EAGGF. In Poland for example, the Institute for Renewable Energy mentioned the lack of clear quantifiable indicators for renewable energy (e.g. MW, installations, etc.) as a key issue in assessing whether the assistance was fully used to reach its purpose. Evaluation is very important for the assessment of effectiveness, for the design and implementation of new policies. It helps improve transparency and accountability. Evaluation has been a relatively recent process in most of the new member states, but there is lack of experience and qualified evaluators.

Case study: Evaluation of RUSE project – Redirecting Urban Areas Development towards Sustainable Energy

Redirecting Urban Areas Development towards Sustainable Energy (RUSE) is aimed at transferring the experience of the EU-15 to the new member states on sustainable energy projects financed from structural funds. RUSE’s objective is the improvement of the use of structural funds and other financial resources by municipalities and other stakeholders in charge with urban development in the new member and candidate states by stimulating the integration of sustainable energy issues (energy efficiency, renewable sources and distributed generation) in their projects. The exchange of practices related to sustainable energy issues is the key to promote the development of the projects at the local level. Therefore, RUSE has four priorities:

(a) To make municipalities and other related entities in the new member states and third countries more aware of the experience of Western European countries in dealing with structural funds by disseminating information, promoting good practices and sharing experience;

(b) To foster capacity building on energy issues in municipalities and collective structures such as city networks, agencies etc.;

(c) To help municipalities prepare projects aimed at integrating the concept of sustainable energy in urban plans and put them into practice; and

(d) To influence national decision makers to integrate energy issues in their programs from the perspective of energy demand and use of renewable sources.

Lithuania, the Czech Republic and Poland have been partners in RUSE operation. The assessment of the submitted and adopted sustainable energy projects shows the absence of a strategic approach of the cities

aimed at implementing sustainable energy development plans and a slow application process for funding oriented to sustainable energy projects. Only Euro 1.24 million was distributed in Lithuania and Euro 6.27 million in the Czech Republic for sustainable energy projects by May 2005. In Lithuania, sustainable energy projects submitted for 2004-2006 structural funds reflect little diversity. In addition, they were not presented in the context of the strategic development plans for the cities.

In many cases however, the EU-15 has gained good experience. This is particularly evident when energy issues have been considered from the point of view of energy demand and promotion of local renewable resources rather than simply from that of the supply side via investments in grids and trans-national networks. Energy efficiency and energy saving measures are Community priorities that should be reflected in the local planning for EU funding. In some cases the structural funds have been used to promote infrastructure projects without taking into account their impact on the natural resources or climate change. The four "cohesion countries" (Greece, Ireland, Portugal and Spain) which have received the most significant part of the EU funds, have recorded by far the greatest increases in greenhouse gas emissions in the EU.

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![Graph of Greenhouse gas emissions of countries receiving the most EU funding (% change 1990-2004)](image)

Source: Eurostat 2006

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Recommendations for Romania

A general analysis of the structural funds for 2004-2006 emphasizes the necessity of an articulated approach of energy efficiency and renewable energy in the development strategies of the new member states. The development strategy should show a long-term approach, a sound financial commitment to energy efficiency improvements and renewable energy development and regional outreach. A stronger political commitment should be better reflected in the allocated budgets of the operational programs. Therefore, specific recommendations for Romania include the following:

- Ensure that energy efficiency and renewable energy are priorities in the national strategies of development, including public-private partnerships.
- Ensure that adequate funds for sustainable energy projects are available to meet the co-financing requirements of the cohesion policy.
- Emphasize and undertake public awareness on climate change and the benefits of energy efficiency and renewable energy sources, capacity building and education of local stakeholders.
- Identify issues related to the proper and efficient use of the structural funds and define measures aimed at improving transparency.
- Link financial support to adequate monitoring and evaluation, including public dissemination of information by beneficiaries.
- Grant adequate legislative and financial independence to municipalities to support local- and community-level energy efficiency and renewable energy activities 59.
- Include initiatives for adopting new technologies and approaches (e.g. carbon capture and storage).
- Include adequate funding for enforcing regulations and developing new regulatory frameworks as needed, including for technical assistance for pre-investment support.
- Adopt policies and measures recommended by the EU, especially regarding cost recovery prices for energy provision and services.
- Remove unnecessary administrative barriers 60 and ensure information flow and exchange at all levels.
- Utilize experience from peer countries and encourage regional and EU-wide inputs for improving the systems and procedures.

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